Evoenergy: ACT and Queanbeyan-Palerang gas network Gas Access Arrangement 2021–26

Consumer
Challenge
Panel

AER Public Forum

4 August 2020

CCP24
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Evoenergy’s head office is located on the land of the Ngunnawal people. The network also traverses the lands of other Indigenous nations. We recognize the traditional owners of these lands and honour their cultures.

AER Consumer Challenge Panel – our role

- advise the AER on whether the network business's proposal is in the long-term interests of consumers; and

- advise the AER on the effectiveness of network business's engagement activities with their customers and how this is reflected in the development of their proposals.

- CCP24 was appointed in July 2019 to review AGN SA and Evoenergy (ACT) Access Arrangement 2021-26 resets

Context for this Access Arrangement

Reset context – significant challenges

- Resets occurring in the context of the most fundamental challenge to the gas market in decades
  - how do gas networks respond to Governments moving towards net zero emissions policies in a timeline considerably less than the asset life of a large part of the existing and proposed asset base?
- CCP24 is presented with the 'Tale of two networks' both of which are investing heavily in a potential hydrogen future but which have taken quite different approaches to their 2021-26 proposal
  - Evoenergy is operating with an explicit ACT Government policy for net zero emissions by 2045 and the NSW Government that has announced, but not legislated, a similar policy
  - AGN presenting a 'business as usual' plan, with a future hydrogen vision
  - The Future of Gas is here, now – and these AA proposals (and the recent JGN in NSW reset) reflect major questions re "future of gas"
- COVID-19

COVID 19 – expected impacts

- Financial impacts for residential and small business customers will be ongoing, higher unemployment expected
- Difficulties in paying utility bills will continue
- Strong focus on price reduction is even more important
- Regular reviews of forecasts eg demand, labour costs, connections, and the changing environment will be necessary
- Engagement needs to continue, it's more important than ever
- Embrace uncertainty, be flexible try good ideas and accept the inevitable mistakes.
- Some inputs and assumptions in the Evoenergy AA developed pre-COVID
  - AER needs to consider the process to allow consumers to comment on Evo's and the AER's view on revised forecasts that incorporate COVID impacts

Consumer Engagement

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Engagement Summary

- Comprehensive GN21 Engagement Plan covering February 2019 to Final Decision in April 2021
- Variety of engagement methods employed
- Engagement activities were tailored to suit the local community
- Citizens' Jury was the centrepiece

Engagement activity	Date	Phase 1	Phase 2	Energy retailers	Household consumers	Small - medium business consumers	Vulnerable consumers	Culturally and linguistically diverse (CALD) community	Major customers (including infrastructure sector)	Government (ACT Government and NSW local government)
Citizens' Jury	Oct/Nov 2019	●	●		●	●	●	●		●
Energy Consumer Reference Council meetings	Six meetings over 2019 -2020	●	●		●	●	●		●	●
ACTCOSS partnership – Energy consumer advocacy workshop	Aug 2019 - ongoing	●	●		●	●	●	●		
Community regional roadshow – community council presentations and drop-in sessions	Feb/Mar 2020		●		●	●		●		●
Deep dive sessions	Mar 2020		●		●	●	●	●	●	●
Energy Matters Gas 2019	Sept 2019	●							●	●
ACTSmart Business Expo	Sept 2019	●			●	●		●		
Online survey	Sept - Nov 2019	●			●	●	●		●	
Hydrogen facility site visits	Aug 2019 - ongoing	●	●		●	●			●	●
Briefings and 1:1 consultations	Aug 2019 - ongoing	●	●	●				●	●	●
Email inbox and written submissions	Aug 2019 - ongoing	●	●		●		●			

Citizens' Jury – a 'first' for Evoenergy

- Overriding engagement theme for Evoenergy was 'the future of the gas network in ACT and surrounding areas'.
- Citizens' Jury considered the central question:

  'The ACT Government has legislated for net zero greenhouse gas emission by 2045. Evoenergy is committed to transform the gas network to meeting this target. As part of this transition, what are our consumers expectations of the service provided to them?'

- Was this an appropriate methodology? Yes – absolutely.

  The capacity for a Citizens' Jury model to be focused on a single, complex question and to involve the perspectives of the diversity of customers means that this methodology is particularly pertinent for Evoenergy in obtaining informed perspectives from ACT and NSW citizens – CCP24

- We commend Evoenergy for having the courage to try this methodology and for a successful implementation.

Major engagement themes

- Environmental sustainability and net zero emissions – the dominant theme
- Renewable gas futures and possibilities
- Affordability
- Concerns for vulnerable customers, and a fair and just transition
- Market expansion decisions for ACT new developments, ACT infill and NSW expansion
- Stranded assets and accelerated depreciation
- Suitability of tariff structures – and conflict between declining block tariffs and ACT Government objectives
- Capital Efficiency Sharing Scheme – performance targets

CCP24 Overview of Evoenergy Engagement

- We have observed a significant ‘step-up’ in engagement from previous resets
- ECRC was informed of progress on GN21 on a regular basis
- Release of the Draft Plan (27th February 2020)
- Draft Plan was used as the focus for detailed engagement including 2 deep dives and community briefings – compressed timeframe for review & feedback
- Impacted by COVID-19
- Further engagement recommended including deep dive to examine the issues of stranded assets and accelerated depreciation

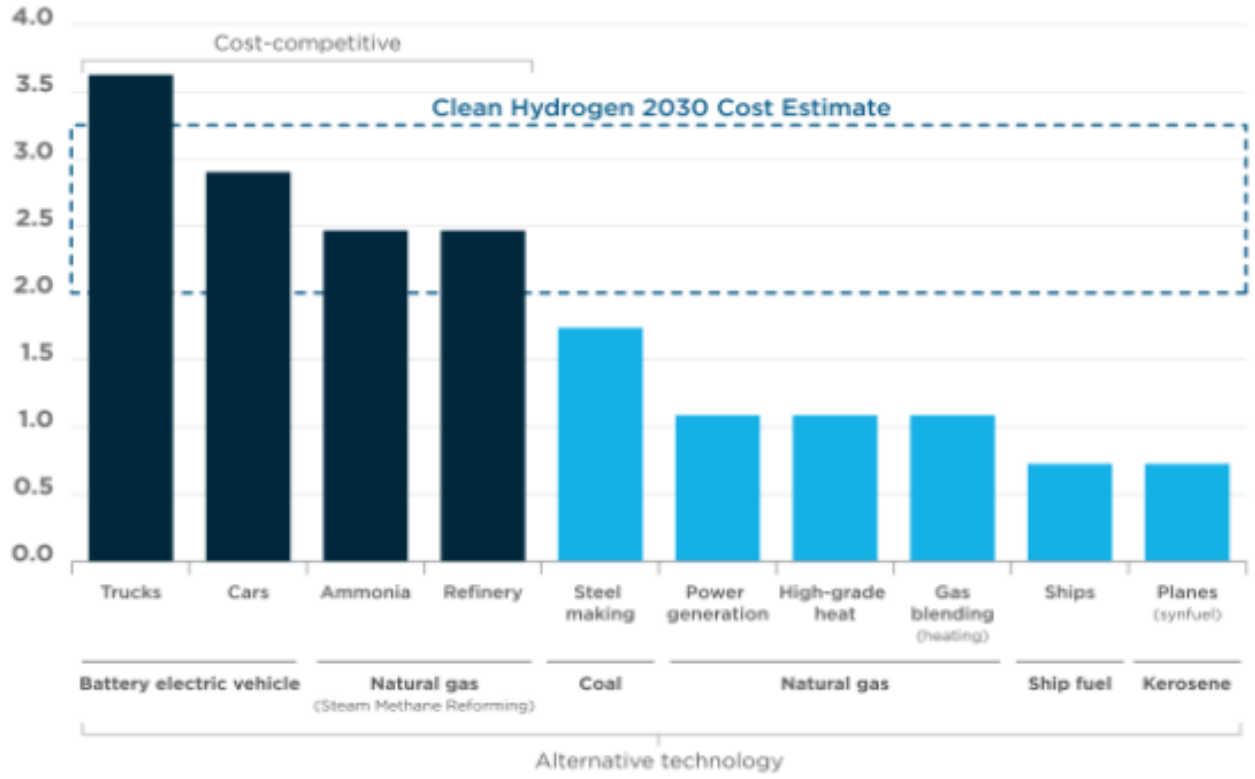
Evoenergy – future plans for the gas network

- Investigate renewable gas options – hydrogen, biogas
- Invest in research and testing at the Hydrogen Test Facility at Canberra Institute of Technology, Fyshwick, to understand hydrogen's potential application and impact on existing materials, equipment and work practices.
- Continue research into the use of biogas to optimise waste-to energy integration.
- Collaborate with the ACT Government, industry, community and other stakeholders to determine how to reduce greenhouse gas emissions at the lowest possible cost and impact.
- Support emissions offset market for gas

Hydrogen and stranded asset risk

- National Hydrogen Strategy – at best by 2030 we will know if H2 is competitive for higher value applications – unlikely for gas reticulation which requires a price well below Dr Finkel's $2/kg stretch target
  - Stranded asset risk if net zero emissions target by 2045-2050 and no accelerated depreciation
  - Stranded asset risk is here now in ACT
  - The slower the move to accelerated depreciation the greater the risk of intergenerational inequity as fewer customers/demand left to pick up cost
- Evoenergy proposes accelerated depreciation of long life new assets but none for existing assets
- Recommendation for wider AER review of gas rules
  - Are they compatible with zero net emission targets eg declining block tariffs

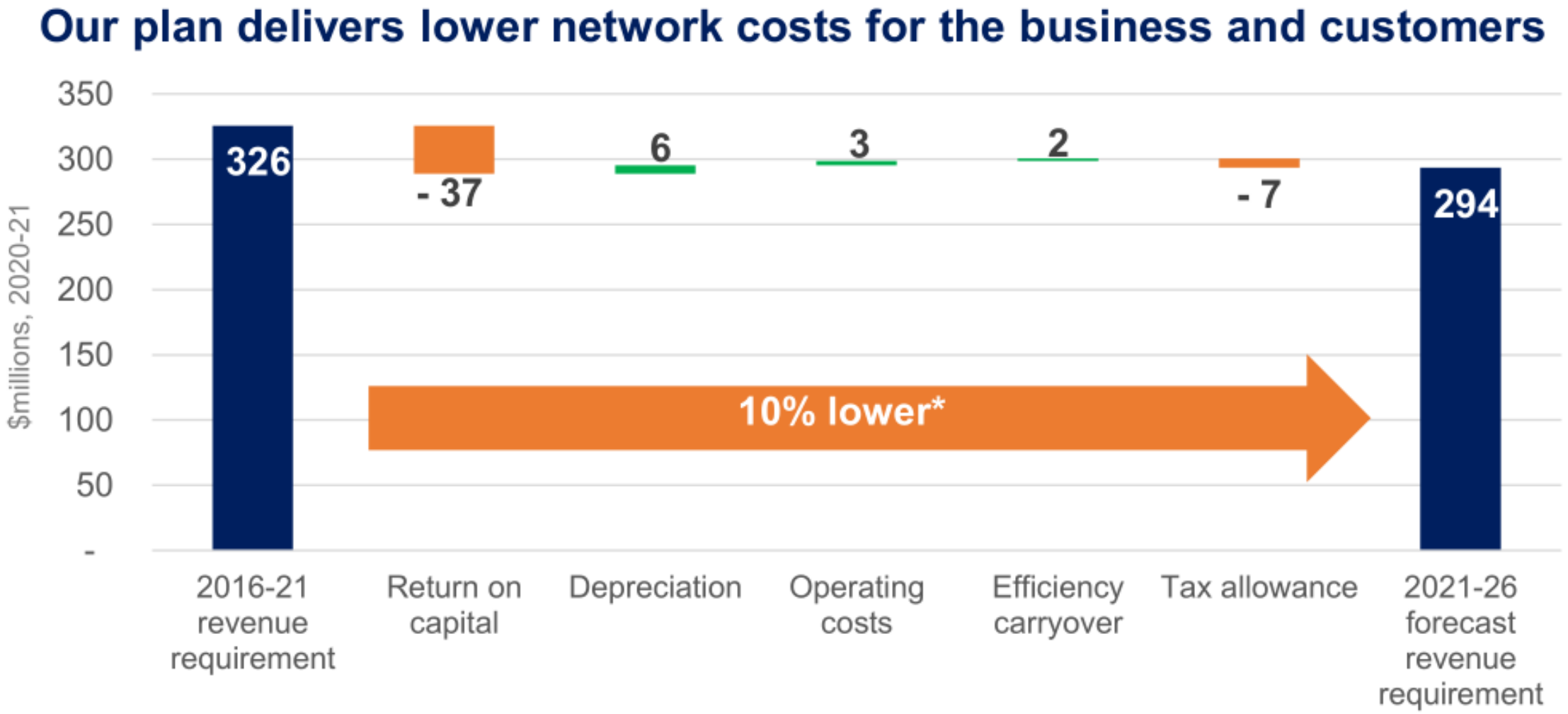
Figure 1.3 Breakeven cost of hydrogen against alternative technology for major applications, in 2030.



Evoenergy – Key aspects of Proposal

- Real price fall of 4% (nominal ~2%?) on 1 July 2021 then CPI increases each year
- Price would have risen without fall in WACC and tax allowance
- Price fall is less than the forecast 10% fall in revenue vs current period allowance because of the fall in average gas consumption
- Demand/customer falls 16% from 19/20 to 25/26, customer numbers increase 3% (~5,000 to 157,300)
- Capex is significantly below both forecast (18%) and allowed (28%) capex for the current period. Accelerated depreciation for new long-lived assets.
- Opex is 3% higher than current period allowance and 10% higher than current period forecast - increased Government charges major factor plus step change of capex to opex for pigging; proposes 0.5% productivity factor
- Total RAB and RAB/customer fall 4% and 6% respectively in real terms at the end of next period vs end of current period
- New Capital Expenditure Sharing Scheme

Prices would have risen without WACC and tax



Operating Expenditure

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Opex

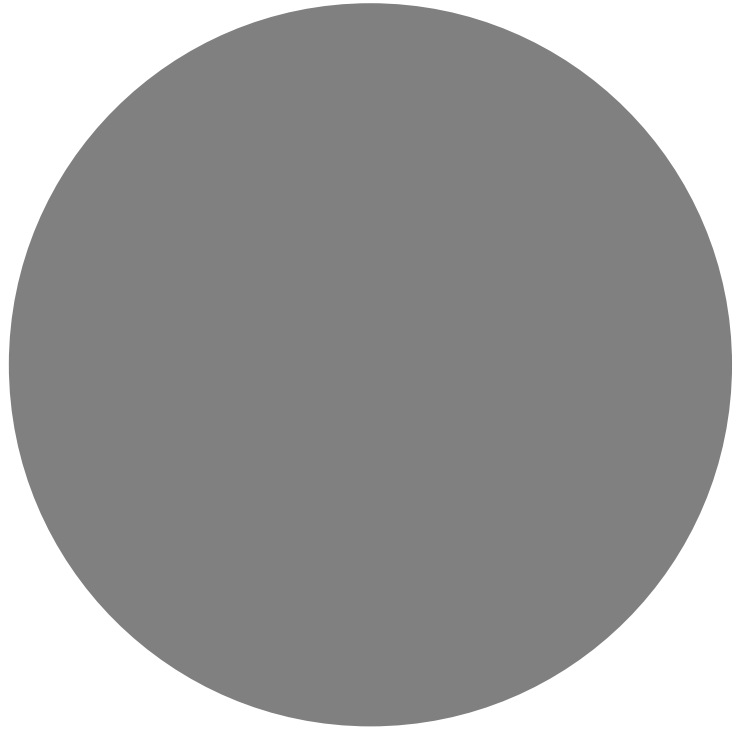
2016-21		2021-26 Forecast	
AER Allowance	Forecast	Draft Plan	AA
$171m	$160m	$173.5m	$175.0m

- Opex is 3% higher than the current period allowance and 10% higher than forecast opex in the current period.
- Applies AER approach of base/step/trend for two thirds; other third bottom up specific forecasts
- Evo argue benchmarking indicates base year 2019/20 is efficient – but “average” is not efficient
- One step change – pigging from capex to opex (decrease stranded asset risk)
- Trend
  - Growth in customer numbers – how does this sit with the potential for stranded asset risk?
  - Average of Deloitte/BIS labour cost growth + zero materials growth
  - Draws on AER review of electricity network opex productivity to propose 0.5%
- Areas we are looking at in more detail include UAFG; expansion opex and marketing
  - ACT Government subsidising conversion to electricity at the same time it is subsidising gas consumers to buy more efficient gas appliances – doubt the continuation of the $1.1m marketing budget in the base year costs

Incentive schemes

- Opex
  - Support continuation of Efficiency Carryover Mechanism in 2021-26 but, as we argued in our submission on the Draft Plan, this should exclude opex associated with new connections to align with the proposed CESS
    - Evoenergy rejects this view is inconsistent with the base/step/trend
  - Proposing 0.5% for 2021-26 vs 0.74% for Jemena NSW
  - Key issue around productivity assumption is “how much goes 100% to consumers and how much is shared 70/30 between consumers/networks?”
  - Two aspects to efficiency (i) movement out of the efficiency frontier and (ii) movement toward that efficiency frontier – electricity network productivity only concerned with (i)
  - Look forward to the AER’s forthcoming work on gas network productivity on both (i) and (ii)
- Capex
  - Support introduction of proposed contingent Capital Expenditure Sharing Scheme performance measures/targets/weightings with exclusion of new connections capex

Capital Expenditure



Capex: 18% reduction from actual spending 2016-21

$ million (2020/21)	AER allowance 2016-21	Actuals 2016-21	Forecast, 2021-26
Market expansion	49.7	45.9	26.3
Capacity development	7.1	7.2	0.9
Stay-in-business - network renewal	17.0	8.2	12.9
Stay-in-business - meter renewal	18.2	17.4	23.6
Non-system	0.6	0.0	0.0
Gross capex	**92.6**	**78.7**	**63.8**
***less* capital contributions**	4.5	1.7	0.5
Net capex	**88.1**	**77.0**	**63.3**

Note: Includes construction management fee, capitalised overheads, and labour cost escalation.

Capex - Initial Observations

- We like the classification categories for Capex: Market Expansion, Capacity Development, Stay in Business and Non-System Capex.
- “Stay in Business” categories the only ones with higher proposed costs than current period actual costs, this is counter-intuitive. Main driver for “Network renewal” is reducing the mains pressure. Is the safety risk reduction ‘material’ to justify the spend?
- 2 Secondary District Regulator Sets (SDRSs) moves to safer sites seems reasonable.
- Meter replacement, why the increase in declining ME? Backlog in replacing end of life meters is reason given, why underspend overall in current AA?
- Non-system capex = $0. Reasonable
- Market Expansion Capex is of most interest

Market expansion Capex; 41.5% of proposed Capex

- Evo says: “Market expansion capex lowers costs for all consumers by allowing fixed costs to be spread over a larger number of consumers.” But declining demand/customer challenges this traditional axiom.
- ME capex projections for C&I and Medium density may be optimistic. We accept that forecasting is really difficult!

Table 3.5 Household take-up of gas (new builds and major renovations) in the NSW portion of our network

	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
Proportion of households with gas	94.1%	95.6%	97.6%	95.8%	95.8%	97.2%

- NSW new connections one to watch, but $4m of $26.3.

expansion capex by category excluding capital contributions

	AER allowance 2016-21	Actuals/ Estimate 2016-21	Forecast 2021-26
Electricity to gas	8.8	1.7	0.6
New homes	25.1	28.0	8.5
Medium density/high rise	6.7	6.3	5.8
Industrial & commercial	8.9	11.3	11.4
Total	**49.5**	**47.2**	**26.3**

Note: Medium Density / High Rise and Industrial and Commercial figures include expenditure on Meter Data Loggers and Metreteks. May not sum due to rounding.

Demand Forecasts

revisions will be needed before revised AA

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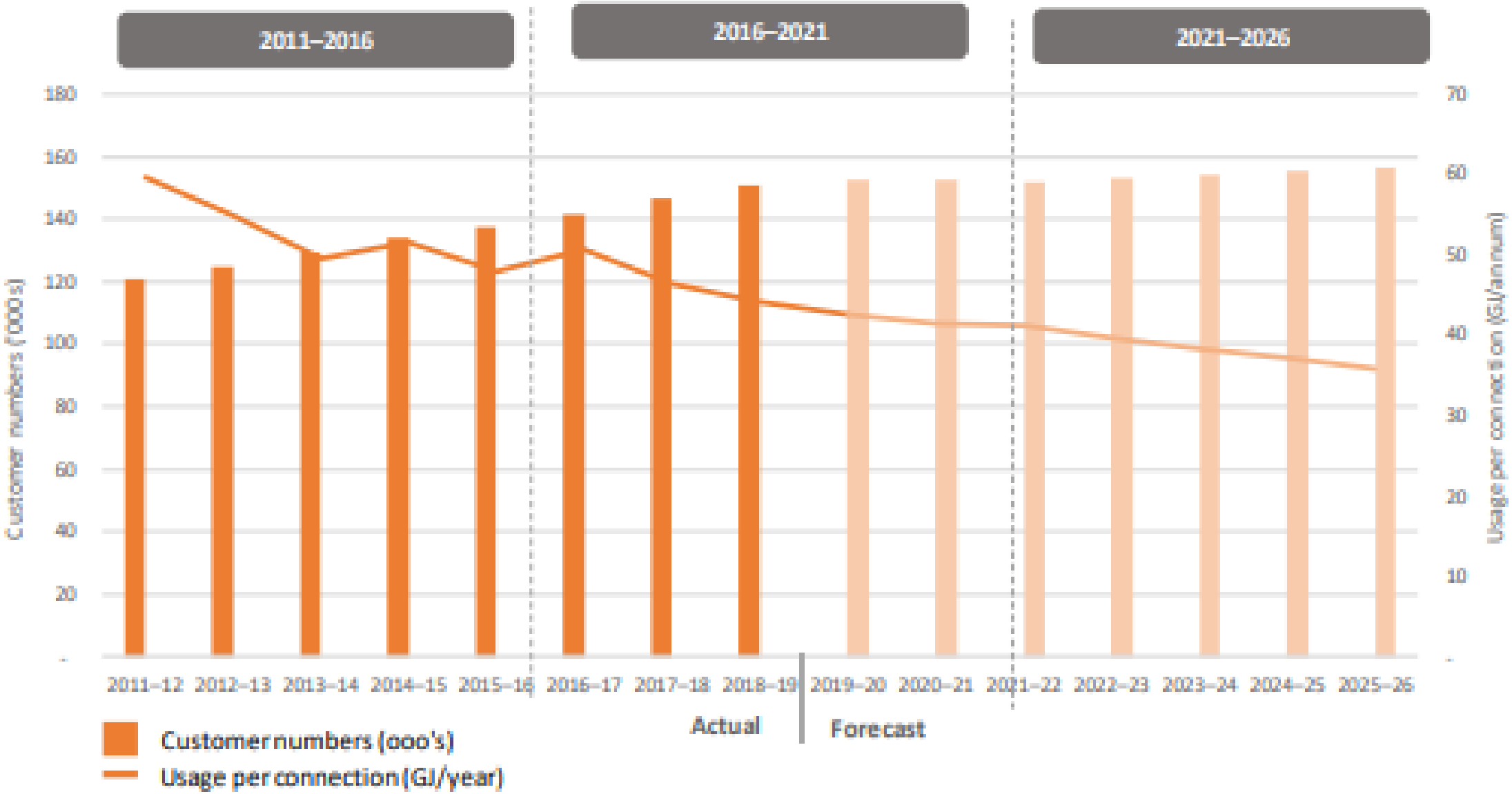
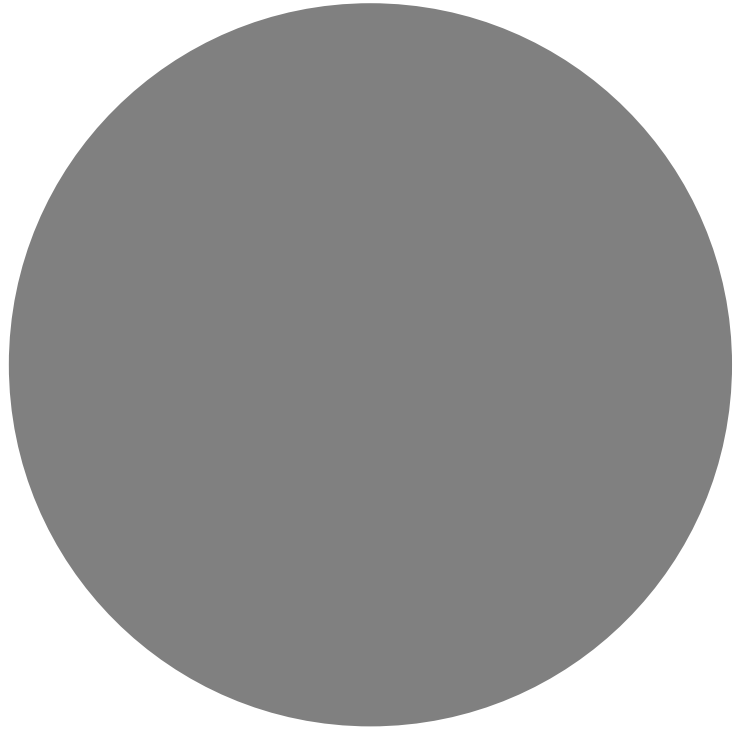
Demand (Volume / household customers)



Depreciation



How to manage stranded asset risk?

- Evoenergy proposes shortened asset lives for new long-lived assets:
  - High pressure mains from 80 years to 50 years
  - Medium pressure mains from 50 to 30 years
  - Medium pressure services from 50 to 30 years
- Inconsistent with 2045 target for net zero emissions (ie 25 years)?
- Inconsistent with asset lives for existing assets of the same class?
- Concerns around intergenerational equity from stranded assets and level and pace of accelerated depreciation
- Argument for faster accelerated depreciation, but significant price impacts for customers. Are differential tariffs an option?
- Recommend further modelling and engagement with consumers and stakeholders

Tariffs

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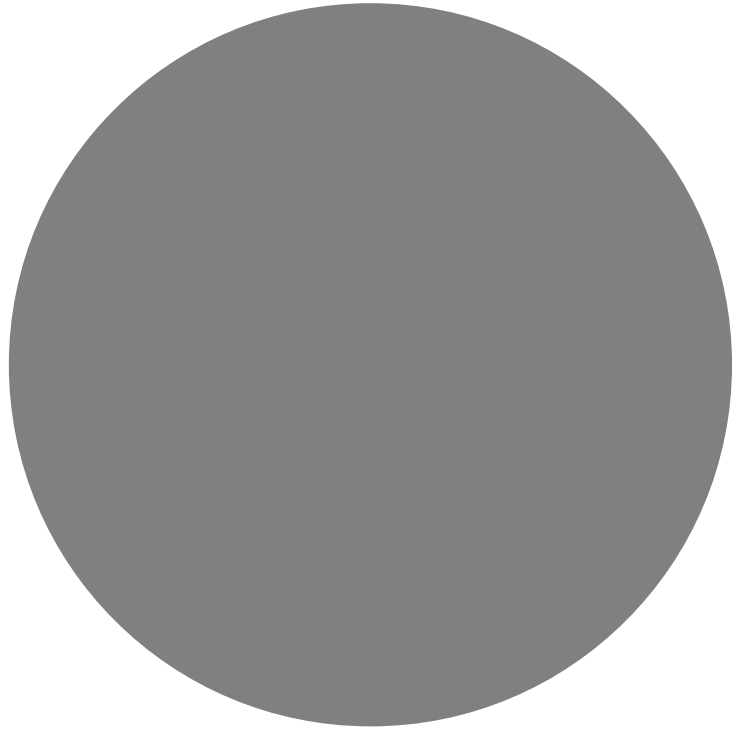
Tariffs

- Support for proposed price path with a 4% real price fall in year 1 and then CPI for years 2-5
- There has been limited engagement on tariffs with no tariff impact analysis
- Simplification of tariffs with removal of those with low take-up is supported
- Evoenergy proposes continuation of postage stamp/declining block tariffs for both ACT and NSW customers
- The different objectives of declining block tariffs
  - Consistent with rules requiring prices reflecting marginal costs and increasing asset utilisation
  - Inconsistent with a zero net emissions target that will involve reduced gas consumption – highlighted in many submissions

Next Steps



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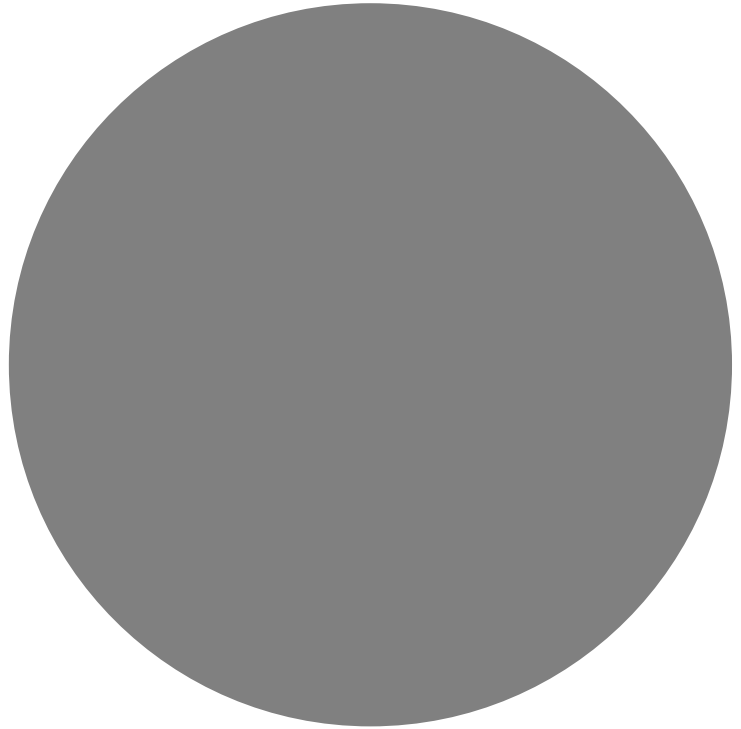
Next Steps for Evoenergy

- Continue to engage with consumers about Evoenergy's challenges, uncertainties and ideas:
  - Including "deep dive" on stranded assets and accelerated depreciation pros and cons.
  - Engagement with NSW based customers about their expectations of future gas use
- Evoenergy to closely monitor ACT Government emissions policy developments including the 2025 priorities and near future policies and publications.
- Revise demand projections in the light of COVID-19 for the revised AA

Questions?



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