

30 September 2022

Sebastian Roberts  
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Australian Energy Regulator  
GPO Box 3131  
Canberra ACT 2601

By email to: [VICGAAR2023@aer.gov.au](mailto:VICGAAR2023@aer.gov.au)

Dear Mr Roberts,

**Re: Submission to AER's review of Victorian gas access arrangements and regulating gas pipelines under uncertainty**

Evoenergy welcomes the opportunity to provide a submission to the Australian Energy Regulator's review of the Victorian gas distribution businesses' access arrangements, and specifically on the topic of regulating gas pipelines under uncertainty. Evoenergy acknowledges the AER's November 2021 information paper<sup>1</sup> as an important step towards understanding how the regulatory framework can best support regulated gas business and their customers through the national energy transition.

Evoenergy owns and operates the electricity distribution network in the Australian Capital Territory (ACT) and gas distribution networks in the ACT and the Queanbeyan–Palerang Regional Council and Shoalhaven City Council local government areas of New South Wales. The ACT Government has recently announced clear policy objectives to phase out natural gas and set a pathway to electrification by 2045. As such, Evoenergy is at the forefront of the national energy transition, and faces a set of regulatory, technical, social and commercial challenges that are without precedent in the Australian energy market. Evoenergy is committed to working through these challenges with our customers, the AER, ACT Government, and other stakeholders.

Evoenergy supports many of the regulatory options raised in the AER's information paper and the Victorian gas access arrangement proposal, including accelerated depreciation. These options can help address some of the risk associated with the ACT's transition away from natural gas. However, Evoenergy considers that the regulatory framework alone cannot protect gas businesses and their customers from the risks of asset stranding and significant price impacts in an environment of declining gas demand. The response to the national energy transition will require a coordinated policy approach across Commonwealth and State/Territory

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<sup>1</sup> Australian Energy Regulator, *Regulating gas pipelines under uncertainty: Information Paper*, November 2021.

governments, to ensure the efficient costs of gas pipeline investments can be recovered equitably over time, while continuing to provide a secure, reliable and affordable service to customers who still rely on the gas network. In this context, it is important to consider not just specific regulatory options such as accelerated depreciation, but also the role and scope of the economic regulatory framework for gas distribution businesses in future years.

This submission sets out our views on the issues raised in the AER's information paper, including some of the specific challenges faced by Evoenergy in the ACT, and possible regulatory options to mitigate the impacts of gas demand uncertainty. We look forward to ongoing engagement with the AER and other stakeholders on this topic.

Should you wish to further discuss matters raised in this submission, please contact Lev Yulin, Manager Energy Transition, at [lev.yulin@actewagl.com.au](mailto:lev.yulin@actewagl.com.au)

Yours sincerely

Zoe Dougall  
A/g General Manager Evoenergy

## Attachment

***The ACT is at the forefront of the national energy transition, and Evoenergy is facing significant demand uncertainty as the Territory moves to phase out fossil-fuel gas by 2045***

Recently, the ACT Government launched the *Powering Canberra: Our Pathway to Electrification* position paper, which sets a course to transition away from natural gas to renewable electricity. The paper outlines several steps to progress the transition, including:

- Regulation to prevent new gas connections in greenfield residential and urban infill developments, commencing in 2023.
- Delivery of education and engagement programs to encourage consumers to transition to efficient electric appliances.
- Development of an Integrated Energy Plan by 2024, which will set a 'whole-of-system' plan to transition and optimise the ACT energy system.

To support the policy announcement, the ACT Government has launched a communications campaign to encourage households and businesses to transition away from gas, including factsheets, and online information materials.<sup>2</sup>

The recent policy announcements build upon existing government initiatives to support electrification, and specific commitments codified in the ACT *Parliamentary and Governing Agreement* to discontinue using gas in the ACT.<sup>3</sup> Existing government initiatives in the ACT include:

- **The Sustainable Household Scheme**, which provides zero-interest loans of up to \$15,000 to assist households and not-for-profit organisations with the costs of purchasing energy efficient electric appliances, solar panels, residential batteries, and electric vehicles.
- **The Energy Efficiency Improvement Scheme**, which is administered by ACT electricity retailers. Under the scheme, ACT residents can receive a rebate of \$1,000 to switch from gas heating to electric reverse-cycle air conditioning, or \$500 to switch to an electric hot water system.
- **The Home Energy Support Program**, which provides a rebate of \$2,500 for eligible households to assist with the purchase of electric heating and cooling systems, hot water heat pumps, and electric cooktops/ovens.

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<sup>2</sup> Online content includes [www.energy.act.gov.au](http://www.energy.act.gov.au), and [www.climatechoices.act.gov.au](http://www.climatechoices.act.gov.au)

<sup>3</sup> ACT Labor and ACT Greens, *Parliamentary and Governing Agreement for the 10<sup>th</sup> Australian Capital Territory Legislative Assembly*, 2 November 2020.

At the same time, the ACT is already seeing a consumer-led increase in the uptake of electric appliances, solar panels, residential batteries, and electric vehicles. This is driven by changing consumer preferences for how they use energy, increased awareness of environmental sustainability, as well as market factors such as high wholesale gas prices.

The combination of wide-ranging government incentives, shifting customer preferences, and market factors has contributed to a rapidly evolving energy landscape and significant demand uncertainty for the ACT gas and electricity networks. Demand uncertainty is expected to continue throughout the electrification pathway to 2045. As was demonstrated through Evoenergy's 2021–26 Access Arrangement review, demand forecasts can no longer rely on historical trends to predict future outcomes.

***The energy transition will require changes to how gas distribution businesses operate and recover efficient costs, as well as extending support to customers who remain connected to the gas network.***

The ACT gas network is transitioning from a period of stable, long-term growth to a future with a diminishing customer base that must share in the significant fixed costs of operating and maintaining a safe and reliable gas network.

Evoenergy operates a relatively new gas network, established in the 1980s, with a current regulated asset base value of around \$380 million. Many of Evoenergy's assets are long-lived and were commissioned on the expectation that the significant capital costs can be recovered from a large and increasing customer base over an extended period of time. The ACT's transition away from natural gas by 2045 significantly constrains the available time for Evoenergy to recover its capital investments and creates the risk of asset stranding. It also raises issues of inter-generational equity, as the burden of past investments may be disproportionately borne by current and future gas customers. Conversely, bringing forward cost recovery creates the risk of unprecedented price spirals if disconnections accelerate in response to higher gas network charges.

Planning future expenditure on the gas network will need to carefully balance the need to maintain a safe and reliable service for remaining gas customers, while avoiding unnecessary investments in asset renewals that increase customer bills.

The energy transition also gives rise to a new category of costs. These include costs associated with abolishing individual customer connections and decommissioning gas network assets. Evoenergy is facing challenges from a growing number of customers who have ceased using their gas supply but are not undertaking a full abolishment of their gas connection. Instead, many customers opt for the less expensive option of a temporary disconnection (whereby their gas meter is 'wadded' to prevent the flow of gas). In these cases, Evoenergy continues to be responsible for the costs of maintaining the network assets connected to the customer's premises, even though there is no active gas account and associated revenue.

Existing regulatory and legislative frameworks, designed around growing gas networks, do not adequately cover the recovery of costs for decommissioning a network. As we see an increasing number of customers switching from gas, careful consideration and consultation is required with key stakeholders, including gas customers, government and industry to determine how mass connection abolishments can be carried out and funded to minimise safety risk and achieve equitable outcomes for gas customers who are not yet ready to disconnect from the network.

The pathway to phasing out gas in the ACT will also have consequences for parts of Evoenergy's network located outside the ACT, including the gas network in the NSW Queanbeyan-Palerang region. Due to the integrated nature of the gas network, it may not be feasible to service some NSW customers if the gas network is phased out in the ACT. Careful and considered planning will be required to minimise the impacts on NSW gas customers who remain connected to the network and are not covered by the ACT Government's 2045 targets and financial assistance packages.

Many energy customers in the ACT currently rely on, or prefer, natural gas to meet their essential heating and cooking needs. As the ACT transitions towards electrification, certain customer groups (including low-income, vulnerable customers, and renters) may face greater challenges in managing their energy costs and switching to electric appliances. Similarly, customers living in multi-unit developments serviced by gas may face significant technical and/or cost impediments to convert their energy supply. As the ACT moves away from gas, the costs of operating the gas network may fall on a smaller number of remaining customers who face difficulties in switching. Putting in place effective mechanisms to support these customers will be key to ensuring a just and equitable energy transition.

***Evoenergy supports accelerated depreciation as one way to manage demand uncertainty. However, we note that regulatory mechanisms available to the AER cannot alone resolve the economic challenges of the ACT energy transition. A coordinated response is required from Governments, policy makers, and gas businesses to ensure a smooth energy transition.***

As demand for natural gas declines across Australia, a key challenge will be enabling gas networks to recover their efficient costs, while appropriately allocating risks and minimising price impacts on consumers. Evoenergy supports the AER's preferred option of using accelerated depreciation as one way to manage demand uncertainty. This was also the option favoured by the Victorian gas distribution businesses in their access arrangement proposals. Evoenergy notes that the AER approved a minor component of accelerated depreciation (in relation to new assets) in its final decision for Evoenergy's 2021–26 access arrangement. Evoenergy considers that further accelerated depreciation on existing capital base assets will be required in future periods to manage the risk of asset stranding.

Accelerated depreciation allows network tariffs to be adjusted to spread more evenly the recovery of costs in long-lived assets between current and future customers. Evoenergy agrees with the AER that accelerated depreciation can help manage demand risk if the rate of depreciation can be flexibly adjusted based on contemporaneous demand trends. However, Evoenergy recognises that accelerated depreciation will not fully resolve the challenges of cost-recovery in rapidly evolving energy landscapes, such as in the ACT. Specifically,

- Accelerated depreciation is most effective in a predictable demand environment which allows for a smooth depreciation profile to evenly distribute costs across the customer base over a long period of time. It is important to achieve a smooth and measured rate of depreciation because gas businesses have large asset values and even a small change to the rate of depreciation can significantly impact customer bills. For the reasons outlined in this submission, the ACT gas network faces significant demand uncertainty, which limits Evoenergy's ability to plan for a stable depreciation pathway.
- In the context of a declining gas network, the rate of depreciation cannot be treated as exogenous to gas demand. Accelerated depreciation causes higher prices which can accelerate the rate of disconnections and, in turn, require an even higher rate of depreciation across a smaller customer base. The potential for an unprecedented upwards price spiral significantly constrains the extent to which accelerated depreciation can achieve efficient cost recovery.
- Evoenergy believes that, even if the rate of disconnections could be forecast with near-perfect accuracy, accelerated depreciation would not permit efficient cost recovery without prohibitive network bill increases. From 2026 (the end of Evoenergy's current access arrangement period), there will only be 19 years remaining to depreciate Evoenergy's regulated asset base of around \$380 million. This would require depreciation of around \$20 million per year to be passed on to Evoenergy's declining customer base.

Evoenergy also acknowledges the other regulatory options presented in the AER's information paper. These include providing ex-ante compensation, sharing costs under capital redundancy provisions, removing capital base indexation, revaluing the regulatory asset base, introducing exit fees, and increasing fixed charges. While we remain open to considering these options, we note that in practice they have a similar outcome to accelerated depreciation – that is, they bring forward the recovery of investment costs. For the reasons outlined above, Evoenergy does not believe this will fully achieve the objective of efficient cost recovery.

In addition to the options outlined in the AER information paper, Evoenergy submits that other regulatory options to manage demand uncertainty may include adjusting the length of the regulatory period or adopting a different form of control, although these too would have similar outcomes under declining demand. Specifically, changes to the form of control and the length of the regulatory period may be needed where it is appropriate to alter the allocation of demand

risk between gas businesses and their customers in response to an acceleration in customer disconnections.

It is also important to consider the interrelationships between gas and electricity networks. As customers switch from gas to electric appliances, demand for electricity is expected to increase, and more investment will be required in electricity networks. The impacts on electricity networks are likely to be amplified since households transitioning to full electrification are more likely to invest in solar panels, residential batteries, and electric vehicles. This means that the same factors that are driving uncertain demand for natural gas, are also creating uncertainty in the demand on electricity networks. Evoenergy believes that, where possible, electricity and gas networks should be considered holistically in the context of the energy transition, particularly in relation to required levels of investment, and impacts on customer bills.

Importantly, it is Evoenergy's view that the regulatory tools available to the AER do not lend themselves to the full breadth of challenges facing gas distribution businesses. Meeting these challenges will require a coordinated and flexible approach, involving customers, gas businesses, government, and regulators. A collaborative approach will be key to ensuring the efficient costs of gas investments can be recovered equitably over time, while continuing to provide both gas and electricity customers with a high quality and reliable network service.

The tools of economic regulation should be applied flexibly and in a way that holistically considers emerging government policy, customer preferences, and the changing commercial realities of operating gas networks. A flexible and responsive regulatory approach is essential so gas businesses can quickly adapt to changing circumstances while minimising the impacts on energy customers.

### ***The role of economic regulation may need to be reconsidered for declining gas networks***

Economic regulation of gas distribution businesses is premised on the notion that gas networks are natural monopolies providing an essential utility service. The regulatory framework was developed so customers could be assured fair prices and reliable services in the absence of competitive market forces. This has been achieved using tools such as price controls, regulatory incentive schemes, and access governance mechanisms.

The regulatory framework also seeks to incentivise gas businesses to make efficient, long-term investments in network assets, the cost of which could be spread over a large customer base over many decades. In turn, gas distributors are allowed low rates of return that reflect a low investment risk, and the expectation that efficient investments in essential services could be recovered with a high degree of certainty. This is known as the 'regulatory compact'.

The Australian energy system is now undergoing a fundamental transformation. Within the ACT, gas may no longer be seen as an essential monopoly service for residential and

commercial customers. ACT Government policy and market factors have contributed to an increase in the competitiveness of electricity as a substitute for natural gas. This includes wide-ranging government marketing campaigns, regulation to ban new connections, and schemes providing subsidies and discounts for customers to transition away from gas. Increasingly, gas networks will see their market power diminish.

The rapidly evolving energy landscape is beginning to challenge the tenets of economic regulation, and this may require different responses from regulators and policymakers. The energy transition will require flexibility in regulatory approaches to protect remaining gas customers from price volatility, while also delivering on the regulatory compact with gas businesses and allowing for efficient recovery of costs. At the same time, regulatory and policy frameworks will need to account for the new class of costs of decommissioning gas networks and supporting an equitable and orderly transition to electrification and renewable energy.

Evoenergy believes that potential changes to the regulatory framework should begin to be explored and discussed with customers, gas businesses, regulators, and policymakers. Planning for the future in a careful and considered way will be key to ensuring a smooth energy transition.