Response to Evoenergy and Australian Gas Networks (SA) Revised proposals 2021-26

Submission

February 2021

ENERGY CONSUMERS AUSTRALIA

Contents

Version history

VERSION	DATE	COMMENTS
1	22 February 2021	Final edit

Introduction

Energy Consumers Australia is the national voice for residential and small business energy consumers. Established by the former Council of Australian Governments Energy Council, our objective is to promote the long-term interests of consumers with respect to price, quality, reliability, safety and security of supply.

We appreciate the opportunity to respond to the Australian Energy Regulator's (AER) draft decisions on Evoenergy's and Australian Gas Networks' (AGN SA) proposals for the 2021-26 access arrangement. This process sets the amount of revenue the businesses may collect from gas customers through the distribution charges from 1 July 2021 to 31 June 2026. In doing so, we also comment on the revised proposals distributors lodged in January 2021.

Overall, it is positive that the distributors have accepted the majority of the AER's decisions. We consider the revised proposals are now closer to being capable of acceptance.

TRAC Partners has provided us with independent expert advice throughout the access arrangement process, and this advice is provided in Annexure 1 and Annexure 2 to this submission to assist the AER in its consideration of the issues.

TRAC Partners on Evoenergy and AGN SA's revised proposals (Annexures 1 and 2 respectively) indicates that many of the issues we raised in our submission to the initial proposals have been addressed either through the businesses providing more information or agreeing with the AER's draft determinations. However, there are issues where we seek further assurance. This submission summarises our views on these matters.

In the context of the AER's further consideration of the access proposals of Evoenergy and AGN SA we see consumer and stakeholder engagement as an integral and important feature of the development of proposals by the distribution businesses, that supports the AER in its exercise of its responsibilities.

This engagement is even more critical when the emissions intensity of gas supplied to homes and businesses is a matter of public debate and in some instances policy settings by government, given the Paris Agreement's net zero by 2050 objective.

In framing our response to the various pathways proposed for the future of the gas networks operated by Evoenergy and AGN SA, we have focussed on the impact on consumers of this transition. It appears that in every instance, consumers will face replacing their current appliances that use gas at some stage as part of the transition. Not only are there these direct cost impacts for consumers, but how the remaining investment costs are recovered also raises equity issues – both vertical and intergenerational.

Specifically, there is a risk to the most vulnerable energy consumers – those who don't have the capacity to pay or to switch to alternative forms of energy – footing the bill for increased costs as businesses seek to recover the costs of their investments over a shorter period of time through accelerated depreciation.

Energy Consumers Australia would welcome the approach of consideration of these key elements outside a regulatory reset process through more appropriate mechanisms such as AER reviews or Australian Energy Market Commission (AEMC) reviews and rule changes.

ACT Government policy settings

The ACT Government in the Parliamentary and Governing Agreement (P&GA) [1] has committed to work with industry and stakeholders on a transition project.

We suggest that the work on transition should be broadened to consider other actions it can take to address the question of the future of gas distribution in a net-zero carbon future, such as the following.

- Assistance schemes to encourage the renewable gas industry (both generation and technology), like the support provided for the renewable electricity sector. The key here will be in coordinating the risk mitigation being sought by the distributor, with the roll-out of any advancements in non-fossil fuel gas, so that consumers aren't paying for the treatment of uncertainty risk if renewable gas options are available.
- Write-downs of government-owned assets so that consumers aren't paying for assets that have been classified as redundant. This could be coupled with an option to return the assets back into the Regulated Asset Base (RAB) at a future point in time if the government is able to secure a return on its investment.
- Utilising Community Service Obligations (CSOs) to share the costs of the future of gas distribution risk between the distributor, government, and consumers.
  - A 1997 Industry Commission (which preceded the Productivity Commission) report defines a CSO as arising "…when a government specifically requires a public enterprise to carry out activities relating to outputs or inputs which it would not elect to do on a commercial basis, and which the government does not require other businesses in the public or private sectors to generally undertake, or which it would only do commercially at

[1] The ACT Parliamentary and Governing Agreement for the 10th Legislative Assembly agrees to "Phase out fossil-fuel-gas in the ACT by 2045 at the latest…". This includes action such as incentivising the use of zero emissions vehicles and efficient electric appliances (see A.1.i.), to regulatory interventions to "…prevent new gas mains network connections to future stages of greenfield residential development in the ACT in 2021-22" (see A.1.vii) and "Commence a transition project, working with industry and other stakeholders, to advance all-electric infill developments, with a goal of no new gas mains network connections to future infill developments from 2023." (see A.1.viii).

higher prices."[2] The report suggests three funding methodologies: cross-subsidies between different users; direct funding; and acceptance of lower rates of return on capital.

- A current example of the direct payment methodology is from the NSW Government to Sydney Water. The Independent Pricing and Regulatory Tribunal (IPART), in its Review of Prices for Sydney Water from 1 July 2020, deducted the cost of a Blue Mountains CSO from Sydney Water's cost of a particular service and its regulated expenditure. Sydney Water subsidises that particular service in the Blue Mountains and "…received full funding from the Government for this subsidy." [3]

- The concept of capital contributions paid to service providers is already established in the regulatory framework of the National Gas Rules and so, could easily be implemented by businesses and regulators when access arrangements are submitted and assessed.

[2] Industry Commission, Community Service Obligations: Policies and Practices of Australian Government Information Paper, February 1997, page 7.

[3] Page 256, access online from https://www.ipart.nsw.gov.au/files/sharedassets/website/shared-files/pricing-reviews-water-services-metro-water-prices-for-sydney-water-corporation-from-1-july-2020/legislative-requirements-prices-for-sydney-water-corporation-from-1-july-2020/final-report-review-of-prices-for-sydney-water-june-2020.pdf

Our observations

Our assessment of the revised proposals is informed by the independent technical advice provided by TRAC Partners who has reviewed the initial and revised proposals of the businesses and the AER's draft decisions. We have also considered supporting information provided by the distributors and stakeholders, as well as the AER and its experts. Our assessment is also grounded in our own research about consumer experience and perspectives, particularly the bi-annual Energy Consumer Sentiment Survey and our 2019 consumer expectations research.

This submission builds on our earlier submission (and technical reports from TRAC Partners) to the initial proposals. We also engaged directly with both distributors as they prepared their revised proposals.

This submission highlights the outstanding issues that we need to be assured about before we can consider them as capable of acceptance.

Evoenergy

We acknowledge that the AER is constrained in its approach for this reset. However, we seek assurance from the AER on the following issues.

- That the treatment of "future risk" is being applied in a balanced and efficient way across all building block components. In Annexure 1, TRAC Partners recommends a "root and branch" review of the capital expenditure (capex) and operational expenditure (opex) to identify all ways to reduce the levels of capex and opex that offset the impact, but in a way that does not compromise safety and service levels. For example, not just looking at the dollar value of the assets, but also looking at the methodology used in the approach to maintenance and, particularly in the case of Evoenergy's proposal, in the allocation of corporate overheads between the gas and electricity businesses.
- That the demand and connection forecasts for NSW reflect the same level of reduction as for the ACT. Given the difference in approach to a net-zero carbon future between NSW and the ACT, we are not assured that the pace of change will be the same in these jurisdictions. We ask the AER to look closely at this.

Inherent uncertainty in the demand and connections forecasts

Traditionally, forecasting of energy usage and connections is heavily based on historical events. But we are in a time when the future (in terms of demand and connections) is less certain than ever. The challenge for this process, with the ACT in particular, is that there is no comparable period, thereby meaning that less reliance can be placed on historical events. The AER still needs to balance the risks for both consumers and Evoenergy and needs to be satisfied that the forecast that is used is the best estimate arrived at on a reasonable basis (as required by the National Gas Rules).

Since the AER's draft determination, Evoenergy has taken steps to try and build a better picture of the future. However, we would suggest that the AER employ caution in the consideration of how much more accurate this information makes the demand and connections forecasts. The information gleaned is valuable in looking at potential trends, but the relevance of the survey results to inform the forecasts will be dependent on the nature of the questions asked in the survey. Further, there are many unforeseen factors outside of the energy sector which can influence a person's decisions around the energy mix used within the home, regardless of any financial incentive provided to move to either electricity or renewable gas. For example, an illness, job-loss, changes in the family mix, the impact on intended timelines of switching an appliance in the context of broader renovations and so on.

Demand and connections forecasts in a price cap environment are worth the AER's scrutiny given the potential risks to consumers from dramatic shifts from the historical.

In a 2013 presentation to a stakeholder workshop on its *Review of the differences between actual and forecast demand in network regulation*, the AEMC noted that under a weighted average price cap (WAPC), the distributor bears volume risk as revenue varies with the volume of sale, which helps incentivise efficient tariff pricing. The AEMC states however that, "…it also creates incentives to under forecast volume at time of determination and rebalance tariffs within period to manage profit risk."[4]

The AEMC continues, noting that "…the ability to change or "rebalance" tariff structures can be used as a way of transferring volume risk onto consumers."[5]

While the AEMC focused solely on the economic regulatory framework for electricity, these risks may equally apply in gas and we ask the AER to consider whether Evoenergy's gas consumers would be exposed to the same type of risk.

We recognise the difficult position that Evoenergy is in and commend them for taking action to try and bring more light to the future of gas distribution in the ACT and NSW.

While we do not believe Evoenergy is intentionally under-forecasting volume, the outcome of the uncertainty on consumers is the same. That is, the volume risk is transferred from the business to consumers at a time when they are already paying for the cost of uncertainty risk through the accelerated depreciation of new assets. Energy Consumers Australia maintains the position that businesses are better able to manage these risks than consumers, who have no tools for such activity. This is especially so when the business has had the opportunity to work proactively with the relevant government departments to develop a plan to mitigate uncertainty driven by government policy (note it is not immediately clear if this is the case). We do not believe that a position that sees consumers bearing this risk as being in the long-term interests of gas consumers.

[4] AEMC, *AEMC Review: Differences between actual and forecast demand in network regulation, Stakeholder Workshop 28 February 2013, Melbourne,* slide 3.
[5] Ibid, slide 4.

This brings us back to a threshold question: how reasonable it is that all or some of the costs of transitioning from a gas network to a low emissions future should be fully borne by today's and tomorrow's consumers?

At Annexure 1, TRAC Partners discusses the option of the AER including something like a trigger event to mitigate the risks of forecasting in such uncertain times. This example is a way of making sure that no one stakeholder (that is, business or consumers) is wearing the risk for the five-year period.

AGN SA

Future of gas distribution networks

The parallel access arrangement processes for AGN SA and Evoenergy has highlighted the importance of a more detailed look at the future of gas distribution networks that involves all stakeholders – industry, consumers, and government.

We see stark differences in the continued take up of gas and the impact of different government policy settings. What we now know for sure, is that the solution isn't going to be found in the depreciation of assets alone. The importance of the "Tale of Two Networks"[6] is the learnings that we take forward to the next round of access arrangement resets in Victoria.

Despite the differences between Evoenergy and AGN's net-zero carbon futures AGN SA's proactive thinking on the future role of gas distribution networks has highlighted that the status quo regulatory framework may not be fit-for-purpose for much longer.

TRAC Partners discusses this in more detail in Annexure 2 for the AER's consideration.

Mt Barker extension

In the case of the Mt Barker extension, the capex of which was agreed by the AER pending final confirmation from AGN SA, we have seen a large growth project removed from the proposal as the distributor is not satisfied with the likely rate of return on this investment.

In Annexure 2, TRAC Partners discusses this issue in more detail and raises two issues of principle for the AER's consideration:

1. Why is it appropriate for a distributor to spend discretionary capex on other projects (and be prepared to earn a return on that investment at the regulatory rate of return), while not being prepared to do so in connection with the Mt Barker expansion project?
2. The regulatory framework does not differentiate between the return to be provided on sunk investment vs new investment, especially when it appears the new investment will have the same level of certainty as the sunk investments.

[6] As characterised by the Consumer Challenge Panel 24 in its presentation at the public forum on AGN SA' original proposal, 27 July 2020, slide 4.

Vulnerable customer assistance program

Given the initial and ongoing impact of COVID-19 on households, small businesses and communities, we expect every part of the supply chain to lean into the problems consumers are experiencing.

In this sense, it is commendable that AGN SA is thinking about the customer problem and appreciate its intention to help mitigate financial impacts for vulnerable consumers.

This type of new activity will always present a challenge for the regulator who has to balance activities for consumers which promote affordability outcomes with the efficiency mandate set out in the regulatory framework.

TRAC Partners has reviewed this issue which is discussed in Annexure 2. We appreciate the effort AGN SA has made to demonstrate the types of activities the program would undertake and to demonstrate that there is no double up of effort between the network business and other stakeholders (such as retailers). TRAC Partners is of the view that further gap analysis of who is delivering what kinds of assistance would be useful before embarking on a big program of works, and suggests that it may be more prudent to allow a reduced amount to fund a proof of concept initiative before expanding the trial.

Conclusion

Overall, what we have observed is two distributors making their best attempt to develop pricing proposals that will allow them to navigate through the incomparable uncertainty that the next five to ten years presents for gas distribution businesses and their consumers.

While the revised proposals are closer to being capable of acceptance, there are outstanding issues which need to be resolved which we have discussed in this submission, including the technical reports from TRAC Partners at Annexures 1 and 2. We would be happy to discuss any of these issues in more detail if that would assist the AER or the distributors.

To discuss the issues raised in this submission, please contact Shelley Ashe, Associate Director via email at shelley.ashe@energyconsumersaustralia.com.au.

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