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Issues paper on the early signal pathway expectations: Jemena Gas Networks (NSW) access arrangement 1 July 2025 to 30 June 2030

Alinta Energy is pleased to provide comment on the Issues Paper released by the Australian Energy Regulator (**AER**) to assist in its review of the Jemena Gas Networks (NSW) Ltd (**JGN**) 2025-30 access arrangement proposal (**2025 Plan**).

Alinta Energy sells gas to over 40,000 residential and business customers connected to JGN's NSW gas network and has significant interactions with JGN with respect to customer connections and disconnections, meter readings and gas supply.

We acknowledge the commitment by JGN to the AER's early signal pathway, particularly as the first gas distribution business to participate.

We agree with the subject matter areas of JGN's proposal highlighted by the AER in the Issues Paper as requiring closer review. We draw the AER's attention to the following specific aspects of JGN's proposal that we believe should be given further consideration:

- JGN's demand forecast, given its key role in calculating reference haulage tariffs;
- The proposed accelerated depreciation, for which JGN should demonstrate stranded asset risk and justify the need for regulatory intervention;
- Elements of future expenditure, especially those that appear inconsistent with the proposed accelerated depreciation; and
- The proposal to move from the current price cap tariff variation mechanism to a hybrid tariff variation mechanism.

Alinta Energy would welcome the opportunity to discuss these issues further with the AER.

Yours sincerely

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1 Demand forecasts

Whilst there is some domestic and international commentary that demand for natural gas will decrease in the long-term, driven in part by the shift towards renewable energy, these predictions are based on highly variable economic, environmental, policy and geopolitical factors.

Ensuring forecast demand is as accurate as possible is of the utmost importance, given its key role in calculating reference haulage tariffs. In this respect we note the AER's recent comment:

> Under price caps, gas distributors have, over the last 10 years, consistently earned more revenue than our determinations have targeted because actual gas volumes have been higher than the forecasts we have used to determine haulage tariffs.[1]

We also draw the AER's attention to the asymmetrical risk applying to JGN and consumers. JGN may apply to the AER to vary an approved access arrangement under the National Gas Rules (**NGR**), noting the AER considers that:

> A driver of an access arrangement reopener application could be actual gas volumes being lower than the forecasts we used to determine a distributor's target revenues.[2,3]

Customers, on the other hand, are not provided with an opportunity to request a reduction in haulage tariffs if actual volumes are higher than forecast.

Mindful that under-forecasting of gas demand will return higher revenue to JGN over the access arrangement period, we urge the AER to carefully consider whether the demand forecasts by Core Energy and Resources for JGN are reasonable, particularly for the volume market where residential and small business demand per connection point is forecast to decline by an average of 1.56% and 3.63% per annum respectively.[4] With regard to this subset of customers, we make the following observations:

Government policy: Despite pressure from some local governments to introduce a ban on new household gas connections in NSW, similar to those introduced in Victoria (from January 2024) and the ACT (from November 2024), Premier Chris Minns has ruled out a state-wide ban.[5] Additionally, the Australian Government's recently released Future Gas Strategy observes that:

> While many gas-reliant households and small businesses are able to electrify using current technology, vulnerable households and communities will require support to transition, and some households may choose to continue to use gas.[6]

Consumer sentiment: JGN's own research has identified favourable attitudes towards gas among its current customers. Using feedback from its customer forums, JGN identified five key customer values to help shape its 2025 Plan, including "choice":

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[1] AER, October 2023, *Review of gas distribution network reference tariff variation mechanism and declining block tariffs – Final decision*, p. 5

[2] NGR 65(1)

[3] AER, October 2023, *Review of gas distribution network reference tariff variation mechanism and declining block tariffs – Final decision*, p. 7

[4] Core Energy and Resources, April 2024, *Gas Demand and Connections Forecast* (Attachment 8.2, JGN 2025 Plan), pp. 32 & 35.

[5] NSW Premier Chris Minns eliminates prospects of Victoria-style gas ban in homes as state energy sector already 'challenged' | Sky News Australia, accessed 21 August 2024

[6] Australian Government, May 2024, Future Gas Strategy | Department of Industry Science and Resources, p. 42, accessed 27 June 2024

> We heard that customers want the choice to be able to use gas both now and into the future, and that there should be diversity of supply.[7]

The customer survey conducted for JGN by the RedBridge Group also provides valuable insights into consumer preferences regarding gas, notably:

- 85% of customers surveyed consider that NSW needs a mix of energy sources, including solar, wind and gas;
- 78% agree that natural gas has a role to play in the transition to renewable energy;
- 76% are concerned about the reliability of the NSW electricity system;
- Just 32% support the ban of gas connections in new homes; and
- Only 31% support the phasing out of existing household gas connections.[8]

These results indicate a strong preference by customers for retaining gas supply.

2 Accelerated depreciation

JGN has proposed an accelerated depreciation profile which will, if approved, front-load cost recovery and mitigate some degree of the risk JGN currently bears of not recovering their investment in the network. Accelerated depreciation is one of a range of mechanisms which could be applied to alleviate stranded asset risk in a situation of declining gas demand. However, it may not be the 'best' instrument in such a situation and it may not be an appropriate mechanism to address other gas market risks.

Accelerated depreciation may have merit regarding intergenerational equity, where this is measured in terms of the imposition of gas prices to cover the cost of supply. On the other hand, it may conflict with equity measured by other terms. In addition, its impact on consumers should be considered in the context of other changes to gas prices.

A main contention is that the direction and magnitude of demand risk is not yet proven and the role of gas in energy transition is not yet clear. Introducing a mechanism for managing future demand uncertainty too early may result in adverse and/or unintended consequences, such as inefficient capital expenditure (**capex**). For example, long-term capital investments in a network must be assessed in the context of the contradictory approach of seeking, at the same time, to accelerate its depreciation.

We note the AER's view:

> … that some form of accelerated depreciation would be appropriate if there is sufficient evidence to demonstrate and quantify the pricing risk and stranded asset risk arising from demand uncertainty.[9]

While JGN's case for accelerated depreciation is based on a decline in natural gas demand, it also includes new investment in renewable biomethane gas connections to help sustain network demand:

> As the supply of renewable gas grows, this will help to lower the risk of asset stranding.[10]

The revenue and pricing principles that apply under the National Gas Law (**NGL**) state that a service provider should be provided with a 'reasonable opportunity to recover at least the efficient costs' of its service provision.[11] This is not, however, a guarantee or complete

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[7] JGN, June 2024, *Jemena Gas Networks 2025 Plan*, p. x

[8] RedBridge Group, December 2023, *Sydney energy attitudes and sentiments*, pp. 4, 7, 8, 10,11

[9] AER, November 2021, *Regulating gas pipelines under uncertainty – Information paper*, p. ix

[10] JGN, June 2024, *Jemena Gas Networks 2025 Plan*, p. 57

[11] NGL 24

insulation from the risks associated with owning regulated gas infrastructure, including stranded asset, changes in demand and inflation.

While accelerated depreciation has been approved for application elsewhere, namely in Victoria, that does not make the case to apply it to JGN's NSW gas network, as different decarbonisation policies, targets and electrification objectives apply in NSW. Although JGN's proposed accelerated depreciation of $300 million ($2024-25) is lower than the final AER-approved aggregate of $333 million ($2022-23) for the three Victorian gas networks for their 2023-28 access arrangement periods, we are concerned that it is a fixed amount, rather than an adjustable amount accommodating movements in other key components (WACC, inflation, etc) that impact revenue and prices.

We do not consider a fixed amount of accelerated depreciation that could materially increase prices to be in the best interests of customers. Should the AER be satisfied that JGN has made the case that accelerated depreciation is justified based on the circumstances particular to the NSW market, we would support an accelerated depreciation amount that targets a set price path outcome, rather than a fixed amount that is not based on achieving any particular price path.

3 Capital expenditure

While JGN's proposed forecast net capex of $792.8 million ($2024-25) is 5.6% lower than its actual/estimated capex for the 2020-25 access arrangement period, we are concerned with the composition of the proposed capex, given JGN's proposal to apply accelerated depreciation.

JGN's reason for applying accelerated depreciation is the risk of asset stranding of the network due to the uncertainty concerning the future of gas. At the same time, however, JGN is proposing to increase capex related to mains replacement (up 76.6%), mains augmentation (up 30.2%) and meter replacement (up 49.2%). Despite regulatory obligations for JGN to connect new customers and maintain a safe and reliable network, the magnitude of the capex related to these categories appears inconsistent with the proposal to apply accelerated depreciation.

We agree with the AER's proposal to review JGN's planned renewable gas projects, including the connection of eight biomethane suppliers to the network. While the revised National Gas Objective (**NGO**) now incorporates an emissions reduction objective, it continues to define the long-term interests of consumers along multiple dimensions, including the price, quality, safety, reliability and security of supply of gas. These dimensions need to be balanced against each other and considered together; the emissions reduction component is not elevated above the other components of the NGO.

4 Operating expenditure

JGN has selected 2023-24 as its base year for forecasting operating expenditure (**opex**), citing:

> … our 2023-24 base year opex provides an efficient basis to forecast opex for the 2025 Plan period.[12]

JGN considers the 2023-24 base year opex needs no adjustment, pointing to an econometric analysis by Competition Economists Group (**CEG**), engaged by JGN to benchmark its performance against its peers.[13] From this analysis JGN concluded that:

> When assessing the efficiency of the latest year where data is available (i.e. 2022), JGN is the most efficient network with an efficiency score of 0.98 compared to the industry average score of 0.80. These findings suggests that we are efficient and [do] not require an efficiency adjustment to our base year opex.[14]

The AER will need to determine whether the selection of 2023-24 as the base year provides the best indication of efficient costs necessary to operate and maintain the network and to meet regulatory obligations, noting that CEG's analysis was based on data *prior to* the selected base year.

We also support the AER's proposal to review the five opex step changes totalling $70.3 million over the access arrangement period.

5 Tariff variation mechanism

JGN is proposing to move from the current price cap tariff variation mechanism to a hybrid mechanism as it considers:

> This will share volume risks between us and customers and address the AER's concerns around gas networks earning higher than forecast revenues by limiting revenue earnt through volume outperformance.[15]

Specifically, a combined "cap-and-collar plus sharing" hybrid mechanism is proposed, whereby JGN would bear volume risk (and any benefit) up to a tolerance level (+/- 5%), beyond which they would equally share the volume risk (and any benefit) with customers.

As noted earlier in our submission, under the current price cap tariff variation mechanism, gas distributors have consistently earned more than targeted revenues because actual gas volumes have been higher than forecast. While sharing future risks and benefits between JGN and customers appears equitable, it does not consider historical access arrangement periods where JGN has been the sole beneficiary of volume under-forecasting. We therefore consider it reasonable that JGN should face over-forecasting risk as part of future access arrangement periods. To justify why moving to a hybrid mechanism is appropriate, the onus must be on JGN to explain why the existing risk allocation is inequitable from their perspective.

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[12] JGN, June 2024, *Jemena Gas Networks 2025 Plan*, p. 85

[13] Competition Economists Group, April 2024, *Benchmarking and forecasting JGN opex* (Attachment 6.4, JGN 2025 Plan)

[14] JGN, June 2024, *Jemena Gas Networks 2025 Plan*, p. 85

[15] JGN, June 2024, *Jemena Gas Networks 2025 Plan*, p. vi

6 Summary

Alinta Energy requests the AER to closely review the following elements of JGN's 2025 Plan before making its Draft Decision:

- Given its key role in calculating reference haulage tariffs and the disposition for gas distributors to under-forecast, the AER should be satisfied that JGN's forecast demand is accurate and reflects current Government policy and consumer sentiment.
- While accelerated depreciation has been approved for application in Victoria, different decarbonisation policies, targets and electrification objectives apply in NSW. The AER should require JGN to demonstrate the magnitude of stranded asset risk and the justification for early regulatory intervention. If approved, accelerated depreciation should be an adjustable amount that targets a set price path outcome, as opposed to a fixed amount that does not achieve any particular price path.
- JGN's proposed increase to some elements of the capex appears inconsistent with the proposal to apply accelerated depreciation. We therefore support a closer review by the AER of these aspects of the capex, as well as an evaluation of the capex proposed for the renewable gas projects.
- The AER should consider whether the selection by JGN of 2023-24 as its base year provides the best indication of efficient opex. We support the AER's proposal to closely review the five planned opex step changes.
- As JGN has been the sole beneficiary of volume under-forecasting to date, JGN should be required to justify its proposal to move from a price cap to a hybrid tariff variation mechanism which would see volume risk shared with customers.