Hon Dan van Holst Pellekaan MP

Government of South Australia

MEM20V0802

Mr Sebastian Roberts
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Dear Mr Roberts

Thank you for the opportunity to comment on the Australian Gas Networks' Access Arrangement proposal for 2021-26.

The South Australian Government acknowledges the significant consumer consultation that Australian Gas Networks (AGN) has undertaken to obtain consumer support for its proposal. However, this submission highlights the South Australian Government's concerns on a number of proposed expenditure items and I encourage the Australian Energy Regulator (AER) to fully assess these items to ensure all AGN's deferrals in the current period and proposed expenditure is fully justifiable.

Capital Expenditure

The South Australian Government welcomes the reduced IT capital expenditure from $41.6 million to $36.5 million in the next period. However, the IT Investment Plan – South Australia (Attachment 8.6, page 19) highlights that in the current period, AGN will spend $41 million, 32 per cent or $20 million less than its approved allowance.

The South Australian Government is concerned that Attachment 8.6, Table 2.5 (page 20) highlights that all but one (Mobility Integration) of AGN's proposed IT investments in the current period are likely to be underspent, some significantly. This does cast doubt on AGN's forecasting accuracy for IT investments.

This lower than expected expenditure is particularly evident with IT application renewals where AGN originally forecasted $19 million but is expected to expend around $7 million. While AGN state the reduced expenditure is due to "a combination of efficiency improvements and prudent deferral of projects" we note that AGN propose to spend $13.9 million on application renewals in the next period. The AER should fully assess this underspend and the proposed expenditure for the next period, which is greater than the expected expenditure for the current period.

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Another large IT capital expenditure item is AGN's contribution to the Australian Gas Infrastructure Group's (AGIG) IT Strategy and Roadmap. This strategy, commenced in 2019, aims to standardise the IT services across the previous separate business elements of the AGIG. Cost to each business element is allocated based on customer numbers with AGN's being 35.8 per cent. However, Figure 1.1: AGN IT infrastructure (page 5) outlines that AGN's share of an enterprise resource planning tool is 60 per cent, totalling $10 million. This appears inconsistent with the allocation of costs based on customer numbers and should be clarified by the AER and benefits to South Australian gas customers articulated.

The accelerated mains replacement program since the 2011-16 regulatory period has seen AGN complete significant works including within the Adelaide Central Business District which will be completed by the end of the regulatory period. AGN's Distribution Mains and Services Integrity Plan – South Australia (Attachment 8.3) appears to show that all extreme risk mains have now been replaced as have a portion of high-risk mains.

The success of the mains replacement program, and in particular the replacement of cast-iron mains, is demonstrated by the significant reduction in Unaccounted for Gas (UAFG) of around 68 per cent since 2008-09. In light of these advancements, the AER should examine whether the volume of the accelerated program is still necessary and whether the continued proposed high capital expenditure of $294 million in 2021-26 is prudent. Furthermore, the South Australian Government notes that AGN's forecast expenditure of $272 million in the current period is $58 million less than the AER's final decision. There is no doubt that mains replacement will be a continued activity to ensure the ongoing safety of the gas network, however, the expenditure on mains replacement in any given period should reflect reductions in risk already achieved.

In addition, AGN states that it is expecting a higher average cost across the mains replacement program in 2021-26 than in the current period. This is somewhat surprising given AGN undertook work within the Adelaide Central Business District which would appear to be significantly complex and therefore relatively costly compared to replacements elsewhere.

It should also be noted that AGN's Distribution Mains and Services Integrity Plan – South Australia was not reviewed by the South Australian Office of the Technical Regulator prior to the proposal. Given the time limitations to undertake a detailed review of all the relevant documents submitted as part of the proposal, further clarity is appreciated on the amount of cast-iron and unprotected steel mains and other materials mains that still require replacement.

SOUTH AUSTRALIA

Government of South Australia

AGN has proposed to introduce a capex efficiency sharing scheme and network innovation scheme. The South Australian Government notes that capex efficiency sharing schemes have been approved for other gas network businesses and therefore considers the AER is best placed to assess the merits of AGN's proposal. The South Australian Government does, however, ask that the AER take into account any differences between South Australia's network arrangements and those in other jurisdictions and ensure that future forecasts are accurate. For example, in South Australia, service performance targets do not apply to AGN which, if the capex efficiency sharing scheme proposed by AGN is introduced, will need to be implemented.

Operating Expenditure

While noting the strong customer support, the South Australian Government is concerned that the Vulnerable Customer Assistance Program ($3.9 million) may duplicate similar programs by retailers. Noting that AGN states that the program will not 'go it alone' and will be designed in conjunction with retailers, the State Government considers that the AER should assess the likely cost of the program in relation to existing retailer programs.

Further, another step change proposed, the digital customer experience project ($1.4 million), may be pre-empting the delivery of the capital expenditure on the Digital Customer Experience ($2.2 million) which is due to be completed in 2024-25.

Unaccounted For Gas

AGN has proposed an operating expenditure of $47.2 million for UAFG which is a 17 per cent increase compared to its forecast expenditure in the current regulatory period. Given this expenditure category makes up around 13 per cent of the total operating expenditure, it is important to ensure that the forecast volume and price of UAFG is as accurate as possible.

Noting that UAFG volumes and cast-iron mains replacement are inversely proportional, we would expect to continue to see a stable but continuous drop in UAFG levels over the next regulatory period as more cast-irons mains are replaced during 2021-26. Based on information provided by the Office of the Technical Regulator, the State Government notes that the volume of UAFG has reduced significantly over the last five years from 1212 terajoules in 2014-15 to 692 terajoules in 2018-19[1]. This 2018-19 actual volume is significantly lower than the forecast 1118 terajoules in the AER's Final Decision for 2016-21.

[1] Annual Report of the Technical Regulator 2018-19 (Technical Regulator South Australia)

SOUTH AUSTRALIA

In this regard, and noting the Office of the Technical Regulator's close involvement in monitoring UAFG, the South Australian Government strongly encourages the AER to consult with the Office of the Technical Regulator in its assessment of UAFG volumes.

The South Australian Government also notes AGN's advice that the increased costs of UAFG reflect the higher gas prices that it expects to pay and note that this appears to be at odds with the Australian Competition and Consumer Commission's most recent data, which shows that the LNG netback price has been decreasing since October 2018 from $13.21 per gigajoule to $2.29 per gigajoule in July 2020, with a forward price to December 2021 of $6.49 per gigajoule. A reduction is also further supported by recent findings of the Australian Energy Market Operator in its Quarterly Energy Dynamics Q2 2020 report which shows that wholesale gas prices continued to fall continuing the downward trend from Q1 2020.

It is therefore crucial that the AER undertakes a thorough assessment of AGN's gas pricing forecasts and ensures these are as accurate as possible. However, if the AER considers that gas price projections are too uncertain, there may be merit in the tariff adjustment factor that currently applies to the price of UAFG continuing in the 2021-26 period. This will ensure that any reductions in gas prices are passed onto customers. The South Australian Government notes, however, that the current tariff adjustment factor works for both under and overspends in UAFG. That is, if gas prices increase for UAFG, AGN's tariffs are adjusted to recover the higher cost from customers. Hence, even if an adjustment factor is applied, accurate gas price forecasts remain just as important and an adjustment mechanism should only be applied if necessary.

Finally, with respect to AGN's proposal to replace up to 20 per cent of its UAFG with renewable gas, we acknowledge AGN's findings that 84 per cent of participants in its engagement program were supportive or strongly supportive of measures to replace UAFG with renewable gases like hydrogen or biomethane. The South Australian Government recognises the opportunities of the emerging hydrogen market and in September 2019, published South Australia's Hydrogen Action Plan to build on the state's vast renewable energy resources.

In order to fully understand AGN's proposal, more information is required especially on its impact on gas customers and the timing of this plan. While AGN's consultation found that participants would be willing to pay between $1.50 and $5.50 for such an initiative, no information is provided on the forecast cost. Furthermore, in its Draft Plan (February 2020), AGN advised that it is aware of one renewable gas production in South Australia and predicted that more projects will commence over the course of 2021-26. Accordingly, it would be worthwhile to understand whether the proposed initiative would commence from the onset of the regulatory period in 2021 or is it likely to commence during the period and if so, this should be reflected in the overall UAFG cost.

Related to this proposal is AGN's discussion on the future of gas and its recommendation not to change the economic lives of its assets and therefore the existing approach to depreciation. The South Australian Government supports this proposal at this point in time given the development of a hydrogen industry and its potential use in gas distribution networks.

Innovation Allowance

In terms of the network innovation allowance, the South Australian Government notes that this proposal was not supported in AGN's current regulatory period and there does not appear to be a significant change in circumstances. The National Electricity Rules allow for this type of incentive to apply to electricity distribution businesses specifically for innovation in demand management. This, however, was introduced as part of a package of measures to tackle the impact on the electricity distribution network of increasing peak demand and to realise potential benefits of investing in non-network solutions. Therefore, the intent is that innovation in this area will ultimately result in reduced costs to consumers.

In contrast, it is unclear what problem an innovation allowance would aim to address in the gas distribution network and how consumers would benefit in the long run. If, however, the AER sees merit in AGN's proposal, it is important that the scope of the scheme be further developed as identified by AGN itself and that the amount of the allowance be narrowed from the current proposal of $2.5 - $5 million. The scoping work should include examples of the type of innovation that AGN may want to explore.

I trust that this submission assists the AER in determining a suitable outcome that meets the needs of AGN to maintain and operate the gas distribution network and the needs of all South Australian gas consumers for downward pressure on their gas prices. I strongly encourage the AER to engage with the Office of the Technical Regulator on a range of expenditure items, particularly on UAFG and mains replacement.

Should you have any questions in relation to this submission, please contact [redacted], Executive Director, Energy and Technical Regulation, South Australian Department for Energy and Mining on [redacted].

Yours sincerely

[redacted]

Hon Dan van Holst Pellekaan MP
MINISTER FOR ENERGY AND MINING

3 / 8 / 2020