



10 August 2020

Mr Sebastian Roberts
General Manager
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

Email: Evoenergy2021@aer.gov.au

Dear Mr Roberts

RE: Submission to Evoenergy access arrangement proposal

Origin Energy (Origin) appreciate the opportunity to provide a response to the regulatory proposal lodged by Evoenergy for its ACT (and surrounding areas) gas distribution network for the period from 1 July 2021 to 30 June 2026. Origin acknowledge the stakeholder engagement program undertaken by Evoenergy and commend Evoenergy for the thoroughness and inclusiveness of the program.

The COVID-19 pandemic is expected to have an unknown, but significant impact on gas demand and expenditure both within the current regulatory period and likely extending into the next. Evoenergy and the AER will need to carefully consider how to incorporate this uncertainty into the 2021-26 Access Arrangement decision. In the first instance, we anticipate that Evoenergy's demand and expenditure forecasts may need to be substantially revised over the review period as COVID-19 impacts become clearer.

At the same time, the ACT Government has legislated for the ACT to achieve net zero greenhouse gas emissions across all sectors by 2045, with several interim targets. In September 2019, the ACT Government released the ACT climate change strategy for the period 2019 to 2025. The ACT climate change strategy proposes actions to reduce emissions from natural gas. In particular, it sets a path toward achieving a target of reducing emissions by 50–60% (from 1990 levels) by 2025 and outlines initial steps towards achieving net zero emissions by 2045. The timelines, transition mechanisms and technical solutions for phasing out new and existing natural gas connections in the ACT remain uncertain.

We appreciate that Evoenergy's proposal is strongly influenced by the policy environment in the ACT, and the significant uncertainty that surrounds the impacts of the ACT Government's target of net zero greenhouse gas emissions by 2045. We are generally supportive of Evoenergy's proposal to minimise investment in the 2021-26 regulatory period in the face of this uncertainty pending the Government's decision on the future of the network.

More broadly, we consider that the issue of asset stranding risk presents a significant challenge for gas networks and stakeholders. We encourage the AER to review the treatment of asset stranding risk to provide networks and consumers with a better understanding of the risks associated with future gas network investments, the regulatory treatment of these investments and the implications for networks and consumers.

Origin support the significant progress the AER and Evoenergy have made in driving the network towards achieving more efficient expenditure levels. Notwithstanding, the price reductions for the 2021-26 period are largely driven by a reduction in WACC and the tax allowance rather than efficient expenditure

reductions. We are concerned that, absent these exogenous factors, total revenues and prices would rise under the Evoenergy proposal.

Origin's response to specific issues identified in the proposal are set out below.

Operating expenditure

Evoenergy forecast operating expenditure (opex) of \$175 million in the 2021-26 period, \$5 million (3%) higher than the current period opex allowance and \$15 million (10%) higher than actual opex for the current period. This primarily reflects an increase in the ACT Government's Utilities Network Facilities Tax (UNFT) and the expensing of previously capitalised pigging costs. The forecast also includes a 0.5% year on year improvement in productivity.

We note that labour costs are forecast to increase an average 0.83% per year in real terms over the regulatory period. Evoenergy determine labour cost forecasts based on the average of Wage Price Index forecasts developed by Deloitte Access Economics and BIS Oxford. While the averaging approach is consistent with the AER's final position in the recent Jemena Gas NSW decision, we note the considerable variance between the two sets of forecasts (Table 2.4, Attachment 2 of the Evoenergy proposal). Further, in the current economic environment we would expect minimal (if any) growth in labour costs at least in the short-term. We appreciate that the uncertainty surrounding COVID-19 impacts and its duration complicates the forecasting process and can produce a variety of outcomes depending on the underpinning assumptions, including the extent and duration of COVID-19 impacts. It is important that the AER critically assess input cost forecasts and provide sufficient flexibility for forecasts to be reviewed as the economic outlook becomes clearer.

Evoenergy incorporated a 0.5% per annum productivity improvement in the forecasts. While we support the application of a productivity growth factor, in the absence of appropriate productivity benchmarking we are unable to comment on the quantum of the proposed improvement or how it compares to other gas distribution networks. We note that Evoenergy's consultant, Economic Insights, conducted an assessment to benchmark Evoenergy's performance against other gas distribution businesses and indicates that Evoenergy perform well against its peers. Further, Evoenergy suggest that the proposed 0.5% is based on the same approach as used by the AER for electricity distribution. We encourage the AER to develop benchmarking data for gas networks to assist in the assessment of proposed productivity growth factors. The data would assist in determining shifts in the efficiency frontier together with the extent of productivity "catch-up" required by individual distribution businesses.

Capital expenditure

Evoenergy forecast capex of \$63.3 million in the 2021-26 period, 28% lower than allowed expenditure in the current regulatory period. Evoenergy note the reduction reflects reducing market expansion capex in response to the general direction of ACT government policy and connection forecasts. We note also that Evoenergy's capex in the current regulatory period is 13% lower than the AER's capex allowance as a result of significant network renewal and augmentation projects being cancelled or deferred.

Given the uncertain future of the gas network, Evoenergy has adopted a pragmatic approach to investment in the 2021-26 period, minimising investment while conducting further analysis on the network's future in the face of net zero emissions targets. We note that Evoenergy forecast a significant reduction in market expansion capex, but nevertheless maintain that some market expansion expenditure is required in order to meet regulatory obligations. Evoenergy also suggest that an increased customer base helps to spread fixed network costs lowering costs for all customers. Evoenergy note that connections in the NSW portion of its network remain relatively strong.

Under the circumstances, we generally support the broad approach proposed by Evoenergy to constrain capex in the 2021-26 regulatory period. However, there remains considerable uncertainty associated with both the pace and extent of ACT Government measures to curtail gas usage and the future of Evoenergy's gas network more generally. While Evoenergy has sought to adjust underlying connections and gas usage

forecasts to account for this uncertainty, we consider there remains significant downside risk associated with these forecasts. Further, it is not clear how or if potential COVID-19 impacts have been incorporated in these underlying forecasts. To the extent these have not been adequately incorporated, the downside risk is exacerbated.

In addition, we question whether any market expansion capex is warranted given current uncertainty. In this environment, the proposed market expansion capex potentially exposes the business and consumers to increased asset stranding risk. In assessing forecast capex and in particular market expansion capex, the AER need to be cognisant of the uncertain future facing the gas sector and the potential asset stranding risk associated with forecast capex. We consider the AER's assessment of proposed capex should seek to limit exposure to potential asset stranding risk. More broadly, Origin recommends that the AER explore the issue of asset stranding risk with a view to developing a consistent and equitable approach to addressing any asset stranding that arises.

Notwithstanding the above, we encourage the AER to retain sufficient flexibility during the review process and within the next regulatory period to accommodate revisions to capex forecasts as more information becomes available.

Demand

Evoenergy commissioned the Centre for International Economics (CIE) to develop detailed forecasts of demand and customer numbers for Evoenergy's network. Evoenergy acknowledge that the CIE forecasts do not incorporate the full effects of the ACT Government's Climate Change Strategy. Accordingly, Evoenergy applied a series of post-model adjustments to reflect an expected reduction in gas usage and connection numbers as customers continue to respond to new incentives offered by the ACT Government.

Evoenergy forecast a 3.1% increase in connections over the 2021-26 period, noting that the rate of growth is slower than historically due to the impacts of the ACT Government's Climate Change Strategy. Concurrently, usage per customer is expected to decline resulting in a 13% reduction in total gas usage between 2021-22 and 2025-26.

The impact of ACT Government initiatives is difficult to determine and we consider there is scope for a more pronounced reduction in both connections and usage. We also retain the view that Evoenergy should seek to limit new connections until such time as a clearer picture of the future of the network emerges. Evoenergy indicates that it continues to look at options including closing the gas network; using the network to transport renewable gas; or a combination of these and/or other possible options. To the extent that Evoenergy continues to pursue new connections in this uncertain environment the quantum of assets subject to potential stranding risk increases, particularly in the event Evoenergy decided to close down the network.

In addition, it is not clear that the volume or demand forecasts incorporate impacts arising from COVID-19. We consider that there is considerable downside risk associated with COVID-19. Further, uncertainty surrounding the extent and duration of impacts complicate the forecasting process at this time. We suggest that Evoenergy will need to revisit demand forecasts and the implications for expenditure and prices as both the impacts from the ACT Government initiatives and COVID-19 become clearer. In this uncertain environment It is critical that the AER provide scope for forecasts to be updated. It may also be pertinent for the AER to clarify the conditions under which a potential re-opening of an Access Arrangement Decision would be considered.

Accelerated depreciation

In response to ACT government proposals for net zero emissions by 2045, Evoenergy propose to accelerate the recovery of new investment in long-lived assets to reduce associated stranding risk. Evoenergy propose to reduce the asset lives of new investments for medium pressure mains and services from 50 to 30 years.

While the proposed accelerated depreciation results in a relatively minor increase in forecast depreciation over the period (\$0.7 million) we have some concerns over the proposal in principle. In the first instance, it

is not clear that consumers should bear the risk associated with ACT Government climate change strategies and the related decision to accelerate depreciation on long-lived assets. We consider that the business owner and ACT Government as 50% owner are better placed to bear the risk. Secondly, in the current economic environment we consider that affordability is paramount and any proposal that unnecessarily increases customer prices should be avoided. Finally, Evoenergy highlights that work is continuing on determining the future of the Evoenergy gas network in a net zero emissions environment. Evoenergy indicate that it is examining various options including: closing the gas network; using the network to transport renewable gas; or a combination of these and/or other possible options. Until such time as Evoenergy clarifies the future direction of its gas network we consider it imprudent to institute accelerated depreciation.

The role of gas networks in a zero emissions environment is an ongoing issue for the gas industry and considerable work is underway assessing the available options. Evoenergy indicate that it intends to continue researching available options, including the use of hydrogen and biomethane in the existing gas network, during the forthcoming regulatory period. We are inclined to agree with AGN in its recent Access Arrangement proposal that the role of gas networks will be much clearer in the leadup to the 2026-31 regulatory period. At that time networks and stakeholders will have a better understanding of the relevant issues and potential solutions, including the extent and treatment of asset stranding risk. In the interim, we encourage the AER to review the treatment of asset stranding risk to provide networks and consumers with a better understanding of the risks associated with future gas network investments, the regulatory treatment of these investments, the risk sharing arrangements and the implications for networks and consumers.

Incentive schemes

To complement the existing opex efficiency benefit sharing scheme (EBSS), Evoenergy propose to introduce a capex efficiency sharing scheme (CESS). We are generally supportive of a CESS subject to providing appropriate safeguards to ensure that service quality does not deteriorate as a result of any efficiencies.

Tariffs

Evoenergy propose to:

- combine the separate residential and business tariff classes;
- simplify its tariffs by abolishing the VRH, VBS, VBM, VRG, and DBG tariffs. Customers who remain on these tariffs on 30 June 2021 will be moved to the VI tariff; and
- simplify the process for demand customers to adjust their chargeable demand.

Evoenergy indicate there is no change to existing decline block tariff structures.

We are generally supportive of measures to simplify existing tariffs. We consider the use of declining blocks is an appropriate means of promoting increased gas utilisation in the face of a general decline in overall consumption. However, while we appreciate Evoenergy's motivation for seeking to increase consumption, this appears at odds with the ACT Government objective of reducing gas dependence over time. We would appreciate further detail in this area to better understand the pricing options available to Evoenergy and how these interact with Government policy.

Ancillary services

Evoenergy propose to maintain the same ancillary activities as offered in the current Access Arrangement. However, Evoenergy propose to modify the existing ancillary changes so that different charge levels apply above and below 25 m³ /hr rather than the current residential/business (more than 6m³ /hr). Evoenergy suggest this is more reflective of costs. We are supportive of cost reflective pricing however we request additional detail regarding the build-up of costs and eventual prices.

Origin request greater visibility on the process Evoenergy proposes to apply to invoice retailers for ancillary services fees. At present it appears that the proposal only includes an overview of available ancillary services.

Where the AER have approved an ancillary services fee schedule, Origin request that each service provided should be in the market as a B2B transaction (MDH) with an applicable product code that matches the ancillary service fee schedule. This increases service fee visibility for retailers allowing retailers to appropriately map and reconcile network charges within their systems.

Reference Service Agreement

Clause 12(b)(i)

With reference to clause 12(b)(i), Evoenergy propose that Volume Customer Delivery Points will be deleted from the Customer List 20 business days from the date of disconnection. Origin consider that Volume Customer Delivery Points should be disconnected from the Customer List from the date of disconnection. Origin note that these sites are likely to become unclaimed and if the customer starts consuming, they will be allocated to a retailer. Origin seek an improved process and clarity on why it takes 20 business days after the disconnection rather than the date of disconnection for a delivery point to be removed from the Customer List.

Evoenergy previously indicated that the RSA would mirror that of Jemena Gas Networks (NSW) in its recent 2020-25 Access Arrangement. We note that Jemena previously incorporated a 20 business day period associated with disconnections but subsequently removed this requirement in its final RSA and opted for deletion from the Customer List from the date of disconnection. Our proposed amendment to the Evoenergy RSA is consistent with the approach adopted by Jemena Gas Networks (NSW).

Clause 15.9(a)

Clause 15.9 sets out the core obligations of Evoenergy to disconnect delivery points on Origin's request. Under the revised RSA Evoenergy has amended clause 15.9(a) to indicate that Evoenergy is required to use reasonable endeavours to disconnect supply or abolish a Volume Customer Delivery Point promptly or, if a later date is nominated by the User when making the request, in accordance with that request. Origin consider that the proposed changes to this clause represent a weakening of the obligation to disconnect, as compared to the current RSA.

The current RSA make it an absolute obligation to complete the disconnection, unless the specific exception relating to preconditions under Law or the Customer Connection Contract applies. In contrast, the latest version, in effect, reduces the obligation to "reasonable endeavours". Origin consider that the proposed revisions to the RSA effectively water down Evoenergy's obligation to disconnect. Rather than increasing the incentives for Evoenergy to maximise its disconnection performance in the overall interests of consumers, we consider that the latest changes are likely to weaken those incentives further. Accordingly, Origin consider that it is not appropriate to introduce a new "reasonable endeavours" standard for disconnections. Origin prefers an absolute obligation to complete disconnection, unless the specific exception relating to the preconditions under Law or the Customer Connection Contract applies.

Clause 15.9(c)

Clause 15.9(c) proposes that where Evoenergy's costs exceed the applicable Ancillary Charge for the disconnection, reconnection or abolishment of a Demand Customer Delivery Point, Evoenergy may recover from the User its additional costs reasonably incurred in disconnecting, reconnecting or abolishing the Delivery Point.

Origin does not agree with this clause. Ancillary charges are created specifically to allocate charges to works performed. This could expose Origin to charges that customers have not agreed to and may expose Origin to unrecoverable costs.

Clause 15.9(d)

Clause 15.9(d) is related to the proposed changes in clause 15.9(a) described above but takes this further by expressly relieving Evoenergy of liability where it is unable to obtain clear and safe access to the Delivery Station.

Origin consider that clause 15.9(d) of the RSA removes any liability on Evoenergy for a disconnection when it is unable to obtain clear and safe access to perform the work required for disconnection or abolishment. Origin find this clause absolves Evoenergy of any responsibility to complete disconnections and is unacceptable. For this reason, Origin consider that clause 15.9(d) should be deleted, consistent with the position under the current RSA.

Liability for ongoing network and energy charges

Origin consider that the most significant issue is not so much whether a failure by Evoenergy to successfully complete a disconnection constitutes a failure to meet its obligations, but who bears the financial risk where this occurs. The RSA addresses the question of when network charges cease upon the successful disconnection of a Delivery Point (see comments on clause 12 above), but not in the event that a disconnection is requested but not completed.

Origin consider there is a fundamental mismatch between the allocation of responsibility for disconnections and the consequences for failure to disconnect i.e. the risk associated with failure to disconnect. Specifically, the primary responsibility to disconnect resides with Evoenergy, however, the financial consequences of a failure to disconnect fall on the retailer. Compounding this issue, the retailer has no means of mitigating this financial risk. Origin consider that Evoenergy may not be appropriately incentivised, financially or otherwise, to disconnect when requested to do so by a retailer.

Origin is seeking a means to ensure Evoenergy is appropriately incentivised to disconnect expeditiously to minimise financial consequences for retailers. We consider that, under the current and proposed RSA, there is no incentive for Evoenergy to efficiently and effectively perform disconnections. This is not to suggest that Evoenergy should bear disproportionate risk for issues beyond its control – but similarly, Origin and other retailers should not be adversely impacted for risks which it is unable to mitigate.

Under both the current and proposed RSA there is no express regime for allocating financial risk where a disconnection is not completed. As a result, the main avenue for Origin to try to argue that network charges should cease (and/or energy charge compensation should be provided) is to assert that Evoenergy has breached its RSA disconnection obligations. In the absence of a clear rule under the RSA or in relevant regulatory instruments as to how financial risk should be allocated this can be a difficult process. Origin consider that if Evoenergy's proposed changes to clause 15.9(a) and 15.9(c) are implemented, the extent of this problem will increase.

One possible solution is that the RSA expressly incorporate a similar principle to that set out in rule 105 of the National Energy Retail Rules (NERR) as to financial liability for sites which have not been successfully disconnected.

That rule provides that where a distributor fails to de-energise a customer's premises within any required timeframes for de-energisation under an applicable distributor service standard, and the failure is not due to an act or omission of the customer or retailer, the distributor must:

- waive any network charges applicable to the premises after the date on which the de-energisation was required to be completed; and
- pay energy charges for consumption at the premises if the retailer has used all reasonable endeavours to recover the charges from the customer and has been unable to do so.

Origin acknowledge that currently there are no applicable service standards for gas in the ACT or New South Wales, meaning this rule currently has no practical operation under the NERR regime (this can be compared with electricity disconnections, where a distribution service standard has been set for completion of retailer-requested disconnections). Origin request the AER's involvement in the development of a disconnections service standard incorporating a mutually agreeable timeframe for requested disconnections that delivers an appropriate sharing of risk and incentivises the disconnection process.

15.9(f)(ii)

Origin consider that the words “and to access the site and perform the work” should be deleted. Origin consider that there are already sufficient general obligations in relation to cooperation and sharing information within the RSA and under the NERR, and that this additional inclusion only serves to blur the lines as to responsibility for completing a disconnection. This is particularly so, given the absence of any express provisions dealing with the allocation of financial risk between the parties where a disconnection is not successfully completed, and given that many of the access issues within Evoenergy’s network are likely due to factors more within Evoenergy’s own control than the retailer’s control (e.g. location of meters, maintenance of information in Evoenergy’s own systems etc.).

Clause 16.5(d)

Origin note that our current sales agreements cover the distributors access to a site without approval and in instances of an emergency. The agreements however, also require that Origin consult and gain consent from the customer for any additional metering equipment. Accordingly, the clause may raise issues under these circumstances. In particular, while Origin have a broad ability to pass on distributor costs to our customers, there is no specific reference to additional metering equipment. As a consequence, Origin may experience difficulties recouping associated costs from customers.

Origin propose that Evoenergy and Origin share responsibility and act reasonably to rectify access to metering equipment. Further, Origin suggest that Evoenergy be required to consult with the customer and user (to gain consent) for any additional metering equipment before proceeding.

Clause 16.7

Origin note that it does not control the customer site and is therefore unable to identify safe access points or warrant other options on behalf of customers. As a result, Origin could potentially be liable if it fails to discuss the issue with the customer and the replicated location for the equipment causes the customer some type of loss. Similar to the above, Origin believes that the consequence of no site access should be shared with Evoenergy such that Evoenergy engage with the user and the customer and review access options available.

Clauses 27.2(b)(C) & (D)

Origin is concerned that these clauses may expose retailers to financial losses. In particular, there is no indication of how liability would be shared amongst claimants. For example, if Evoenergy pay out \$2 million to a retailer in the first 6 months of the year, it appears that no other claims could be paid for the remainder of the year – this is unreasonable. Similarly, if there were an issue with the pipeline and all retailers suffered some loss, it is not clear how the \$2 million would be apportioned as between retailers. Origin consider that it is Evoenergy’s responsibility to manage their potential exposure to their many users – that should not limit a retailer’s right to recover amounts to which they are entitled. Accordingly, we request that Evoenergy reconsider the clauses in light of these issues.

If you have any questions regarding this submission, please contact [REDACTED] in the first instance at [REDACTED]

Yours sincerely

[REDACTED]
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