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Mr Warwick Anderson
General Manager, Network Finance and Reporting
Australian Energy Regulator
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Dear Mr Anderson

Thank you for the opportunity to provide comment on the Australian Gas Networks (AGN) (SA) Access Arrangement 2016-2021.

The Government of South Australia is a strong advocate for reducing the cost of living pressures on South Australian households. Equally, the Government actively works to assist industry and business on opportunities for job creation and economic growth. Increasing energy costs has been one area of particular concern over recent years for South Australia's community at large. We have therefore taken a number of measures to assist South Australians who face energy-related financial stress, including provision of the energy concession which applies to both electricity and gas usage, progressing work in areas of Affordable Living and actively participating in the Australian Energy Regulator's (AER) regulatory processes.

While the Government notes AGN's proposal to reduce distribution tariffs by 11% in real terms on 1 July 2016, we are concerned with the proposed 5% increases in subsequent years, which are not insignificant for gas consumers and will be even higher once inflation has been applied. Given the current favourable financing environment, the Government submits that the AER should assess whether there is a potential for AGN to achieve further and more sustainable price reductions for South Australia's gas consumers. Certainly the Governments' consideration of AGN's Access Arrangement Information indicates that there are areas that could serve this objective. Accordingly, the Government provides commentary on a number of areas to assist the AER in its decision making process.

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Operating Expenditure – Unaccounted for Gas
It is pleasing to see AGNs' progress on reducing the levels of unaccounted for gas (UAFG) in the current regulatory period.

With regard to operating expenditure, the Government notes that UAFG accounts for around 16%, or $55.4 million of the proposed expenditure for 2016-2021. Noting this significant contribution to AGNs' expenditure, it is critical that the AER is satisfied with forecast UAFG volumes. An important part of the forecast is determining the base level volumes which have reduced significantly since AGN's mains replacement program during 2016-2021. It is therefore recommended that, as part of its assessment, the AER engage with South Australia's Office of the Technical Regulator to determine an accurate base level volume of UAFG.

Furthermore, the Government notes AGN's assertion that "the impact of increasing UAFG prices will offset any benefit that consumers would have otherwise received from the decrease in UAFG volumes."[1] While AGN expects to remove the forecast operating expenditure in its revised proposal if arrangements under the Retail Market Procedures are amended, it is nonetheless important that the AER closely examine the costs provided. In the event that UAFG associated operating expenditure remains, the AER must be satisfied that the expenditure reflects appropriate forecasts of wholesale gas prices. The Government acknowledges the uncertainty with respect to the wholesale price of gas, in part due to the development of significant export facilities in Queensland and because previous long-term contracts are reaching term. However, most recently, expectations about the level of any increase are lower compared with earlier forecasts.

Capital Expenditure - Mains Replacement
AGN is seeking a capital expenditure of $417 million over the 2016-2021 regulatory period which is a significant increase over the AER approved amount of $235.9 million for the 2011-2016 period. If approved, AGN provide that the increased capital expenditure will be spent on completing the cast iron (CI) and unprotected steel (UPS) mains replacement program as well as allow it to continue with targeted replacement of high-density polyethylene mains.

The mains replacement program for the current period represented a significant increase in capital expenditure compared to the 2006-2011 allowance. The AER's decision for 2011-2016 was based on the view that an increase was necessary to allow AGN to replace pipelines to address the high gas leakages at the time. For the current regulatory period, AGN provide that its mains replacement program has been very successful at combating these concerns with UAFG reducing by 34%.

AGN's Mains Replacement Plan (Attachment 8.2) provides details on how it has determined the level and priority of the proposed replacement having regard to a number of factors such as leakage risk, history of breaks and pipeline age.

[1] Australian Gas Networks SA Access Arrangement Information July 2015, page 114

The Government provides that the AER is best placed to assess AGN's mains replacement proposal, through engineering and technical advice. The result should provide AGN with sufficient revenue to tackle the most at risk gas mains, regardless of their type but should not represent an over investment. AER's assessment should therefore be holistic and needs to take into account the reduction of CI and UPS mains and the significant reduction in UAFG during the current regulatory period and what this should mean for the program moving forward.

In addition, the Government notes AGN's proposal seeking capital expenditure for live camera inspections of gas mains which AGN provide will improve its current risk assessment techniques and assist with "a more focussed risk reduction strategy"[2]. This appears to offer an efficient tool to aid risk assessment and it also demonstrates that in the absence of this technology for the current proposal, the AER needs to pay particular attention to AGN's risk assessment for 2016-2021 and be satisfied that the replacement proposal is justified.

Noting the complexities of accurate risk assessment and forecasting expenditure an extensive mains replacement programs, the Government notes the AER's approach to the Envestra (Victoria) Access Arrangement for 2013-17. In that Final Decision the AER allowed for a pass through mechanism for mains replacement. The Government provides that if; based on its engineering and financial assessment, the AER is not satisfied with AGN's proposal, a similar approach does offer a unique approach to mitigate uncertainty. For example, the live camera inspections will provide a further tool and it may be more prudent to await the results of those findings before the AER is satisfied that certain pipelines need replacement.

Of concern is how AGN will prioritise its allowance for replacing pipelines to ensure that the money it receives is spent on the most at risk areas. Critically, AGN should target those mains that are most at risk, even if they may also be the most difficult to replace. For example, noting the previous significant increase in allowance, AGN expected to complete the replacement of CI and UPS mains within the CBD during 2011-2016, which has not occurred. AGN provide that this was as a result of unexpected time delays in the development of a strategic plan and tendering of work. This example not only points to the importance of prioritisation but also of the timing that large mains replacement projects can take. Accordingly, the AER must also consider whether AGN's proposed program for 2016-2021 is achievable within the 5 year regulatory period.

Finally, the AER must ensure that any cost efficiencies gained from the replacement of gas mains during 2011-2016 is adequately reflected as a reduction in AGN's operating expenditure. That is, AGN should see operating efficiencies such as reduced maintenance, call-outs, and associated field staff engagement which should be reflected in AGN's operating expenditure.

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[2] Australian Gas Networks, Attachment 8.3, Mains Replacement Plan, page 24

Capital Expenditure – Relocation of Meters
AGN has proposed a capital expenditure of $2.3 million to relocate gas meters which are located in unsafe locations as a result of changing circumstances on customer premises.

While it is reasonable to provide that the cost of this program should not be recovered from all South Australian gas customers, the Government understands that many customers with meters in unsafe locations may be unaware. Accordingly, the Government does not object to the expenditure but provides that this should be a once-off expenditure to resolve a legacy issue. To avoid any future costs of this nature AGN must inform customers of their obligations with respect to gas meters and other infrastructure on their premises. For example, AGN should produce a similar document to SA Power Networks' Service and Installation Rules that are used for customers, consultants and electrical and building contractors.

Capital Expenditure - Fire Safety Valves
AGN is proposing to install fire safety valves at consumers' premises at a total expenditure of $10.5 million. It is understood that this program is a significant expansion of the current project under which fire safety valves are only installed at premises located within high bushfire risk areas. Instead, the new program will also see installation of valves at all new domestic consumer sites and at existing sites when the meter is changed over as part of the periodic meter change. The Government notes that of the proposed $10.5 million, $7.2 million relates to the periodic meter changes and $2.1 million relates to new meters.

It is understood that AGN's proposal is based on the stakeholder engagement finding that 89% of consumers are prepared to pay for the roll-out of fire safety valves and that the risk of not carrying out the proposed further work is *moderate*.

However, the Government considers that, through technical analysis and further information from AGN, the AER must satisfy itself on a number of critical areas before it is able to make an informed decision. These include:

- the requirements of the Australian Standards relating to gas meter requirements;
- the number and type of gas meter related incidents that have caused or contributed to fires;
- the gas fuel load contribution to house fires;
- information about the reduction to fire risk resulting from the project; and
- whether any other options have been considered such as educating customers in bushfire areas about turning off meters on days of extreme fire danger and as part of evacuation plans.

As a result of these further findings, the AER will be better placed to determine whether this program is necessary or whether perhaps one of the other options presented by AGN is more prudent. For example, noting the higher risk associated with brush fences, it may be necessary to only install the valves on premises where the gas meter is in close proximity to brush fences, which as provided by AGN would result in a capital expenditure of only $1.2 million.

Capital Expenditure – Remote Meter Readings
AGN propose to run a trial program to install remote meter reading devices to those customer premises where meter access is difficult at a capital cost of $2.5 million.

The Government is concerned with this proposal on the basis that gas consumers at large should not fund meter changes to address site-specific problems. Under the National Energy Customer Framework, customers must provide AGN with safe and unhindered access to their premises to allow AGN to read meters. If some of AGN's customers do not fulfil this legal requirement, it is prudent for AGN to work with those specific customers on a resolution, which may include installation of a different meter. This however, should not be funded by all gas consumers.

In terms of trialling new technology as a potentially cost effective method to carry out meter reads, the Government considers that this type of activity could be funded by the proposed network innovation scheme, if approved by the AER.

Incentive Arrangements
The Government notes AGN's proposal to retain the Efficiency Benefit Sharing Scheme and introduce the Capital Expenditure Sharing Scheme. AGN propose that the application of the existing schemes be amended to strengthen the current incentives by applying a sharing ratio of 50:50 rather than the current 30:70 between distribution businesses and consumers. The Government is concerned about the impact of this proposal, as it reduces the benefit consumers receive from efficiency gains.

As noted in AGN's proposal, AGN should be provided with effective incentives in order to promote economic efficiency with respect to reference services the service provider provides. AGN argues that as the industry matures and privately-owned businesses such as AGN improve in terms of productivity, it becomes more difficult to achieve productivity gains and in light of this, incentive mechanisms need to be strengthened. The Government notes, in both the 2006-2011 and 2011-2016 AGN Access Arrangements, AGN's actual operating and capital expenditure have been lower than the AER approved allowance. These outcomes are under the existing incentives, which provided for a 30:70 sharing ratio with consumers. This suggests that the 30:70 incentive is working successfully. AGN's proposal does not appear to provide any evidence that maintaining the 30:70 incentive will not promote further economic efficiency.

Customer Service Incentive Scheme
AGN is proposing to introduce a new Customer Service Incentive Scheme, the parameters of which it proposes to develop with a view to introduce the scheme on 1 July 2017. AGN provide that the areas to be targeted by the scheme will include telephone responsiveness on leaks and emergencies and on the general enquiry line as well as the number of complaints.

In considering this proposal, the Government notes the outcomes of the Essential Services Commission of South Australia's (ESCOSA) Final Decision on AGN's Service Standards for the 2016-2021 Regulatory Period. In arriving at that decision, ESCOSA specifically considered and consulted on a telephone service standard and performance target but concluded against their introduction. ESCOSA drew this conclusion based on a number of factors and stakeholder views including AGN's own submission which provided that "the low percentage of complaints received by the Energy and Water Ombudsman SA supported the view that AGN's complaint handling procedures were working appropriately".[3]

ESCOSA also found that AGNs' current telephone responsiveness exceeded the telephone responsiveness targets that apply to SA Water, SA Power Networks and South Australian energy retailers with AGN answering approximately 93 per cent of leaks and emergencies calls within 30 seconds, with an average response time of 11 seconds.[4] The Government commends AGN on this performance.

In considering AGN's Customer Service Incentive Scheme, the AER should take into account ESCOSA's decision. Implementing a scheme during this regulatory period, will mean that, unlike the Service Target Performance Incentive Scheme (STIPS) which relates to frequency and duration targets for electricity distribution businesses, AGN's scheme would not be directly linked to targets that have been set by an independent regulator. However, the Government notes that ESCOSA's decision includes a requirement on AGN to report on its call centre responsiveness which could provide a basis for the parameters of the scheme.

Network Innovation Scheme

AGN also propose a new Network Innovation Scheme to allow it to invest up to $1 million per year on innovation projects.

The Government sees benefit in this proposal and acknowledges that a similar allowance applies to SA Power Networks in relation to demand management activities. However, that scheme is directly aimed at assisting the electricity industry with the challenge of peak demand growth. That scheme provides electricity distribution businesses with incentives to consider non-network options with the aim of reducing network costs and therefore network charges to consumers.

Accordingly, if a similar scheme is approved for AGN the AER must consider what is the ultimate purpose of the scheme and how will it benefit the long term interest of consumers using the national gas objective. Criteria for the scheme need to be well defined and set within clear boundaries.

The AER will also need to determine whether AGN's proposal of $1 million per year is appropriate. To inform this decision, the AER should consider the Demand Management Incentive scheme that applies to electricity network businesses. In terms of AGN's proposal to seek prior approval from the AER for projects that are forecast to exceed the proposed $1 million threshold, it may be more appropriate to cap the innovation scheme and ensure that it cannot be exceeded. As noted earlier, as far as possible, consumers should be provided with certainty regarding the price path for the period.

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[3] Australian Gas Networks Jurisdictional Service Standards for the 2016-2021 Regulatory Period, Final Decision, page 17

[4] Australian Gas Networks Jurisdictional Service Standards for the 2016-2021 Regulatory Period, Final Decision, page 17

Reference Tariff Structures

The Government notes that AGN's proposed tariff structures and charging parameters are designed to reflect the predominantly fixed cost nature of gas distribution and provide a signal to customers of their costs to connect, and are consistent with current structures. Given the recent demand trends and forecasts presented in AGN's proposal, concerns may arise if total consumption continues to decline and future AGN costs need to be recovered from an ever-reducing base, resulting in higher tariffs in the future. Any change to the tariff structure that may provide a way to alleviate, to some extent, issues associated with the declining trend in total gas consumption should be considered.

Cost Pass Through Events

AGN has proposed two new cost pass through events to be included in its Access Arrangement for 2016-2021. Broadly, the Government is concerned with wide-ranging application of cost pass through events because such events represent increased risk and can harm price stability for gas customers. Accordingly, in general, cost pass through events should be limited as much as possible to unforeseen circumstances with strict definitions and parameters.

AGN propose a "Security of Supply Event" which it provides has resulted from its recent experience of dealing with a major outage on the transmission pipeline to Port Pirie on 12 April 2015 and AGN's concerns with areas of the network that are vulnerable to a single supply risk. AGN provide that as a result of the recent outage it incurred operating expenses of around $0.7 million.

In large part, the Government's concern with this proposal relates to the insufficient definition of a "security of supply event" with further clarity needed around the scope of the proposal. The explanation of the event appears to include 2 parts: the first is the cost of the assessment including engineering and commercial expertise as well as stakeholder consultation; and the second is the cost of an actual project if one is required. The definition, however, is not clear on these separate triggers and further parameters are required around the recovery of each component. Importantly, this should not result in the ability for AGN to recover additional expenditure multiple times and rather should be limited to recovery of funds for an identified project.

AGN also propose a new "Significant Extensions Event" which relates to the recovery of material costs relating to network extensions to new towns or areas in South Australia. While the Government is not opposed to the intention of this cost pass through, we again consider that more work is required on the definition and the proposals parameters. Similarly to the security of supply event, it is not clear from the definition what the scope of the cost pass through is. We assume that it does not include any expenditure on feasibility studies and will only include the cost of a project that extends the network. This however is not clear from the definition.

In both cases, to mitigate the risk of unexpected and potentially significant price increases during the regulatory period, the Government suggests that the AER give consideration to whether it is appropriate to place a cap on each proposal. This could be, for example, a monetary cap or, in the case of the significant extension event, a cap on customer numbers.

Finally, with regard to AGN's proposed broadening of the "Natural Disaster Event" to include other significant safety events, we consider the definition of the proposed event should maintain current text which makes it clear that any event covered is 'beyond the control of AGN'.

Should you require any further information on any element of the attached submission, please contact Mr Vince Duffy, Executive Director of the Energy Markets and Programs Division, Department of State Development on (08) 8226 5500. Thank you for the opportunity to provide our views as part of the consultation process to the AGN Access Arrangement 2016-2021 and I look forward to the release of the AER's Preliminary Decision.

Yours sincerely

Jack Snelling

Hon Jack Snelling MP
Acting Minister for Mineral Resources and Energy