Jemena Gas Networks (NSW) Access arrangement 2020-25 Proposal

Submission to the AER

August 2019

ENERGY CONSUMERS AUSTRALIA

Contents

Version history

VERSION	DATE	COMMENTS
1	15 August 2019	Final edit

Summary

Consumers are telling us affordability is their number one priority. Affordable gas will promote the continued utilisation of the network and fair returns for gas network businesses.

Energy Consumers Australia is the national voice for residential and small business energy consumers. Established by the Council of Australian Governments (COAG) Energy Council in 2015, our objective is to promote the long-term interests of energy consumers with respect to price, quality, reliability, safety and security of supply.

We appreciate the opportunity to respond to the Australian Energy Regulator (AER) on Jemena Gas Networks' (JGN) proposed access arrangement for 2020-2025.

Affordability is a priority for households and small businesses and is Energy Consumers Australia's focus in applying the long-term interests of consumers test when reviewing network revenue proposals. JGN's estimate is that this proposal will result in bill savings of 11 per cent (or approximately $150) for the average residential customer over the period of the access arrangement. When combined with a 'hand-back' of the over-recovered revenue during the current period (2015-2020, this will increase to 18 per cent, or $244. This is welcome relief for consumers at a time when they are facing significant affordability challenges.

In this context, there is alignment on key elements of the proposal.

We do however seek further assurance about elements of the proposal which we outline in this submission. Our analysis is informed by advice from the consulting firm, TRAC Partners, who we engaged to provide a technical perspective on the JGN proposal. We made a submission to JGN's draft plan in March 2019, which included initial advice from TRAC Partners outlining strategic questions for the network.[1]

TRAC Partners has undertaken further detailed analysis since the AER published JGN's formal proposal in July 2019 (Attachment A). This advice poses questions about the proposal that we are keen to explore in the next phase of the process, including:

- While the total capital expenditure (capex) actually (or estimated to be) incurred during 2015-20 is largely of a similar amount to the total approved by the AER for that period, on a line item basis, the capex amounts differ from the line item amounts of capex approved by the AER

[1] https://energyconsumersaustralia.com.au/publication/jemena-gas-networks-draft-2020-plan-submission/

for that period – in some cases by as much as 58 per cent. The AER should therefore assess whether the line items of actual capex incurred in this prior period meet the prudency and efficiency criteria under the National Gas Rules (NGR). This is important for three reasons:
  - The AER did not assess these levels of expenditure when it assessed the forecast for the 2015-20 period and so, it should not be presumed that the levels are prudent and efficient. We note that JGN has provided a substantial amount of information to substantiate the prudency and efficiency of capex. In the time allowed, we have not been able to undertake any meaningful assessment.
  - Past capex levels are used by JGN as one basis for justifying the appropriateness of the level of forecast capex for 2020-25. In these circumstances, how reliable are past capex levels as a guide for assessing the prudency and efficiency of JGN's forecast capex in the current proposal?
  - The capex incentive mechanism being proposed by JGN relies on setting efficient levels of only some of the categories of capex (as opposed to the total capex).
- Forecast operational expenditure (opex): while we note that JGN's level of opex benchmarks favourably against that of its peers, we ask the AER:
  - satisfy itself that the transformation savings have been included in the base year of expenditure that is being used to set the level of forecast opex and to identify the areas of opex where these savings have been achieved. We were unable to verify this in the supporting information provided by JGN.
  - explore the reasoning for the increase in the level of opex per dwelling since 2015-20.
  - seek more information to explain the Cost Allocation Methodology changes that are proposed (other than the proposal to expense corporate overheads that have previously been capitalised; and the removal of non-reference service related opex from the base year opex).
- Depreciation and asset lives: the National Gas Law (NGL) and NGR do not guarantee the service provider the recovery of capital invested, rather they give the *opportunity* to recover *efficient* investment and to earn a return on it. We have not seen the evidence to suggest that consumers covering the business cost risk is the appropriate strategic approach to the issue. This submission discusses the strategic approach to risk in more detail below.
- Capital Expenditure Sharing Scheme (CESS): JGN has previously underspent on capex allowances (some by up to 58 per cent). It may be more appropriate for the AER to focus on ensuring JGN's capex forecasting is more accurate and efficient before implementing a CESS-style scheme.

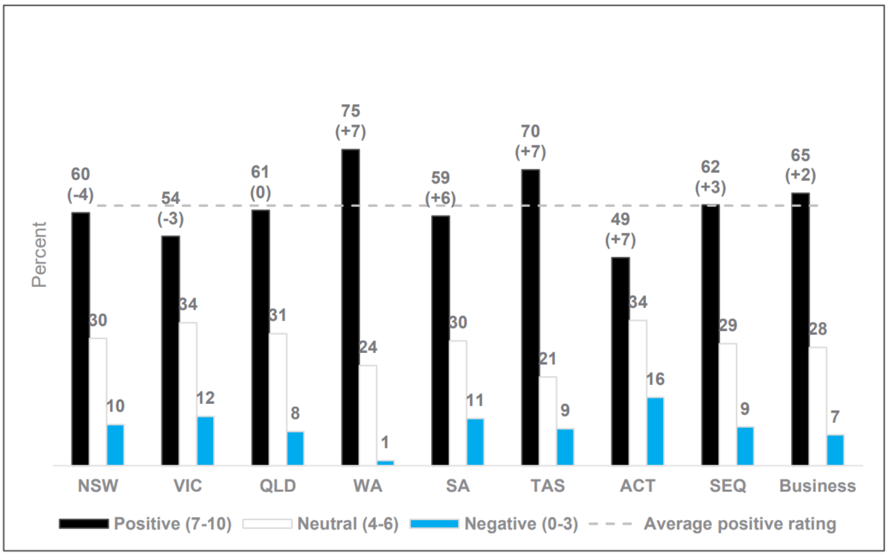
What energy consumers in NSW are telling us

Energy affordability remains a priority for households and small business consumers. This is reflected in the latest results of our Energy Consumer Sentiment Survey, which indicates that consumers are more satisfied with gas reliability (78 per cent) than value for money (60 per cent). We note that satisfaction on these metrics has slipped in the last twelve months (seven and four per cent respectively).[2] Figure 1 shows that compared to its national peers, NSW sits in the middle of pack in terms of consumer satisfaction with the value for money of gas.

Figure 1: Overall value for money[3]

How would you rate the overall value for money of the products and services provided by your gas company in the last 6 months?

0-10 scale, 0='very poor', 10='excellent'

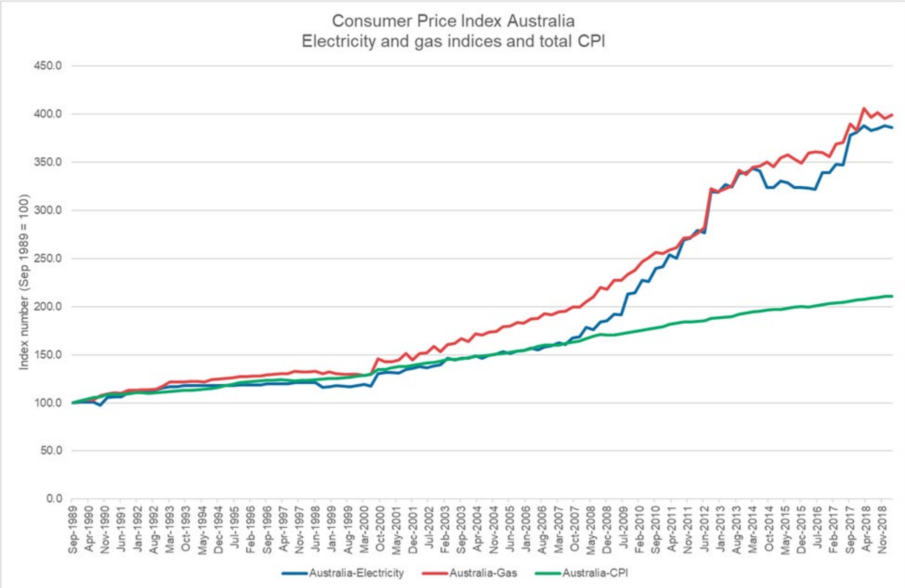


For context, Figure 2 demonstrates how energy prices have increased above the consumer price index (CPI) over the past ten years.

---

[2] June 2019 Energy Consumer Sentiment Survey, page 60.
[3] Ibid, page 15.

Figure 2: Electricity and gas indices and total CPI



Source: internal analysis

Our framing and approach

The objective – the long-term interests of consumers

Promoting the long-term interests of consumers means that current and future consumers pay no more than they need to for the quality of service they require. To put it in even simpler terms, not one dollar more is spent than necessary; not one day earlier than needed. This is an outcome that can best be achieved through a process of dialogue and alignment between network businesses and the consumers they serve. When this happens, businesses are demonstrably careful with consumers' money and investors are earning reasonable returns.

This does not happen when investors or managers are incentivised to follow a strategy that is distorted by objectives beyond the regulatory framework. In our assessment of regulatory proposals, we are guided by three principles to explore and understand the direction the business is taking.

1. The network business should be able to demonstrate that it has developed a deep understanding of the preferences of its consumers.

2. The business should be able to talk about its longer-term strategy and business plans to provide a context for the five-year revenue proposal under consideration, including a long-term price path expectation.

3. The business should be able to acknowledge the problems created by decisions made previously – comparatively less spending per se, is not enough. Consumers are looking for positive assurance that the spending proposed and approved is designed to meet the National Gas Objective (NGO). Indeed, in cases where less

spending is reflective of poor forecasting rather than efficiency improvement effort, the business should not obtain incentive benefits.

How we asses draft plans and regulatory proposals

We include TRAC Partners' detailed advice to support our submission (Attachment A) and as a shared resource for all stakeholders engaging with JGN as a part of this process.

It is important to note that this advice does not reflect an Energy Consumers Australia final position. Rather, it is an input which informs our thinking and highlights areas for further exploration. We ask that network businesses and the AER consider the questions posed and issues raised in the advice, to help further public understanding of the network's strategy and reasoning for the access arrangement proposal.

When we engage with proposals, we hope to see the link between the business strategy and the access arrangement proposal clearly demonstrated. In these documents, we look to see if the business has unpacked why the decisions being made (or proposed) are in the long-term interests of consumers. We seek evidence about the claims in the proposal and how they link back to consumer preferences and outcomes; and how informed consumer preferences have influenced decisions within the business.

Based on our experience in similar processes, we have also come to the position that if one party has information that would make the choice between two alternatives in a draft plan or access arrangement proposal clear, but will not provide the information, we will assume the information works against the proposed preferred option. Consequently,

- If we are not provided with the information we request, our position is that the expenditure is unjustified.
- If we cannot see evidence of consumer preferences, our position is that the expenditure is unjustified.
- If we cannot see clear evidence of ring-fencing integrity, our position is that the expenditure is unjustified.

Our observation is that different businesses are at different stages of maturity as we move away from the old way of making revenue determinations. Some businesses have taken on the entire journey; some have willingly shared non-public information with us and our experts; and some re-started this journey with a clear and demonstrate commitment.

At the end of this process, we would ideally be in a position where we can confidently assure consumers that the very best use of their next $1 is to spend it with their local network to deliver the high-quality network services consumers have said they wanted.

We recognise it is the responsibility of the AER to set the maximum revenues that networks can recover from consumers through network tariffs over the five-year regulatory period, based on its assessment of efficient costs and an informed view on expected electricity demand.

Consumer views and perspectives are integral to ensuring that the decisions made by the AER are in the long-term interests of consumers.

Our response

Stakeholder engagement

In informing our views on this proposal, Energy Consumers Australia has had a laser-like focus on affordability, which needs to be a constraint on all expenditure decisions of the business.

In our submission to JGN's Draft Plan, we stated that JGN was "leading the way" in how it engages with consumers. We recognise that its approach to engagement reflects a broader cultural commitment to consider consumers, as we have seen the same dedication applied to its regulated electricity business in its pre-proposal engagement. JGN has taken an innovative approach to listening to the views of its consumers from across the state.

JGN's direct consumer engagement approach has involved information being shared through a combination of face-to-face forums with consumers, websites and one-on-one meetings with larger customers. JGN has allowed its access arrangement proposal to be influenced by the views gleaned through its direct engagement with consumers, as well as consumer advocate groups and other stakeholders.

We have engaged with JGN through its Customer Council; one-one-one engagement with both Energy Consumers Australia and our technical experts, TRAC Partners; deep dives (one general; and one covering the proposed CESS); and responding to emailed questions. We also made a submission to JGN's draft plan.

JGN has provided valuable insights and perspectives about how to meet the long-term interests of consumers with respect to price, service quality and service safety.

We are of the view that the following factors should be considered when assessing the long-term interests of consumers: In forming a view about Jemena's proposal, we have considered:

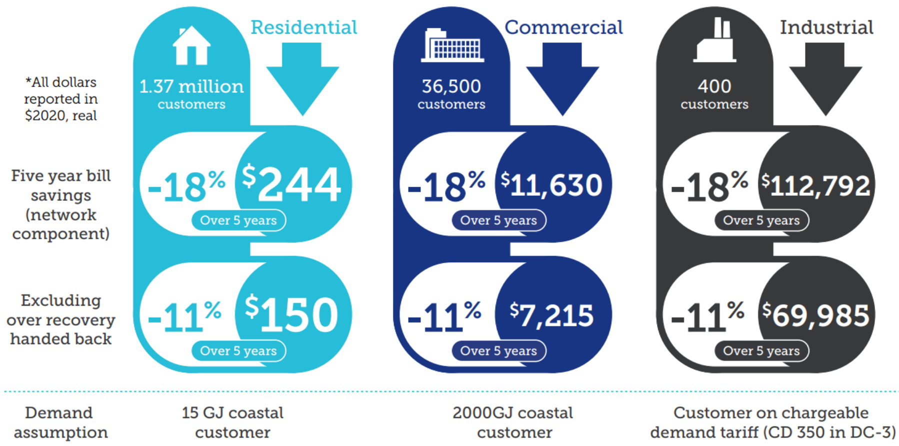
- what JGN has heard directly from consumers in its own engagement;
- what consumers are telling us through the Energy Consumer Sentiment Surveys and other research;
- what experts engaged by consumer organisations (such as Energy Consumers Australia) have said in relation to the Draft Plan and proposal that JGN submits to the AER in June 2019. We have engaged gas pipeline and regulatory experts, TRAC Partners, to assist us assess JGN's Draft Plan. We have included TRAC Partners' report at Attachment A. TRAC Partners' assessment focuses on both the strategic initiatives that underpin JGN's Draft Plan and all of the building blocks used to set the revenue and charges proposed in that Draft Plan;
- detailed analysis undertaken by the AER of the formal proposal that JGN submitted to the AER in June 2019. Not only does the AER have the resources and skills to undertake detailed analysis, it has a statutory

responsibility to ensure that it assesses what is in the long-term interests of consumers (being the national gas objective). We have observed that the AER continues to give weight to consumer needs and how these needs have been considered in regulated revenue processes.

The bottom line – costs to consumers

JGN has heard from its consumers that affordability is their main concern. In response to this, JGN has crafted a proposal and price path that aims to lower costs for consumers and provide a steady network price path that can be adjusted to give retailers room to move with the fluctuations in wholesale gas price. Figure 3 below outlines the indicative network bill impacts of its 2020 plan and separates out the revenue that will be handed back from the current period.

Figure 3: Network bill impacts of the 2020 Plan (excluding the impact of inflation)[4]



New South Wale's residential gas prices were significantly higher (more than 15 per cent) than the national average for the period 2015-2017. Distribution network costs also account for a significant proportion of the total residential gas bill.[5]

We appreciate that JGN is proposing several measures in its proposal to address affordability concerns, such as:

- an 11 per cent reduction in network charges for all customers;
- continuing with an operating cost productivity improvement factor each year during the Plan period (0.74 per cent pa);
- adopting a medium-term approach to certain capital expenditure initiatives, to reduce the growth in the asset base and therefore keep prices down over the longer term; and

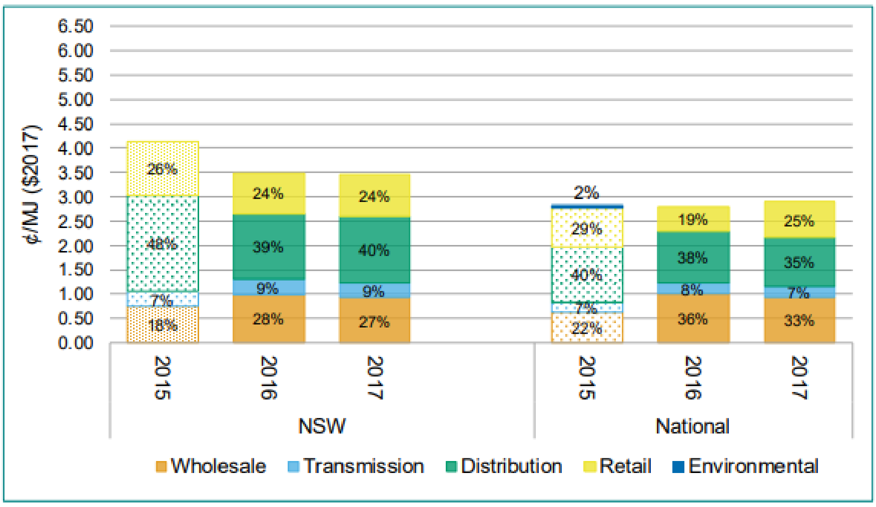
---

[4] JGN, *2020 Plan*, page v. Accessed from https://www.aer.gov.au/system/files/JGN%20-%202020%20Plan%20-%20June%202019%20-%20Public.pdf

[5] 'Gas Price Trends Review 2017', Commonwealth of Australia 2017 - https://www.energy.gov.au/sites/default/files/gas_price_trends_review_2017.pdf

- balancing network charges across the period to counter expected movements in other areas of the supply chain, with the goal of achieving a smooth retail gas bill.

Figure 4: NSW residential gas price trend 2015 to 2017



Source: Gas Price Trends Review 2017

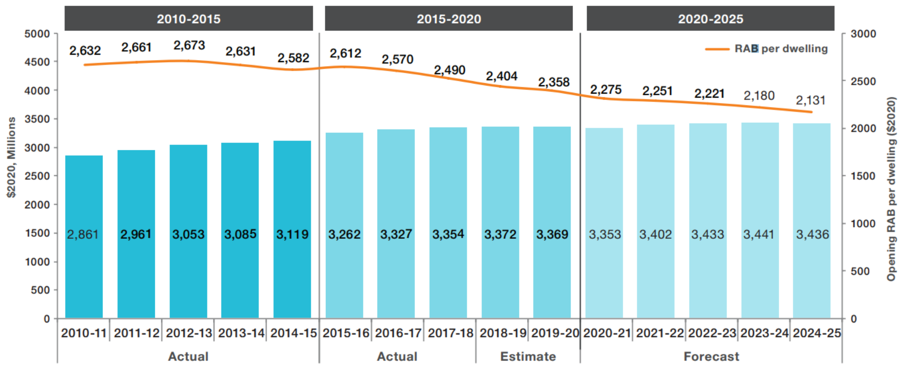
The Regulated Asset Base (RAB)

A business's RAB level has a significant impact on the affordability of network charges, as (in simple terms) the higher the RAB per customer, the greater the overheads the network will recover from consumers and the greater the pressure on bills.

This is why the RAB is one of the first things Energy Consumers Australia looks at when it is assessing network regulatory proposals and access arrangements.

While JGN's proposal would see its RAB increasing by 2.7 per cent across the period (that is, from $3.35 billion to $3.44 billion). Figure 5 demonstrates how that, even though the RAB would increase, the RAB that each consumer would pay (on a per dwelling basis) is decreasing.

Figure 5: Changes in JGN's RAB from 2010-11 to 2024-25[6]



Comments on key components

The JGN proposal incorporates material savings for consumers that lays a platform for improved consumer outcomes over the period.

The TRAC Partners advice indicates that JGN has either addressed some issues raised or provided further clarification of its programs since the Draft Plan, which we welcome. However, further substantiation is required for several key elements of the Proposal. We provide a high-level summary of these issues below, with a more detailed discussion available in Attachment A.

Setting a precedent for dealing with uncertainty

JGN is proposing three strategic solutions for dealing with the business risk of uncertainty, which are outlined in Table 1 below.

Table 1: Proposed strategic initiatives and our response

INITIATIVE PROPOSED BY JGN	OUR COMMENTS
1. Shortening asset lives for pigging activities	This does not appear to either cost or benefit consumers. We do not object to this.
2. Expensing of capitalised overheads	This appears to put upward pressure on prices today. We ask the AER to undertake further analysis on this initiative given our submission that maximising the affordability of gas today should be the overarching goal for what is in the long-term interests of consumers.

[6] JGN, *2020 Plan*, Figure 7.5, page 81. Accessed from https://www.aer.gov.au/system/files/JGN%20-%202020%20Plan%20-%20June%202019%20-%20Public.pdf.

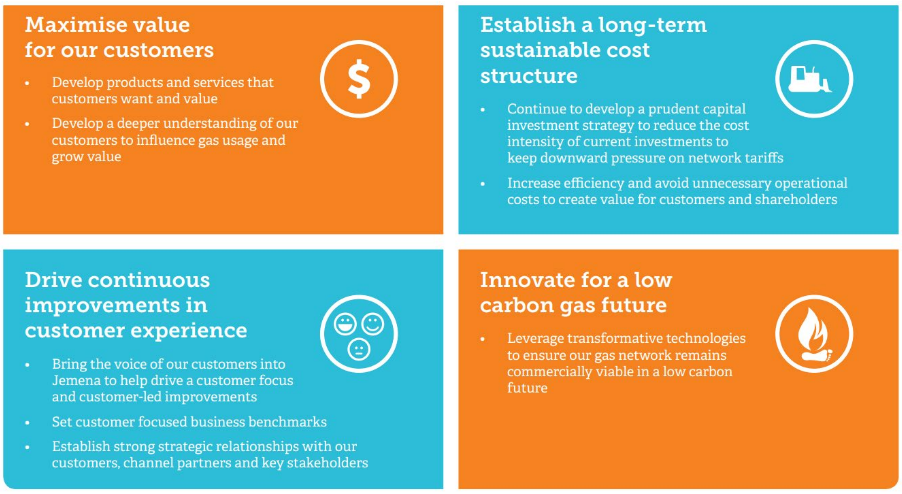
INITIATIVE PROPOSED BY JGN	OUR COMMENTS
3. Shortening asset lives for new investments (known as "accelerated depreciation")	We recognise that JGN's direct consumer engagement supports this approach and we commend JGN for limiting the proposal so that it will not be seeking to accelerate depreciation for its current asset base.[7] However, we have some fundamental concerns about this initiative and its potential to set a precedent that could negatively impact the long-term interests of consumers in both JGN's footprint and across other Australian gas markets.

Quantifying and mitigating business risk

We have not seen any compelling evidence to support the proposed initiative for the shortening of asset lives for new investments.

JGN points to the future decarbonisation of the energy market as one of the main drivers of uncertainty, referring to the Paris Agreement; the Federal Government's target to reduce carbon emissions by 26-28 per cent by 2030; and the NSW Government's net-zero carbon emissions target by 2050.[8] In response to this, JGN has developed its Gas Market Strategy (see Figure 6) as a way to mitigate the risk of uncertainty.

Figure 6: JGN's Gas Market Strategy[9]



The factsheet published by the NSW Government indicates that reaching the target could include several activities "…involving different combinations of action on renewable energy, energy efficiency, carbon sequestration and

[7] Ibid, page 84.
[8] Ibid, page ix.
[9] Ibid, page x.

emissions savings from other sectors such as agriculture and land use"[10]. It does not appear to include specific actions related to the use of gas for residential and commercial purposes in NSW.

In our view, it is not clear how JGN's Gas Market Strategy assesses the risks of uncertainty against the benefits of the many future opportunities for gas in the market. This would include:

- JGN's own forecasts demonstrate that the number of new customers that will connect to the network during the five-year period will continue to grow – in fact over the next five years, it is forecasting the number of new customers will equal the size of Canberra's population.
- Opportunities for gas as a transitional fuel as we move to a lower carbon energy market. This includes the role of gas in electricity generation as we move towards a generation mix that includes a higher penetration of renewable, intermittent energy sources. In a media release, Jemena states that "As we transition to a low-carbon future gas will play an increasingly important role in complementing intermittent renewable technologies such as wind and solar generation that, currently, are unable to provide firming power."[11]
- Actions that may improve the gas supply outlook in NSW, including:
  - the development of a Hydrogen Strategy, whose working group is due to report back to the COAG Energy Council in December 2019[12];
  - the development of the Port Kembla Gas Terminal. In June 2019, Australian Industrial Energy (AIE) announced that it had awarded a construction contract for the Port Kembla Gas Terminal and that it is on track to deliver the project by late 2020. AIE states that the terminal will have the capacity to supply over 70 per cent of NSW's natural gas needs and that EnergyAustralia has committed to a five-year contract of at least 159 petajoules of gas per annum from 2021[13].
  - Jemena's Northern Gas Strategy which aims to address gas shortages across the east coast.[14]

---

[10] NSW Government, *Fact Sheet: Achieving net-zero emissions by 2050*, page 3. Accessed from https://www.environment.nsw.gov.au/-/media/OEH/Corporate-Site/Documents/Climate-change/achieving-net-zero-emissions-by-2050-fact-sheet-160604.pdf

[11] Jemena, *Construction of the Atlas Gas Pipeline Commences*. Accessed from https://jemena.com.au/about/newsroom/media-release/2019/construction-of-the-atlas-gas-pipeline-commences.

[12] National Hydrogen Strategy and Workplan – April 2019 Update, page 3. Accessed from http://www.coagenergycouncil.gov.au/sites/prod.energycouncil/files/publications/documents/National%20Hydrogen%20Strategy%20and%20Workplan%20-%20April%202019%20Update.pdf

[13] AIE, Media Release: *AIE awards construction contract for the Port Kembla Gas Terminal*, 3 June 2019. Accessed from https://ausindenergy.com/file/2019/06/EPC-Award-announcement_FINAL-3-June.pdf.

[14] Jemena, *Proposed Route for the Galilee Gas Pipeline Revealed*. Accessed from https://jemena.com.au/about/newsroom/media-release/2019/proposed-route-for-the-galilee-gas-pipeline-reveal

- Additional measures from the COAG Energy Council to improve transparency in the east coast gas market. The COAG Energy Council is currently consulting on a Regulatory Impact Statement (RIS) which is examining options for improving transparency.[15]

At the AER's public forum on 7 August 2019, JGN stated that uncertainty is its biggest risk and that doing nothing is not an option.

At a time when JGN should be promoting the competitiveness of gas a fuel in a market that can choose between gas and electricity, it is not clear why the preferred risk mitigation option is one that does not look at all opportunities to place downward pressure on network costs.

Given the many opportunities for gas in the future, we would expect JGN to move away from the traditional risk-mitigation approach that sees consumers "insuring" the business against future investment decisions.

The precedent of accelerated depreciation across Australia

Energy Consumers Australia's constitution compels us to consider national energy market matters of strategic importance or material consequence for energy consumers.[16]

We believe that setting a precedent of shortened asset lives for the purposes of depreciation to be a matter of strategic importance. This is especially so, given the risk of uncertainty is a boundless argument. The risk to consumers is that the network business extends this approach to all of its investments. We note JGN is not applying to decrease the lives of its existing assets (or accelerating depreciation) due to its desire to meet its consumers' affordability outcomes. JGN is to be commended for this.

While this indicates that JGN is bearing most of the risk that it claims is now more real (that is, the risk of stranding of the assets because of the uncertain future of gas), this position, like any, may be subject to change in future. Any debate about accelerated depreciation must be managed in an open and transparent way through a process like the Australian Energy Market Commission's Electricity Network Economic Regulation Frameworks Review (ENERF). We ask the AEMC to consider options for such a forum for gas.

It is critical that an agreed national strategy about asset stranding is adopted to ensure that risks are not inappropriately passed-through to consumers. Instead of a "gas death spiral" could we end up seeing a "consumer insurance staircase". Neither are attractive options. We reiterate that the NGL and NGR provide the *opportunity* to recover the costs of the assets, rather than a guarantee that the network business will recover the costs. More importantly, we see that the case for acting to change asset lives for depreciation purposes should only be adopted in circumstances where:

[15] http://www.coagenergycouncil.gov.au/publications/measures-improve-transparency-gas-market-consultation.

[16] Energy Consumers Australia, *Constitution*, section 4.1 (a). Accessed from https://energyconsumersaustralia.com.au/wp-content/uploads/Constitution-Energy-Consumers-Australia-Limited.pdf.

- there has been a fundamental change in the expected future role of gas – we do not believe that this case has been made out by JGN; and
- changing asset lives (and/or accelerating depreciation for existing assets) is the most appropriate course of action for addressing this change – we again do not believe that the case has been made out as it is contrary to the long-term interests of consumers (because the increase in prices today will only further disincentivise the ongoing use of gas as an energy source).

More information on depreciation and asset lives is at Attachment A.

Volume Boundary Metering

From 1 July 2020, JGN is proposing to only offer a volume boundary metering (VBM) connection for sites with a centralised hot water system (also known as "common hot water" or "bulk hot water").[17] This is part of JGN's strategy to reduce capex (by around $6 million per year[18]) and to facilitate the embedded-network solutions market to ensure good consumer experiences of the gas market.[19]

We applaud JGN for looking at ways to reduce its capex and provide a more streamlined experience for its consumers.

Taking a broader view at the regulatory framework that supports embedded network-type gas installations, there is the potential for consumers to see a different level of consumer protections than for direct supply consumers.

For example, the Energy and Water Ombudsman NSW's (EWON) factsheet on common hot water systems says that if the distributor owns the hot water meter, the consumer is charged for the megajoules of gas used to heat the water, rather than the amount of water recorded by the meter. Under this scenario, the consumer would still be covered by the National Energy Retail Law and Rules (NERL and NERR). However, if a third party bills the consumers for the amount of hot water used (that is, litres, not megajoules), then the consumer would not necessarily enjoy the protections of the NERL and NERR.[20] This examples highlights a need to review protections to ensure that consumers (who may be owner-occupiers or renters) have the same access to consumer protections (including dispute resolution) as direct supply consumers.

In its updated review of embedded networks, the Australian Energy Market Commission (AEMC) found that gas on-sellers will be captured by the requirement to become an off-market retailer, which would mean that it would be subject to most requirements that retailers are subject to. However, the AEMC found that the regulatory framework for embedded gas networks lacks clarity and recommends that jurisdictions review whether their

---

[17] JGN, *2020 Plan*, Figure 7.5, page 40. Accessed from https://www.aer.gov.au/system/files/JGN%20-%202020%20Plan%20-%20June%202019%20-%20Public.pdf
[18] Ibid, page 41.
[19] Ibid, page 40.
[20] EWON, *Common hot water systems*, page 1. Accessed from https://www.ewon.com.au/content/Document/Resources%20for%20customers/EWON-Factsheet-Common-hot-water.pdf

frameworks a minimum level of protections to customers in embedded networks.[21] We encourage the AER to engage with the NSW Department of Planning, Industry and Environment to help inform its view of the consumer benefits of this proposal.

Attachment A draws out two key questions about actual savings to consumers and the impact of consumer choice.

Capex

We raised several questions about JGN's actual capex in 2015-20 and its forecast capex proposal for 2020-25 in its Draft Plan. This includes questions about connections capex; the impact of saved expenditure on future reactive maintenance; and the extent to which JGN's approach to asset replacement aligns with the AER's industry practice application note.

We have some further questions about these issues which are outlined in Attachment A.

Opex

We view the fact that no step changes (that is, costs not covered by base opex and the rate of change. For example, new regulatory requirements[22]) have been proposed as a positive, and we are advised that the rate of change is consistent with regulatory precedent.

We seek clarity from JGN about how transformation program savings have been taken into account; what the longer-term impact of capitalised overheads will be; and why unaccounted for gas volumes are higher at a time when consumption has reduced. See Attachment A for more information on these issues.

CESS mechanism

In principle, the inclusion of mechanisms that incentivise network operators to become more efficient in the expenditure they incur is something that should be in the long-term interests of consumers. However, introducing a new incentive mechanism is a big change to the framework and the potential impacts on consumers can be just as big and need to be thought through.

We participated in JGN's consultation on the CESS through the discussion at the February deep dive, the April CESS-specific deep dive, and emailed questions. JGN's decision to exclude connections from the CESS design

---

[21] AEMC, *Final Report: Updating the regulatory frameworks for embedded networks*, June 2019, page xv. Accessed from https://www.aemc.gov.au/sites/default/files/2019-06/Updating%20the%20regulatory%20frameworks%20for%20embedded%20networks%20-%20FINAL%20REPORT.PDF

[22] AER, *New Reg: Towards Consumer-Centric Energy Network Regulation. AusNet Trial – AER Staff Guidance Note 4: Opex – 29 August 2018*, page 5. Accessed from https://www.aer.gov.au/system/files/AER%20-%20AusNet%20Trial%20Staff%20Guidance%20Note%204%20-%20Opex%20-%20August%202018_0.pdf

reflects positively for JGN and is evidence of JGN's willingness for consumers to inform its proposal.

However, we think it is important for the AER to assess:

- whether the current circumstances in NSW are, of themselves, acting as an adequate incentive to drive efficient cost outcomes that maximise the affordability of gas; and
- whether the level of efficiencies that could be achieved by a mechanism such as that proposed by JGN could be outweighed by the impact of a mechanism not being structured appropriately.

One view is that businesses like JGN's NSW network are incentivised to constantly achieve efficiencies during the five-year regulatory period because of the commercial reality that gas is a "fuel of choice" and facing increasing competitive pressures (including from electricity).

Because network businesses are constantly facing increasing pressures to remain cost efficient, in theory (at least), this should drive them to find efficiencies in (among other areas) capex throughout the five-year regulatory period. While it is noted that in the case of JGN's 2010-15 Plan, it overspent its total capex allowance by about 2.2 per cent, we note that JGN expects to underspend the AER's total capex allowance by about 7.6 per cent for the current period.[23]

In its Consultation Paper, JGN states that "…the Victorian CESS took account of the Victorian GDBs' operating environment. Our CESS should similarly take account of our operating environment in NSW."[24]

Table 2 highlights some material differences between gas use in NSW compared to gas in Victoria. These differences indicate that while gas usage in Victoria is very high, gas usage in NSW is still a minority energy supply.

We would expect that JGN would operate similarly to businesses in competitive markets, given its low consumption levels and low penetration levels. A more competitive market provides greater opportunities for growth and expansion, and places downward pressure on prices to make the investment more attractive.

[23] JGN, *Capital Expenditure Sharing Scheme (CESS) Consultation Paper*, Table 1, pages 3-4. Accessed from https://yournetwork.jemena.com.au/42637/documents/101356
[24] Ibid, page 12.

TABLE 2: COMPARISON OF GAS IN NSW AND VICTORIA

HOW RELIANT IS THE STATE ON GAS?	NSW	VICTORIA
Number of gas customers compared to electricity customers.	1.3 million gas customers[25] compared to 3.6 million electricity customers.[26] 36 per cent of NSW energy consumers have gas.	1.9 million gas customers[27] compared to 2.9 million electricity customers[28]. 66 per cent of Victorian energy consumers have gas.
Penetration of households connected to the distribution system	42.9 per cent (in 2014)[29]	83 per cent (in 2014)[30]
Average household consumption	Metro NSW (served by JGN): around 20 gigajoules (GJ) per annum; and Rural NSW (served by networks other than JGN): around 41 GJ per annum[31].	Between 45-55 GJ per annum.[32]
Delivered cost of gas	3.52 cents/MJ[33]	2.35 cents/MJ
Distribution component of the delivered cost of gas	1.39 cents/MJ (that is, 40 per cent)[34]	0.62 cents/MJ (that is, 43 per cent)[35]

At this time however, we are not convinced that a case has been made for the introduction of a CESS mechanism. Attachment A highlights some questions for consideration on the proposed CESS mechanism.

We note there have been instances of JGN underspending its non-connections capex set by the AER. We are seeking further assurance about

[25] AER, *State of the Energy Market 2018*, Table 5.1, page 226. Accessed from https://www.aer.gov.au/publications/state-of-the-energy-market-reports/state-of-the-energy-market-2018
[26] Ibid, page 136.
[27] Ibid, page 226.
[28] Ibid, page 136.
[29] Oakley Greenwood, *Gas Price Trends Review 2017*, page 192. Accessed from https://www.energy.gov.au/sites/default/files/gas_price_trends_review_2017.pdf
[30] Ibid, page 169.
[31] Ibid, page 185.
[32] Ibid, page 172.
[33] Ibid, page 164.
[34] Ibid, page 183
[35] Ibid, page 164.

the accuracy and robustness of forecasting of as part of consideration of whether a CESS style scheme is appropriate. We would also ask the AER to consider undertaking a cost/benefit analysis to clearly demonstrate how consumers will be better off with a CESS mechanism.

JGN has indicated a willingness to continue the discussions about the design of the CESS. We would be happy to contribute to this process.

Conclusion

JGN has proven itself to be a network business with a consumer-focused culture. This is through it signing up to The Energy Charter and actively embedding the principles into its business culture. It is also evidenced in the professional way in which JGN engages with consumer advocates where views on some issues are not always aligned.

JGN and Energy Consumers Australia have agreed to continue to work through our additional questions and comments. We look forward to continuing to engage with JGN on these issues.

If you have any questions about this submission, please contact Shelley Ashe, Associate Director (Networks), Advocacy and Communications on 02 9220 5514 or by email at shelley.ashe@energyconsumersaustralia.com.au.

A Suite 2, Level 14, 1 Castlereagh Street, Sydney NSW 2000
T 02 9220 5500
W energyconsumersaustralia.com.au

@energyvoiceau
in /energyconsumersaustralia
f /energyconsumersaustralia

ABN 96 603 931 326

ENERGY CONSUMERS AUSTRALIA