

**ECA RESPONSE TO
EVOENERGY'S 2021-26 ACCESS
ARRANGEMENT PROPOSAL**

TRAC
Partners

EXECUTIVE SUMMARY



OVERARCHING OBJECTIVES THAT SHOULD FRAME EVO'S 2021 PLAN

- We have approached our review of Evoenergy's 2021 Plan by focusing on the following objectives, as they are all relevant to the long-term interests of consumers with respect to price, reliability, quality and security of supply:
 - Network tariffs must be **affordable**, a function of **individualised** services and provided within an **optimised** system.
 - Gas prices must be kept as low as possible for today's household and small business consumers.
 - Current and future consumers should be paying no more than they need to for the quality of service they require - "Not one dollar more is spent than necessary; Not one day earlier than needed".
 - There should be sufficient information made available to substantiate that the proposal promotes the long-term interests of customers.
 - There has been meaningful consumer engagement in developing key aspects of the proposal.
- Achieving these objectives will:
 - help keep network prices as competitive as possible;
 - maximise the incentive for consumers to continue usage of the network for the foreseeable future; and
 - align very closely with the interests of network investors to give them the best chance that they will be able to recover their investment and earn a return on that investment.
- This is in the long term interest of today's and tomorrow's consumers and investors in infrastructure.

KEY FEATURES OF EVO'S PLAN THAT ALIGN WITH OBJECTIVES

There is substantial alignment between Evoenergy's Plan and the interests of household and small business energy consumers.

2021 Plan Feature	Relevant Objective
<ul style="list-style-type: none"> • Network costs (\$294m) 10% per cent lower in total (13% lower per customer) compared to the current (2016–21) period 	<p>Long term consumer interest with respect to price</p>
<ul style="list-style-type: none"> • ~4% real reduction in network tariffs in 2021, with stable prices in real terms over the remainder of the Plan period 	<p>Long term consumer interest with respect to price</p>
<ul style="list-style-type: none"> • Sharing of tariff reductions across all customer classes 	<p>Long term consumer interest with respect to price</p>
<ul style="list-style-type: none"> • Opex and Capex forecasts allow for spending on safety and reliability while Evoenergy considers the future of the network 	<p>Long term consumer interest with respect to reliability and security of supply</p>
<ul style="list-style-type: none"> • Continuation of the current opex efficiency carryover mechanism and inclusion of a proposed capital expenditure sharing scheme (CESS) to promote further efficiencies 	<p>Long term consumer interest with respect to price</p>

However, in our view there are outstanding features of the Plan where there are areas for improvement or aspects which we believe requires further investigation by the AER, before the Plan could be considered capable of acceptance by the AER.

The following slides comment on each of the aspects of Evoenergy's 2021 Plan:

-  - consistent with key objectives
-  - further work or analysis required before ECA should accept that it is consistent with key objectives and capable of acceptance by AER

EVOENERGY'S 2021 PLAN FEATURES

Focus Area	Evoenergy's Proposal	Our Position
Forecast Capital expenditure	<ul style="list-style-type: none"> No forecast connection of gas customers in new ACT developments 	 (slides 9, 14 & 20)
	<ul style="list-style-type: none"> Lower forecast rate of new gas connections within the existing network 	 (slides 9 & 24)
	<ul style="list-style-type: none"> Level of forecast capex (\$63.3m) is significantly below allowed capex for 2016-20 (28%) 	 (slides 19 & 20)
	<ul style="list-style-type: none"> Increase forecast meter replacement capex by \$6.2m to \$23.6m - attributable to meters coming to end of life 	 (slide 20)
Begin Now the Transition Roadmap to Net Zero Emissions by 2045	<ul style="list-style-type: none"> Commencing Evoenergy's transition roadmap in 2021 (at least in part) notwithstanding the ACT Government's roadmap not being outlined until 2024 	 (slides 13-17)
	<ul style="list-style-type: none"> Accelerated depreciation of new, long-lived assets 	 (slides 13-17)
Operating expenditure	<ul style="list-style-type: none"> Expense pigging costs previously capitalised 	
	<ul style="list-style-type: none"> The extent to which Jemena's opex savings from its transformation program impacts on Evoenergy's forecast opex and productivity improvements 	 (slides 21)

EVOENERGY'S 2021 PLAN FEATURES

Focus Area	Evoenergy's Proposal	Our Position
Operating Expenditure	<ul style="list-style-type: none"> Propose to use 2019-20 opex levels in the base-step-trend methodology 	 (slide 21)
	<ul style="list-style-type: none"> Insurance costs forecast to increase Unaccounted for Gas forecast to increase Derivation of the IT Asset Utilisation Fee 	 (slides 21 & 22)
Vulnerable Customers	<ul style="list-style-type: none"> Will work with stakeholders to understand and consider the needs of vulnerable customers and what it can do to help as it develops its transition roadmap. 	 (slides 21 & 29)
Inflation	<ul style="list-style-type: none"> Use of CPI all groups index for 8 capital cities for the December quarter over the December quarter for the previous year, published by the ABS 	 (slide 25)
Rate of return	<ul style="list-style-type: none"> Accept AER's approach in guidelines 	
Tax (and gamma)	<ul style="list-style-type: none"> Calculated in line with the AER's final tax decision and rate of return instrument 	
Demand	<ul style="list-style-type: none"> Customer numbers are forecast to grow by 3 per cent (~ 5,000), with a total of 157,300 customers forecast by 2025-26. 	 (slide 24)

EVOENERGY'S 2021 PLAN FEATURES

Focus Area	Evoenergy's Proposal	Our Position
Innovation	<ul style="list-style-type: none"> Continue sustainability initiatives, such as the Hydrogen Test Facility 	
Depreciation	<ul style="list-style-type: none"> Shorten asset lives for some new investment to ensure fair recovery of costs from customers 	 (slides 14-17 & 23)
	<ul style="list-style-type: none"> Accelerate depreciation of in line inspections 	
Total Revenue	<ul style="list-style-type: none"> Proposing a \$32m (or 10%) reduction in the 5 yr total revenue allowance compared to what the AER allowed in 2016-20 (\$326m) 	
Pricing and service levels	<ul style="list-style-type: none"> ~4% real reduction in network tariffs in 2021, with stable prices in real terms over the remainder of the Plan period 	
Tariff Variation	<ul style="list-style-type: none"> Proposing an intra-year tariff variation mechanism 	 (slide 29)
COVID Impacts	<ul style="list-style-type: none"> Forecasts haven't been adjusted to address impacts of COVID. This will be done in response to the Draft Decision 	 (slides 22 & 30)
Incentive Mechanisms	<ul style="list-style-type: none"> Introduce a CESS 	

EVOENERGY'S KEY FACTORS DRIVING ITS 2021 PLAN



CONSUMER ENGAGEMENT SHAPING EVOENERGY'S 2021 PLAN

- Evoenergy states that the findings of engagement with energy consumers on the gas network and how it should operate was one of two key factors that have shaped the development of its 2021 Plan.
- Gas is still a fuel of choice in the Network area as there is only a 75 per cent average penetration rate among end use customers and a connection rate (per km of mains) of only 31 which is below the national average density.
- Engagement with customers was extensive:
 - Citizen's Jury held to consider and make recommendations on the future of Evoenergy's gas network based on information from a variety of viewpoints.
 - Publication of draft plan in February 2020 and call for submissions.
 - community roadshow conducted following release of draft plan where community responses were recorded.
 - Deep dive sessions held in March 2020.
- Having said this:
 - Survey questions were high level in nature and should not, of themselves, be relied upon to substantiate the position Evoenergy has taken on a particular topic in its 2021 Plan.
 - Engagement on some key topics was high level and based more on principles rather than a detailed analysis of the proposal.

KEY FACTORS SHAPING EVOENERGY'S 2021 PLAN

- Two factors have primarily shaped the development of Evoenergy's 2021 Plan:
 - the ACT Government's climate change policy - to achieve net zero greenhouse gas emissions across all sectors (including gas) by 2045, with several interim targets (Factor #1); and
 - the findings of Evoenergy's consumer engagement process on how the network should operate (Factor #2).
- Evoenergy has proposed a number of initiatives in its 2021 Plan that it claims are aimed at addressing these factors, as shown on next slide (**Initiatives**). Our response to each Initiative is shown on the following slide.
- All Initiatives should be focused on ensuring affordability for customers and cost competitiveness - to ensure that "Not one dollar more is spent than necessary; Not one day earlier than needed".

Evoenergy Initiative	Factor #1	Factor #2
Excluding expansion of network in new ACT suburbs in its forecasts, but including necessary replacement and growth of the network in areas where the network already exists	✓	✓
Demand forecasts to show a decline in usage volumes per customer (but increase in customers)	✓	✓
Accelerate the recovery of new investment in long-lived assets so as to manage stranded asset risk	✓	✓
Minimalist capex program but sufficient for safe and reliable network as we develop a transition roadmap	✓	✓
Continue sustainability initiatives, such as the Hydrogen Test Facility	✓	✓
Opex & Capex forecasts to be limited but will still allow Evoenergy to continue to maintain the level of safety and integrity of the network and reliability of service consumers value and expect	✓	✓
Opex forecast includes a reduction in the base year and a reduction in the proposed growth rate, including a 0.5 per cent year on year improvement in productivity		✓
Reduction in network prices of ~4% in 2021/20 with stable network prices for the remainder of the Plan		✓
Marketing program to be included in base opex - assists gas customers who need or choose to use gas to upgrade to more energy efficient gas appliances & retains customers		✓
Retention of the efficiency carryover mechanism		✓
Introduction of a CESS to provide more balanced incentives for efficient expenditure with performance measures and weightings based on consumer feedback		✓
No change to the current declining block tariff structure. No separate tariff for NSW customers		✓

Evoenergy Initiative	Comment
Excluding expansion of network in new ACT suburbs in its forecasts, but including necessary replacement and growth of the network in areas where the network already exists	Slides 13-17
Demand forecasts to show a decline in usage volumes per customer (but increase in customers)	Slide 24
Accelerate the recovery of new investment in long-lived assets so as to manage stranded asset risk	Slides 13-17
Minimalist capex program but sufficient for safe and reliable network as we develop a transition roadmap	Slides 13-17
Continue sustainability initiatives, such as the Hydrogen Test Facility	
Opex & Capex forecasts to be limited but will still allow Evoenergy to continue to maintain the level of safety and integrity of the network and reliability of service consumers value and expect	Slides 20-22
Opex forecast includes a reduction in the base year and a reduction in the proposed growth rate, including a 0.5 per cent year on year improvement in productivity	Slides 21 & 22
Reduction in network prices of ~4% in 2021/20 with stable network prices for the remainder of the Plan	
Marketing program to be included in base opex - assists gas customers who need or choose to use gas to upgrade to more energy efficient gas appliances & retains customers	Slide 21
Retention of the efficiency carryover mechanism	
Introduction of a CESS to provide more balanced incentives for efficient expenditure with performance measures and weightings based on consumer feedback	
No change to the current declining block tariff structure. No separate tariff for NSW customers	

INITIATIVES TO ADDRESS IMPACT OF ACT'S CLIMATE CHANGE STRATEGY

- Evoenergy claims that one of the key impacts of the ACT Government's Climate Change Strategy is stranded asset risk for the network.
- Evoenergy has proposed to manage this risk in its Plan by shortening the asset lives of some new, long-lived assets.
- While Attachments 4 & 4.3 of Evoenergy's 2021 Plan contains more information to support JGN's approach to shorten asset lives, we are still to be convinced that:
 - The likelihood of stranded asset risk has increased over the last 5 years;
 - Stranded asset risk requires different action to be taken in this current Plan;
 - Even if it does require action to be taken, that shortening asset lives is the correct action to be taken; and
 - The proposed shortened asset lives are appropriate.

IS THERE AN INCREASED RISK OF ASSET STRANDING?

Factors that make the risk more likely	Factors that suggest the risk hasn't increased
<ul style="list-style-type: none"> Average usage rate for natural gas consumption is declining 	<ul style="list-style-type: none"> New connections growth forecast to continue during the Plan period (albeit at a lower rate than in the current period – 5,000 new customers)
<ul style="list-style-type: none"> ACT's policy is legislated and requires net zero emissions from gas sector 	<ul style="list-style-type: none"> Evoenergy's own survey of customers indicates that almost 60% per cent expect to use the same or more gas over the next 5-10 years
<ul style="list-style-type: none"> Rate of disconnections is forecast to be three times higher than modelled 	<ul style="list-style-type: none"> Hydrogen may displace natural gas in networks. Hydrogen is being successfully trialled in other jurisdictions (eg UK and Japan)
	<ul style="list-style-type: none"> Disconnection rates haven't declined Federal Government's Technology Investment Roadmap promotes the continued use of gas
	<ul style="list-style-type: none"> Hydrogen Strategy completed Other strategies should be considered – eg carbon capture & storage, implementing offsetting programs

IS NOW THE RIGHT TIME TO ADDRESS RISK OF ASSET STRANDING?

- We would have expected a more detailed cost/benefit analysis to assess the impact on today's and tomorrow's customers of the following scenarios:
 - Accelerating depreciation of existing and new long lived assets from 2021 onwards
 - Accelerating depreciation of long lived assets from 2026 onwards
 - Accelerating depreciation of new assets from 2021 onwards and for existing assets from 2026 onwards
- Even if there is an increased risk of asset stranding, now does not appear to be the time to act to address it because:
 - We do not know the ACT Government's timeline for its transition roadmap – this will come in 2024 – and so it may be best to wait until 2026 Plan.
 - Given what we believe should be the overarching objective in the setting of the 2021 Plan, retaining the current asset lives for future investments will result in a reduction in the total revenue of \$0.65m during the 5-year Plan period.
 - Because gas is a fuel of choice, ensuring gas is as affordable as possible today maximises the incentives for continued asset utilisation . This maximises the likelihood of continued use of the network and minimises the risk that the asset may become stranded in the future.
- Furthermore, keeping prices as low as possible during the 2021 Plan period and waiting to re-assess the position on asset lives until the next re-set of 2026 will have other benefits:
 - It will give time to provide further clarity around alternatives to natural gas for the use of the network – if hydrogen can be commercialised and has a role to play in the network, any risk of asset stranding diminishes significantly and so there should be no need to make a change to asset lives at that point in time;
 - Any additional cost to “tomorrow's” consumers (ie those in the next 2026 Plan) will not be significant.

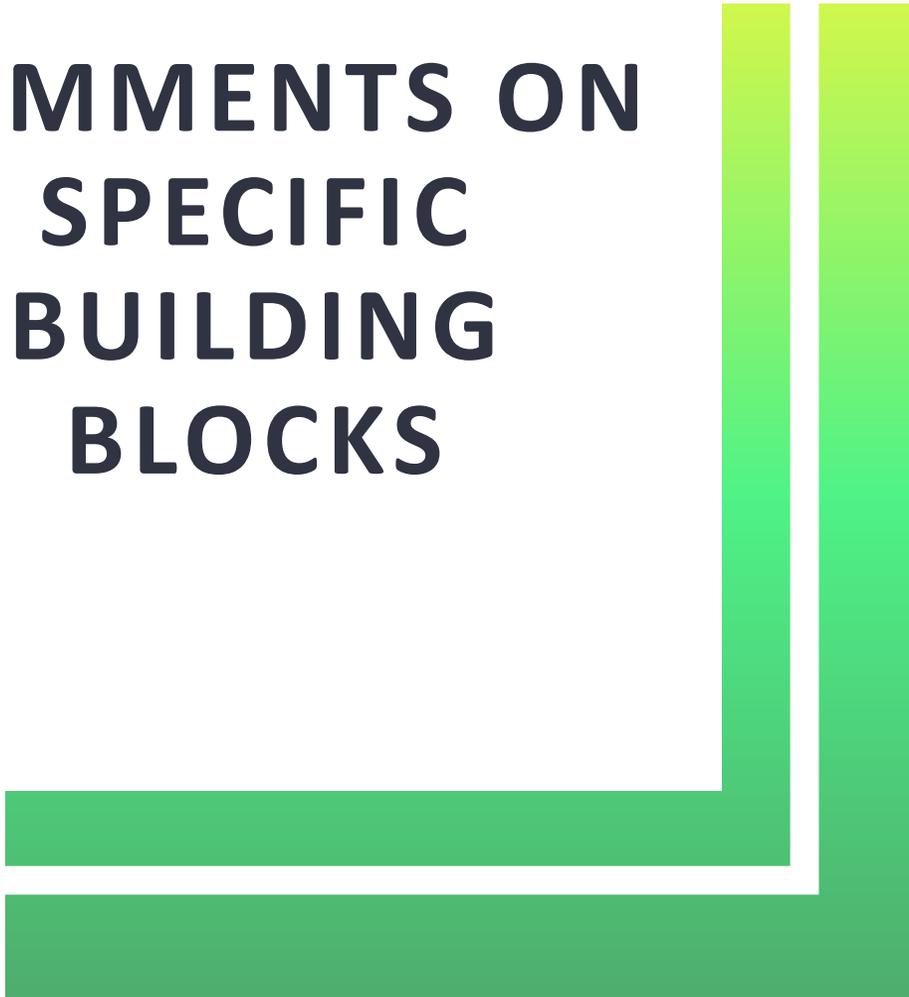
EVEN IF THERE IS AN INCREASED RISK OF ASSET STRANDING

- It's not clear whether some of the pathway options being considered by Evoenergy in its Plan (section 2.1.1 of Overview) are appropriate options, including the option of an electricity only network. This is so for a number of reasons:
 - Reliance on one single energy source exposes consumers to significant additional risk, particularly in light of recent issues with respect to the integrity of the NEM during summer months and the fact that ACT consumers have the second highest rate of gas consumption in the NEM.
 - We would expect to have seen a more detailed cost/benefit analysis of each option. Even Evoenergy's own analysis shows that there would not only be significant cost involved but that these costs may be difficult for certain community members to bear.
 - The cost/benefit analysis that has been provided doesn't appear to identify the amount (and cost) of additional infrastructure that would be required to be invested in the electricity network (both generation capacity and poles and wires) given the role that gas currently plays in meeting energy demand in peak times.

ARE THE INITIAL ACTIONS IN THE PLAN TO ADDRESS ASSET STRANDING RISK APPROPRIATE?

- While there is a forecast reduction in average usage, Evoenergy is forecasting increasing number of customers (3%) by 2026. This was a critical issue relied on by the AER in the JGN reset for why shortening of asset lives was not allowed.
- We would have expected a cost benefit analysis to have been undertaken to show the price impacts of deferring a decision on accelerated depreciation on new assets versus taking the action in this AA plan. Also, increasing prices for today's customers has a bigger impact now with the impact of COVID-19 on vulnerable customers.
- There are other options which don't appear to have been considered in the documentation reviewed to date – such as:
 - Subsidies by government to the business to fully or partly address the impact; or
 - Creating a notional account so that the amount that would otherwise be included in the total revenue (by accelerating depreciation) is placed in it and so that it accrues interest over time. Should a viable renewable gas option be developed, the amount in the account gets added to the total revenue in subsequent years until the account is depleted.

COMMENTS ON SPECIFIC BUILDING BLOCKS



ROLL FORWARD OF RAB

- While total actual/estimated capex between 2016-21 is well below the AER approved total (by 12.6%), there are significant divergences in most line items.

Capex Category	Actual 16-21 Expenditure (\$m)	Variance from AER approved forecast (%)
Market expansion	45.9	↓7.6%
Capacity Development	7.2	↑1.4%
SIB – network renewal	8.2	↓51.8%
SIB – meter renewal	17.4	↓4.4%
Non-system	0.0	↓100%

- Evoenergy has however, provided detailed information in support of its actual expenditure which is of a level we would expect.
- These divergences however, raise an issue the AER should consider in more detail - how reliable are past capex levels as a guide for assessing the prudence and efficiency of Evoenergy’s forecast capex in the 2021 Plan?

FORECAST CAPEX ISSUES

Forecast Capex Issue		Our Comments
Assume no expansion of network in the ACT suburbs because of removal of the mandate for gas connections		A mechanism should be considered to be included which adjusts tariffs on an annual basis for any new connections that do occur within the year. Including this will ensure that the benefits of new connections are shared between consumers and the service provider.
Inclusion of allowances for capex associated with researching new technologies (eg Hydrogen)		It is noted that neither the JGN or AGN SA Plans included allowances for this sort of capital expenditure. To the extent that an allowance should be included, it should not be for research work that is already underway by other businesses.
\$1.5m reduction in medium/high rise expansion capex is being forecast		Further information should be provided by Evoenergy over and above what is in section 3.4.2 of Attachment 3 to explain this reduction when this type of customer isn't forecast to decline in demand.
Different expansion rates for the ACT part of the network and the NSW part of the network		While table 3.6 of Attachment 3 breaks down the forecast expansion capex between the two jurisdictions, we would expect more information to have been provided to compare actuals and forecasts under each category of capex in each jurisdiction.
\$6.2m increase spend on meter replacement capex from \$17.4m (actuals) to \$23.6m forecast.		It is not clear how the justification for the expenditure – to replace meters coming to end of life - reconciles with the statement that “It is expected that these meters will be approved for a five-year life extension with the additional opportunity to include testing to attain a subsequent life extension at 20 years”

OPERATING EXPENDITURE ISSUES

- Evoenergy doesn't perform as well from a benchmarking perspective than the other gas distribution businesses in some key measures (eg efficiency score) and has proposed a 10% increase compared with actuals for 16-21.
- While the proposed methodology for setting the forecast opex for the Plan is largely consistent with the AER's methodology adopted in current plan, we have some comments:

Step		Our Comments
Establish an efficient base year		<p>The AER should test whether its appropriate to use 2019/20 as the base year because:</p> <ul style="list-style-type: none"> - there has been a step increase in opex between 2018/19 to 2019/20 (see table 2.1 in Attachment2), even after discounting the increase attributable to increases in the UNFTax (\$0.46m); - Some of the increases are in categories which appear to be within Evo's control; - Its not clear the extent to which any of the benefits of Jemena's transformation program have flowed onto Evoenergy under its asset management arrangement.
Marketing costs		<p>While we support programs that deliver measurable outcomes of improved efficiency in use of appliances, it's not clear how this fits into the transformation roadmap that Evoenergy is promoting. Further information is required to justify its inclusion in opex forecast. Also, consideration could be given to assisting by amortising the purchase costs of efficient appliances for more vulnerable consumers.</p>

OPERATING EXPENDITURE ISSUES (CONT'D)

Step		Our Comments
Trending base year forward		Rate of change approach is consistent with regulatory precedent, although in light of COVID-19, wages increase assumption needs to be tested further
Developing specific forecasts		<ul style="list-style-type: none"> • We would expect more information to substantiate an increase in insurance premiums but note that this is a cost pass through • While UAG allowance methodology is consistent with approved AER methodology, the AER should explore why UAG volumes are higher at a time when consumption has reduced.
Forecast of step change items		No step changes being proposed.
Expensing pigging costs		This is consistent with recent regulatory practice and doesn't result in overall increase in prices for customers
Unaccounted for Gas (UAG)		We would expect the AER to require further information on how UAG is calculated (above the information referred to in section 2.8.3 of Attachment 2). Particularly, the basis for which the unit cost estimate for replacement gas is derived, given that it is supplied by a related party (Jemena).
IT Asset Utilisation Fee		The formula to calculate the fee includes an internal cost of capital. It is not clear why this should be included in an opex forecast or if it should be, why it should be a rate of 2.6%

DEPRECIATION & ASSET LIVES

- Evoenergy proposes to change the standard asset lives for new investments in long lived asset classes as follows. This change will increase Evoenergy's revenue in the 2021 Plan by \$0.65m (compared to retaining the current standard lives).
- We have previously commented on the appropriateness of this proposal.
- However, even if the principle of shortening asset lives were supported (which it is not), the proposed changes to asset lives is not supported by regulatory precedent:

Asset class	Evoenergy (proposed)	JGN	AGN SA	MNG	Ausnet	AGN Vic
HP mains	80 down to 50	80	60	50	60	60
MP mains	50 down to 30	50	60	50	60	60
MP Services	50 down to 30	50	60	50	60	60

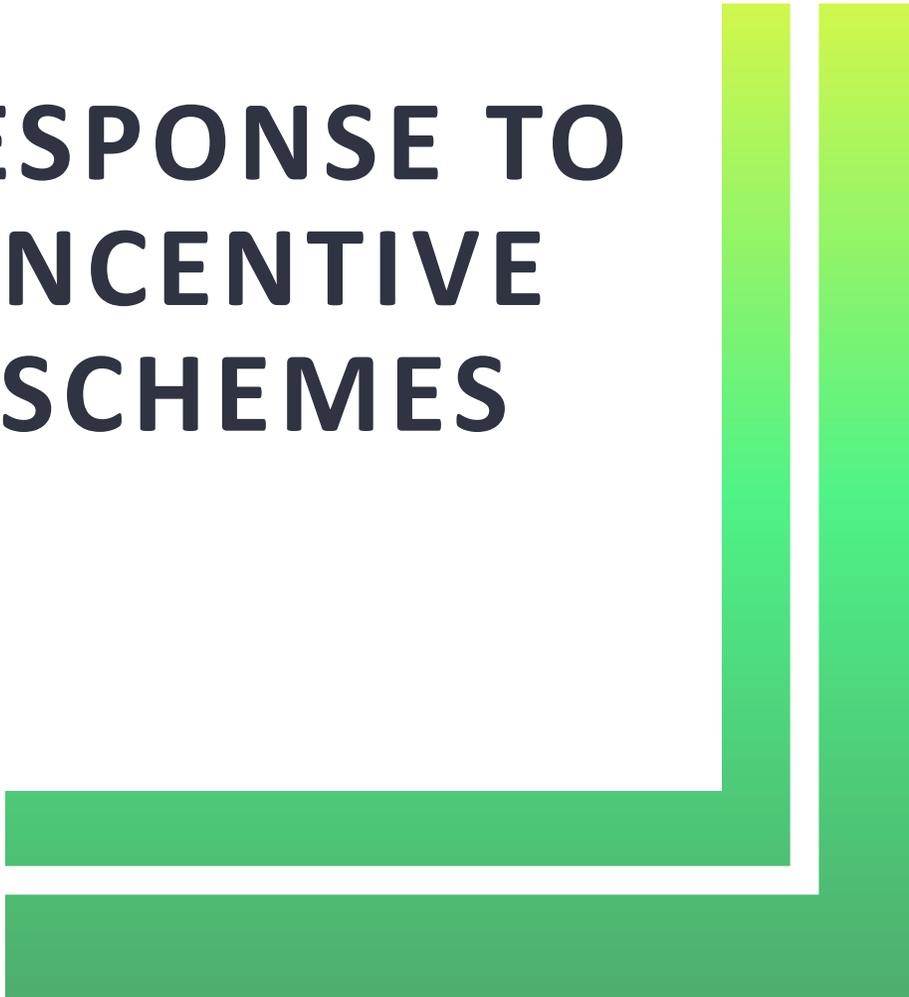
FORECAST DEMAND

- While Evoenergy is forecasting a reduction in the average usage per average customer, it is forecasting a 3% increase in the number of customers.
- Forecast of demand doesn't seem to address the following relevant matters which may signal an increase in demand:
 - Federal Government's Technology Investment Roadmap promotes the continued use of gas;
 - The potential for additional supplies of gas into NSW and the resultant impact that this could have in reducing the wholesale price of gas; and
 - The success of hydrogen trials throughout other jurisdictions.
- While we support the engagement of an expert to develop an independent and detailed forecast of demand and customer numbers, we question the appropriateness of making a set of post model adjustments to the demand forecast to reflect a conservative expectation of decreasing gas usage and a higher number of disconnections over the 2021–26 period as a result of the ACT Government's campaign.

OTHER BUILDING BLOCK ISSUES

- Forecast inflation – we encourage the AER to complete its current consultation process in relation to inflation in time for its position to be adopted in the Draft Decision

RESPONSE TO INCENTIVE SCHEMES



INCENTIVE MECHANISMS

- It is noted that Evoenergy is proposing to continue the ECM for opex but with some minor modifications. We would support these modifications if they aligned with the modifications required by the AER in the JGN Plan for 2020.
- The proposed introduction of a Capital Expenditure Sharing Scheme should match the features of the scheme approved by the AER for JGN. It is not clear what differences (if any) are being proposed.
- We do not believe that at this stage, the case has been made for the inclusion of other incentive mechanisms (eg similar to that being proposed by AGN SA).

OTHER ISSUES RAISED BY EVOENERGY'S 2021 PLAN



OTHER ISSUES RAISED IN EVOENERGY'S 2021 PLAN

Issue	Our Comments
Assisting Vulnerable customers	 - we believe further work is required, particularly in light of COVID-19
Charges for ancillary services	 - we support these charges being more cost reflective
Service levels – disconnection processes and arrangements	 - we support these charges being made to protect the interests of vulnerable customers
Tariff variation mechanism to be intra-year	 - we would expect the AER to seek further justification for moving to an intra-year variation mechanism.

COVID 19 IMPACTS

- Evoenergy notes that forecasts haven't been able to be adjusted to assess the impacts caused by COVID and that therefore they will incorporate any COVID related adjustments into their revised proposals that they will submit in response to the Draft Decision.
- This raises a potential procedural fairness issue for consumers, particularly if the COVID related adjustments are substantive in nature.
- It means that while consumers will be able to make submissions on the revised proposals that the businesses submit, they will not have an opportunity to make submissions on the AER's thinking on the COVID related adjustments because this will only be outlined in the Final Decision. But the process under the NGR does not prescribe for consultation in response to the AER's final decision.
- AER should give consideration to how procedural fairness is afforded to consumers – options include:
 - Option 1 - the AER could require any COVID related adjustments to be submitted by the businesses prior to the Draft Decision and open up a round of mini consultation on these adjustments before the draft decision is issued. Then the AER's draft decision can take into account both the COVID related adjustments and any submissions consumers make in response.
 - Option 2 – the AER could maintain the status quo until after submissions have been received in response to the revised proposal submitted in response to the Draft Decision. The AER could then issue a preliminary position paper on the COVID related adjustments and request submissions from consumers on its position. Following consideration of these submissions, the AER would then make its final decision.