



2023-2028 Victorian Gas Distributors' Access Arrangement

Draft decision and Revised Proposals

Submission from Brotherhood of St. Laurence

February 2023

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The views expressed in this document do not necessarily reflect the views of Energy Consumers Australia.

1 Summary

This submission represents the interests of residential, and particularly vulnerable, consumers in response to the Australian Energy Regulator (AER)'s draft decision for the 2023-2028 Victorian gas distribution access arrangements, and the distributors' revised proposals.

Despite the distributors' acceptance of the AER's draft capex and opex decision, there is a strong argument to undertake a full review of all aspects of the access arrangement for the final decision. The importance of this access arrangement, the likelihood it will set a precedent for responding to the risk of stranded assets, and the ongoing changes in Victoria's energy environment warrant a full re-evaluation at the final stage.

The draft decision does not satisfactorily address the key concerns, raised (in different ways) by all consumer stakeholders, around the contradiction between the proposed capex and opex programs, and the networks' bid for accelerated depreciation in the face of the risk of asset stranding.

Given the acknowledged stranding risks, it's important for consumers to understand how networks will be managed to conserve safe, reliable, and affordable energy through the transition. The assessment approach demonstrated in the AER's draft decision does not go far enough – especially with respect to capex and opex evaluation – in considering the characteristics of efficient investment in the context of declining demand.

We encourage the AER to better evaluate the scope of the acknowledged stranding risk, and to re-evaluate capex and opex proposals in light of potential timelines for demand decline.

Growth capex is a particularly important area of focus for the final decision. Given the very low levels of demand forecast for new estates, customer contributions should be substantially increased, there is a strong case for transferring the whole cost of augex and new connections onto new connecting customers (details below).

To inform BSL's engagement in the current Victorian gas access arrangements, we partnered with the ARC Centre of Excellence for Children and Families over the Life Course (Life Course Centre) at the University of Melbourne to conduct research on the attitudes of households facing energy stress towards the gas transition and barriers they face to adopting alternative fuels. Findings are summarised in Appendix 1.

1.1 Recommendations

We make the following recommendations:

- the circumstances of this determination warrant a re-evaluation of capex and opex building blocks for the AER's final decision
- stakeholder concerns raised around design and management of an accelerated depreciation program should be addressed, including arrangements for the reservation of funds returned early through accelerated depreciation, as well as ownership and commissioning of depreciated assets
- accelerated depreciation allowances should not be increased from the draft decision

- stranding risk should be evaluated by the regulator, especially in terms of possible timelines usage decline on parts of the network, to properly inform an evaluation of efficient expenditure
- expenditure should not be approved on the basis of alignment with the current period, given the changed circumstances of the current reset
- growth capex and augex should be fully funded by new connecting customers given the low level of consumption expected for greenfield sites, and the high risk of inefficient investment
- non-network solutions should be fully explored to avoid augex
- capex and opex in excess of the AER's evaluation should not be granted
- repex should be evaluated in the light of expected demand decline
- community consultation should test interest of communities to be supported to disconnect from the network, where this is able to avoid significant repex expenditure – at least in the form of a pilot program
- current opex spending not in the interest of consumers should be assessed, with adjustments made
- the Priority Services Program should not be funded
- the AER should work closely with gas networks and stakeholders to clarify that activities that prolong gas usage for customers, especially vulnerable consumers, are not acceptable
- costs incurred through abolishment should be minimised where this is possible to do safety. Management should be considered in the context of an anticipated network wind-down
- costs incurred through abolishment should be socialised, but not between remaining gas customers. Contribution from the Victorian Government to serve some or all of this cost may be a suitable alternative. Transferring the costs incurred to be recovered through electricity tariffs may be another. (Of the AER's two suggested options to fund abolishment costs, the user pays ancillary reference service option is preferable to funding through haulage fees)

2 Introduction

The Brotherhood of St. Laurence (BSL) would like to thank the Australian Energy Regulator (AER) for the opportunity to make a submission to their draft decision for the 2023-2028 Victorian gas distribution access arrangements, and the distributors' revised proposals (including AusNet Services (ASG), Multinet Gas Networks (MGN) and Australian Gas Networks (AGN)). This submission represents the interests of residential, and particularly vulnerable, consumers. BSL has been participating in the distributors' Roundtable stakeholder consultation process.

This submission follows earlier input from BSL to the distributors' draft submissions and initial proposals, APA's transmission access arrangement, and an associated submission to the AER's consultation on

Regulating Gas Pipelines Under Uncertainty, which are consistent with the arguments made in this submission.

Our participation in the access arrangement process has been enabled by an Energy Consumers Australia (ECA) grant, however the views expressed here do not necessarily reflect the position of ECA.

3 The draft decisions do not adequately respond to stakeholder concerns

The AER's draft decisions do not adequately respond to important concerns raised by the Consumer Challenge Panel (CCP), BSL and other stakeholders.

Most importantly, the draft decisions don't address the need for a revised and conservative approach to capex in the context of proposed accelerated depreciation – which was brought up in almost every consumer stakeholder submission (whether supportive of accelerated depreciation or not).

Instead, the AER has conducted an evaluation of capex and opex that does not adequately respond to the context of this determination.

The AER's draft decision has ignored specialist advice from stakeholders involved in the process in their areas of expertise. Clear examples include: advice on accelerated depreciation from senior regulatory economist and CCP28 member Ron Ben-David¹; advice on the standard of consumer engagement from market researcher and CCP28 member Helen Bartley²; and a joint submission from eight Victorian community organisations, who engaged in the networks focused consultation on the Priority Services Program, arguing that the funding for this opex step change was not warranted.

Overlooking this advice has led to a draft decision that is imbalanced against the interests of consumers, at a critical time - when energy costs are contributing to a cost-of-living crisis, and when inefficient spending will increase the impact of the transition on vulnerable consumers.

Non-network solutions for proposed capex should be more actively explored.

Where substantial repex programs are planned – especially in regional areas that have committed to ambitious carbon reduction pathways – networks should be required to explore opportunities to avoid repex by offering communities voluntary opportunities to be supported to disconnect from the gas network (potentially as pilot programs). Developing frameworks to manage community migration will be an important tool for managing the network through the upcoming transition.

Recommendation: key consumer concerns – particularly the importance of planning capex and opex programs appropriate to the acknowledged stranding risk – should be considered in reaching the final revenue decision

¹ 'Let's be in no doubt. Consumers will pay the cost if these questions are not asked and answered thoroughly before far-reaching regulatory decisions are made as part of the APA-VTS access review.' – (CCP28, 2022)

² Concerns raised in the table on p7 (CCP28, 2022)

4 Circumstances warrant re-evaluation of capex and opex for the final decision

Although network businesses accepted the AER’s draft determinations for capex and opex, the concerns we raise in this submission and the evolving context of the energy landscape warrant a re-evaluation of capex and opex building blocks at the final stage.

Important factors that justify a re-evaluation of building blocks are:

- AEMO’s 2023 Gas Statement of Opportunities, due March, is expected to include lower gas consumption forecasts, especially for ‘slower’ transition scenarios (like Progressive Change). The networks have cited this expected forecast as a reason for their request for increased accelerated depreciation, and its implications for capex should also be considered
- Ongoing evidence for rapidly growing consumer interest in disconnecting from the network warrants a re-evaluation of the main building blocks³
- Substantial rises in energy, and especially retail gas, costs through the start of 2023, as the impact of gas price caps lags its introduction may increase individual households’ incentive to disconnect
- Distributors have not accepted the draft decision on accelerated depreciation. Establishing appropriate depreciation levels is closely interrelated with the proposals for capex and opex. Therefore, keeping the decision on accelerated depreciation open for negotiation should imply that capex and opex are also subject to change

In addition to the factors above, there are processes expected this year that may require aspects of the access arrangement to be revisited, including the Essential Services Commission’s upcoming distribution code review, and the Victorian Government’s 2023 update to the Gas Substitution Roadmap.

Given the interrelation between capex and opex spending, and the drivers of electrification, it’s important that if any aspects of the access arrangement are revisited, then capex and opex are also reassessed, with the issues raised in this submission taken into account.

Recommendation: the circumstances of this determination warrant a re-evaluation of capex and opex for the AER’s final decision

³ For example, ASG’s consumer sentiment survey recorded a doubling in the proportion of customers intending to leave the network between August 2021 and 2022. Recent consumer research from the Sunrise Project’s Climate Compass 2022 found that 43% were open to replacing gas appliances with electric ones for environmental reasons.

ASG (2022). *Gas Access Arrangement Review 2024-2028 Addendum to Proposal September 2022* p.12
<https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/ASG-services-access-arrangement-2023%E2%80%9328/proposal>
 Sunrise Project (2022), *Climate Compass 2022*.

5 Qualitative concerns regarding accelerated depreciation must be addressed

During consultation, two key qualitative concerns (separate to its tariff impact) were raised regarding the logic, and the outcomes of accelerated depreciation:

1. The CCP noted the importance of resolving potential future cash-flow issues, potentially through quarantining depreciation collected early through accelerated depreciation, to ensure sufficient liquidity available to serve network requirements through its lifetime⁴
2. BSL raised the consideration of ownership of assets that have been fully paid down, to ensure that Victorians still have access to any that might be usefully repurposed

These concerns have not been addressed by the AER, despite their acknowledgement in the APA's draft decision stage, that the concerns were valid. With respect to the proposal to quarantine depreciation, the AER's draft decision for APA stated: 'Some consumer groups have expressed concerns that accelerated depreciation now will be paid out as dividends, for example, and that this would leave the VTS exposed if a reversal was required. We acknowledge this concern and would not want to rely exclusively on the possibility of reversal to support an accelerated depreciation proposal.'⁵

These remain valid and important considerations, and should be satisfactorily resolved before approving accelerated depreciation in the final decision.

Recommendation: arrangements regarding the reservation of funds returned early through accelerated depreciation, as well as ownership and commissioning, must be addressed before accelerated depreciation is allowed

6 Accelerated depreciation should not be increased

BSL's earlier submissions have opposed the implementation of accelerated depreciation, especially in the absence of adequate planning to manage the consumer risks of the expected decline in consumption, and the absence of agreement on a changed approach to network expenditure appropriate to the changed circumstances of this reset.

As stated, we are concerned about the impact of the draft decision on energy costs through the next period and through the transition – especially with respect to the unresolved contradiction between proposed capex and accelerated depreciation.

The accelerated depreciation sought by ASG, in particular, is substantial. ASG's proposed \$200m of accelerated depreciation is a 148% increase on a straight-line rate, increasing the percentage of the June 2023 asset base returned through the period from about 7% to about 18%.

⁴ AER (2022), *Draft Decision APA Victorian Transmission System (VTS) Access Arrangement 2023 to 2027*

⁵ AER (2022), *Draft Decision APA Victorian Transmission System (VTS) Access Arrangement 2023 to 2027*

<https://www.aer.gov.au/system/files/AER%20-%20Draft%20Decision%20-%20APA%20VTS%202023-27%20Access%20Arrangement%20-%20Overview%20-%20June%202022%20%281%29.pdf>

If ASG considers their stranding risk substantial enough to warrant an acceleration of this magnitude, then other avenues for reducing the size of the asset base must be pursued first. Importantly, ASG should increase the proportion of customer contributions for new connections and augex to 100% (See Section 7.4).⁶ This measure would avoid adding \$130m to the asset base over the next period. It would allow accelerated depreciation to be reduced from the AER’s draft value, and it would reduce risks for consumers as well as networks.

We don’t accept that the preferences presented by distributors from their customer engagement exercises, for earlier, rather than later revenue recovery can meaningfully be interpreted as an endorsement of the proposal for increased accelerated depreciation.⁷

Recommendation: accelerated depreciation allowances should not be increased from the draft decision

7 Capex should be re-evaluated in relation to the acknowledged stranding risk

7.1 The AER should quantify stranding risks, to allow adequate evaluation of efficiency

7.1.1 Some data indicates the potential for near term risks, warranting careful risk quantification

Some information included in the networks’ proposals may indicate that a risk of unsustainable declines in demand in the near term, especially for some parts of the network.

Notable points:

⁶ As detailed in Section 7.4 the low level of use anticipated for new greenfield sites in particular threatens their viability, and warrants that any investment be 100% funded by new connecting customers.

⁷ ASG (2022), *ASG - Gas Access Arrangement review 2024-28 - Revised Proposal - 24 January 2023 - PUBLIC (1)*
<https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/ASG-services-access-arrangement-2023%E2%80%9328>

- Distributors’ consumer choice models indicates that tariffs of 2.94 c/MJ⁸ may trigger a collapse in demand. It is important to consider plausible scenarios that could deliver these tariffs, and their likelihood
- There are indications that distributors may be significantly underestimating disconnections. For example, ASG’s consumer sentiment surveys show rapidly growing interest in electrification (intention to

⁸ This Figure has been derived from the ASG Gas Substitution Roadmap Consumer Choice Model.

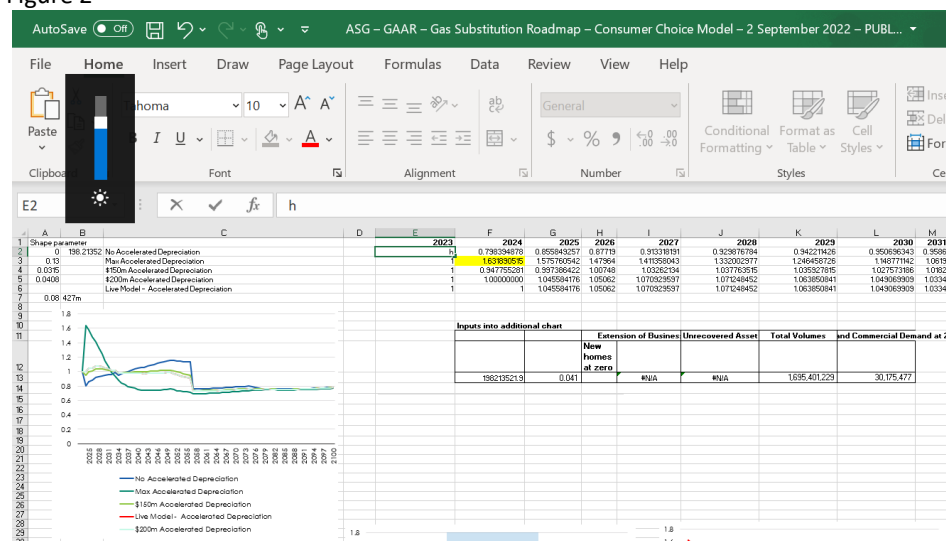
Figure 1 from this file, shown below shows the Year 1 retail tariff unit rate as \$18.04/GJ (including a wholesale gas component at \$11.39/GJ). Figure 2 shows the tipping point tariff value reached in the ‘Max Accelerated Depreciation’ scenario as being a factor of 1.6 of the year 1 value. This implies a tipping point tariff of 2.94c/MJ.

ASG (2022), *ASG – GAAR – Gas Substitution Roadmap – Consumer Choice Model – 2 September 2022 – PUBLIC*
<https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/ASG-services-access-arrangement-2023%E2%80%9328/proposal>

Figure 1

Year	Distribution fixed charge \$/day	Distribution \$/GJ	Retail fixed charge \$/day	Wholesale \$/GJ	Transmission \$/GJ	AEMO costs \$/GJ	Environmental \$/GJ	Retail margin \$/GJ	Retail gas price \$/GJ
2021	0.227687006	3.93	0.81	10.16	2.32	0.23	0.47	1.02	17.73
2022	0.340	2.71	0.92	11.63	2.32	0.23	0.47	0.93	18.29
2023	0.459	2.71	1.04	11.39	2.24	0.23	0.50	0.97	18.04
2024	0.452	2.71	1.03	11.38	2.22	0.23	0.55	0.98	18.07
2025	0.471	2.84	1.05	10.59	2.16	0.23	0.62	1.01	17.48

Figure 2



disconnect more than doubled between August 2021 and 2022)⁹ – the *rate* of change has not been taken into account in forecasting

- As has been observed with the uptake of solar PV, electrification may be taken up unevenly across the network. Some parts of the network may become underused sooner than others – this possibility warrants assessment, so as to allow meaningful evaluation of the efficiency of capex proposals
- The business case for electrifying is much better for some customers than others, such as PV owners. Faster disconnection from sizable subgroups has the potential to impact tariffs for remaining gas users (currently 25% of Victorian homes have PV installed), and to influence behaviour of remaining customers.
- Network businesses do not consider the AER’s accelerated depreciation allowances adequate to manage their risks. For example ASG’s Revised Proposal does not accept the \$83m allowance, suggesting that \$200m is required to manage their risk.
 - Ausnet’s bid suggests that the company deems a 148% increase in the rate of depreciation necessary to manage their risk, and that a 61% increase is insufficient. This indicates that networks consider the stranding risk to be material, which is a signal that warrants an independent evaluation of risk by the regulator, so that this can be considered in the evaluation of proposals’ efficiency

The indications listed warrant an estimate of possible time frames for usage decline, as part of the AER’s evaluation of proposed investment.

Recommendation: indications warrant an evaluation of the materiality of stranding risk by the regulator, especially with respect to potential timelines for usage to fall on parts of the network

7.1.2 Quantifying stranding risk is necessary to determine efficient expenditure

The AER’s decision on accelerated depreciation acknowledges that a stranding risk faces the network.

Understanding the potential scale of this risk (in terms of possible timelines) is essential to evaluating the efficiency of all capex (and also opex) proposals, in line with the AER’s requirement to determine efficient revenue in line with the National Energy Objectives and National Gas Law.

⁹ ASG (2022), *Gas Access Arrangement Review 2024-2028 Addendum to Proposal September 2022* p12
<https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/ASG-services-access-arrangement-2023%E2%80%9328/proposal>

AER states ‘Whilst [transition policy] measures are expected to accelerate the decline of gas demand, there is uncertainty as to how quickly that will happen.’^{10 11} Uncertainty applies to all forecasts, however it is important to attempt to quantify at least the range of credible outcomes, in order for the AER to fulfill their obligations in evaluating expenditure proposals in line with the NEO and NGL.

Understanding potential demand decline on different parts of the network will allow:

- A re-evaluation of business case assessments against time-scales relevant to best estimates of remaining operational timelines
- The identification of cases where non-network solutions (e.g. temporary adjusted reliability standards, demand management, or voluntary community transition from the network) are more appropriate to manage potential short-term system constraints
- The identification of cases where repex might be deferred until near-term expected asset retirement – or alternatively, where community consultation on bringing forward retirement might be appropriate
- Informed and meaningful consumer engagement in network and AER consultation processes

Recommendation: quantifying stranding risk is necessary to inform an evaluation of efficient expenditure

7.2 Expected stranding increase the risks for consumers of inefficient capex

The acknowledgement of a stranding risk and the draft decision on accelerated depreciation increase the consequences of approving inefficient expenditure, especially growth capex. This fact warrants a higher-than-BAU level of evidence for need for expenditure, that was not demonstrated in the AER’s draft decision.

The consequences of allowing spending that proves to be inefficient in the context of a stranding risk pose a greater threat to energy affordability than under BAU conditions.

Inefficient spending has the potential to accelerate customer exodus, and bring forward the date where energy becomes unaffordable. It puts pressure on costs in the short term, during a cost-of-living crisis. It adds to the size of the stranding risk, that is likely to be borne by customers, or the public. All these factors increase the risks associated with approving inefficient spending under the circumstances of an acknowledged stranding risk, and warrant a high level of scrutiny from the AER.

¹⁰ AER (2022), *AER - Draft decision - MGN Access Arrangement 2023–28 - December 2022*, <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/multinet-gas-access-arrangement-2023%E2%80%9328/draft-decision>

¹¹ While future policy settings may be unknown, useful scenarios can be constructed from existing policy – such as Victoria’s climate commitments, consumer sentiment, and the economic case for household electrification. The distributors’ consumer choice models are a useful starting point, but do not adequately consider the range of likely energy prices over the coming periods, different consumer types, and other important aspects.

Where the AER approves growth capex before it proves to be necessary in a context of declining demand, this investment might never be used. In a growth paradigm, on the other hand, assets approved early will almost certainly be used in time.

These changed circumstances warrant assessment at a higher level of detail than is evident in the AER's draft decisions that draw heavily on comparison with the previous period's spend.

7.3 Approving capex on the basis of alignment with the current period does not adequately respond to current circumstances

The AER's draft decision relied strongly on trend assessment against last period's expenditure.¹²

This method assumes BAU conditions, despite the changed circumstances of the current access arrangement, the increased risks associated with inefficient spending summarised in Section 7.2, and the potential opportunities to safely reduce operational costs that may be enabled by a context of declining demand (such as changed economics around reusing parts.)

(Capex adjustments proportional to lower connections forecasts are an insufficient response to the circumstances of a stranding risk – new approaches to planning expenditure appropriate to declining demand must be explored in this access arrangement.)

Awarding accelerated depreciation in the absence of a consideration of these issues will increase the challenges facing stakeholders at the next access arrangement.

Recommendation: when re-evaluating capex for the final decision, approval on the basis of alignment with the current period is not sufficient given the current circumstances

7.4 Growth capex and augex must be 100% funded through customer contributions

The access arrangements contain evidence that all new proposed connections, especially greenfield sites, risk unviable levels of underuse from day one. Despite this, \$449m¹³ of connections capex (excluding customer

¹² The approval of building block elements based on trend assessment against the current period is apparent throughout the draft decisions. A single example is the AER's draft decision on ASG's repex. The AER states:

'\$132.3 million for forecast mains replacement (26.2% of total capex), which is similar to replacement expenditure in the current period, and we consider is reasonably required to maintain network safety.'
(AER (2022) *Draft Decision ASG Gas Services Access Arrangement 2023 to 2028*, p17)

And

'Our assessment was particularly focussed on the materiality of the capex categories, whether the expenditure was significantly higher than historical expenditure, if the capex related to a new type of asset and if there was significant precedent value in our decision or where stakeholders have raised significant issues.'
(AER(2022) *AER - AusNet 2023-28 - Draft Decision - Attachment 5 - Capital expenditure - December 2022*, p4)

This described methodology won't allow any consideration of appropriate changes that would maintain safety, reliability and affordability in the context of declining demand.

¹³ This includes \$370m, of connections capex not including customer contributions, and \$79.1m of augex.

contributions) and augex has been approved. Given the networks' expectation that gas use will be below viable levels in new estates (sometimes from day one), the customer contribution should be 100% for new connections - to avoid growing the asset base at risk of stranding. It's essential that this issue is revisited in the final decision.

The proposals expect very low gas use in new suburbs:

- ASG expects new connections in greenfield sites to decline by 75% by 2028 (In those estates where gas is available (50%), uptake by homes is expected to decline by 50% on current levels). Additionally, new customers are expected to use 40% less gas than current averages,¹⁴ so that total usage in connected greenfield sites will reduce by 70% by the end of the period.
 - ASG's consumer choice model suggests a retail gas tariff (usage) 1.6 times year one rates¹⁵, risks triggering a collapse in demand. A 70% reduction of demand would result in tariffs that exceed this limit (even without expected period of gas market prices above the assumed \$11/GJ).
- Similar forecasts from AGIG expect a 13% fall in new connections in the first year of the period rising to a 75% reduction in year 5. On top of this, new customers are expected to use 34 GJ less than average (a 65% reduction of the stated average 52 GJ). Combined, these forecasts anticipate a reduction of 91.3% against typical usage.
 - Consumption this low should be expected to render this investment unviable from the outset.
- The difficult forecasting environment should warrant a conservative approach to haulage-funded growth capex – i.e. an allowance should be made for possible low use for assets planned to be built through all years of the upcoming period

ASG has stated that capital contributions from connecting customers are expected to rise from 9.5% of connections capex to 50% by the end of the period.¹⁶ BSL has been unable to find information from AGIG on customer contributions in their documentation – however the ratio of growth capex to forecast new

¹⁴ ASG (2022), *Gas Access Arrangement Review 2024-2028 Addendum to Proposal September 2022*

<https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/ASG-services-access-arrangement-2023%E2%80%9328/proposal>

¹⁵ ASG's network tariffs are 33% of typical residential bills. Usage reduction of 70% would increase network tariffs for remaining customers by a factor of 3.3. If the new assets were operating in isolation, this would result in an equivalent total residential tariff 1.76 times the current rate – higher than the consumer choice model's tipping point value of 1.6 factor - suggesting that this level of forecast usage would lead to gas retail tariffs sufficient to drive a critical mass of customers to electrify (according to the S curve constructed in Ausnet's consumer choice model). This outcome should be understood to mean that these new assets are unviable, and unlikely to conform with the requirements of Rule 79 unless fully funded through connecting consumer contributions.

¹⁶ AER (2022) AER - ASG 2023-28 - Draft Decision - Attachment 5 - Capital expenditure - December 2022 Section 5.5.1.2 <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/australian-gas-networks-victoria-and-albury-access-arrangement-2023%E2%80%9328>

connections is consistent between the pre- and post- roadmap proposals, suggesting it has not been adjusted.

The AER's assessment of connections capex acknowledges ASG's proposal for increased customer contributions, but it does not document an evaluation of the level of contribution that would constitute an adequate application of Rule 79 (specifically 79 2b.)¹⁷

The AER makes no mention of customer contributions in its assessment of AGIG's proposal, suggesting an inconsistent application of their requirements around customer contributions – despite stakeholders raising this aspect of the determination as being particularly important in their submissions.

The AER's rationale for approving augex similarly omit any documentation that the expenditure has been evaluated against Rule 79.¹⁸

Given the evidence that new assets will likely be unviable (cited above), it is important that the AER, in their final decision:

- Increase the required contribution from new connecting customers to 100% (of connections capex and augex), given the likelihood that new assets will not be viable (see above)
- Review the approach adopted to calculate new customer connections to ensure that it is appropriate to the changed circumstances of a stranding risk, in line with the Rule 79 requirement that 'the present value of the expected incremental revenue to be generated as a result of the expenditure exceeds the present value of the capital expenditure.'¹⁹ An appropriate methodology to estimate revenue from new assets must consider its cost-competitiveness against electrification over its lifetime to be adequate
- Ensure there is a consistent and optimal approach is adopted by the different businesses

New connections, and the associated augex (all augex for the period) should be funded entirely through connector contributions. The importance of this change warrants re-evaluating the capex building block for the final decision.

(The proposal for high customer contributions for assets likely to become stranded was raised in the 2021 South Australian Gas Distribution reset.)²⁰

¹⁷ AER (2022) AER - ASG 2023-28 - Draft Decision - Attachment 5 - Capital expenditure - December 2022 Section 5.5.1 <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/australian-gas-networks-victoria-and-albury-access-arrangement-2023%E2%80%9328>

¹⁸ AER (2022) AER - AGN 2023-28 - Draft Decision - Attachment 5 - Capital expenditure - December 2022 Section 5.5.1 <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/australian-gas-networks-victoria-and-albury-access-arrangement-2023%E2%80%9328>

19AEMC, (2023) *National Gas Rules* <https://energy-rules.aemc.gov.au/ngr/350/42041>

²⁰ CCP (2021), *CCP24 Advice to the Australian Energy Regulator on Australian Gas Networks South Australia Draft Plan for Access Arrangement July 2021-June 2026*

Recommendation: Growth capex and augex are too high to justify the anticipated low level of consumption on greenfield sites. New connections and augex should be fully funded by new connecting customers

7.5 AGIG's \$27m capex awarded above AER estimates must be reversed

The AER's decision awards AGIG networks \$27m in excess of their estimate. The AER states:

'We accept AGN's capex forecast of \$433.5 million (\$2022–23) total net capex for the 2023–28 access arrangement period as conforming capex under the NGR.

We assessed AGN's forecast capex against our alternative estimate of efficient capex, considering the available evidence, engineering advice from our consultants and submissions from stakeholders.

Overall, we found that most aspects of AGN's proposal were likely to be conforming capex. We determined an alternative forecast of \$418.2 million (\$15.3 million or 3.5% less than AGN's proposal) because we did not accept proposed expenditure on hydrogen readiness (\$10 million) and a cyber security uplift in information technology (\$5.3 million). On balance, our alternative estimate is not materially different from AGN's forecast capex and we accepted AGN's total capex proposal of \$433.5 million as prudent and efficient.'

This decision raises a number of issues:

- The difference in the AER's forecast and AGN's (MGN's is equivalent) is entirely due to the finding that the hydrogen readiness and cyber security uplift programs are non-conforming under the rules. Given that these categories are found to be non-conforming, they should not be funded. (The AER accurately notes strong stakeholder opposition to hydrogen readiness spending.)²¹
- Approving the additional capex does not fulfil the AER's role in determining revenue in line with the National Gas Objective (NGO) and particularly the National Gas Rules' (NGR) New capital expenditure criteria (Rule 79) – which requires funding for each category to be evaluated.
- Approving \$27m on the grounds that this sum constitutes a 'rounding error' does not adequately respond to consumer concerns about the heightened need for scrutiny regarding new capex in the context of a stranding risk
- The decision is unfair to ASG, who removed equivalent sums of proposed hydrogen readiness capex from their proposal in response to stakeholder feedback. AGIG ignored stakeholder preferences, and has been allowed to retain funding for non-conforming capital.
 - Decisions like this clearly disincentivise good-faith participation from networks under the Better Regulation framework

²¹ AER (2022), *AER - Draft decision - MGN Access Arrangement 2023–28 - December 2022*, <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/multinet-gas-access-arrangement-2023%E2%80%9328/draft-decision>

- Clarification is needed around expectations for the inclusion of hydrogen readiness expenditure in the RAB.
 - The \$27m of excess capex must be allocated to a capex class for the purposes of depreciation over the coming period – assumably this will be the distributors’ proposed classes. At the 2028-33 review, the AER will have to determine whether each item of actual capex, including any spending for hydrogen, is conforming capex (for rolling into the RAB), and adjust the depreciation schedule.
 - This will require an adjustment for amounts included notionally for 2023-28 but which, as part of the 2028-33 AA, do not get accepted as actual conforming capex.
 - Stakeholders have opposed hydrogen expenditure and the AER has found it to be non-conforming.
 - Despite the decision on allowing the \$27m in additional capex spending, stakeholders expect any spending towards this end to be properly tracked through the period, and dis-included from the RAB, even where network actual capex does not exceed the total allocated.

Our preferred remedy for this oversight is that this allowance is not approved in the final decision, requiring that building blocks are re-evaluated in the final determination in line with our argument in Section 4. Funds should be approved for necessary and conformant spending only.

Recommendation: when re-evaluating capex for the final decision, funds for non-conforming capex should not be granted

7.6 Non-network solutions must be fully explored to avoid augex

As stated in Section 7.2, investments in augex in the context of network stranding risk have a high likelihood of being inefficient over their lifetime. (Augex should be 100% funded by new connecting customers.)

This context warrants an active and meaningful attempt to explore all non-network alternatives to augex.

The AER’s assessment for all network augex proposals cites network modelling that show minimum pressure during peak periods to drop below the threshold in the next 5 years: ‘analysis of network flows and growth, network modelling and scoping design, cost estimates and how the proposed augmentation will rectify the issue.’ However, there is no indication that the AER has considered the implications of stranding risk for this proposed expenditure.

There is no indication that the AER, or distributors have worked to explore alternative solutions – such as demand management, or the potential to tolerate temporary capacity constraints for the proposed augex. The Zincara technical report cites the network business case options assessments that include no non-network solutions.²² Like the AER and the distributors, Zincara has apparently considered the impact of the

²² Zincara (2022), *Access Arrangement Review Australian Gas Network (AGN)*

<https://www.aer.gov.au/system/files/AER%20-%20AGN%202023-28%20-%20Draft%20Decision%20-%20Zincara%20-%20Public%20-%20December%202022.pdf>

Roadmap on forecasts in a narrow way, without considering the broad implications that a stranding risk must imply to the approach to all capex spending.

Additionally, there is no consideration of the higher-than-normal level of uncertainty of the networks' demand estimates, given the rapidly changing context of the current environment, and the ongoing impacts of high gas market prices driven by the global factors.

The AER has approved augex for AGN that is 285% higher than in the current period.²³ This increase is concerning in the current circumstances. ASG's has also increased (22%). (Multinet's is consistent with the last period – its area does not include significant greenfield developments.)

The AER's evaluation of augex proposals should be re-evaluated, including a consideration of:

- Non network solutions, including demand management, supported electrification, or consultation on the potential to adjust reliability standards where capacity constraints might be temporary
- The additional conservatism warranted by the expectation of short-to-mid-term demand decline
- The difficult forecasting environment, and the high possibility that forecasts have been over-estimated (also warranting a conservative approach to approving new augex)
- The significant amount of augex scheduled for the later years of the 2023-2028 period - and the opportunity to defer this to the next period

Consideration of the above is essential to determine efficient expenditure for the current access arrangement, and to allow effective regulation through a transition.

Recommendation: non-network solutions should be fully explored to avoid augex

7.7 Repex should also be re-evaluated in line with expected demand decline

All stakeholders, including the BSL, agree that network safety must be maintained through the transition.

However, this does not mean that the context of declining demand does will not require changes to the approach to managing repex.

The AER's assessment does not adequately consider:

- Whether current circumstances might warrant changed management approaches – for example, whether there is a better case for reusing parts in any instances

²³ AER, (2022) *AER - AGN 2023-28 - Draft Decision - Attachment 5 - Capital expenditure - December 2022*, Section 5.3.2 <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/australian-gas-networks-victoria-and-albury-access-arrangement-2023%E2%80%9328/draft-decision>

- Whether repex programs might be safely undertaken at a slower rate, given expectations for declining gas use
- Whether repex programs are currently being designed on the assumption of ongoing growth – for example, whether they have been designed to deliver augmentation or achieving economies of scale that might no longer apply in the context of declining use

The AER’s assessment has allowed MGN to increase meter replacement by 40%, and mains replacement by almost 100%. ASG’s meter replacement has increased 11%, and their mains replacement is still substantial, in line with last period. AGN’s meter replacement has increased 14%, with a relatively small mains replacement allowance to complete their program. All networks have also been approved for significant increases in the ‘Other’ category, which includes substantial repex.

Recommendation: repex should be evaluated in the light of expected demand decline

7.8 Telemetry has been insufficiently evaluated by the AER

AGN’s telemetry program is an example where unnecessary capex has likely been approved by the AER. AGN removed 5 growth related telemetry upgrades in the post Roadmap proposal, given that they were no longer justified by increased demand. However, AGN replaced with 5 alternative projects that they did not originally present as being necessary.

While fast-tracking works from another period might sometimes be appropriate in a ‘normal’ situation of ongoing growth, this type of expenditure should not be assumed to be efficient when the future of the system is uncertain.

Recommendation: a high level of evidence of necessity should be required for capex in the current period

7.9 Voluntary community disconnection should start to be explored, to avoid repex

Eventually, if network businesses hope to recover their investment on a network, it is likely that a staged wind-down will need to retire parts of the network as assets approach their end of life.

This will require significant planning and orchestration to achieve while maintaining safe, reliable, and affordable service.

In this context, consultation for this access arrangement should have incorporated early considerations for the design for a community consultation process, to explore whether some communities might choose to disconnect from the networks, where substantial capex is otherwise planned.

Regional towns that already have committed, ambitious climate targets may be particularly suitable sites to test interest in a program to support decommissioning. ASG and AGN’s mains replacement program should be reviewed for opportunities. For example, there are areas in the ASG network that are scheduled for mains

replacement, that also have committed, ambitious local emissions reductions targets: including Warrnambool,²⁴ Ballarat²⁵ and Bendigo.²⁶ Testing this process - at least in the form of a pilot - would provide important information for planning the ongoing transition, and establish processes to allow avoidance of inefficient investment through this period and the next.

Recommendation: community consultation should test interest of communities to be supported to disconnect from the network, where this is able to avoid significant repx expenditure – at least in the form of a pilot program

8 Opex must also be evaluated with reference to acknowledged stranding risk

8.1 Opex allowances should be reviewed in detail

As we have argued elsewhere, it's also important to be particularly stringent in determining efficient opex appropriate to the new paradigm of declining use.

An appropriate opex assessment would have:

- Reviewed base year capex, to consider changes appropriate to the new paradigm of declining demand forecasts
- Applied stringent standards to approving all step changes
- Disallowed funding for non-compliant programs (rather than accept this expenditure as a 'rounding error', see Section 8.2)
- Responded to stakeholder input – such as the submission from 8 community organisations, who had engaged in the networks' workshops, stating that funding the Priority Services Program was not warranted

²⁴ Warrnambool will reduce its citywide emissions by 20% by 2026, and achieve net zero by 2040 with all energy sourced from renewables.

W2040 (2021), Warrnambool 2040 The Community Vision for the Future

<http://www.w2040.com.au/sites/w2040.com.au/files/documents/W2040%20Plan%202021.pdf>

²⁵ Ballarat Council has committed to a community wide net zero target by 2030

Ballarat Regional Energy and Zero Emissions (2022), Net Zero 2030! Congratulations Ballarat!

<https://breaze.org.au/editor/newest-articles/setting-a-community-zero-target-ballaratzero2030>

²⁶ Community and business don't use fossil fuel for their stationary energy by 2036

City of Greater Bendigo (2021), Climate Change and Environment Strategy 2021-2026

<https://www.bendigo.vic.gov.au/sites/default/files/2022-02/Summary%20-%20Climate%20Change%20%26%20Environment%20Strategy%202021-2026%20WEB.pdf>

- Responded to consumer concerns about spending that is not in consumer interests – such as subsidising gas appliances for consumers switching from electricity

Recommendation: opex should be re-evaluated for the final decision

8.2 AGIG's non-conforming step changes should not be funded

The AER determined that two of the AGIG networks' step changes were non-conforming, and unsuitable for a revenue allowance - specifically cyber security and renewable gas communication. These total \$16.5m between the businesses. The AER noted 'strong stakeholder opposition' to the communication step change.

However, in a decision similar to the approach taken for capex (Section 7.5), the draft decision funds these proposals anyway. The AER treats the difference between their estimate and AGIG's as an insignificant 'rounding error', despite the fact that the difference - ~\$7.5m for each network – relates directly to the non-conforming programs.

The objections listed in Section 7.5 largely apply here: this approach should be expected to lead to non-conforming opex, it falls short of the AER's responsibilities under the NEO and the NGR, and it fails to respond to stakeholder feedback that the circumstances of this reset warrant conservative expenditure. It rewards AGIG's failure to respond to consumer feedback about the promotional step change, and punishes ASG who did respond.

The fact that the AER has not acknowledged AGIG's inappropriate gas appliance subsidy programs, despite the concerns raised by stakeholder, increases the likelihood that the funds allowed through this decision will be spent as AGIG has proposed, on promoting hydrogen to consumers.

Our preferred solution for this discrepancy is that opex be re-evaluated for the final decision, and funding above the AER's revised estimate be disallowed.

Recommendation: opex revenue in excess of the AER's estimate should not be approved

8.3 Non-conforming opex (appliance subsidy programs) should be removed from the base year

In BSL's submission to the Initial Proposals, we raised concerns around the choice by AGIG (in particular) to fund subsidies for gas appliances and connections.²⁷

The AER has not addressed this concern in their draft decisions.

While distributors have no legal restrictions on how to spend their revenue, it's important that the AER respond to inappropriate spending to ensure that expenditure is made in line with consumer interests.

²⁷ BSL (2022), *Brotherhood of St Laurence - 2023-2028 Victorian Gas Distributors' Access Arrangement - September 2022* <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/australian-gas-networks-victoria-and-albury-access-arrangement-2023%E2%80%9328/proposal>

In the re-evaluation of opex at the final stage of this determination, this expenditure should be quantified, and removed from the base year.

In the ongoing context of the risk of a network wind-down, it will become increasingly likely that consumer interests and gas network business interests may diverge. Therefore, the AER must scrutinise opex spending, and establish effective regulation to ensure that expenditure is made to serve consumer interests.

Recommendation: current opex spending that is not in the interest of consumers should be assessed, with adjustments made

8.1 The Priority Services Program should not be funded

Unnecessary opex increases should be avoided in the context of an expected decline in usage.

Community organisations²⁸ engaged in the networks' participatory consultation regarding the Priority Services Program. They concluded that there were useful measures that could be pursued without additional funding, and that there was no strong case derived from need for funding proposed activities.

We suggested a prudent path forward would be to establish a program funded through existing base opex for the next period – and if this focus discovered activities with a strong case for additional funding, then that could be considered at the next access arrangement.

The AER's decision has granted the funding for the opex program, while requesting that networks 'refine and revise the scope of the program, test customer support and demonstrate an efficient use of resources'. The networks have accepted the AER's opex decision (as expected, given their full opex proposals were allowed by the draft) – so under normal circumstances (see Section 4) the regulator would no longer have an opportunity to adjust the allowance. It's not clear why the allowance was granted before the regulator was satisfied with the project's design, customer support and efficiency. The decision, therefore, does not seem to be in line with the AER's responsibilities for determining efficient expenditure in line with the NEO and NGR.

Opex should be re-evaluated in the final decision, and this funding removed.

Recommendation: the priority services program should not be funded

8.1 The Priority Services Program must not subsidise continued gas use

One of the proposed activities under the Priority Services Program is 'gas safety checks, emergency repairs and outage support.' BSL supports gas safety checks and outage support, depending on the final details of a program. Gas appliance repairs may also be a positive intervention for some homes.

²⁸ BSL (2022), Victorian Community Organisations submission to Victorian Gas Distributors' Initial Proposal <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/australian-gas-networks-victoria-and-albury-access-arrangement-2023%E2%80%9328/proposal>

However, given the high risk (acknowledged by both the AER and network businesses) that low-income consumers will be more likely to be left on the network paying higher network tariffs after those with more agency have left, it is important to ensure that programs don't encourage continued gas use.

For example, It is important not to establish a program that replaces gas appliances with new gas units. This would lock vulnerable consumers into higher operating costs over the appliance life, and increase exposure to the risk of high network tariffs in a declining use scenario.

Guarding against this possibility is particularly important in the context of some networks' ongoing programs described in Section 8.3.

Recommendation: The AER should work closely with gas networks and stakeholders to clarify that activities that prolong gas usage for customers, especially vulnerable consumers, are not acceptable.

9 Abolishment costs should be minimised where possible, and socialised outside gas network tariffs

9.1 Risk management around voluntary disconnections must be considered in the context of a network wind-down, and costs minimised where possible

Distributors have proposed new service abolishment fees between \$825 and \$950 as user-pays ancillary reference services. The AER has proposed that they might alternatively be socialised between remaining gas customers through haulage.

With over 2 million Victorian homes and businesses connected to gas²⁹, raising the costs of disconnection by around \$800 (by abolishing the service at the street rather than the meter), has the potential to increase the cost of winding down the network by more than \$1.7b – and the decision to grant accelerated depreciation recognises that the prospect of a wind-down is a real possibility.

Energy Safe Victoria (ESV) has confirmed that disconnecting the line at the street, rather than the meter, is preferred approach to treat the risk represented by live service lines under the ground.³⁰ In meetings with the BSL, ESV has confirmed that the primary nature of the associated risk is similar between unused and used lines, which is that it may be hit during excavation. We understand that the reduced awareness of live gas lines likely in an electrified home is a minor, secondary factor in the ESV's recommendation. ESV has informed BSL that there are about 3,000 hits on service lines per year, a significant number. When consumers electrify, there is an opportunity to eliminate this risk, given the services is no longer needed, so this is the ESV's preferred approach.

²⁹ Department of Environment Energy and Climate Change (2022) *Victorian Gas Substitution Roadmap* <https://www.energy.vic.gov.au/renewable-energy/victorias-gas-substitution-roadmap>

³⁰ ESV (2022), *ESV Response to AER Questions Gas Connections*

However, given the likelihood of a continued decline in the use of the network, it is essential that the decision to require disconnection at the street continues to be reviewed through the transition. For example, where a critical mass of consumers are choosing to disconnect – so that mains is expected to be decommissioned within a given period (e.g. 5-10 years) – it may make more sense to disconnect at the meter rather than the mains, for the temporary remaining operational life of the mains.

Whether consumers or other public funds are covering the cost of stranded assets, and the incurred costs of the transition, it's important to explore safe and appropriate ways to minimise expenditure. Cost savings should be identified as part of a framework adequate to respond to a scenario of falling demand – i.e. one to manage a staged wind-down of the network, that is also able to respond to falling consumption as it emerges on parts of the network.

Recommendation: Costs incurred through abolishment should be minimised where this is possible to do safety. Management should be considered in the context of an anticipated network wind-down

9.2 Abolishment costs should be socialised, but not by remaining gas customers

The AER has requested feedback on whether costs associated with a new standard practice to require voluntary disconnections to be enacted at the mains rather than the meter (costing between \$825 and \$950 per property) should be socialised between remaining gas customers through haulage, or charged as user-pays ancillary reference services.

Both these options will deliver poor equity outcomes in the context of an expected wind-down.

Given the decision on accelerated depreciation, it's important to acknowledge the likelihood that all customers will be eventually required to transition from the gas network. Given this likelihood, it's important to preserve lower-cost transition pathways for all households, and not to increase the upfront costs, given the disproportionate barrier that upfront costs represent for low-income households.

On the other hand, given the acknowledged risk of a collapse in demand, it is also undesirable to increase the burden for remaining consumers, who may face increased network tariffs as customer numbers fall.

In this context, it's preferable that these new incurred costs be socialised through a different pool than remaining gas customers. An adequate solution will require additional consultation. We would prefer that the Victorian Government contributions to the cost of abolishment, with funds raised through taxes. A potentially acceptable alternative would be for these costs to be transferred to be recovered through electricity distribution charges. This would allow this cost to be borne by all energy customers.

(Incurred costs should also be minimised as far as possible, as per Section 9.1).

Recommendation: Costs incurred through abolishment should be socialised, but not between remaining gas customers. It would be preferable for these costs to be served through Victorian Government taxes, or via a cost transfer to electricity customers

9.3 An ‘ancillary reference service’ fee is preferable to using haulage tariffs to fund abolishment

As stated in Section 9.2 BSL prefers that incurred abolishment costs are socialised through or state funds or electricity tariffs.

However, of the two options nominated by the AER, ancillary reference services are marginally preferable, so as to avoid the inequity of transferring these costs onto a declining number of remaining customers.

Recommendation: Of the AER’s two suggested options to fund abolishment costs, the user pays ancillary reference service option is preferable

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Appendix 1 – BSL and University of Melbourne: household research

BSL and University of Melbourne: household research

As part of the BSL's project to engage in the current Victorian gas access arrangements, we partnered with the ARC Centre of Excellence for Children and Families over the Life Course (Life Course Centre) at the University of Melbourne to conduct research on the attitudes of households facing energy stress towards the gas transition and barriers they face to adopting alternative fuels.

Methods

Our research involved a literature review, and survey and focus group discussions conducted in August and September 2022. We received 236 survey responses, of which 220 met our low-income criteria for inclusion. We held six focus groups (four in person and two online) with 34 participants in total. Survey data was analysed using Stata Statistical Software (Release 17). Descriptive summaries were used to appraise the sociodemographic profile of survey respondents, and inferential analyses explored variation in experiences and attitudes based on individual and household characteristics.

Demographics of respondents

Respondents were from lower income households, with 85% reporting an equivalised income of less than \$40,000 per year and 86% receiving one or more forms of income support payments. Around a third of participants own their own home, another third rent privately, and 14% are in social housing. Most participants (88%) use gas in their home. Over half (57%) of participants were considered to be in financial stress – significantly higher than national figures – and more common amongst renters, those with lower income, and younger age groups.

Findings and implications

Despite high levels of support for the transition away from gas (69%), all our participants faced barriers to electrifying their homes. Only about one in ten surveyed households had replaced gas appliances with electric ones in the past five years. Less than one in five households currently use solar power, ranging from around one in three homeowners (30%) to one in fifteen in private rental or social housing (7%). Our survey shows having solar panels is significantly linked to an ambition to replace gas appliances in the near future.

A key barrier to electrification for our cohort was tenure, with renters lacking agency, resources and motivation to contribute to property upgrades. This implies the need for policy to promote electrification for renters, for example minimum standards, however the risk of pushing up rents needs to be considered carefully. Financial resources were another significant barrier, implying the need for policy measures such as rebates or no-interest loans, to enable the purchase of energy-efficient electrical appliances.

Vulnerable households also commonly lacked the information or energy literacy needed to electrify, and were understandably deterred by perceived risks. Trusted sources of information included social networks (particularly Culturally and Linguistically Diverse households), local government and social welfare organisations. Our findings points to the need for independent information and advice about electrification, which should be provided by government or a non-profit organisation, rather than interested parties such as network businesses.

Households with higher desire and capacity to electrify were more likely to be able to make long-term plans to electrify their homes. Those with lower capacity and desire are more likely to have to make reactive purchasing decisions when an appliance breaks down. Both groups would benefit from certainty in gas network planning, for example to enable them to know how long gas use will remain affordable or the gas network will exist.