Consumer
Challenge
Panel

Submission to the Australian Energy Regulator (AER)

Consumer Challenge Panel

Jemena Gas Networks (NSW) (JGN)

Access Arrangement 2020-25

Submission to the AER on the AER's Draft Decision and JGN's Revised Regulatory Proposal

Sub-Panel CCP19

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Confidentiality

To the best of our knowledge this advice neither presents any confidential information nor relies on confidential information for our comments.

1. Introduction

1.1. The role of the Consumer Challenge Panel (CCP)

The AER established the Consumer Challenge Panel (CCP) in July 2013 as part of its Better Regulation reforms. These reforms aimed to deliver an improved regulatory framework focused on the long-term interests of consumers.

The CCP assists the AER to make better regulatory determinations by providing input on issues of importance to consumers. The expert members of the CCP bring consumer perspectives to the AER to better balance the range of views considered as part of the AER's decisions.[1]

The author of this submission is CCP19, a sub-panel of the AER's Consumer Challenge Panel that the AER has established to focus specifically on the AER's regulatory determination of the Jemena Gas Networks (NSW) (JGN) access arrangement for 2020-25.[2] The views expressed in this paper are the views of the members of CCP19: David Prins (chair) and Chris Fitz-Nead.

CCP19 previously provided a submission to the AER in August 2019 on JGN's initial regulatory proposal.[3] Since then, the AER published its draft decision in November 2019, and JGN provided a revised regulatory proposal in January 2020.[4]

1.2. Context and structure of this submission

This submission covers our view of the key issues in the AER's draft decision and JGN's revised regulatory proposal from a consumer perspective. It builds on our previous submission and on the documentation published since then by the AER and JGN, as well as our ongoing interactions with the AER, JGN and other stakeholders.

The remainder of this submission is structured as follows:

- Section 2 discusses JGN's stakeholder engagement activities;
- Section 3 discusses JGN's capex proposal;
- Section 4 discusses JGN's opex proposal;
- Section 5 discusses JGN's proposal for accelerated depreciation of some of its assets;
- Section 6 discusses JGN's proposed Reference Service Agreement;
- Section 7 discusses JGN's proposed Capital Expenditure Sharing Scheme (CESS); and
- Section 8 discusses JGN's proposed price path.

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[1] Detailed information on the CCP is available on the AER website at https://www.aer.gov.au/about-us/consumer-challenge-panel

[2] Full information on this regulatory process can be found on the AER website at https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/jemena-gas-networks-nsw-access-arrangement-2020-25

[3] JGN's June 2019 initial regulatory proposal is also referred to by JGN and others as the JGN's 2020 Plan

[4] JGN's January 2020 revised regulatory proposal is also referred to by JGN and others as the JGN's Revised 2020 Plan

2. JGN stakeholder engagement

2.1. Stakeholder engagement undertaken by JGN and CCP involvement

2.1.1. Engagement before JGN's submission of its regulatory proposal to the AER

In our previous submission, we summarised the stakeholder engagement activities that JGN had undertaken in advance of its submission of its regulatory proposal to the AER on 28 June 2019.

CCP19 thanked JGN for being open with the sub-panel and inviting the sub-panel to participate in JGN's stakeholder engagement events.

We also stated that we were pleased that at the AER's Public Forum in Sydney on 7 August 2019 both JGN and the AER stated their willingness and desire to hold further workshops and forums in the coming months to try to resolve any outstanding differences in view between stakeholders, in parallel with the AER's compiling of its draft decision which was due to be released in November 2019. We welcomed this approach, and saw it as in line with "AER 2.0" – Working together to restore confidence in energy regulation.[5]

CCP19 welcomed the opportunity to participate in those discussions, subject to our overall budget and priorities. In the event, as shown in Table 1 below, one workshop was held, on 14 October 2019.

2.1.2. Engagement since JGN's submission of its regulatory proposal to the AER

Table 1 below lists the JGN stakeholder engagement events that were attended by CCP19 members since JGN's submission of its regulatory proposal to the AER.

Table 1: JGN stakeholder engagement events attended by CCP19 members

Date	Event	Location
14 October 2019	Asset lives workshop	North Sydney
11 December 2019	JGN Customer Council meeting	Teleconference
3 February 2020	Teleconference organised by AER on JGN's Reference Service Agreement	Teleconference

We were also informed of a JGN Customer Council meeting that was taking place on 12 September 2019, which was not going to discuss anything related to JGN's regulatory proposal. Our role as CCP19 is strictly limited to matters related to JGN's regulatory proposal and the AER's decision making process regarding the access arrangements review. Therefore we did not seek to attend.

2.2. Our views on JGN's stakeholder engagement activities

In our previous submission, we stated our overall view that JGN has shown a genuine commitment to consumer engagement and to stakeholder engagement more generally.

JGN's stakeholder engagement relating to the regulatory proposal of which we are aware that has been undertaken since JGN's submission of its regulatory proposal to the AER has been more limited, as shown in Table 1 above.

[5] For more information on AER 2.0, see speeches by the AER Chair to Energy Networks Australia Regulation Seminars in July 2017 and July 2018, transcripts of which are available on the AER website at https://www.aer.gov.au/news/working-together-to-restore-confidence-in-energy-regulation and https://www.aer.gov.au/news/regulatory-innovation-and-collaboration-in-a-dynamic-environment-what-has-been-achieved-and-where-to-from-here respectively.

We note in section 5.2 in regard to accelerated depreciation that JGN may have missed opportunities for further consumer engagement to inform its revised proposal to the AER where JGN's perception had advanced and where therefore consumers could have been presented with an updated set of scenarios and asked for their updated views on capex proposals given the risks to JGN's capex spend that it has now identified.

2.3. Jemena's Consumer Engagement Award

Jemena was announced in September 2019 as the winner of the Energy Networks Australia and Energy Consumers Australia 2019 Consumer Engagement Award. Jemena was the unanimous choice of the judging panel for its Gas Networks Deliberative Forum in NSW as well as its Electricity Networks People's Panel citizens' jury in Victoria.[6]

In response, Jemena Managing Director Frank Tudor said it was important to hear from a cross-section of the community when developing its pricing and services plans. "When delivering energy to over 1.5 million customers it's crucial that we work closely with the people and businesses who use our power and gas every day to find out what matters to them," said Mr Tudor.[7]

We expect on that basis that JGN will continue undertaking stakeholder engagement on an ongoing basis as part of its "business as usual" activities, and not just when it is submitting its regulatory proposals.

2.4. Customer engagement activities are part of the regulatory decision-making process

We noted in our previous submission that customer engagement activities are a key part of the regulatory decision-making process, but do not determine outcomes in a vacuum on their own, away from other regulatory decision making activities.

Care is required to ensure that early engagement with customers is not seen to replace the role of customer advocates, or the role of the AER. Those parties may legitimately come to a conclusion based on a different perspective, or wider knowledge, or reflecting the views of different subsets of customers, given that customers are not one homogeneous set.

Without wanting to play down the important role that direct consumer engagement can have, there must be recognition that the AER takes consumers' views into account alongside other stakeholders, and is required to act in accordance with the Rules without showing undue favour.

We made these points in our previous submission in the context of accelerated depreciation. This remains relevant, as discussed in section 5.2 below. In section 3 below, we also discuss suggestions now being made by JGN in regard to linking asset lives with the viability of capital expenditure which does not appear to have been considered in JGN's stakeholder engagement activities, and which may have changed some customer attitudes had they been explored in deliberative forums.

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[6] See https://energyconsumersaustralia.com.au/news/energy-network-annual-award-winners-announced for more information on this award

[7] See https://jemena.com.au/about/newsroom/media-release/2019/jemena-awarded-for-putting-customers-first

3. Capital expenditure (Capex)

3.1. Introduction

The AER's draft decision provided $804 million gross capex over the 2020-25 period compared to the $912.8 million proposed in JGN's Plan. Table 2 below provides an overview of JGN's Plan capex forecast, the AER's draft decision, and JGN's Revised Plan.

Table 2: Comparison of JGN's proposed 2020-25 capex to AER's draft decision ($2020, $M)

	JGN's 2020 Plan	AER's draft decision	Revised 2020 Plan
Connections	387.5	363.9	392.2
Meter replacement	118.0	105.7	117.6
Facilities and pipes	72.2	63.2	71.5
IT	107.2	73.3	101.2
Augmentation	60.8	47.6	62.0
Mains replacement	44.8	36.2	44.6
Other[17]	34.3	30.1	31.2
Overheads	88.1	84.0	85.9
Gross total	**912.8**	**804.0**	**906.2**
Contributions	13.4	12.9	13.1
Net total	**899.5**	**791.1**	**893.1**

Source: JGN Revised Plan, page 12

The AER reduced the capex allowance in all categories.

The AER explained that the main differences between JGN's proposed capex and its alternative capex estimate for the 2020-25 period concerned the following capex drivers:

- *IT – Our draft decision is to include $73.3 million ($2019–20, direct costs) of IT capex in our alternative capex estimate. This is 32 per cent less than JGN's forecast capex of $107.2 million. We consider that JGN did not provide adequate justification for its IT program to enable us to form the view it is conforming capex. In section 5.4.5, we set out the areas where further information is required.*
- *Connections – Our draft decision is to include $363.9 million ($2019–20, direct costs) of connections capex in our alternative capex estimate. This is 6 per cent less than JGN's forecast capex of $387.5 million. We consider that JGN did adjust historical data to reflect current circumstances when calculating unit rates for 2020– 25 period. Our consultant has developed an alternative capex estimate by removing outliers in historic data used in the calculation of unit rates.*
- *Augmentation – Our draft decision is to include $47.6 million ($2019–20, direct costs) of augmentation in our alternative capex estimate. This is a reduction of 22 per cent from JGN's forecast capex of $60.8 million. JGN's proposal did not adequately demonstrate proposed expenditure of $15.2 million in relation to the Aerotropolis is conforming capex. We have allowed $2.0 million for JGN to facilitate planning and design.*

- *Meter replacement – Our draft decision includes $105.7 million ($2019–20, direct costs) for meter replacement capex, which is $12.3 million (or 10 per cent) less than JGN's forecast of $118.0 million, principally by extending the life of some meter families.*
- *Mains replacement – Our draft decision includes $36.2 million ($2019–20, direct costs) for mains replacement capex, which is $8.5 million (or 19 per cent) less than JGN's forecast of $44.8 million, by the deferral of one project.*
- *Speculative capital expenditure account – Our draft decision is to exclude the Western Sydney Green Gas Trial from the speculative capital expenditure account. We have excluded the use of this on two grounds: hydrogen does not meet the National Gas Law (NGL) definition of 'natural gas', and the plant used to produce hydrogen is akin to a production facility which cannot be part of the distribution system.* [8]

JGN's Revised Proposal rejects the reduction in all categories, and provides further information to seek to support the capex it proposes.

Table 3 below shows JGN's actual capex compared to the AER allowance over the two regulatory periods preceding the 2020-25 period, along with JGN's 2020 Plan (dated June 2019) for the next period. It demonstrates that in several expenditure categories in the 2010-15 and 2015-20 regulatory periods JGN's actual expenditure was materially lower than the sum allowed by the AER. This anomaly justifies the AER's thorough review of the JGN capex proposals.

Table 3: Capital expenditure over time by category ($2020, Millions)

	2010-15		2015-20		2020-25	
	Allowance	Actual	Allowance	Actual/ Estimate	Draft 2020 Plan	2020 Plan
Connections	451	436	397	592	449	480
Metering	145	99	193	106	143	146
Facilities and pipes	91	69	125	78	90	89
Information Technology	106	142	148	119	103	107
Augmentation	85	118	110	50	97	75
Mains replacement	24	21	75	34	67	55
Others*	48	99	45	47	30	35
Change in how we recover corporate overheads**	-	-	-	-	-78	-76
Total gross capital investment	951	984	1,094	1,025	901	913
Customer contributions	25	41	22	15	11	13
Total net capital investment***	926	943	1,071	1,011	889	899

Notes:
* Other includes property, fleet and SCADA (the system which controls our network).
** We are changing how we recover our corporate costs. For more details see section 6.3.
*** This net capital investment does not take into account asset disposals.

Source: JGN 2020 Plan, page 48

[8] Draft Decision JGN 2020 to 2025 – Attachment 5 Capital Expenditure Nov. 2019, p 5-11

CCP19 considers key areas of capex in the following sections. Some capex matters considered by CCP19 in its advice to the AER on the JGN 2020 Plan, such as boundary metering for new high-rise buildings, have been resolved, and are not be considered further here.

CCP19 also holds some reservations regarding the scale of capex in the context of the evolved position on accelerated depreciation which JGN sets out in its Revised Proposal. For example, JGN states:

> *Problem 1 – Our efficient investment incentives during 2020-2025*
>
> *If the status quo is maintained for our new investments, we would be expected to commit a further $0.9B now based on a recovery period out to 2105 for high pressure pipelines and 2075 for medium pressure pipelines.*
>
> ***No prudent investor would subscribe to these conditions** without financial compensation for the inherent stranding risk.* [9] [emphasis added]

JGN further states:

> *While reasonable minds may debate the timing and materiality of these changes, the changes are inevitable. We cannot wait for perfect information to take action, and indeed on current best information, it is incumbent on our directors to ensure a risk of this materiality and probability*[10] *is being acted upon. We must act now on the best information currently available, and we can adjust in future as new information becomes available.*
>
> *Failure to do this brings risk for our customers in that* ***we cannot be expected to commit efficient levels of capital investment if there is every chance we won't ever recover that investment.*** *If we curtail gas connection growth our current and future customers suffer through higher prices; if we curtail replacement or augmentation*, our customers suffer through lower service performance and increased risk of public safety.[11] [emphasis added]

With the strong implication that without the accelerated depreciation sought by JGN, it may not be commercially viable for it to invest new capital, some question hangs over the capex program proposed by JGN. For example, one might question why mains extensions to new estates are pursued and why marketing expenses for new customer connections are justified. These concerns are considered further in section 5.2 below. Our analysis in this section of our report is meanwhile based on current asset lives.

3.2. Customer growth (connections)

The AER engaged Zincara to assist it with the technical aspects of reviewing JGN's connection cost forecasts and determined a connection capex allowance of $363.9 million being a 5% reduction from what JGN proposed.[12] JGN queries the AER's methodology in assessing connection costs and

[9] JGN Revised 2020-25 Access Arrangement Proposal – Attachment 8.2 Response to the AER's draft decision - Proposed changes to asset lives for new investments, p. iv

[10] A JGN footnote here reads: "At the October 2019 stakeholder forum, we presented our corporate risk assessment to stakeholders to explain how the risk consequence 'catastrophic' and probability 'possible' make this risk the highest rating 'extreme'. Our risk management framework is consistent with best practice including that it is consistent with ISO31000 Risk Management Guidelines."

[11] Ibid. p.11

[12] Draft Decision JGN 2020-25 – Attachment 5 Capital Expenditure Nov. 2019, p.5-22

provides further information. CCP19 is not commenting on the details of this technical matter. However, JGN has set out a detailed explanation of its issue with the AER's approach and provided further information, which hopefully allows the AER to provide a better informed and reasoned decision on the matter.

CCP19 recommends that the AER carefully consider JGN's position on assessment of connection cost to determine a prudent and efficient capex allowance.

Customer growth (being the cost of connecting new services to the network) is JGN's biggest category of capex. This is a cost that is in some part beyond the control of JGN, as it reflects the market demand for gas supply to new and existing residences where there is an existing gas main adjacent. This "demand" is of course influenced by JGN's marketing activity, for which consumers pay.[13] Broadly, the addition of new gas connections provides additional customers to spread the networks fixed costs over so may reduce the networks costs to gas consumers. JGN states:

> *Our investment in connections will lower bills by about $300M over the period to 2050.*[14]

In light of JGN's elevated concern about investing capex without changes to asset lives, CCP19 considers that consumer engagement would have been enhanced and better balanced if consideration of reducing or eliminating customer connection capex and other "growth capex", such as increased capex requirements resulting from marketing, had been costed and presented as an option to manage the risks associated with network under-utilisation or demise in the 2050s or soon thereafter. As this capex is not associated with managing safety or reliability, it may be a category that JGN could most easily cut if required to reduce its capex in light of its perception of the network redundancy risk and the duties of officers and directors.

JGN appears to have emphasised the financial benefit to all consumers of new connections through the consumer engagement process too. For example, in Deliberative Forums, speaker notes include the following:

> *BACKGROUND: Around 45,000 new customers connect to the gas network each year. They might be developers who have built new homes, or customers who had all electric appliances but now want gas because they want gas cooking, hot water or heating. This is a good thing for existing customers because it means the cost of our large fixed investments –* ***the $3 billion of pipes and other equipment already installed – will then be shared amongst more customers in future. This means lower prices for everyone.*** *However, in some cases, customers can be quite expensive to connect because they might be in an isolated location. This might require us to install a longer more costly pipe, or use expensive excavation equipment to install the pipe. While this new customer would share in paying the cost of our large fixed investments – which is a good thing for all customers – this can be outweighed by the additional large cost they put on everyone else to connect them to the network.*[15]
> [emphasis added]

[13] Marketing opex is discussed further in section 4.2 below
[14] JGN 2020 Plan p.55
[15] 2020-25 Access Arrangement Proposal, Attachment 2.3 engagement materials, p.321

The possibility that new connections other than line-of-main, such as laying new mains into new estates, might not be economically viable without changes to depreciation or might best be discontinued (at an opportunity cost to existing customers), does not seem to have been considered in JGN's consumer engagement.

JGN summaries the outcome of its consumer engagement as:

> *Four key themes emerged in our discussions and we have used them to shape our 2020 Plan. These themes are: affordability, a safe and reliable gas service, fairness, and innovating and planning for the future.*[16]

New connections appear to be presented as an affordability matter rather than as a question of fairness and managing the risk of the future viability of the gas network.

In light of JGN's apparent doubts about whether new investment might be viable without changes to asset lives, it would have been good to see the consumer engagement explore whether reduction of new connection and the resulting cost to consumers might be a good way to deal with the possible massive under-utilisation of the gas network in the 2050s. Of course, JGN's concern about investment viability may have evolved in significance since the consumer engagement process. Lack of further consumer engagement given this evolution is discussed further in section 5.2 below in regard to accelerated depreciation.

3.3. Augmentation capex

In CCP19's advice to the AER we expressed concern with augmentation capex for the Aerotropolis development and the Sydney Primary Main Integrity Project (Lane Cove to Willoughby pipeline upgrade versus two new secondary mains).

Where JGN sought $60.8 million capex the AER's Draft Decision allows $47.6 million accepting the Sydney Primary Main Integrity Project and providing a $2.1 million allowance for planning and design of the Aerotropolis network expansion.[17] CCP19 notes that the AER has looked closely at these projects and we have further comment on the Aerotropolis project in section 3.3.2 below.

3.3.1. Two new augmentation project proposals

In its revised proposal, JGN has added two new augmentation projects:

- A connection of the Malabar Sewerage Treatment Plant to its secondary mains at a cost of $2.5 million in order to supply biogas produced at the plant into the Sydney gas network.[18]
- A connection to a water factory (an advanced waste-water treatment plant which will service the new Western Sydney Airport and Western Sydney growth demand), which Sydney Water requires (and JGN has presented as part of the Aerotropolis project), at a cost of $2 million.[19]

The Malabar Sewerage Treatment Plant connection is said to provide an additional, albeit small, supply of gas to a market that is experiencing higher prices due to gas supply constraints. The biogas being produced is currently used to generate electricity or is flared.

[16] JGN 2020 Plan p.19
[17] Draft Decision JGN 2020 to 2025 – Attachment 5 Capital Expenditure Nov. 2019, p.5-55
[18] JGN Revised 2020-25 Access Arrangement Proposal Attachment 4.2 Capital Expenditure, p. 61
[19] Ibid, pp.43 & 48

JGN says that it has customers who are indicating that they want a renewable supply of gas or they might switch to non-gas energy options. JGN estimates that losing these customers will result in a revenue loss of $2.1 million per annum by 2050 and that if these customers leave the network the reduction in network utilisation and the resultant revenue loss would mean higher network charges for remaining customers.[20]

JGN seems to presume that the Sewerage Treatment Plant is a long-term asset and that it will continue to produce the gas bi-product for as long as it operates, so JGN's investment in the connecting main should contribute to the network for a very long time.

There is little information on the water factory supplied, but if it is an essential public facility with a long-term future, it seems likely that the investment to supply gas is justified.

CCP19 considers that there may be merit in the proposed capex for these mains extension projects if they connect long-term infrastructure to the gas network. On the other hand, if for example biogas does not have such a long-term future there are risks that the investment could result in sunk costs and effectively stranded assets that increase rather than decrease costs to consumers. CCP19 recommends that the AER review the projects accordingly.

3.3.2. Aerotropolis

In its 2020 plan, JGN explained that the Aerotropolis is being developed as a third city for Sydney with the Western Sydney Airport at its centre. The airport is planned to open in 2026 and will be surrounded by industrial, agricultural and residential development. By 2036, the population is expected to grow by 464,000 with an additional 180,000 dwellings. To supply gas to the Aerotropolis, JGN says that it will need to install three sections of secondary steel pipe to supply the core of the Aerotropolis, the Sydney Science Park, and the Airport itself.[21]

JGN's proposal for the Aerotropolis network extension was set out and justified as:

> *For the Aerotropolis, we could either install 150mm or 250mm pipes depending on whether we took a medium or longer term approach. The larger diameter pipes will provide additional capacity and greater future proofing for further development of the Aerotropolis. But, this option would add costs and provide additional capacity that might not be required.*
>
> *However, we believe that there is a high probability that the additional capacity will be used for the mains to the Aerotropolis core and airport – given the indications from NSW Government of a significant amount of industry, agriculture and new dwellings to be built.*
>
> *To increase capacity in these areas, it is much cheaper to install a larger pipe now than laying another pipe later on once the area is developed.*
>
> *We are less confident about the prospect of increasing loads in the region around the Sydney Science Park.*

[20] Ibid. p.61
[21] JGN 2020 Plan p.62

> *As a result, applying a mixed approach (based on customer feedback as outlined earlier) means installing a smaller diameter main to the Sydney Science Park and a larger diameter main to the Aerotropolis core and airport.*[22]

In its draft decision, the AER provided an alternative capex forecast based on advice from Zincara and the AER's assessed planning and asset scope uncertainty of the Aerotropolis development. The AER substituted the Aerotropolis development with $2.1 million allowance for JGN to continue planning and design until such a time the planning and project scope is more certain. The AER states that this allowance should provide sufficient funding and lead time for JGN to seek a further allowance under the rules as uncertainty is reduced.[23]

JGN responded in its Revised Proposal that in its view there is no mechanism within the Rules for JGN to seek additional allowances during the 2020-25 period. JGN recognised that the AER was referring to Rule 80, which allows the AER to make an advance determination on whether a project will meet new capex criteria. This Rule does not, however, allow the AER to change the 2020-25 allowance or provide additional funding during the period.

One of the authors of this report some experience with the application of Rule 80 having been on the CCP sub-panel that assessed an application from AGN in regard to Mount Barker under Rule 80.[24] We commend to JGN to consider the route of an application under Rule 80 at the appropriate time when costs are more certain and if capex for the Aerotropolis may exceed that allowed by the AER's final decision.

Meanwhile JGN has provided updated information on its plans and capex forecast, and claims to have addressed each of the concerns that the AER had identified in its draft decision on JGN's approach to demonstrating compliance with Rule 79(2)(b).

CCP19 recommends that the AER give further consideration to JGN's updated forecasts and plans in regard to the Aerotropolis, with a view to accepting the proposed capex if it now can be considered to reflect efficient capex.

3.4. Information Technology (IT)

In our previous submission we noted that IT capex has been a consistently large component of JGN's expenditure:

- 2010-15: $142million;
- 2015-20: $119million; and
- $107 million proposed for 2020-25 (see Table 4 above).

[22] Ibid. p.62
[23] AER Draft Decision, Attachment 5, section 5.4.6 – augmentation
[24] See https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/australian-gas-networks-future-capital-expenditure-determination-mount-barker-gas-network-extension for more information on AGN's application and the AER's decision making on the application

Table 4: IT capex by categories

Table 3-20: Information technology capex ($2020, Millions, excluding overheads)

	2015-20		2020-25
	Allowance	Actuals/estimate	Forecast
Maintain	131.6	119.1	101.4
Cost benefit	0.0	0.0	0.0
Compliance	11.4	0.1	0.0
Customer	4.6	0.3	5.8
Total	**147.6**	**119.5**	**107.2**

Table 3-21: Recurrent and Non-recurrent Information technology capex ($2020, Millions, excluding overheads)

	2015-20		2020-25
	Allowance	Actuals/estimate	Forecast
Recurrent	91.7	59.3	79.5
Non-recurrent	55.9	60.1	27.7
Total	**147.6**	**119.5**	**107.2**

Source: 2020-25 Access Arrangement Proposal, Attachment 5.1 Capital expenditure, p.33

This is a category that JGN materially underspent its allowance in the current regulatory period – particularly in the category "recurrent" expenses. The 2020-25 proposal saw the recurrent expenses materially higher than the current period.

The AER's draft decision disallowed $33.9 million of JGN's proposed $107.2 million of IT capex on the basis that it required more justification of JGN's proposed expenditure. The AER also included 'placeholder' decisions for some projects, totalling $7.4 million.

In its revised proposal, JGN set out additional justification for its proposed IT capex program which it claimed demonstrated that this capex is prudent, efficient and complies with Rule requirements.

As we stated in our previous submission, the IT expenses of network businesses are notoriously hard to assess as to their reasonableness and their benefit to the long term interests of consumers. However, they are significant, representing more than 10% of JGN's proposed capex in its regulatory proposal. While we can examine in some detail the appropriateness of expanding a pipeline or carrying out rehabilitation that may have much lower impact on the RAB, IT costs remain an enigma. This is an ongoing matter of concern for the CCP as a whole.

4. Operating expenditure (Opex)

4.1. Introduction

The revised forecast opex (excluding debt raising costs) is $1,092 million, which is approximately $5 million lower than the AER's draft decision, and $29 million lower than JGN's 2020-25 AA amended proposal.

The matters raised by CCP19 in its advice to the AER on the JGN 2020 Plan have been addressed in the AER's draft decision. JGN has substantially accepted the AER draft decision, with one area of concern, the appropriate labour cost escalator, on which JGN has made further submissions. CCP19 leaves the AER to resolve that in its final decision.

4.2. Marketing

The remainder of this section 4 on opex concerns marketing. This is not because marketing is a substantial issue, but rather because we believe there is a matter of principle at stake which has not been addressed in the regulatory process and which may be relevant to other network determinations.

Sections 4.2.1, 4.2.2 and 4.2.3 below are copied from our previous submission. Section 4.2.4 contains our new comments on marketing.

4.2.1. JGN comments regarding marketing opex

JGN sets outs:[25]

> *Natural gas is a fuel of choice in NSW and competes with electricity and other fuels.*
>
> *With the warmer NSW climate natural gas must be competitive to attract new customers and encourage them to purchase additional natural gas appliances, particularly for services such as heating. Marketing research tells us that potential customers see the upfront costs of purchasing and installing new natural gas appliances as barriers, particularly when they have many alternatives such as reverse cycle air-conditioning and induction cooktops. Incentive rebate programs have proven to be a highly effective strategy in addressing this barrier and can be targeted to influence customer behaviour by helping them with the upfront costs of buying new natural gas appliances.*
>
> *Our marketing program is focussed on encouraging the sale and installation of natural gas appliances by establishing natural gas as a highly desirable energy option. It does this by promoting natural gas and working with alliance partners to promote the sale of gas appliances via incentive payments.*
>
> *Marketing promotes greater utilisation of our network, which helps to lower prices for our customers.*

[25] JGN 2020 Plan p.70

JGN also noted:[26]

> *PIAC expressed concern regarding the use and implementation of rebates and incentives to encourage the purchase or replacement of gas appliances, noting that households may choose to purchase lower-efficiency gas appliances because of the rebates.*

Overall, PIAC stated in its submission to the Draft Plan:

> *PIAC does not consider that expenditure on the marketing of gas or the provision of appliance rebates is necessarily in the long-term interests of individual consumers.*

4.2.2. Previous regulatory decisions

In the decision-making processes for the current regulatory period, for 2015-20, the CCP sub-panel at the time (CCP7) did not take a firm stance on whether marketing costs should be allowed by the AER, but left it to AER discretion:[27]

> *We believe the AER should consider whether the proposed marketing expenditure is prudent. Will it provide overall benefits for existing customers and for new customers?*

In the event, the AER did approve an allowance for marketing.

The decision-making on the Victorian gas distributors' proposals for 2018-22 was complicated by the fact that one of the three Victorian gas distribution businesses (AGN) already had an allowance for marketing in its 2013-17 access arrangement, but the other two businesses (AusNet and Multinet) did not. All three businesses proposed a step change in operating expenditure to undertake a joint gas marketing campaign in Victoria in 2018-22.

CCP11 considered in some detail the requests from the Victorian distributors for step changes in their marketing allowances for 2018-22, covering a wide range of views from stakeholders.[28]

The CCP11 advice included the following statements:

> *Marketing of gas and provision of appliance rebates may not be in the long term interests of individual consumers under these circumstances.*
>
> *By its nature, the proposed marketing campaign in large part represents a transfer of wealth (or cross subsidy) from one group of Victorian residential gas consumers to another. It is therefore imperative that the proposed expenditure by each network business has the support of its residential customers.*
>
> *These proposed marketing step changes should be considered in the light of recent regulatory decisions. Regulated gas distribution businesses that have carried out marketing and had their allowances approved by the AER and the ERA in the last five years include JGN, ATCO Gas, AGN, Allgas and ActewAGL. Marketing allowances have now been approved for regulated gas network businesses in all other Australian jurisdictions, and are included in*

[26] 2020-25 Access Arrangement Proposal, Attachment 6.1 Operating expenditure, p.2
[27] CCP - Subpanel 7 - Advice on Jemena Gas Network access arrangement review - 3 September 2014, p.10
[28] Subpanel 11 - Response to proposals from AGN, AusNet and Multinet for the 2018-2022 Access Arrangements - 3 March 2017, pages 55-61

their base year expenditures. Marketing may now be considered to have become a standard business cost for gas businesses.

… from a customer perspective, we suggest that the AER should consider whether it is prudent to encourage new customers to connect to the gas network, and existing customers to renew gas appliances, at a time when wholesale gas prices, and hence retail gas prices are predicted to rise substantially.

Marketing is not a regulatory obligation, and expenditure on marketing does not directly relate to the provision of a safe, reliable and efficient supply of energy to consumers. Consequently, there is a need for proposed expenditure on marketing to be subject to additional scrutiny. Consistent with the opinions expressed by consumer representatives, we are not yet convinced that such expenditure is prudent.

The AER's Draft Decisions did not include marketing step changes in opex allowances for any of the Victorian gas distribution businesses, on the basis that the businesses had not made a case for marketing being a step change, rather than being in opposition to a marketing allowance per se. All three businesses accepted the Draft Decisions rejecting the marketing step changes.

4.2.3. CCP19 advice on JGN's current proposal

We again suggest that the AER should consider whether it is prudent use of opex to encourage new customers to connect to the gas network.

4.2.4. Our further comments regarding marketing opex following the AER's draft decision and JGN's revised proposal

In the event, the AER's draft decision on JGN's regulatory proposal for 2020-25 did not discuss marketing opex, and nor did JGN's revised proposal. There is no evidence that the AER gave any regard in its draft decision to the comments on marketing opex that we made in our previous submission.

Under the AER's base, step and trend approach to opex, this means that the marketing opex that was regarded as being efficient opex in JGN's current regulatory period 2015-20 has been carried forward to 2020-25 without any discussion with stakeholders in the AER's regulatory processes as to whether the marketing opex is still efficient. It would be inappropriate to second-guess what the outcome of such discussion would have been had it taken place. However, given concerns about the future of the gas network, and given the AER's recent decisions since JGN's final decision for 2015-20 not to allow marketing as efficient opex for gas networks, there is a reasonable possibility that analysis would have concluded that marketing opex would not be efficient in 2020-25.

Essentially what we have identified is an asymmetry in the way the AER's base, step and trend approach to opex is applied. Had JGN not had an allowance for marketing opex in 2015-20, and requested one for 2020-25 as a positive step change (to increase opex), it would have been rigorously analysed with stakeholder feedback sought and taken into account in the AER's decision-making on whether to approve the positive step change. However, given that JGN did have an allowance for marketing opex in 2015-20, and did not propose a negative step change moving to 2020-25, this "slipped under the radar", notwithstanding our previous submission.

Potentially this could be a wider issue than just marketing opex. While it is too late now to open a review of marketing opex for JGN for 2020-25 at this stage in the review of its access arrangements, we commend to the AER that it should be more stringent in future reviews of electricity and gas networks to consider whether there are any elements of the existing allowance which as part of the base, step and trend approach to opex should be considered as candidates for negative step change, even if not proposed for negative step change by the network business in question.

5. Depreciation

5.1. Introduction

JGN's 2020 Plan proposed accelerating the depreciation of:

- Network assets including high pressure pipelines, medium pressure pipelines and services, and metering assets; and
- Capex for past pipeline pigging.

The acceleration of depreciation of assets has the effect of increasing the cost to consumers in the short term, and reducing it in the longer term.

In its advice to the AER in August 2019, CCP19 expressed concern with the acceleration of depreciation of network assets but supported the proposed changes for past pipeline pigging and for metering assets.

In its draft decision, the AER accepted the proposed acceleration of depreciation for past pigging costs and for reducing the asset lives of all new meter and meter reading devices from 20 years to 15 years. It did not accept JGN's proposal for the acceleration of asset lives of other network assets.[29]

5.2. Accelerated depreciation of network assets

5.2.1. JGN's response to the AER's draft decision

JGN does not accept the AER's position on acceleration of depreciation for network assets (excluding meters and meter reading devises which the AER accepted) and summarises the AER's decision as:[30]

- Not considering in any detail the preferences expressed by customers who JGN says strongly supported these actions recognising the benefits to future customers and that there would be a marginal reduction in our short-term price savings as a result.
- Not recognising that this change is required by JGN to ensure that efficient investment incentives are preserved during the 2020-25 period by providing asset lives that give with the correct investment incentive for capex during the 2020-25 period. JGN says that the AER's decision must ensure it has a reasonable expectation of recovering its costs and a normal return during that period.
- Not recognising that JGN's proposal is exactly what the gas law and depreciation criteria rules intend the regulated depreciation allowance to do, and what good regulatory practice and precedent support.
- Stating that the reduction in asset lives is speculative at this point in time whilst also relying on what JGN calls "the highly speculative assumption" that hydrogen 'could have a substantial positive impact on the future of gas distribution networks'.[31] JGN states that this reasoning is contrary to the AER's decision to exclude the Western Sydney Green Gas Trial from the speculative capex account because the Nation Gas Law definition of gas does not cover hydrogen.

[29] Draft Decision JGN Access Arrangement, 2020 to 2025 Overview, November 2019, p. 38
[30] Jemena Gas Networks Revised 2020 Plan, p.ix
[31] Ibid. p.40

JGN's Revised Plan proposes the same changes to asset lives as its initial Plan, as summarised in Table 5 below.

Table 5: Revised proposed changes to asset lives for new investments

Asset Class	Current standard lives (years)	Proposed standard lives for new investment (years)	Percentage of initial forecast capital expenditure in asset class compared to capital program as a whole
Trunks	80	50	0%
High pressure mains	80	50	14%
Medium pressure mains	50	30	16%
Medium pressure services	50	30	33%

Source: JGN Revised 2020-25 Access Arrangement Proposal Attachment 8.2, p.10

The changes are proposed to apply only to new assets added to the network from 1 July 2020.

5.2.2. Risk and investment incentive

JGN's Revised Plan sets out further material regarding the risk to the future of its gas network and, more firmly than back in June 2019 in the 2020 Plan, asserts the potential impact of the risk to it of an under-utilised network in the 2050s. As previously quoted in section 3.1 above:

> *While reasonable minds may debate the timing and materiality of these changes, the changes are inevitable. We cannot wait for perfect information to take action, and indeed on current best information, it is incumbent on our directors to ensure a risk of this materiality and probability*[32] *is being acted upon. We must act now on the best information currently available, and we can adjust in future as new information becomes available.*
>
> *Failure to do this brings risk for our customers in that* ***we cannot be expected to commit efficient levels of capital investment if there is every chance we won't ever recover that investment.*** *If we curtail gas connection growth our current and future customers suffer through higher prices; if we curtail replacement or augmentation*, our customers suffer through lower service performance and increased risk of public safety.[33] [emphasis added]

The firm implication here is that without the accelerated depreciation sought, JGN may find new capital investment approved by the AER not to be commercially viable.

This position is affirmed and strengthened in the following statement by JGN (emphasis added):

> *The AER's draft decision approved that we need to invest $791.1M ($2019–20) of total net capex for the 2020– 25 AA period because it independently viewed this as conforming capex under the NGR. While our revised proposal considers this allowance needs to be higher, even this draft decision shows that a material amount of investment is needed to maintain our*

[32] A JGN footnote here reads: "At the October 2019 stakeholder forum, we presented our corporate risk assessment to stakeholders to explain how the risk consequence 'catastrophic' and probability 'possible' make this risk the highest rating 'extreme'. Our risk management framework is consistent with best practice including that it is consistent with ISO31000 Risk Management Guidelines."

[33] JGN Revised 2020-25 Access Arrangement Proposal – Attachment 8.2 Response to the AER's draft decision - Proposed changes to asset lives for new investments p. 11

network and meet customer demand. While the AER draft decision rejected our asset lives proposal on a fear of potential over investment when the assets are fully depreciated after 2050 for medium pressure assets and after 2070 for high pressure assets, ***the issue here is actually an incentive for under investment during the 2020-25 period****.*

We are committed to making the necessary investment, but only where it is commercially prudent to do so. ***We cannot be expected to invest amid the present level of cost recovery risk, particularly for the period after 2050****. Beyond 2050, we already bear significant risk for our existing investments that are not affected by our proposed change. Under a stable demand scenario where JGN is expected to invest capex at current levels, our proposed approach lowers the investment risk only marginally because in 2050 we are expected to still have $2.5B in unrecovered investment.*

In a situation where the regulator is not allowing us to be compensated for that risk – either in the WACC which is the same as electricity networks who don't face such risk, or in a proper application of the depreciation criteria – we cannot be expected to compound our current risk by spending a further $0.9B by 2025.

JGN's ability to mitigate this risk is prospective at the time it commits to an investment. The 'wait and see' logic presented in the draft decision and raised by some stakeholders simply ***doesn't address the risk of us being unwilling to optimally invest during 2020-2025****. Investing additional capex when our corporate risk assessment, following good industry risk practice,* ***would be contrary to the duties of our directors****.*

At the October stakeholder 2019 forum, we presented our corporate risk assessment to stakeholders to explain how the risk consequence 'catastrophic' and probability 'possible' make this risk the highest rating 'extreme'. Our risk management framework is consistent with best practice including that it is consistent with ISO31000 Risk Management Guidelines.[34]

It appears that JGN is claiming that its management and its Board may be prevented by corporate law from undertaking the capex program accepted by the AER in its draft decision, let alone the larger program which JGN seeks in its Revised Plan, unless the AER accepts the shortened asset lives proposed by JGN.

If this is the case, then we consider that in its revised proposal JGN ought to have set out a capex program that would manage the risk associated with continuation of the current asset lives for new investment, and would in JGN's opinion comply with the statutory duties of officers of JGN.

Table 6 below shows the remaining lives of the existing gas network assets. It can be seen from this that without new investment, much of the current RAB will be depreciated away by 2050. Thus, a capex plan that eliminated network growth and new connections, and which would not impact safety or reliability, would go a long way to manage the risk which concerns JGN.

[34] Ibid. pp.18-19

Table 6: Proposed changes to standard asset lives compared to equivalent remaining asset lives

Asset Class	Current standard asset lives (years)	Current remaining asset lives (years)	Proposed standard lives for new investment (years)
Trunks	80	35.9	50
High pressure mains	80	49.2	50
Meters/meter reading devices	20	8.2	15
Medium pressure mains	50	23.8	30
Medium pressure services	50	37.2	30

Source: 2020-25 Access Arrangement Proposal, Attachment 7.10, Proposed changes to asset lives for new investments p.28

JGN points to additional risk factors in governments' policies and statements from developers, commercial customers and local government. For example, JGN references the major property developer, Mirvac's strategy for a net positive carbon by 2030 by embracing a "fossil-fuel free" mindset.[35]

JGN also cites the risk that NSW will be short of affordable gas after 2025.[36] However, a recent announcement of a $2 billion agreement between the NSW and Commonwealth governments to provide support for investment in energy security for NSW includes commitments from the NSW Government to facilitate investment opportunities to inject an additional 70 petajoules of gas per year into the east coast market.[37] This demonstrates that the future of energy markets and government policies on these matters is actually quite fluid.

Governments do sometimes step in to smooth transition of participants in markets subject to disruption. An example is the NSW government's scheme to compensation taxi licence holders for the disruption caused by the emergence of rideshare services such as Uber.[38] The serious impacts of the demise of gas networks on consumers and on the investment environment for businesses is likely to be highly politically sensitive, and will affect the policy decision of governments. There is currently no certainty regarding what will be the policy positions and strategies of Australian Commonwealth, State and Territory governments if the demise of gas networks becomes more certain.

5.2.3. Consumer engagement on accelerated depreciation

Consumer engagement on accelerated depreciation prior to lodgement of JGN's regulatory proposal

In JGN's revised regulatory proposal, as in its original regulatory proposal, support for acceleration of depreciation garnered through JGN's consumer engagement is given significant weight as the reason why the AER should accept the shortened network asset lives proposed.

[35] Ibid. p.19
[36] Ibid. p.21
[37] https://www.pm.gov.au/media/nsw-energy-deal-reduce-power-prices-and-emissions, 31 January 2020
[38] https://www.transport.nsw.gov.au/projects/point-to-point-industry-assistance/industry-adjustment-assistance-package

In presenting the case that the AER should accept the proposed shorter asset lives, JGN highlights that 90% of its customers expressed support for JGN's Draft 2020 Plan:

> *In light of the strong support from our customers, we incorporated the change to asset lives for new investment into our Draft 2020 Plan published in January 2019. When we then tested that we had accurately captured their preferences on this topic in our plan, customers again voted overwhelmingly in support of this proposal.* ***A significant majority (78%) of customers considered that we had responded very well or quite well to their feedback in this area, and 90% of our customers strongly or moderately agreed that our Draft 2020 Plan was in their long- term interests****.* [emphasis added]
>
> *Given the strong positive response from our customers, we included the approach in our 2020 Plan and are retaining it in our Revised 2020 Plan.*[39]

The 90% referenced is from a one day workshop held in March 2019:

> *Once the Draft 2020 Plan was published we re-convened a group of 32 customers (from a pool of 69 who expressed their interest to take part), with representatives from across the five cities. The aim of the final session was to understand whether or not we had applied customers' feedback correctly and to refine our understanding of their preferences. Specifically we wanted to answer the question 'Is JGN's Draft 2020 Plan in customers' long-term interests'?"*[40]

Figure 1 below shows a more nuanced picture of this 90%, with a material 35% in the more hesitant "moderately agree" response.

Figure 1: Voting result on support for Draft 2020 Plan

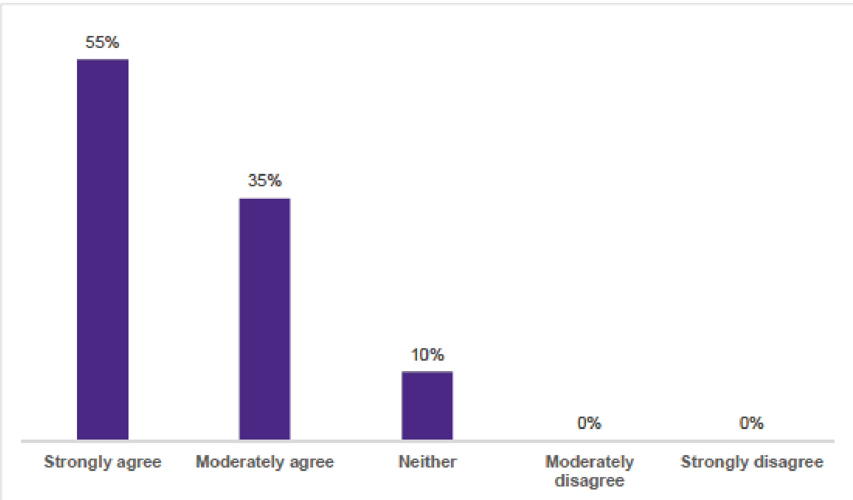

Figure 10: Voting results: To what extent do you agree that the Jemena Gas Networks' Draft 2020 Plan is in the long-term interests of customers? (N=31)

Source: Draft 2020 Consultation Report, RPS 2019 (provided in Attachment 2.2 to the JGN 2020 Plan June 2019 at page 340)

[39] JGN Revised 2020-25 Access Arrangement Proposal – Attachment 8.2 Response to the AER's draft decision – Proposed changes to asset lives for new investments p. 24

[40] JGN 2020-25 Access Arrangement Proposal – Attachment 2.1 – Overview of community and stakeholder engagement program 30 June 2019, p.15

In arguing that it has consumer support for accelerated depreciation, JGN quotes CCP19 in its revised proposal:[41]

> *CCP19 acknowledges that through a thorough consumer engagement process JGN has received feedback supporting its proposed acceleration of depreciation.*

However, CCP19 expressed reservations about how consumer participants reached their conclusions, with the discussion being framed under the topic of "fairness". The following extract from the speaker notes on acceleration of depreciation for these deliberative forums shows this framing:

> *QUESTION 1: With the uncertainty about whether our pipes will actually be used beyond 2050, **would it be fairer*** [emphasis added] *for current customers to pay more for new investments we make on the network relative to future customers?*
>
> *BACKGROUND: Many of our gas assets – particularly the gas pipes – won't deteriorate for around 50. They are made of long-lasting plastic. However, there is uncertainty about whether people will actually use gas in 50 years from now. Therefore, we are considering whether to recover the cost of new investment in gas pipes faster than we have in the past – for example 30 years instead of 50 years. This would mean that bills would rise over the next 30 years – around $7 per annum on average over the next 30 years. The alternative is that we wait until some point in the future when we are clearer about whether the assets aren't going to be used if that turns out to be the case, and only then move to a faster recovery. This would prove to be the right decision where the pipes did end up being needed beyond 30 years, because we wouldn't need to move to that faster recovery charging the additional $7. However, if they end up being not used, this might result in future customers receiving a more significant price increase as we move closer that time, because we need to rush the recovery into a shorter period. If this was 10 years, we estimate an additional increase of $20 per annum over those 10 years to cover the catch-up. With the different impacts on current and future customers, thinking on behalf of the community and both current and future generations, what is fairest way of addressing this uncertainty in whether our pipes will be used into the future in terms of how we recover our investment costs?*[42]

The speaker notes following describe the session on fairness which preceded the discussion of depreciation:[43]

> *The aim of this session is to provide information that customers asked for that relates to fairness.*
>
> *Many of the decisions we make affect how fair things are, particularly around issues of who pays and how. There are many regulatory rules which tell us what we can and can't do.*
>
> *We'd like you to help us understand what you believe is fair. What does this group believe is fair? We know from last week that this question is too big, so we have split it into four different ways to look at fairness.*

---

[41] JGN Revised 2020-25 Access Arrangement Proposal – Attachment 8.2 Response to the AER's draft decision – Proposed changes to asset lives for new investments p. 23
[42] 2020-25 Access Arrangement Proposal, Attachment 2.3 engagement materials, p.318, 333, 358, 603
[43] Ibid. p.317

You also asked last week for some examples of fairness – on your table there is a diagram showing three kids at a sports game.

The diagram shows that EQUALITY – treating everyone the same – doesn't necessarily mean FAIR: EQUITY is about making sure everyone has access and that may mean different things for different people. We also have a table which tries to demonstrate a Market Justice versus Social Justice Model.

In the revised proposal, JGN notes that one of CCP19's concerns with its consumer engagement on accelerated depreciation was that, with the complexity of the issue and the level of information provided, consumers may have erred on the side of fairness. JGN responds referencing a report prepared for it by Professor Graham addressing the issue of customers 'erring on the side of fairness', and how this is not irrational nor inconsistent with research, so there is no reason to dismiss their views.[44]

Under the heading "Consumer views are wrong – behavioural economics", Professor Graham considers CCP19's concern regarding the effect of framing the discussion of accelerated depreciation in a discussion of fairness [emphasis added]:

> *Behavioural economics and psychological studies establish that consumers are not the rational persons of economic modelling. They approach decision-making with inherent biases. In particular, the way that a question is framed may affect the way that they respond. This approach seems to lie behind the CCP's comment about consumers erring on the side of fairness when confronted with the question over asset lives.*
>
> *There are two responses to this line of criticism.* ***The first is that behavioural biases are not necessarily irrational or wrong****. This is a point often made in the context of debates about switching suppliers in competitive energy markets. Zhu makes the point clearly:*
>
> > *"…the evidence acquired from several markets casts serious doubt on the proposition that consumers' searching and switching decisions necessarily reflect errors to be corrected rather than non-standard preferences formed in response to uncertain and complex choice situations."*
>
> *The* ***second response is that there is evidence that consumers are more concerned with fairness in transactions than is assumed in conventional economic theories****. CCP suggested that one of the reasons for the outcomes might have been that the discussion was framed in terms of "fairness". This is a plausible explanation, as the framing of a question may influence the results.*
>
> *There is, however, research that suggests people may be more generally other-regarding and this comes out of behavioural economics research into the ultimatum game.*
>
> *…*

[44] JGN Revised 2020-25 Access Arrangement Proposal – Attachment 8.2 Response to the AER's draft decision – Proposed changes to asset lives for new investments p. 38

What this research suggests is that the responses of Jemena's consumers may not simply be the result of a framing effect but may accurately represent a judgement about intergenerational fairness.[45]

CCP19 did not say, or intend to suggest, that participants in JGN's consumer engagement were irrational or wrong, and we agree with Profession Graham's statement that taking the view that "*consumer views on this are wrong would be very paternalistic*".[46]

Along with other stakeholders who have participated in JGN's process, we have expressed comments that demonstrate that determining the scale of the risk of under-utilisation of the gas network in the 2050s, and how and when to respond to it, keeping in mind the long term interests of consumers, is extremely complex.

Some participants in JGN's consumer engagement expressed how they have similar concerns:

Within Goulburn forums, most customers and table groups responded that yes, it would be fair (19 comments recorded). Next most frequent comment in relation to this question was around ***more information required to make this decision****. Several people indicated there were renewables or alternative energy sources to be considered, and fewer responses indicated they were unsure, and* ***the question is complex****. Only one person indicated no.*[47] [emphasis added]

The following summary from the Western Sydney forum shows the same concern, and similarly qualifies the feedback:

With this group, many agreed that yes it would be fairer for current customers to pay more. Many participants also ***wished to have more information prior to making the decision****, and many had a comment about future energy sources and the network use. Two indicated that no, it wouldn't be fair.* ***Several other comments were made about being unsure, the complexity of the topic*** *and future supply.*[48] [emphasis added]

The difficulty of the subject matter for participants is demonstrated in Table 7 below, showing the apparently inconsistent position on supporting shortening of asset lives to address the risk of the network being redundant in the future, versus rejecting a short-term asset investment strategy to address the same risk.

[45] JGN Revised 2020-25 Access Arrangement Proposal – Attachment 8.4 Response to AER's draft decision – regulatory decision making and consumer voice, pp. 20-21
[46] Ibid. p.21
[47] 2020-25 Access Arrangement Proposal, Attachment 2.2, JGN's customer engagement p.235
[48] Ibid. p.238

Table 7: Summary of deliberative forums decisions on shortening asset lives and long term asset investment

Recommendation (phrasing is indicative only)	Goulburn	Griffith	West Syd	Bathurst	Newcastle	Over 55	CALD
To help manage future uncertainty around the long-term viability of JGN's gas network, JGN should recover money spent on new pipes. For more information refer to Attachment 7.10 Asset Lives:							
Over a 30 year period	75%	64%	82%	83%	94%	Yes (group vote)	Yes (group vote)
Over a 50 year period	25%	36%	18%	17%	6%	No	No
To help manage future uncertainty around the long-term viability of JGN's gas network, JGN should change its asset investment strategy to plan for a shorter-term window (~10 years) rather than assuming that customers will always use gas, and that the network has a secure long-term future. For more information refer to Attachment 5.1Capital Expenditure	25%	36%	18%	61%	0%	NA	NA

Source: JGN 2020-25 Access Arrangement Proposal – Attachment 2.1 – Overview of community and stakeholder engagement program 30 June 2019, p.26

JGN put this inconsistency to participants, and they said they could reconcile it:

> *Customers told us that they recognised the link and felt most comfortable with faster recovery of our future investment costs, and a long-term investment approach paired together. While customers also had the opportunity to change their voting when the combined bill impacts of these two strategies were presented, very few customers did so.*[49]

However, this stands as another demonstration that consumer participants grappled as best they could with a new and complex set of consideration. This reality is relevant to considering their feedback against their feedback on other matters like affordability as well as the consumer views expressed elsewhere, and the input from other consumer representatives and stakeholders.

Consumer engagement on accelerated depreciation since lodgement of JGN's regulatory proposal

As mentioned in section 2.1.1 above, JGN's stakeholder and consumer engagement subsequent to lodging its 2020 Plan in June 2019 included a forum on asset lives on 14 October 2019, which representatives of CCP19, PIAC and the ECA attended, with the AER attending as an observer.

The outcomes of this meeting record:

> *The workshop was successful in improving a mutual understanding between Jemena and advocates on respective opinions regarding asset lives. Participants enjoyed the workshop and felt it was a worthwhile discussion.*

[49] 2020-25 Access Arrangement Proposal, Attachment 7.10, Proposed changes to asset lives for new investments p.15

There appears to be greater understanding on why Jemena believes there is a material risk to Jemena's gas network and advocates gained a better insight to Jemena's sentiment on this trend. Advocates also reported an improved understanding of Jemena's rationale for investment, despite this risk.

However, alignment was not achieved on the need to act over the next five years within the parameters of the regulatory framework to address market uncertainty; whether accelerated depreciation is the most appropriate regulatory tool to use; or on whether reduced asset lives passes risk onto customers.[50]

In other words, the meeting did not result in support for JGN's proposals for acceleration of depreciation.

As discussed in section 3.2 above, the possibility that new connections other than line-of-main, such as laying new mains into new estates, might not be economically viable without changes to depreciation or might best be discontinued (at an opportunity cost to existing customers), does not seem to have been considered in JGN's consumer engagement prior to submitting its regulatory proposal.

Now, however, as discussed in section 5.2.2 above, JGN's revised proposal appears to imply that without the accelerated depreciation sought, JGN may find new capital investment approved by the AER not to be commercially viable. JGN is also now claiming that its management and its Board may be prevented by corporate law from undertaking the capex program accepted by the AER in its draft decision, let alone the larger program which JGN seeks in its Revised Plan, unless the AER accepts the shortened asset lives proposed by JGN.

To our knowledge, JGN has not gone back to consumers to ask them regarding their support for marketing activities, mains extensions, housing estate extensions, high-rise connections and non-line-of-main new connections in light of these risks to its capex program.

It would have provided a much more robust outcome for consumer and stakeholder engagement if JGN had now reconvened its customer forums to make this issue clear in its engagement process. Customers could have considered the costs to consumers and the service impacts of a capex program that would provide JGN with comfort to invest under the current asset life regime.

For example, as noted in section 3.2 above, consumers were told new connections were good because that lowered the cost of the network to each consumer – here they could have considered what changes to the capex spend they would support in order to have a capex spend that addressed the risk of a less utilised gas network in the 2050s.

Summary

JGN received consumer feedback giving a level of support for its proposed acceleration of depreciation, based on consultation that has not provided more options, particularly in light of JGN's newly emphasised concern that the risk posed if asset lives are not reduced may require its officers and directors to implement a smaller capex program than the AER approves, in order for them to meet their statutory duties having regard to their assessment of the risk.

[50] See Attachment 2.1 to JGN's revised regulatory proposal

Further cost options on alternate start dates for accelerated depreciation would also have been useful for consumers to consider. As it was, they were given the options of rushing the recovery over a 10 year period immediately prior to 2050, where it would add $20 per year to each gas bill, instead of $3 per year if it is done now.[51] Would consumers have been comfortable with a sum determined in 2025 or 2030 or the loss of network charges reductions from a no-growth capex program?

5.2.4. The regulatory context

JGN says that it would be wrong to favour the views of consumer advocates over customers' views, and quotes Professor Graham for support:

> *A regulator can reject consumer and stakeholder views if they are contrary to the legislation or to an expressed government policy that the regulator is bound to follow. This is not the case here. …Rejecting express consumer views will have negative consequences: companies will have less incentive to take consumer engagement seriously and consumers will be less inclined to engage.*[52]

Consumers who participated in JGN's engagement process expressed a range of views on each matter JGN put to them with varying degrees of support, or not, and with competing outcomes. In this context it seems an oversimplification to say an "express consumer view" exists considering the context, including:

- That view is based upon a majority view (often based on "strongly agree" plus "moderately agree") and there are dissenting views;
- The sample of consumers consulted is minute compared to the customer base;
- Participants have expressly noted the complexity, the time constraints and the desire for further information; and
- There are "majority" views on different issues that are inconsistent with each other or competing for priority.

JGN says that there is bias in some stakeholders' rejection of the accelerated depreciation proposal:

> *We also note that the views expressed by a number of consumer advocates have a strong bias to short-term pricing outcomes over this action to address long-term interests. For example, CCP19 states:*
>
>> *CCP19 has concerns with the proposed accelerated depreciation. For a start it will increase costs to consumers in the short term, at a time when energy affordability is a major community issue and against the feedback from JGN's consumer engagement that affordability is key.*[53]

Does this observation mean that JGN rejects (in its terms) the "express consumer view" for affordability, emphasised by CCP19, an expression by JGN of "bias"? Of course, it can't be – there is a balancing process to be applied.

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[51] 2020-25 Access Arrangement Proposal, Attachment 2.3 engagement materials, p.318
[52] JGN Revised 2020-25 Access Arrangement Proposal – Attachment 8.2 Response to the AER's draft decision – Proposed changes to asset lives for new investments p. 23
[53] Ibid. p.26

CCP19 expressed its views on JGN's 2020 Plan, and does so now, balancing the views from JGN's consumer engagement process with a range of other factors including the points noted above in considering the potential to oversimplify and say there is an "express consumer view". It appears to CCP19 that JGN has also undertaken a balancing process to craft its proposal accounting for the consumer feedback it received. Some of the other parties involved in the 2020-25 access arrangement review process have relationships with JGN's customers that might give these parties (such as retailers, ECA and PIAC) awareness of different customer perspectives that should be validly weighed in the process.

JGN quotes Professor Graham review to assert that there is no basis for the AER to ignore customers express views including:[54]

> *A regulator is justified in rejecting consumer views if they are of the opinion that the engagement was not objective or if they feel that the views are not representative of consumers. Neither argument applies here.*

The AER is legally charged with applying the Rules to allow the gas network prudent and efficient capex that is in the long-term interests of consumers. It is required to consult and consider submissions from anyone who want to make them. JGN's consumer engagement undoubtedly provides the AER with a unique and valuable source of insight to assist it in applying the Rules along with the insights from all the other parties who might participate in its review process.

Therefore, CCP19 does not accept that it or the AER has ignored the views of consumers on the matter of accelerated depreciation.

5.2.5. Our conclusion on accelerated depreciation

CCP19 continues to have concerns with the proposed accelerated depreciation. We continue to be concerned that it will increase costs to consumers in the short term, at a time when energy affordability is a major community issue and balancing consumer priority for affordability.

It also appears to be counter to JGN's confidence in the future with its large capex program noting that JGN's position on this may have moved as it now suggests that without the accelerated depreciation sought, JGN may find the scale of investment in the gas network (with the capex program approved by the AER) not to be commercially viable. It is difficult to reconcile the capex sought in the revised proposal with the apparent elevated assessment of risk that JGN's comments on commercial viability of network investment with the current asset lives presents.

The additional information on the risk of network under-utilisation or demise in the 2050s provided in the Revised Proposal suggests some increase in risk, but not sufficient to change CCP19's view that the move may be warranted in the future when there is greater certainty about the longer-term prospects for the gas network.

CCP19 rejects the assertion that it or the AER have ignored an express consumer view. We reject the notion that consumer engagement delivers a monolith and binding "express consumer view" on a matter in a sea of potentially competing or conflicting consumer views, other stakeholder and consumer representative view, the Rules and the obligation of the AER.

[54] Ibid. p25

CCP19 continues to believe that it would not be in the long-term interests of consumers to implement the proposed accelerated depreciation at this time.

6. Reference Service Agreement (RSA)

6.1. Our previous advice

Retailers at the public forum on 7 August 2019 commented that they had some concerns with the Reference Service Agreement (RSA) proposed by JGN. At that stage we had not reviewed the RSA, and we stated in our previous submission that it was likely that we did not have the skills that retailers would have to review this document critically.

We stated that we might however have views on whether changes proposed are in the long-term interests of consumers. If a forum were being held between retailers and JGN to discuss this document we would consider attending if invited as observers to consider the interests of consumers in any discussion / negotiation between retailers and JGN.

6.2. RSA discussions since our previous advice

As mentioned in section 2.1.2 above, on 3 February 2020 we participated in a teleconference organised by AER on JGN's RSA as provided by JGN as part of its revised regulatory proposal.

The remainder of this section summarises two key issues that were discussed on that teleconference, and gives our views on those issues.

6.2.1. Gas quality specification

JGN had noted the application in NSW of the *Gas Supply (Safety and Network Management) Regulations 2013 (NSW)* (***Gas Supply Regulations***). Regulation 23(1) prohibits JGN from conveying non-compliant natural gas through its network, and Regulation 26(1) prohibits JGN from conveying natural gas through its network unless it has tested or caused the gas to be tested to ascertain whether it is compliant.

However, for practical purposes, JGN cannot control the quality of gas provided to it by users, and is not party to upstream gas production or gas supply arrangements. This means that JGN is dependent on other parties to ensure that gas provided to JGN for delivery to its customers meets the gas quality specification, and that JGN does not breach its obligation under the Gas Supply Regulations.

The conclusion we drew was that for practical purposes the parties that actually are in a position to ensure the quality of the gas that goes into transmission and distribution networks, and to test the gas to ensure compliance, are the producers of the gas that they physically put into the system. Ultimately, therefore, the contractual obligation to ensure compliance must rest there.

We understand that producers are, however, not party to the RSA, and while retailers as users in the RSA can contract obligations with producers when they trade gas bilaterally, this is not possible when they procure gas through the Short Term Trading Market (STTM).

We recommend that this is seen as an issue that should be addressed at a national level, and not just in the JGN access arrangement review. There is a need to review the obligations to create a contractual framework that is consistent with the market arrangements that now apply. We would expect that such discussions at a national level would involve network operators, retailers and other users, as well as regulators, governments, and the market operator (AEMO). If rule changes are required, AEMC involvement would also be necessary.

6.2.2. Impact on network charges if JGN did not disconnect a customer when requested

This issue was framed by JGN as being in regard to the liability of the retailer to continue to pay network charges if JGN "was unable to disconnect a customer". Seemingly when the customer was not disconnected when requested it was due to an inability of JGN to do what it was asked to do, rather than some other cause.

JGN addressed the matter in discussion by setting out in some detail the circumstances when they were unable to disconnect. While retailers understood the difficulties that JGN sometimes faced, the performance of JGN was considered to be much lower than that of other distribution businesses in other jurisdictions. Those distribution businesses also faced the same difficulties with disconnection, yet seemed to perform much better.

We got to understand that the real issue was JGN's performance, and if that were improved then the network charges would not be a contentious issue in what would then be much rarer circumstances of lack of timely disconnection. Our overall conclusion was that this issue was best addressed by benchmarking across networks and the establishment of performance standards. These could likely be administered by the AER.

A comment was made by JGN that its operating costs may have to increase if it has to meet new higher standards. We would suggest that efficient costs should be part of the benchmarking. Operating to a higher performance standard may be achievable under existing allowed operating costs. It certainly does not automatically mean that the business needs to achieve higher revenue in respect of efficient operating costs.

7. Capital Expenditure Sharing Scheme (CESS)

In its Draft Plan, JGN indicated that it believed that a CESS is in the long-term interests of consumers as it would help JGN to further improve its efficiency, keeping a downward pressure on bills. It noted that the approach developed by the Victorian gas businesses and accepted by the AER may be a starting point to develop a CESS for its network.

JGN subsequently published a CESS consultation paper[55] which explained the design of its proposed CESS, and held a deep-dive workshop on the CESS which we attended along with other stakeholders in April 2019. JGN has described this CESS workshop as its richest source of CESS feedback.[56]

As we presented in the public forum on 7 August 2019, we are pleased that subsequent to the workshop JGN has acted on feedback to remove connections from the scheme as these are not under the control of JGN, and to change weightings of elements of the scheme.

We favour incentive schemes in principle, provided they do truly incentivise a regulated business to produce outcomes that are most in the long-term interests of consumers. In regard to this CESS, as we presented on 7 August 2019, we are particularly concerned that the scheme should embody stretch targets for the business to achieve beyond what it would otherwise be expected to achieve, and should not reward efficiencies that should be captured in the base capex allowance.

In its draft decision, the AER largely accepted JGN's proposal, and JGN's revised proposal accepted all the AER comments, with three having some modification based on Zincara's advice.

The AER's draft decision seeks to remove outliers from performance targets which JGN accepts with the additional proviso that material events outside its control (bush fire damage issue from 2013 was the example they gave) adjusted in measuring actual performance.[57] In principle, this seems reasonable, but requires detailed consideration by the AER.

The AER proposed that JGN review performance targets against its internal targets. JGN responds that most internal targets are tied to employee performance and it can't see why it would loosen these if the CESS target was easier. Only two internal targets are higher than comparable CESS[58]. CCP19 has no comment on this matter.

The last JGN issue is seeking to change the contingent payment factor of 80-100 proposed by the AER to 90-100. JGN sets out a justification for this. CCP19 notes that the Victorian gas companies have the 80-100 in their CESS.[59] On that basis, subject to the AER's consideration, CCP19 would in principle expect that the same should apply to JGN in NSW.

CCP19 recommends that the AER give consideration to JGN's remaining issues with the CESS, with a view to providing a fair and challenging regime to reward capex outperformance.

[55] The consultation is provided as Appendix A to JGN's Attachment 7.11 Incentive Schemes
[56] JGN's Attachment 7.11 Incentive Schemes, p.5
[57] 2020-25 Access Arrangement Proposal, Attachment 11.1, Response to Draft Decision – CESS, p.1
[58] Ibid. pp. 2-3
[59] Ibid. p.4

8. JGN's proposed price path

8.1. JGN's rationale to set a price path to achieve a stable retail price path

Based on customer feedback obtained through consumer engagement, JGN's rationale for its proposed network price path is to achieve stable retail price of gas for consumers across the regulatory period. We fully understand why consumers would seek such a price path. Mass market customers do not see the network component of their bill, and therefore any objective for a price path that is based solely on the network component is not meaningful to those customers. Rather, customers would support an objective based on the retail bill, which is meaningful to them.

Retail bills comprise costs of network charges, wholesale gas prices, retail operating costs and retail margins. Retail bills are not price regulated, and therefore the competitive market and customer behaviour (tendency to switch vs inertia) are likely to be the factors that drive the margins that retailers seek to achieve, which may vary over time and across customer classes.

Wholesale gas is also traded in various ways, through spot markets and bilateral trades, in short medium and longer term contracts. In some cases the retailer may be vertically integrated with a producer, and the wholesale gas cost to the retailer is a transfer price between them.

The gas market can also be volatile in the short and long term, as it is affected by domestic and international pricing and economic outlooks.

All these would make it very difficult in practice for a distributor to predict retail pricing, which would anyway not be uniform across retailers. While distributors like others can procure independent consultants' predictions and suggested scenarios for gas pricing over coming years, or use forecasts provided by AEMO and other such organisations, the forecasts may not turn out as predicted, and we do not see it as the role of a distributor to involve itself in predictions for wholesale and hence retail gas pricing, and to second guess retailer behaviour. Nor is it the role of the AER's network branch to get involved in those matters to test if JGN's price path would or would not smooth retail prices. The pricing principles in the Rules refer only to prices reflecting network revenue requirements, not retail bill requirements.

Similarly in the electricity industry it would not be the role of either party to forecast future electricity wholesale contract prices or other factors that might affect retail pricing. While important to consumers, those future scenarios are just not part of the remit of the AER in setting a price path in an access arrangements determination.

Further, there is no obligation for retailers to pass on changes in network charges in their retail offers to consumers. It might not be a good outcome for consumers if the network business' encroachment into achieving retail bill outcomes changed retailers' competitive behaviours.

That said, we understand that JGN's revised proposal meets the criteria set out in the AER's draft decision, including aligning unsmoothed building block costs with smoothed revenues, providing price signals that reflect underlying efficient costs[60] and returns smoothed revenue to within 3% of building block revenues.

[60] Noting that returning revenue over-recovery means that prices must under-signal the efficient costs in some years

On that basis, we commend the AER ensuring that the price path final decision should be based on the same strategy as JGN's revised proposal, meeting the criteria set out in the AER's draft decision.

8.2. Lack of consultation on prices during a regulatory period

A further issue is that after the first year of a regulatory period, there is no further stakeholder consultation on prices for the next four years. Rather there is a bilateral process involving the network business and the AER, with no involvement of any other party. Each year, the network business submits its proposed prices to the AER, and provided the proposal meets the formulaic requirements set out in the draft decision, it is accepted without any stakeholder consultation.[61]

This applies across all electricity and gas network businesses.[62] Yet price structures and levels and rebalancing between tariffs and tariff components are issues that are all important to customers (and retailers and other stakeholders).

This issue was highlighted by Etrog Consulting in a report to the Queensland Council of Social Service (QCOSS) on Energy Queensland's revised tariff proposals to apply in the coming 2020-25 regulatory period.[63] The Etrog Consulting report proposed a "Transition Working Group" to apply a co-ordinated and considered approach to tariff reform and development, involving a range of interested stakeholders including consumers. While this is more urgently needed in the electricity sector where tariff reform is happening at a fast pace rather than the gas industry where tariff structures are more stable, we commend the approach to the AER to consider for the gas industry to enable more considered decision-making on annual tariff variations during a regulatory period.

[61] See for example https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/pricing-proposals-tariffs/jemena-gas-networks-nsw-annual-tariff-variation-2019-20 – the current JGN price setting process. It is based on a final decision set out five years ago, with no opportunity for stakeholder (consumer or other) input.

[62] More generally, see the wording at https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/pricing-proposals-tariffs. The network business proposes tariffs and the AER approves, with no consultative processes.

[63] The report is available at https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/ergon-energy-determination-2020-25/revised-proposal#step-67323 and https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/energex-determination-2020-25/revised-proposal#step-67299. The author of the Etrog Consulting report is a co-author of this submission to the AER.