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6 March 2017

Mr Chris Pattas
General Manager, Network Regulation
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

Submitted electronically

Dear Chris,

Re: Australian Gas Networks Access Arrangement

A: Introduction

Red Energy (Red) and Lumo Energy (Lumo) welcome the opportunity to respond to the Australian Energy Regulator (AER)'s consultation on the Australian Gas Networks (AGN) gas access arrangement (AA) for the period 1 January 2018 to 31 December 2022.

AGN executed an effective stakeholder program during the development of its AA proposal. This stakeholder engagement has given us the opportunity to provide feedback on the key aspects of their proposal for their consideration including the expenditure that it proposes to undertake during the AA period.

Following our review of the AA proposal, our position in response to AGN's revised AA proposal includes support for:

- **Marketing program** - the marketing program subject to the condition that its benefits exceed its costs. We expect that AGN will submit a cost benefit analysis as part of its AA submission to justify these costs.
- **Capital expenditure** - the capital expenditure program including the mains replacement and the IT program. Our support for mains replacement program subject to the condition that Energy Safe Victoria (ESV) support it. This would provide us with further comfort that this expenditure was necessary for reliability and safety reasons. Also, we support the IT project is subject to the condition that expenditure remains at or below industry mean.
- **Financing costs** - AGN's approach to determining financing costs in adopting the AER's guideline.
- **Inflation** - AGN's decision to adopt the AER's approach to determining inflation.
- **Incentives** - at this stage we do not support the introduction of a capital expenditure efficiency benefit sharing scheme given the current level of efficiency of capital expenditure. Nevertheless, we support further dialogue between the AER and AGN before introducing an incentive scheme on capital expenditure.

- **Tariffs and prices** - price reductions in all of the tariff zones with a greater proportion of costs recovered from variable charges. However, we do not support any proposal to relax the current CPI + 2% rebalancing constraint.

AGN's proposal has been consulted on widely through the industry, resulting in an AA that is expected to provide broad benefits to consumers in the long run.

B: Key Issues

Marketing costs

Subject to a positive cost benefit analysis, Red and Lumo support the AGN's plan to include \$1 million per annum joint marketing program with the other two Victorian Gas Distributors.

Regulated monopolies do not require marketing costs to promote their business because it has market power. Nevertheless, in this case, the marketing program should increase the usage of the network, spreading the fixed costs amongst more customers and delivering lower unit costs to customers.

Our support for the marketing costs would be subject to the condition that AGN can demonstrate that the benefits of the marketing program would exceed the costs. In order for the AER to approve the costs over the next regulatory term, we would expect the costs benefit analysis to be submitted as part of their overall rate proposal.

With the higher costs of wholesale gas in Australia continuing to rise, it is important that we utilise our gas networks assets more efficiently in the future. As such, if the marketing program will lead to increased throughput on the network delivering lower unit costs, then we would support it. We expect that the costs benefit analysis submitted to the AER would capture and quantify these benefits.

Capital expenditure

Red and Lumo support the AGN's capital expenditure plan. More specifically, we support:

- The continuation of the mains replacement program on the basis that is primarily driven by safety considerations and reliability of the network. In general, we are comfortable with the capital expenditure program in this area on the basis that it is supported by Energy Safe Victoria (ESV). We note that the mains replacement program should be reflected in lower unaccounted for gas, which AGN will also receive an incentive for.
- The extension of the national IT program on the basis that it brings in AGN's capabilities in line with the industry standard. In general, we are comfortable with the approach on the basis that the costs of the program remain below the industry mean.

Finally, we are generally pleased that the capital expenditure program for the next regulatory period has been forecast to decrease in real terms by 6% overall. In addition, we support the improved safety and reliability that is provided to customers in general as a result of the capital expenditure.

Financing costs

Red and Lumo support the AGN's approach to financing costs.

AGN have applied the AER's guideline approach to establish the key parameters in the Weighted Average Cost of Capital (WACC). This approach is consistent with the approach it used when they lodged their AA in South Australia.

AGN consider the rate of return to be an industry issue. As such, they consider the same methodology should be applied by each gas distribution business when determining the respective rates of return. Overall, we consider this approach to be satisfactory.

Finally AGN has argued that it will make any adjustments to the parameters in its WACC should there be a successful judicial or meter is based review that is currently in the courts. Once again, we consider this approach to be reasonable.

Inflation

Red and Lumo support AGN's decision to adopt the AER's approach to determining inflation. Nevertheless, we understand that AGN has expressed some concerns regarding the methodology that has applied to the AER.

In order to rectify this, we would encourage AGN to work with the AER on adopting an alternative method that they consider would more accurately the inflation rate. In this regard, we support AGN's decision to collaborate further with the AER in the forthcoming review that the AER has announced to determine the most appropriate manner for determining inflation.

Incentives

Red and Lumo support the current incentive framework. In general, we support AGN's decision to continue to apply the current operational expenditure incentive scheme on the basis that it incentivises the business to implement strict cost control measures and operational efficiencies.

AGN has operated at very close proximity to the Production Possibility Frontier (PPF) in delivering its capital expenditure under its current approach. As such, we have no objections to the current approach.

Tariffs and prices

Red and Lumo support AGN's approach to tariffs and prices. Overall, we support AGN's decision to provide:

- price decreases to all customers including all of those located in the northern region. It is important that all customers in the different zones all get price decreases under the revised AA.
- a greater proportion of cost recovery from the variable charges . More reliance on fixed charges will impact more vulnerable customers disproportionately when the costs are passed through.

Nevertheless, we do not support the proposal to adjust the current CPI+2% rebalancing constraint in order to align tariffs across zones. AGN has proposed to introduce a revised tariff rebalancing constraint of CPI+5%.

Such a change could potentially lead to significant price increases in some zones in order to get alignment in the different tariff zones. As such, we are not convinced that the benefits of this change would exceed the costs.

C: Conclusion

Red and Lumo are pleased to have the opportunity to respond to AGN's AA proposal. We have raised a broad range of issues for the AER to consider in its consultation process in determining the final AA. These issues range from the broad based expenditure related issues through to pricing issues.

D: About Red and Lumo

Red and Lumo are 100% Australian owned subsidiaries of Snowy Hydro Limited. Collectively, we retail gas and electricity in Victoria and New South Wales and electricity in South Australia and Queensland to approximately 1 million customers.

We look forward to working with the AER in the future to discuss our positions further as part of its consultation process. Should you have any further enquiries regarding this submission, please call Con Noutso, Regulatory Manager on 03 9976 5701.

Yours sincerely

A handwritten signature in black ink, appearing to read "Ramy Soussou". The signature is fluid and stylized, with a long horizontal line extending from the bottom.

Ramy Soussou

General Manager Regulatory Affairs & Stakeholder Relations

Red Energy Pty Ltd

Lumo Energy Australia Pty Ltd