Hon Lily D'Ambrosio MP

Minister for Climate Action
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Dear Clare Savage

Thank you for the opportunity to make a submission to AusNet Gas Services (AusNet) access arrangement (AA) variation proposal submitted to the AER on 30 September 2024.

AusNet's variation proposal is unprecedented within the context of the operation of the National Gas Law (NGL) and National Gas Rules (NGR). With this context in mind, I raise several issues with AusNet's variation proposal which I encourage the AER to closely scrutinise in your consideration of this request.

AusNet's rationale

AusNet's proposal outlines an argument that the NGL and NGR provide it with, amongst other things, a reasonable opportunity to recover at least the efficient costs it has incurred in providing gas pipeline services.

AusNet further argues that since its investments have been "compelled" by its licence to operate and have been determined to be efficient through regulatory review, recovery of those investments has been "effectively guaranteed."

AusNet's position is that the policy and regulatory changes undertaken by the Victorian Government have adversely affected gas demand and as such it now faces a real risk that it will not recover all its sunk investment and so would not recover the efficient costs it has incurred.

While a decline in the demand for gas does present a risk for gas distribution network service providers (DNSPs), the conclusion of the argument made by AusNet is that, in the absence of any other party, it is consumers that effectively guarantee the recovery of the efficient costs incurred by the gas DNSPs in a given regulatory period.

However, it is a feature of the price cap form of regulation that governs gas distribution networks that DNSPs carry demand or volume risk.

Over the last decade, the DNSPs have benefited from this risk arrangement as actual demand has exceeded forecasts and subsequently, and they have been more than adequately compensated for their investments through the additional revenue that they have returned to their investors. I note the AER's *Gas Network Performance Report 2023* states that since 2011, "scheme pipelines in aggregate have consistently recovered more revenue than forecast"[1]. In addition, the Institute for Energy Economic and Financial Analysis reports that from 2014–22, regulated gas networks (transmission and

[1] Gas network performance report 2023. See Figure 3-7 which shows the trend in reference service revenue compared to forecast revenue from 2011 to 2022.

distribution) in Australia made $1.8 billion in additional profits on top of the $2 billion in profits allowed by the AER under the incentives-based regulatory framework.[2]

While a variation proposal is allowed for under the NGR it should not be used by DNSPs to manage the downside risk of a price cap form of control at the first sign of an adjustment in gas demand. I note that DNSPs did not request their AAs to be reopened when gas demand was higher than forecast over the last decade. The gas DNSPs should remain bound to the principle of the regulatory framework in which they bear the risk of actual demand being lower than initial forecasts.

In addition, I would highlight that the unprecedented nature of AusNet's variation proposal may encourage other gas DNSPs requesting variations to their access arrangements at the first sign of a decline in demand, where that decline would present a downside risk to their revenue requirements.

AusNet's proposal

The basis of AusNet's variation proposal is that the policy changes by the Victorian Government have affected the outlook for gas and set a clear path to electrification, leading to the forecasts of customer numbers for the current AA period being no longer credible.

To establish its proposal, AusNet has provided revised residential customer numbers and revised consumption forecasts in its variation proposal. A comparison of these revised figures to AusNet's final decision is shown below in Tables 1 and 2.

Table 1 – Comparison of residential customers numbers from final decision to variation proposal

	2023–24	**2024–25**	**2025–26**	**2026–27**	**2027–28**
Final decision	781,161	792,591	802,844	808,824	818,193
Variation proposal	781,161	792,591	791,983	789,892	783,990
Change	-	-	-10,861	-18,938	-28,204
% Change	-	-	-1.4%	-2.3%	-3.5%

Source: AusNet

Table 2 – Comparison of residential gas consumption from final decision to variation proposal

	2023–24	**2024–25**	**2025–26**	**2026–27**	**2027–28**	**Total**
Final decision	30,595,873	30,156,233	29,338,860	27,941,877	26,044,333	**144,077,177**
Variation proposal	30,595,873	30,156,233	29,101,067	27,927,869	26,247,216	**144,248,260**
Change	-	-	-237,793	-14,008	422,883	**171,083**
% Change	-	-	-0.8%	-0.1%	1.6%	**0.1%**

Source: AusNet

The Victorian Government notes that under AusNet's revised proposal as published on the AER's website, AusNet is forecasting a decrease in residential customer numbers each year from 2025**–**26 to 2027**–**28. However, when these revised customer numbers are compared over the full 5-year period from 2023**–**24 to 2027**–**28, AusNet is still expecting residential customer numbers to increase, albeit marginally by 2,829. Similarly, AusNet is forecasting that over the full five-year period, residential gas consumption will increase by 0.1%.

Victoria encourages the AER to closely scrutinise whether those revised forecasts are evidence of a material or significant change in demand, or simply represent a steady state for residential customer

[2] Gas networks are making persistent and significant supernormal profits | IEEFA. Target and Actual revenue from 2014 to 2022 for the three Victorian gas DNSPs, AusNet's Target revenue over the period was $1852 million, compared to actual revenue was $1926 million. See https://www.aer.gov.au/system/files/2023-12/Gas%20Distribution%20-%20Operational%20Performance%20data%20-%202023%20-%20PUBLIC_0.xlsx

numbers and demand over the remaining period to 30 June 2028 and are not representative of a dramatic change in demand that warrants a re-opening.

AusNet argues that, given that continued customer growth is no longer a credible forecast, early actions such as faster capital recovery is the best way to protect customers and enable AusNet to continue managing the network safely. Further, AusNet states that "stabilising the long-term price, recovering sunk costs and managing the impacts of a network that is declining are best addressed while the customers for which the sunk investment was made remain on the network".

As a result, AusNet is requesting an increase in accelerated depreciation from the amount of $105 million approved by the AER to $175 million, stating that accelerated depreciation offers a balance between higher prices in the near term and greater price stability, reducing the potential for sharp price increases in the 2030s and 2040s.

The impact of the proposal is that AusNet's revenue requirements increase by 7.2% ($90.8 million) ($ nominal) relative AusNet's revenue requirement in its current AA.

Continued reliance on allowing accelerated depreciation as the primary mechanism to manage the risks of a downturn in gas demand may also contribute to a hastening of consumers exiting the network. This risks a disorderly transition that would undermine the operation of the regulatory framework.

As noted above, it is important that consumers are not facing asymmetric risk due to reopening under price cap regulation. To the extent the AER was considering a change to enable additional accelerated depreciation, requested by AusNet in response to out-turn demand variation in a price cap framework, it must also assess and account for the over recovery of revenue that AusNet benefited from in any previous AA periods. In the case of AusNet's variation proposal, the magnitude of the uplift in accelerated depreciation in AusNet's' variation proposal (from $105 million to $175 million) appears not to be justified given the forecasts of residential demand and customer numbers provided by AusNet. The risk of a dramatic decline in demand over the period to 30 June 2028 is not demonstrated. With this in mind, the AER should closely consider whether the variation is necessary, and if so, if it is necessary at the scale requested.

Additional measures

In addition to examining the level of accelerated depreciation that AusNet has requested, I encourage the AER to closely examine and scrutinise AusNet's capex program. In particular, its mains replacement program. The AER should assess the scope for AusNet to identify material and credible savings to offset any approved increases in revenue requirement which will impact on the costs being paid by customers. Further scrutiny should also be afforded to AusNet's connection capex requirements, and particularly the drivers of the $71 million net capex request under the variation given the forecasts of residential customer numbers provided in the variation proposal.

A reduction in the regulated asset base beyond that forecast in the variation proposal ($13.7 million) that could take effect to account for redundant assets in the next regulatory period would assist in reducing the cost of a decline in network demand being primarily borne by customers.

Conclusion

Overall, the variation proposal seeks to pass the costs of the change in demand in large part onto residential customers, while AusNet's investors benefit through an increase in the return of capital and additional revenue accruing to the business.

The Victorian Government questions whether AusNet's request for additional accelerated depreciation and revenue, and the extent thereof, is supported by the evidence presented in the variation proposal and encourages the AER to consider whether it is consistent with the level of risk to the change in demand forecast in the variation proposal.

In principle, AusNet should accept downside risk of the price cap form of control - as it has benefited from upside risk without reopeners - and bear the costs of a decline in demand. In particular, the Victorian Government questions whether those risks should be passed back to consumers who have returned additional revenue to the DNSPs over previous AA periods, while also investing in the energy transition.

If you would like to discuss these matters further, please contact Ben Ferguson, Executive Director, Energy Transition and Strategy Division at the Department of Energy, Environment and Climate Action at ben.ferguson@deeca.vic.gov.au or on [redacted]

Yours sincerely

[redacted]

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17 / 12 / 2024