

De Mamiel, Helen

Subject: FW: Mount Barker Gas Network Extension [SEC=UNCLASSIFIED]

From: David Headberry <[REDACTED]>

Sent: Sunday, 2 September 2018 4:39 PM

To: [REDACTED]

Cc: [REDACTED]

Subject: RE: Mount Barker Gas Network Extension [SEC=UNCLASSIFIED]

Dear Helen

Thank you for the invitation for the Energy Consumers Coalition of SA (ECCSA) to comment on the proposed extension to the AGNSA gas network to include Mt Barker and environs. The ECCSA is an affiliate of major Energy Users Inc (MEU) so this response is from both organisations.

The MEU and ECCSA are concerned at the proposal to increase the AGNSA network in South Australia. This concern is based on the requirement that any extension to a gas network must deliver a net benefit to existing consumers of gas in the network so they see a reduction in prices as a result of the extension rather than lead to an increase. While the costs of an extension are relatively straight forward to assess, the revenue from new connections is less so. An assessment of the revenue is directly related to the numbers and types of new connections that drive the volumes of gas that will be transported as a result of the extension over its economic life.

The ECCSA/MEU has reviewed the Core Energy (CE) forecast of gas usage which provides the basis of the expected revenue that will arise from the extension proposed by AGNSA.

The ECCSA/MEU is concerned about a number of aspects of the forecast usage developed by CE. In particular, there is concern that the report does not address the following:

1. The total amount of gas expected to be transported on the extension is primarily driven by residential demand. The ECCSA/MEU also points out that consistently across the gas markets, forecasts of industrial gas demand show gas usage falling over time, implying an even greater dependence on residential demand to underwrite the extension.
2. The residential demand forecast assumes a penetration rate in the new extension will replicate that seen in other new subdivisions. This is a concern as the penetration rate is dependent on a number of factors that do not seem to have been considered –
 - a. The price of gas has risen significantly in the last 2-3 years, making gas usage less attractive
 - b. As gas is predominantly used for heating, there are other just as efficient sources for heating now being used as an alternative to natural gas
3. The amounts of gas used per residential connection shows a significant reduction over time (see for example CE report table 2.3). CE uses the average consumption for the last 5 years but the future consumption needs to be based on the expectation that gas usage per connection will further decline rather than stay at the average of the last 5 years which CE uses. This declining usage per connection is a reflection a number of factors including a general trend of increasing ambient temperatures being seen, increasing gas prices, alternative forms of energy use, increased efficiency of gas using devices, etc. The CE assessment does not recognise these realities
4. The ECCSA/MEU notes that CE has an expectation that gas usage reduction due to increased efficiency in gas using equipment will only occur after 2035 as equipment is replaced. This belies the fact that the new equipment installed now as a result of the network extension will already include more efficient plant than that deduced from historic residential gas usage.
5. The ECCSA/MEU is concerned that a significant amount of the assessment is based on what is seen in Melbourne. What is important to note is that the Melbourne data reflects gas usage for many decades when gas prices were very low. The ECCSA/MEU considers that greater reliance should be placed on Melbourne data from new developments rather than historic averages. This observation also applies to data drawn from SA sources as well.

6. As a general observation, the ECCSA/MEU has seen that forecasts of gas usage has been commonly lower than the forecasts included in revenue resets, supporting their view that gas usage forecasts need to be examined closely. In this case, an error in forecasting usage will result in consumers paying more for their gas transport than is allowed under the rules which require there to be a net benefit to all consumers leading to lower overall transport costs for existing consumers.

The ECCSA/MEU makes the following additional comments about the proposal

1. For other industrial customers, the ECCSA/MEU and its consultants have provided an assessment of the costs for various forms of thermal energy and has identified that the use of natural gas at current prices is marginally favoured over other forms of thermal energy (eg LPG) but this marginal benefit could be readily lost with rising prices for natural gas, noting that gas transport costs also need to be added to the commodity price to arrive at the delivered price for gas seen by consumers. This implies that there is no certainty that natural gas is necessarily a lower cost option over the longer term, especially as the cost of gas transport will increase in the future as the cost of capital increases along with the price of gas as a commodity
2. The discount rate used to demonstrate the benefits is low. The ECCSA/MEU is aware that the current WACC is already considered to be low and that, over the economic life of the extension, the cost of capital will rise significantly leading to a higher discount rate. The ECCSA/MEU considers that a WACC based on the RBA expectation of future risk free investment will have a neutral value some 150-200 bp higher than current levels and this higher discount rate should be used to reflect the long life of the assets.
3. The ECCSA/MEU notes that there is an incentive for AGNSA to minimise the capital cost for the extension as an over-run in capital costs could be rolled into asset base at the next reset. With this in mind, the ECCSA/MEU expects that the AER will carry out an in-depth assessment of the proposed capital costs and will ensure that only efficient costs (eg costs used for the assessment) will be added to the asset base.

The ECCSA/MEU does not oppose the proposed extension per se, but is very concerned that its implementation should not impose any additional cost to existing consumers connected to the AGNSA network. The ECCSA/MEU has observed over the years that gas networks have been extended where the commercial assessments have been not properly executed with the result that existing consumers have incurred additional costs for their gas transport as a result of such network extensions.

If this submission requires additional explanation, please contact the undersigned.

PS. Helen, I can convert this brief response to a formal letter if that is needed

Regards

David

David Headberry
Public Officer
Major Energy Users, Inc
2 Parkhaven Crt, Healesville, Victoria, 3777
Ph: (03) 5962 3225, Fx: (03) 5962 3237, Mb: 0417 397 056
www.meu.asn.au