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Mr Chris Pattas
General Manager, Distribution
Australian Energy Regulator

Lodged by email: JGNGAAR2020-25@aer.gov.au

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Dear Mr Pattas

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

EnergyAustralia welcomes the opportunity to make this submission to the Australian Energy Regulator's (AER) consultation on Jemena Gas Networks NSW Ltd's (JGN) access arrangement proposal for the period from 1 July 2020 to 30 June 2025.

EnergyAustralia is one of Australia's largest energy companies with around 2.6 million electricity and gas accounts in New South Wales, Victoria, Queensland, South Australia, and the Australian Capital Territory. We also own, operate and contract an energy generation portfolio across Australia, including coal, gas, battery storage, demand response, wind and solar assets, with control of over 4,500MW of generation capacity in the National Electricity Market (NEM).

EnergyAustralia applauds the significant efforts JGN has put into consumer engagement.

However, we have concerns that the reference services agreement (RSA) is highly unfavourable to retailers, who have the primary relationship with end customers. Several clauses in the RSA appear to be targeted at shifting JGN's liability for ongoing operational issues. We consider this is inconsistent with the tripartite relationship and distributor obligations to end customers that is set out in the National Energy Retail Rules (NERR). Inefficient allocation of risk results overall in higher costs to consumers.

JGN's Access Arrangement (AA) is proposing to recover the risk of stranded assets from customers through accelerated depreciation; it also appears to overstate the benefits of price reductions to customers, and attribute factors outside of its control to improvements in efficiency. We are also concerned that customers will be unnecessarily exposed to pricing risk through its proposed price path.

While JGN has placed considerable weight on customer feedback to support its proposals in the AA and RSA it also effectively removes consumer protections for certain customers. We are therefore concerned that overall, the proposed AA and RSA will result in consumer detriment.

Our detailed submission and response is attached. We welcome the opportunity to discuss this submission in further detail with the AER. Please contact Shawn Tan on 03 82628 1512 or shawn.tan@energyaustralia.com.au.

Yours sincerely

Carmel Forbes
Industry Regulation Lead

Attachment A – EnergyAustralia Detailed Submission

Attachment B – Specific concerns with proposed Reference Services Agreement

1.0 Jemena's proposed Reference Services Agreement (RSA)

We acknowledge that there are improvements in JGN's proposed RSA for the 2020-25 period compared to its current RSA, including greater mutual sharing of transfer and novation rights. We also commend JGN for their significant efforts in consumer engagement. However, we are surprised that the terms in the RSA appear to be overall, more unfavourable than the ones provided initially in draft to retailers and issues raised in pre-consultation with JGN have not been given any consideration.

We discuss our high-level concerns below and have provided a more detailed response to specific clauses of the proposed reference services agreement in **Attachment B**.

1.1 Physical access to assets

The proposed RSA (and AA) reduces JGN's responsibility for its inability to access its own metering assets in medium density and high-rise dwellings. This is notwithstanding JGN's publication of its 2014 Residential Metering Guide for medium density & high-rise[1] procedures to ensure that metering assets would have to be installed where they could be accessed. This explicitly states that *"[n]atural gas meters for individual apartments must be located within common areas of the development, generally as close as practicable to the point of use to achieve the most cost effective installation."*[2]

As a result of not being able to access meters, customers across the NSW gas retail market continue to receive estimated readings affecting the accuracy of billing; are more likely to be back-billed, and; some customers are subject to the unknown customer process. We consider this is inconsistent with promoting the long-term interests of consumers, and may results in retailers pricing a higher level of risk into retail prices.

In addition, JGN's historical less than acceptable performance in managing physical access to its meters has resulted in high non-completion rates for service orders. EnergyAustralia has experienced, over three years (2016 to 2018) an average disconnection service order non-completion rate of 72% for known customers, and 89% for unknown customers for sites where we are the financially responsible operator (FRO). On average, service order non-completion rates for other gas distributors are around 10%. We have been unable to resolve this in dealing directly with JGN, which ultimately results poor customer experience and higher, and avoidable, costs in supplying end use customers.

We also consider the obligations on the user, and sharing of risk, in the proposed RSA are inappropriate with JGN's role as an asset owner and operator, and the powers of entry granted to JGN as a gas distributor under section 55 of the *NSW Gas Supply Act 1996.* Rather, the proposed RSA attempts to put the onus on the user to assist JGN to obtain access to its own assets; in our opinion, the primary responsibility for access to the premises should logically be borne by the person that owns the pipeline and has statutory rights of access. The RSA also has unbalanced consequential loss provisions not common in other AAs and limits JGN's liability to an 'insured sum' or $5M in all other cases even in cases of negligence, leaving JGN with little commercial incentive to observe its duty of care in connection with the contract; it also makes the retailer liable for many things which would ordinarily be excluded.

[1] Section 3.7, Jemena Gas Networks Natural Gas & Central Hot Water Metering Guide ADG-002- Medium Density & High Rise Residential https://jemena.com.au/getattachment/57f48414-0536-40ad-9ae7-d628c1474beb/Metering-Guide-Medium-Density-High-Rise-Residentia.aspx

[2] Section 3.7.1 Individual Apartment Meters, ibid

1.2 Liability

Consequential loss and liability are specifically defined in JGN's proposed RSA. These provisions are excessively in favour of JGN (refer to **Attachment B** for specific clauses) and also by comparison to other access arrangements. For example, AGN's 2016-21 T&Cs clause 29.6 excludes economic or consequential loss mutually for both parties. AusNet Services' 2018-22 T&Cs[3] does not define consequential loss or loss specifically, and notes its responsibility for enforcement of its rights against customers in section 11. We do not consider there are materially different operating conditions in NSW compared to other jurisdictions to justify these differences.

JGN's proposed terms and conditions may prevent market entry, competition, and choice for customers. Retailers are exposed to significant and one-sided risk in terms of recovering network charges from customers, have limited scope to mitigate risk in this situation, and must smear the cost of participating in the NSW retail gas market across its customer base. This is likely to disproportionately affect smaller retailers who have a smaller base for which to absorb network charges they are unable to bill the customer. The resulting increase in the cost of gas retailing in the NSW gas market may have a direct impact on competition and choice available to customers in the NSW gas market.

It may be appropriate for the AER to consider, in the absence of a consistent approach to gas distribution services terms and conditions nationally, whether the risk return balance sought by JGN is, overall, appropriate.

2.0 Proposed 2020-25 Access Arrangement (AA)

We commend JGN on their consumer engagement so far and make the following observations in its proposed AA.

2.1 Boundary Meters

We do not support JGN's proposed boundary metering solution for hot water meters. As proposed it requires the developer, and subsequently the consumer, to sit in a de-facto gas embedded network for hot water meters that is effectively unregulated. The AEMC's recent report on embedded gas networks[4] identified that currently, in NSW, for an embedded gas network:

- Metering regulations and standards do not apply.
- Embedded network operators do not need to register with the relevant retail market procedures.
- Customers do not have access to ombudsman schemes.
- Embedded gas network operators do not enjoy the property rights available to a gas distributor, impacting the ability of operators to access their assets.

While boundary metering is consistent with practices by distributors in South Australia (SA) and Victoria, the regulatory framework in these jurisdictions is significantly different. In SA an embedded network operator for gas must be a retailer or exempt seller, or cap charges. As such, gas metering standards and protections for disputes against an exempt seller under the National Energy Retail Law (NERL) exist. In Victoria, the Essential Services Commission of Victoria (ESCV) must grant a licence or exemption to a gas embedded network operator and has the power to put conditions in the licence/exemption to protect consumers (such as compliance with the gas metering code, require gas allocation arrangements with the distributor, or participation in an

[3] AusNet Services 2018-22 T&Cs (Part C of AA)
[4] Embedded Gas Networks Report for the Australian Energy Market Commission, 28 May 2019 https://www.aemc.gov.au/sites/default/files/2019-06/Embedded gas networks - overview.PDF

ombudsman scheme). In addition, in both SA and VIC, embedded gas network operators do not enjoy property rights available to a gas distributor.

We consider that what JGN has proposed will potentially lead to consumer detriment through the lack of consumer protections for the provision of hot water metering services. The boundary meter arrangements will also have the effect of removing any liability or obligations JGN have beyond the parent meter while allowing JGN minimal risk of recovering network charges at the parent meter. We suggest that AER review whether assignment of a single volume tariff (VI or VB tariffs in table 2.3(c) of the AA) at the parent meter, and clause (2.2(b)(ii)(D) in the AA is appropriate.[5]

JGN also states *"[h]ot water meter provision, servicing and reading is not JGN's, or other gas distributors', core business"*[6]. A detailed study of what proportion hot water meters constitute its metering asset base may be appropriate. Consumers should not be worse off due to an organisation's strategic decisions, and further study might be needed by the AER on whether capital expenditure proposed by JGN accurately reflects this.

2.2 Capital Expenditure Sharing Scheme

JGN are proposing to include performance in their meter read estimation rate in its Capital Expenditure Sharing Scheme (CESS) calculation.[7] In our opinion these activities are part of a gas distribution network company's day to day operations. We consider that it is inappropriate to use the CESS to address areas of operational deficiency. This also appears inconsistent with JGN's RSA which absolves JGN of liability for accessing (and therefore reading) its metering assets. In comparison, AusNet's asset performance index used in the calculation of CESS is similar but does not include the ability to reward performance for being able to read its own meters. AGN's CESS is not specific to the level of detail of JGN.

3.0 Reference Services Pricing

3.1 Communicating price impacts to customers

JGN states in attachment 7.1:

> *"Retailers, when determining retail tariffs, will factor in JGN's network charges with their own wholesale and retail costs. We do not have any ability to control the charges that retailers levy on their customers. However, it is in our interests that gas continues to be a competitive fuel choice for our customers. This means that we will actively advocate for retailers to pass on network price reductions by continuing to publicise, through press releases and government briefings, any changes in our network tariffs, and will encourage customers to contact their retailers if these reductions are not passed on."*[8]

We have no objections to JGN (or the AER) publicising expected price reductions for customers as a result of this AA review. In raising customer expectations, however, any quantification of price changes should be accurate and reflect what customers are likely to face. JGN's comment above is concerning in that if customers do not receive a certain bill reduction, this will be attributed to retailers withholding reductions in gas distribution costs.

[5] We are not aware of boundary meter tariffs and customer classifications appearing explicitly in AusNet Services' or Australian Gas Networks' respective determinations.
[6] Jemena Gas Networks, *2020 Plan*, June 2019, p. 5.
[7] (CESS) – Access arrangement schedule 9, page 81 Part F
[8] Jemena Gas Networks, 2020-25 Access Arrangement Proposal - Attachment 7.1 - Revenue and price path, p. 2.

JGN has already publicised that residential customers could expect to receive a bill reduction of $244 over the next five years.[9] This value is repeated throughout its plan, equated to an 18% reduction in the network bill component.[10] Our view is that these figures grossly overstate what customers can expect to see in terms of actual price or bill impacts.

Based on the indicative bill impact submitted with JGN's proposed AA[11]:

- we cannot identify or calculate any value that matches or even comes close to the $244 or 18% reduction quoted by JGN ($244 does, however, match what a typical residential customer would pay for gas distribution costs in total in 2020-21)
- the typical residential customer could expect an 11% decrease (nominal) in the gas distribution component of their bills from 1 July 2020, which translates into a 5% total bill reduction or $31, assuming all other bill components remain constant. This is the largest year-on-year change that a customer would see in the five-year period
- after 2020, gas distribution bill costs are roughly flat before increasing by 7% in 2023 and another 7% in 2024, returning to their 2019-20 nominal levels from July 2025
- overall, JGN's bill impact calculation shows that the typical residential customer will actually receive no change in their bills over the next five years, rather than a $244 reduction it has already publicised.

JGN's plan also states that "*[i]n isolation, our Plan will result in bill decreases of 11% over the 2020-25 period, or $150 for a typical residential customer*".[12] Again we are unable to verify these figures from JGN's price and revenue modelling.

We recommend the AER apply scrutiny to the headline bill reductions highlighted in JGN's proposal and promoted elsewhere. The size of these values may reflect what customers pay in total over the current and next access period, however again we cannot reconcile on this basis, and in any case this bears no resemblance to what customers would expect to see on their bills. We would be concerned if JGN is highlighting or publicising favourable impacts for customers that are erroneous or are intentionally misleading, particularly as it has shown an intention to deflect any unmet expectations onto retailers.

3.2 Price path and drivers for price changes

JGN states that delivering price reductions early in the period, with subsequent increases in later years, reflects customer feedback received in its recent consultation.[13] We encourage further engagement with customers and their representatives in the coming months to verify this view, as well as how the proposed price path interacts with forecast changes outside of distribution costs. For example, new data on forecast wholesale cost changes will become available by early to mid-2020 that may justify revising JGN's proposed price path in line with its objectives.

While we have not examined JGN's supporting documentation in detail, our overall observation is that there appears to be scope to further challenge JGN to deliver controllable efficiency gains and deliver sustained price reductions for customers.

JGN's plan notes that its smoothed revenues will reduce by around 5.5%, from $2,300M to $2,180M, from the current AA period to the next AA period.[14] Our analysis suggests this reduction is largely being driven by:

[9] Jemena, New South Wales Gas Distribution Prices to Fall, Media release, 3 July 2019.
[10] Jemena Gas Networks, *2020 Plan*, pp. iii; iv; v; 38.
[11] Jemena Gas Networks Attachment 12 – Workbook 4 – indicative bill impact – June 2019 – Public.
[12] Jemena Gas Networks, *2020 Plan*, p. iv.
[13] Jemena Gas Networks, 2020-25 Access Arrangement Proposal - Attachment 7.1 - Revenue and price path, pp. 13-14.
[14] Jemena Gas Networks, *2020 Plan*, p. xi.

- a revenue decrement of $169M, reflecting the over-recovery of revenues from customers in the current AA period following the appeal and remittal of the AER's 2015 final decision. This offsets around 40% of JGN's annual revenue requirement for 2020-21, or 7% for the whole of the next AA period
- the lower proposed WACC from the previous access period (to 4.96% from 5.40%, contributing a further reduction in required revenues of around 3% for the next AA period
- some offsetting increases in underlying costs, primarily operational expenditure (opex) and depreciation.

JGN notes recent feedback that "*affordability is a key issue for our customers and that network businesses have a key role in keeping prices down*." In addressing this feedback, JGN states its plan will deliver price reductions by:

- connecting 130,000 new customers, resulting in lower regulated revenues per customer
- implementing a transformation program to reduce its operating cost base, with an additional opex productivity improvement of 0.74% each year
- implementing the AER's rate of return instrument
- reducing the growth in its RAB
- Offering large-industrial customers the opportunity to reset their charges if they have reduced their peak gas consumption over the past 5 years (i.e. reset of Chargeable Demand).[15]

Our observations on each of these items are:

- customer growth is largely outside of JGN's control. The addition of 130,000 customers equates to roughly 10% of JGN's current customer base and would deliver around a 7% increase to its annual revenues by the end of the period. This should be considered in examining JGN's proposed increase in opex to account for network growth.
- JGN's transformation program and 0.74% productivity improvement would avoid around $59M of opex of over five years. Despite this, JGN's opex will increase on average by 2 to 3% annually (in real terms) over the period. This is largely driven by an additional $158M for UAG and $76M to reflect items that were previously capitalised.
- While certainly important for JGN, the reduction it its rate of return arising from the AER's 2018 WACC determination is also not something that reflects JGN's efforts in reducing finance costs and passing these gains back to its consumers in the way they would hope.

  JGN's RAB is forecast to increase by 16% over the period in nominal terms. Our interpretation is that JGN has characterised this as a benefit to consumers in terms of being a slower rate of growth than occurred over the current AA period. This appears to reflect an expected fall in connections capital expenditure rather than controlled efficiency gains.

3.3 Depreciation

JGN's proposed depreciation results in slightly higher prices than would otherwise have been the case. Specifically, it has proposed to shorten the standard lives of new investments to ensure its capital costs are fully recovered in the face of uncertainty created by climate policy. It cites NSW Government policy to achieve net zero emissions by 2050, suggesting that natural gas assets

[15] Jemena Gas Networks, *2020 Plan*, p. vii

will become stranded given its high carbon content. JGN indicates that these changes will cost customers $22M in total[16], which equates to roughly a 1% increase in revenues per customer.

It also cites AER comments made during its recent WACC review that networks can mitigate stranding risk via discounting and accelerated depreciation rather than in the rate of return.

The potential stranding of gas infrastructure assets is an issue that regulators and governments should be considering sector-wide and, noting JGN's proposal must be dealt with, it is a larger issue than a single gas access arrangement.

In competitive markets, policy changes affecting business value can be taken as a write down of assets, and would rarely result in increase in prices ahead of changes being implemented in order to recover sunk costs. EnergyAustralia's parent company wrote down the value of the EnergyAustralia retail business by $1.3B in June 2019 because of the raft of regulatory changes commercially impacting us.[17] While not something we necessarily advocate in a regulated setting, the AER and governing energy market bodies may wish to explore whether the gas access regime allows similarly writing down of asset values, or whether it requires RAB values to be recovered irrespective of changing circumstances.

JGN appears to place considerable weight on customer feedback to support this proposal, which should be directly validated with customers and representatives. We note that the ECA and PIAC raised several questions around JGN's approach to accelerating depreciation, and JGN's responses to these should be explored by the AER.[18] The ECA also questioned JGN's approach to in-line inspection assets.[19] Specifically on metering assets, we do not consider climate policy poses a risk of stranding these assets given their relatively shorter lives, and that JGN's justification for deferring metering expenditure in the current AA period[20] suggests meter lives should be extended to 25 years rather than shortened to 15 years.

3.4 Demand forecasts

The AER should carefully examine JGN's demand forecasts, particularly the combination of increasing customer numbers and declining average consumption. Data from JGN's pricing and revenue models indicates it expects the average customer to achieve annual reductions in consumption of 2.2%, which appear to be in line with trend.

The AER's final decision for the current AA period materially underestimated volume market consumption and new connections,[21] which has likely been a key contributor for prices being higher than they otherwise need to be. The AER should explore the extent to which the reasons for this underestimation (i.e. Sydney housing boom) have been addressed or are no longer factors affecting JGN's forecasts. On a minor note, the 130,000 new customer connections quoted throughout JGN's plan[22] materially overstates the forecast customer numbers contained in its (public) post tax revenue model (PTRM).

[16] Jemena Gas Networks, *2020 Plan*, pp. 84.
[17] https://www.clpgroup.com/en/Investors-Information-site/Announcements%20and%20Circulars/2019/E_CLP_EA%20_Announcement%20(2019_Jun)_Final%20Version.pdf
[18] Jemena Gas Networks, 2020-25 Access Arrangement Proposal - Attachment 7.10 - Proposed changes to asset lives for new investments pp. 20-22.
[19] Jemena Gas Networks, *2020 Plan*, p. 2.
[20] Jemena Gas Networks, 2020-25 Access Arrangement Proposal - Attachment 5.1 - Capital expenditure p. 19.
[21] Jemena Gas Networks, *2020 Plan*, pp. 91-2.
[22] See for example, Jemena Gas Networks, *2020 Plan*, p. vii