

Submission to the Australian Energy Regulator (AER)

Consumer Challenge Panel

Submission to the AER on JGN's Regulatory Proposal

Sub-Panel CCP19

David Prins (chair)

Chris Fitz-Nead

9 August 2019

Contents

- Submission to the Australian Energy Regulator (AER) 1
- 1. Introduction..... 4
 - 1.1. The role of the Consumer Challenge Panel (CCP) 4
 - 1.2. Structure of this submission..... 4
- 2. JGN stakeholder engagement 5
 - 2.1. Stakeholder engagement undertaken by JGN and CCP involvement 5
 - 2.2. Our views on JGN’s stakeholder engagement activities 7
 - 2.3. Customer engagement activities are part of the regulatory decision-making process 9
- 3. Capital Expenditure (Capex) 11
 - 3.1. Introduction..... 11
 - 3.2. Customer growth (connections)..... 13
 - 3.3. Boundary metering for new high rise buildings 14
 - 3.3.1. JGN’s proposal 14
 - 3.3.2. Outcomes from JGN’s consultation process regarding this proposal 15
 - 3.3.3. Responses to the proposal published in JGN’s Draft 2020 Plan..... 15
 - 3.3.4. CCP19 views on the proposal 15
 - 3.4. Augmentation capex 17
 - 3.4.1. Lane Cove to Willoughby pipeline 17
 - 3.4.2. Aerotropolis..... 19
 - 3.5. Information Technology (IT)..... 21
 - 3.6. Speculative capex 22
- 4. Operating Expenditure (Opex) 24
 - 4.1. Introduction..... 24
 - 4.2. Accounting changes..... 24
 - 4.2.1. Corporate overheads reclassification..... 25
 - 4.2.2. Pigging cost reclassification..... 25
 - 4.3. Productivity improvements..... 26
 - 4.4. Marketing 27
 - 4.4.1. JGN comments regarding marketing opex 27
 - 4.4.2. Previous regulatory decisions..... 27
 - 4.4.3. CCP19 advice on JGN’s current proposal 29
- 5. Depreciation 29
 - 5.1. Introduction..... 29
 - 5.2. Accelerated depreciation of network assets..... 29

5.2.1.	JGN’s proposal	29
5.2.2.	JGN’s consumer engagement	31
5.2.3.	Our conclusion.....	33
5.3.	Accelerated depreciation of pigging capex	34
6.	Reference Service Agreement.....	36
7.	Capital Expenditure Sharing Scheme (CESS)	37

Figures

Figure 1:	JGN customer engagement in numbers.....	5
Figure 2:	Customer groups identified by JGN for face to face consultation	6
Figure 3:	JGN Customer Council members.....	6
Figure 4:	Voting results: To what extent do you agree that the Jemena Gas Networks’ Draft 2020 Plan is in the long-term interest of customers?.....	8
Figure 5:	Voting results: how well do you think Jemena responded to customer feedback on the key themes and price path?.....	9
Figure 6:	JGN opex forecast.....	24

Tables

Table 1:	JGN consumer engagement events attended by CCP19 members.....	7
Table 2:	JGN’s capex proposal.....	11
Table 3:	JGN’s capex peer comparison.....	12
Table 4:	Numbers and costs of JGN connections	14
Table 5:	Augmentation capex.....	17
Table 6:	IT capex by categories	22
Table 7:	Proposed changes to asset lives	29
Table 8:	Asset lives benchmarked	30
Table 9:	Remaining asset lives.....	30
Table 10:	Deliberative forum support for accelerated depreciation	31

1. Introduction

1.1. The role of the Consumer Challenge Panel (CCP)

The AER established the Consumer Challenge Panel (CCP) in July 2013 as part of its Better Regulation reforms. These reforms aimed to deliver an improved regulatory framework focused on the long-term interests of consumers.

The CCP assists the AER to make better regulatory determinations by providing input on issues of importance to consumers. The expert members of the CCP bring consumer perspectives to the AER to better balance the range of views considered as part of the AER's decisions.¹

The author of this submission is CCP19, a sub-panel of the AER's Consumer Challenge Panel that the AER has established to focus specifically on the AER's regulatory determination of the Jemena Gas Networks (NSW) (JGN) access arrangement for 2020-25.² The views expressed in this paper are the views of the members of CCP19: David Prins (chair) and Chris Fitz-Nead.

1.2. Structure of this submission

This submission covers our view of the key issues in JGN's proposal from a consumer perspective.

The remainder of this submission is structured as follows:

- Section 2 discusses JGN's stakeholder engagement activities;
- Section 3 discusses JGN's capex proposal;
- Section 4 discusses JGN's opex proposal;
- Section 5 discusses JGN's proposal for accelerated depreciation of some of its assets;
- Section 6 briefly references proposed JGN's Reference Service Agreement; and
- Section 7 discusses JGN's proposed Capital Expenditure Sharing Scheme (CESS).

¹ Detailed information on the CCP is available on the AER website at <https://www.aer.gov.au/about-us/consumer-challenge-panel>

² Full information on this regulatory process can be found on the AER website at <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/jemena-gas-networks-nsw-access-arrangement-2020-25>

2. JGN stakeholder engagement

2.1. Stakeholder engagement undertaken by JGN and CCP involvement

JGN undertook considerable stakeholder engagement in advance of its submission of its regulatory proposal to the AER on 28 June 2019.

This stakeholder engagement has included:

- Multiple rounds of deliberative engagement with a broad, representative group of consumers across NSW;
- Targeted workshops with select groups of consumers – including CALD, over 55s, residential and small business customers;
- Workshops held entirely in language with both residential and small business customers;
- Use of Jemena’s Customer Council of consumer representatives;
- Public consultation on a Draft Plan;
- Consultation with retailers; and
- Deep dives for consumer representatives on the Draft Plan and on JGN’s proposed Capital Expenditure Saving Scheme (CESS).

Figure 1 below from the JGN Plan sets out some facts and figures regarding JGN’s engagement activities.

Figure 1: JGN customer engagement in numbers

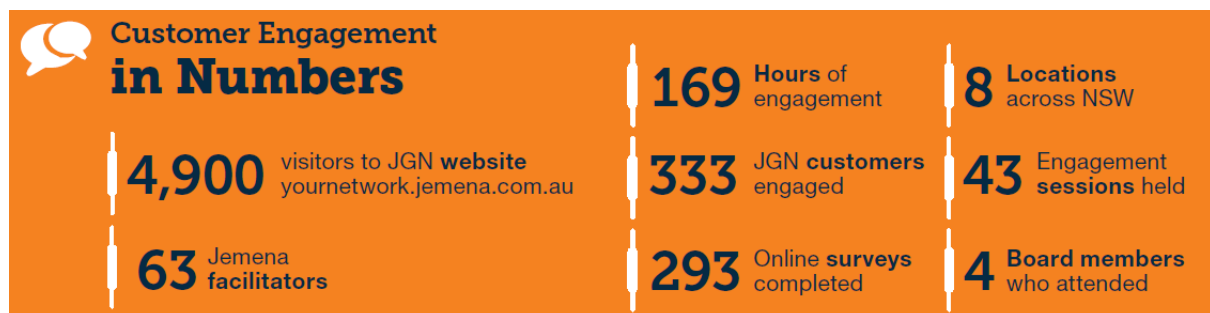
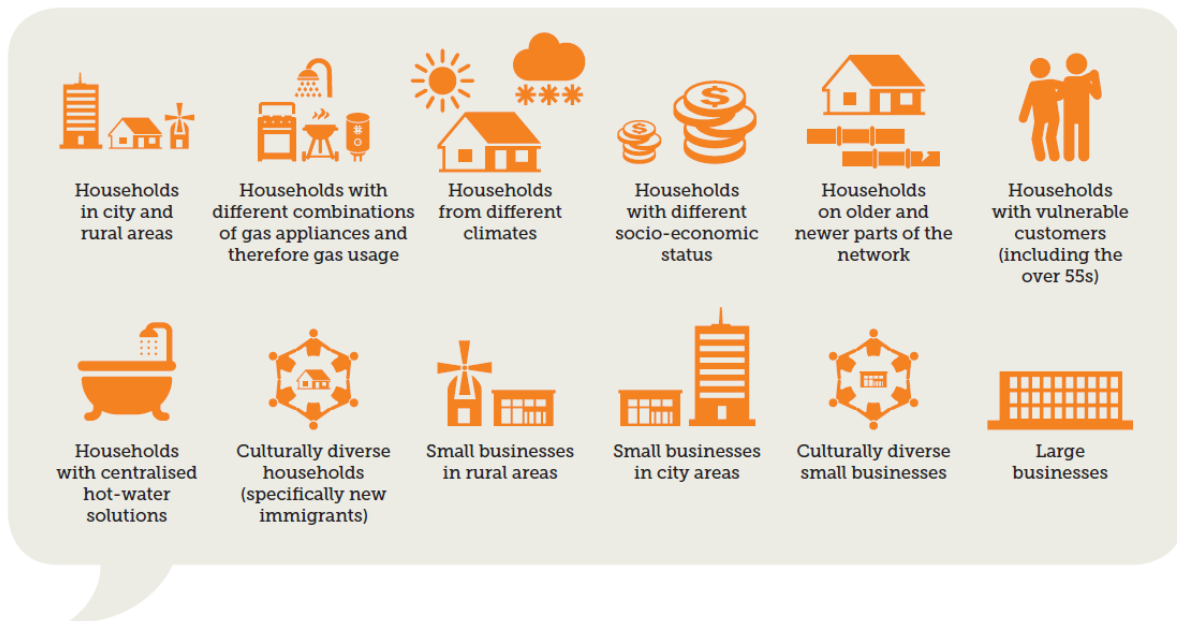


Figure 2 below from the JGN Plan shows which customer groups identified for face to face consultation. As it was not possible to speak to all of its 1.4 million customers, JGN sought to hear from customers that represented the different ways that gas is used and experienced across NSW.

Figure 2: Customer groups identified by JGN for face to face consultation

Figure 2.1 Customer groups identified for face to face consultation

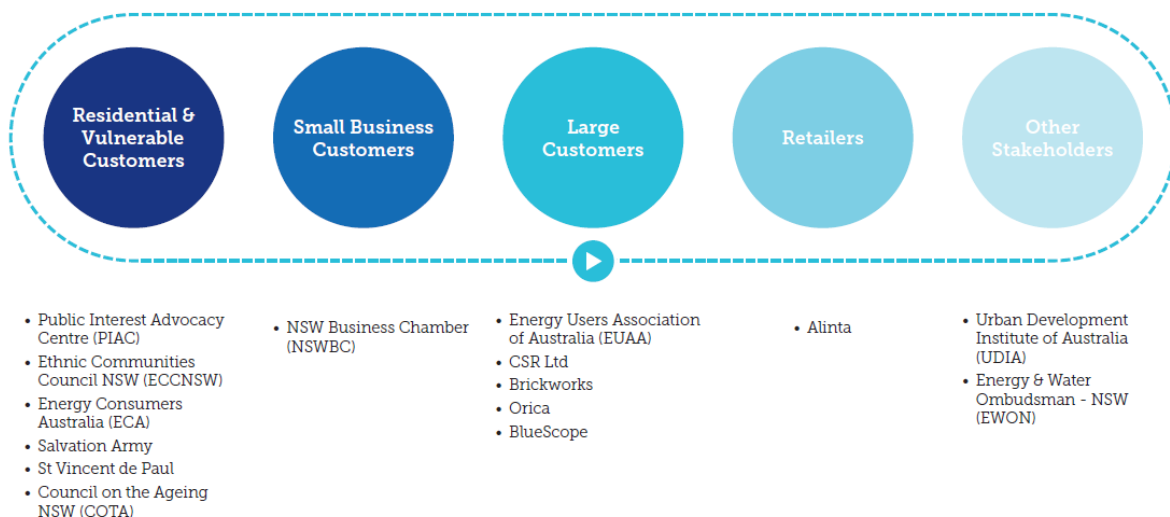


Much of the stakeholder engagement activity was undertaken through an external independent facilitator – Straight Talk. (Straight Talk joined the international consulting firm RPS in 2018.)

Figure 3 below from the JGN Plan shows the composition of JGN’s Customer Council. To ensure transparency, JGN invited customers who had participated in its forums to attend a Customer Council meeting. This was a successful initiative, leading to the ongoing inclusion of additional end-use customers (both residential and industrial) to the Customer Council.

Figure 3: JGN Customer Council members

Figure 2.4 Our Customer Council members



JGN has maintained a website for stakeholder consultation³ where interested parties can sign up to receive updates, comment on the Draft Plan, read many documents and view relevant videos.

³ See <https://yournetwork.jemena.com.au>

Straight Talk provided Mid-Program summaries of the JGN Deliberative Forums in August 2018.⁴

The customer stakeholder engagement undertaken and outcomes from the engagement are summarised in JGN’s proposal in section 2. More detailed information on JGN’s customer and stakeholder engagement program is contained in Attachments 2.1 to 2.4 to the JGN Plan.

CCP19 thanks JGN for being open with the sub-panel and inviting the sub-panel to participate in JGN’s stakeholder engagement events. Where we did not attend an event, it is because we had to prioritise our available resource and therefore could not attend every event (and some events occurred in 2017/18 before CCP19 was established).

This submission relies both on our own observations at events we attended, and information included in JGN’s regulatory proposal.

Table 1 below lists the JGN consumer engagement events that were attended by CCP19 members

Table 1: JGN consumer engagement events attended by CCP19 members

Date	Event	Location
19 May 2018	2 nd Deliberative Forum	Goulburn
31 May 2018	Small and medium business focus group	Parramatta
6 June 2018	Study Circle Low Income / over 55s Workshop 2	Parramatta
13 June 2018	Study Circle Low Income / over 55s Workshop 2	Parramatta
28 June 2018	JGN Customer Council meeting	North Sydney
25 August 2018	3 rd Deliberative Forum	Goulburn
19 February 2019	Deep Dive – Draft Plan	North Sydney
9 April 2019	Deep Dive – CESS	North Sydney

CCP19 also attended and presented at the AER’s Public Forum in Sydney on 7 August 2019.

We were pleased that at the public forum both JGN and the AER stated their willingness and desire to hold further workshops and forums in the coming months to try to resolve any outstanding differences in view between stakeholders, in parallel with the AER’s compiling of its draft decision which is due to be released in November 2019. We welcome this approach, and see it as in line with “AER 2.0” - Working together to restore confidence in energy regulation.⁵

CCP19 welcomes the opportunity to participate in those discussions, subject to our overall budget and priorities.

2.2. Our views on JGN’s stakeholder engagement activities

Our overall view is that JGN has shown a genuine commitment to consumer engagement and to stakeholder engagement more generally.

PIAC stated in its submission to JGN’s Draft Plan:

⁴ See <https://yournetwork.jemena.com.au/what-customers-are-saying> for a PDF of this report, and summary on the webpage itself of what customers told JGN in customer forums.

⁵ For more information on AER 2.0, see speeches by the AER Chair to Energy Networks Australia Regulation Seminars in July 2017 and July 2018, transcripts of which are available on the AER website at <https://www.aer.gov.au/news/working-together-to-restore-confidence-in-energy-regulation> and <https://www.aer.gov.au/news/regulatory-innovation-and-collaboration-in-a-dynamic-environment-what-has-been-achieved-and-where-to-from-here> respectively.

PIAC commends the consumer engagement which Jemena has conducted in the lead up to preparing its initial proposal for the 2020-25 access arrangement. ... Not only has this engagement been broad and comprehensive, but it also commenced early – over 18 months before the initial proposal was due to the AER.

Energy Consumers Australia (ECA) stated:

Jemena Gas Networks (JGN) has followed an exemplary consumer engagement process to help it understand the long-term interests of consumers.

Energy Consumers Australia acknowledges and appreciates the mature approach that JGN has followed to understand the long-term interests of consumers; and how it has applied these learnings to its Jemena Gas Networks Draft 2020 Plan (the Draft Plan). JGN has undertaken an extensive consultation process over the last 18 months (and which is ongoing), which we recognise represents a big commitment from the staff who have spent many weekends engaging with consumers. It has involved information being shared through a combination of face to face forums with consumers, websites and one on one meetings with larger customers. In our view, JGN is “leading the way” amongst its peers in the energy networks businesses in the evolution of the consumer engagement journey (both for gas and electricity distribution).

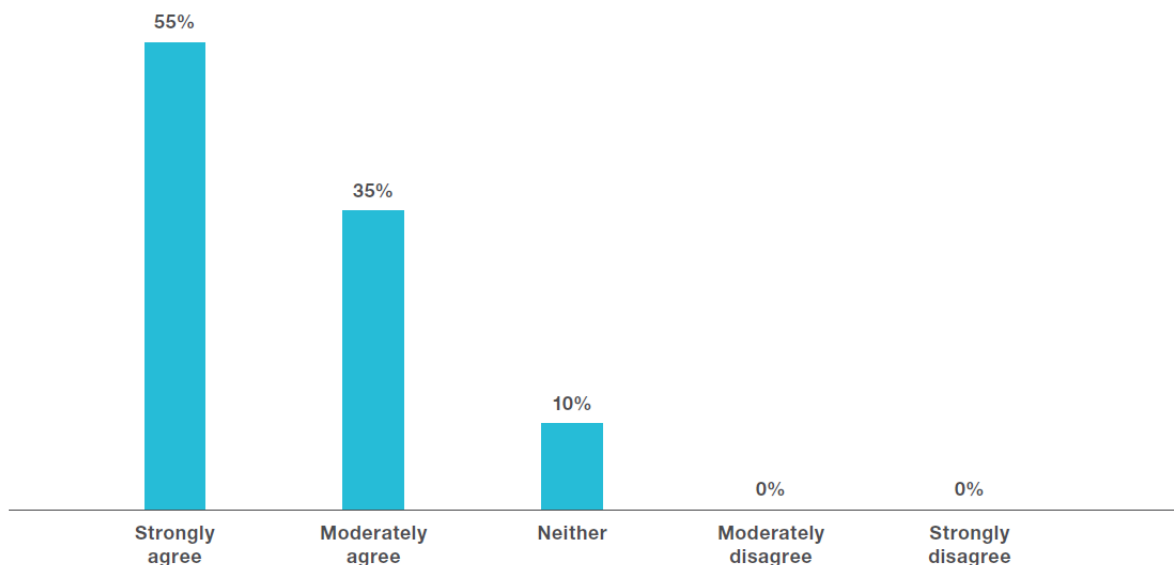
We support those comments. We also find it pleasing that the process followed has already enabled differences of view to be discovered and already discussed in JGN’s proposal.

JGN’s Plan demonstrates how consumer engagement has shaped its proposal. As shown in figures 4 and 5 below, it led to very positive results when customers were asked:

- Did they feel that JGN had accurately reflected their feedback in its plan; and
- Did they think JGN’s approach for 2020-25 is in their long term interests?

Figure 4: Voting results: To what extent do you agree that the Jemena Gas Networks’ Draft 2020 Plan is in the long-term interest of customers?

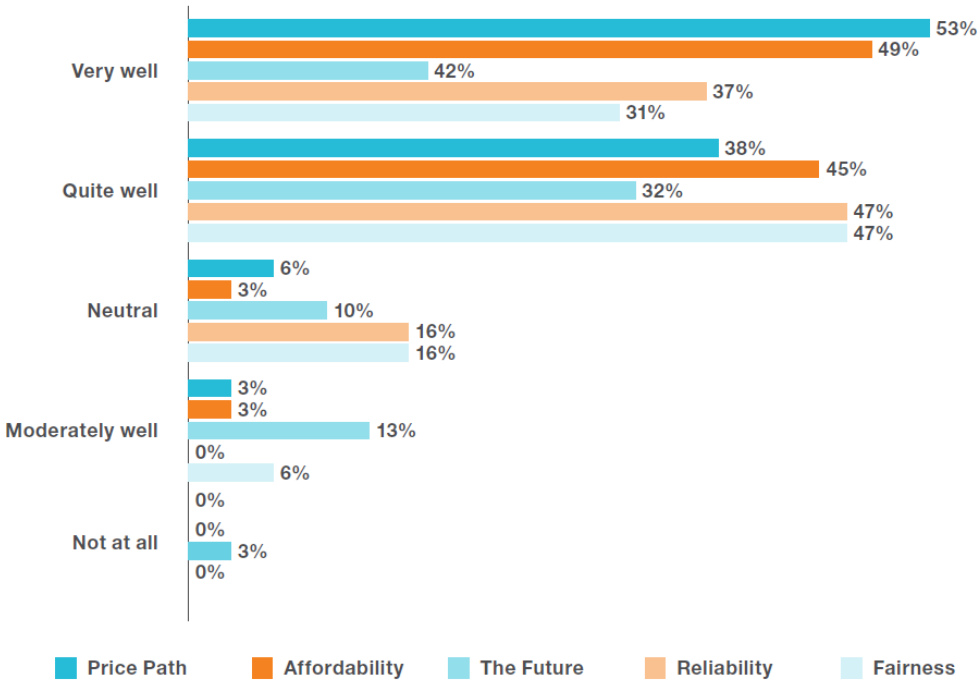
Figure 2.5 Voting results: To what extent do you agree that the Jemena Gas Networks’ Draft 2020 Plan is in the long-term interest of customers? (N=31)



Source – Draft 2020 Plan Consultation Report, RPS 2019 (provided in Attachment 2.2)

Figure 5: Voting results: how well do you think Jemena responded to customer feedback on the key themes and price path?

Figure 2.6 Voting results on a scale of 1 to 5, how well do you think Jemena responded to customer feedback on the key themes and price path



Source – Draft 2020 Plan Consultation Report, RPS 2019 (provided in Attachment 2.2)

As stated by JGN: “we are incredibly humbled to report on behalf of our customers that we have delivered a plan that, despite the varying needs of our customers, finds a fair balance and is in their long-term interests.”

2.3. Customer engagement activities are part of the regulatory decision-making process

ECA stated in its submission to JGN’s Draft Plan:

Extensive consumer engagement is one “piece of the puzzle” in ensuring that the long-term interests of consumers is being understood.

Customer engagement activities are a key part of the regulatory decision-making process, but do not determine outcomes in a vacuum on their own, away from other regulatory decision making activities.

By way of example of what we have in mind here, in regard to accelerated depreciation, JGN has documented in Table 4-2 of Attachment 7.10 of its proposal responses to issues raised by various parties. We discuss accelerated depreciation in more detail in section 5.2 below. It is good that early stakeholder engagement has smoothed the process, allowing more transparency, and enabling stakeholders to engage with JGN’s views at a much more detailed level at this stage than would have been the case without the early engagement.

However, we state in section 5.2.2 our view that the consumer engagement that JGN undertook does not necessarily lead to the conclusions drawn by JGN in regard to accelerated depreciation. We do

not see this as contradicting our overall views regarding the effectiveness of JGN's consumer engagement activities. We provide detail in section 5.2.2 below why we think this is the case.

Care is required to ensure that early engagement with customers is not seen to replace the role of customer advocates, or the role of the AER. Those parties may legitimately come to a conclusion based on a different perspective, or wider knowledge, or reflecting the views of different subsets of customers, given that customers are not one homogeneous set.

We highlight Table 4-1 of Attachment 7.10 where JGN states that "The AER should weight our customers views at least as highly, if not higher than, those of consumer representative organisations."

The AER may indeed decide to weight customers' views that highly, or the AER may decide that other stakeholders raise valid points that were not considered in JGN's consumer engagement, or may for other reasons decide to weight a different view more highly. Without wanting to play down the important role that direct consumer engagement can have, there must be recognition that the AER takes consumers' views into account alongside other stakeholders, and is required to act in accordance with the Rules without showing undue favour.











3. Capital Expenditure (Capex)

3.1. Introduction

The JGN Plan proposes \$899 million of capex over the 2020-25 period. Table 2 below shows the proposed 2020-25 capex by category compared to capex allowed by the AER in the preceding two regulatory periods and the actual/estimate in these preceding periods.

Table 2: JGN’s capex proposal

Table 5.1 Capital expenditure over time by category (\$2020, Millions)

		2010-15		2015-20		2020-25	
		Allowance	Actual	Allowance	Actual/ Estimate	Draft 2020 Plan	2020 Plan
	Connections	451	436	397	592	449	480
	Metering	145	99	193	106	143	146
	Facilities and pipes	91	69	125	78	90	89
	Information Technology	106	142	148	119	103	107
	Augmentation	85	118	110	50	97	75
	Mains replacement	24	21	75	34	67	55
	Others*	48	99	45	47	30	35
	Change in how we recover corporate overheads**	-	-	-	-	-78	-76
	Total gross capital investment	951	984	1,094	1,025	901	913
	Customer contributions	25	41	22	15	11	13
	Total net capital investment***	926	943	1,071	1,011	889	899

Notes:

- * Other includes property, fleet and SCADA (the system which controls our network).
- ** We are changing how we recover our corporate costs. For more details see section 6.3.
- *** This net capital investment does not take into account asset disposals.

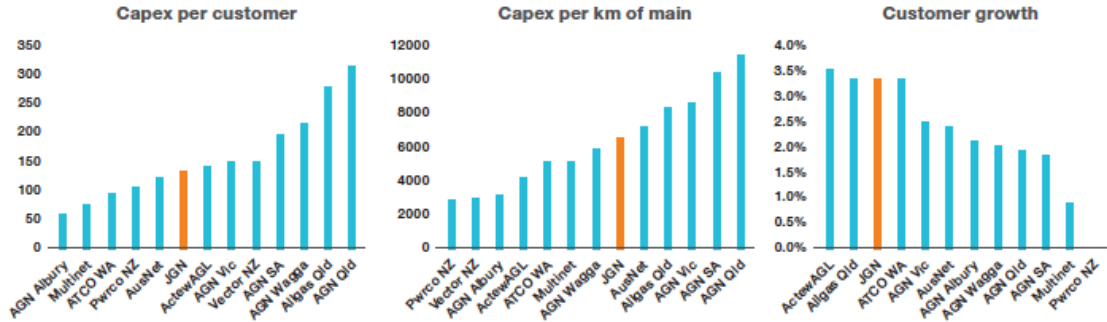
Source: JGN 2020 Plan, page 48

JGN addressed key capex issues through its consumer engagement, and this is considered in discussion of those issues below.

JGN seeks to demonstrate with the following table that its capex is efficient relative to its peers, and by these measures its overall capital expenditure benchmarks well, particularly with networks with larger customer growth.

Table 3: JGN’s capex peer comparison

Figure 5.1 How our customer growth and capital expenditure compares to other Australian networks (\$2010)



Source: JGN, based on Economic Insights data (Attachment 6.4). Charts rely on the longest time horizon presented: capex is average over the last five years; customer growth is since 1999 (or earliest available).

Source: JGN 2020 Plan, page 49

At this high level, CCP19 has some concern with the pattern in some of the expenditure categories in the 2010-15 and 2015-20 regulatory periods of JGN’s actual expenditure being materially lower than the sum allowed by the AER. In those regulatory reviews, the AER provided JGN an allowed capex for each category of capex based on the case made by JGN and the subsequent review process, just as JGN is now making a case for 2020-25 capex. In the current period the estimated actual is lower than the allowance in all the categories that JGN has substantial control over expenditure. Customer connections, the category over which JGN has least control, is the one category where estimated actual is materially greater than the amount allowed by the AER.

In JGN’s Attachment 5.1,⁶ some detail is provided which seeks to justify the differences in the sum allowed by the AER for the 2015-20 period compared to the estimated actuals. Some cancellation or deferral of planned expenditure is easy to understand like the cancelled \$14.2 million in capex to upgrade country facilities to support a planned pressure upgrade of the Moomba to Sydney transmission pipeline by its owner APA. APA did not proceed with the pressure upgrade, so the work was not required.⁷

For other issues, such as the substantial underspend on mains replacement (\$75 million planned and \$34 million estimated to be completed in the period), the justification is less clearly or objectively demonstrated:

Over the 2010-15 period we deferred mains replacement programs in Goulburn, Wollongong as well as the Bankstown / Chullora / Greenacre area. However, we also brought forward the Matraville mains replacement project.

In Goulburn we had planned to continue the mains replacement program that commenced in the earlier 2010-15 period. We replaced the mains with the highest safety risks first: areas with shallow mains in denser commercial areas. Before proceeding with the last stages we undertook a leakage test of the last sectors and found that these areas were in better condition than expected. Accordingly, have deferred these works beyond the 2020-25 period.

⁶ 2020-25 Access Arrangement Proposal, Attachment 5.1 Capital expenditure
⁷ Ibid. p.26

For Wollongong, we planned to replace mains to increase the capacity of the network so we could supply nearby residential and commercial developments. This project followed on from earlier mains replacement works undertaken in the 2010-15 period. However, the planned developments did not occur and a subsequent leak test found that the condition of the remaining mains was better than expected. Based on this new information we were able to defer the replacement of the last sections until the 2025-30 period.⁸

JGN now seeks approval for \$55 million of mains replacement capex in the 2020-25 period. How certain is it that this work needs to be carried out or will be completed?

CCP19 recommends that the AER and its advisors should look closely at underspends of allowed capex categories in the 2015-20 period, and consider these when assessing the robustness of the capex forecast in each category for the 2020-25 period.

Some areas of capex are considered in more detail in the following sections.

3.2. Customer growth (connections)

Customer growth (being the cost of connecting new services to the network) is JGN's biggest category of capex. This is a cost that is somewhat beyond the control of JGN, as it reflects the market demand for gas supply to new and existing residences. This "demand" is of course influenced by JGN's marketing activity,⁹ for which consumers pay. Broadly, the addition of new gas connections provides additional customers to spread the networks fixed costs over so may reduce the networks costs to gas consumers. JGN states:

Our investment in connections will lower bills by about \$300M over the period to 2050.¹⁰

In Table 2 above, connection costs in the 2020-25 period are forecast to be \$480 million, compared to the estimated actual in the current period of \$592 million. (Note from the table that JGN proposes changing how it capitalises overheads, so the 2020-25 sum assumes the same capitalisation of these as the current period to compare like for like). JGN attributes the lower forecast capex to reductions in the number of new connections, and in the average cost per connection (based on expected changes to supplier charges), and the plan to no longer install individual hot water meters for high-rise apartments (discussed in section 3.3 below on boundary meters).¹¹

The following table shows the projected decline in the number of connections along with the plateauing cost per connection.

⁸ Ibid. p.43

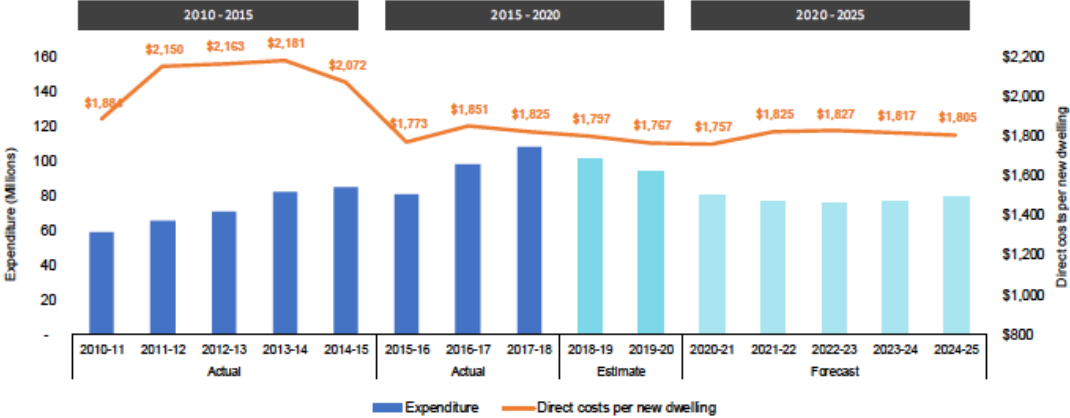
⁹ See section 4.4 below for our more detailed commentary on marketing activities.

¹⁰ JGN 2020 Plan p.55

¹¹ Ibid. p.56

Table 4: Numbers and costs of JGN connections

Figure 3-1: Annual connections capex and average connection costs per new dwelling (\$2020, excluding overheads)



Source: 2020-25 Access Arrangement Proposal, Attachment 5.1 Capital expenditure, p.17

While the cost per new connections does reduce, it is a very modest reduction in an environment of fewer connections, and a weakening construction market.

CCP19 recommends that the AER look to benchmark JGN’s cost per connection to consider whether it is reasonable.

3.3. Boundary metering for new high rise buildings

3.3.1. JGN’s proposal

JGN proposes ceasing from 1 July 2020 to install and support individual hot water metering in new high-rise buildings, where the building has a centralised hot water system. Instead, it will supply a single meter at the boundary of the high-rise building, and another party specialising in this service (referred to here as an Embedded Network Provider or ENP)¹² will install, own and maintain the gas network beyond the boundary meter. JGN has provided this as an option since 2015 with around 13,000 apartments now being serviced by an ENP. JGN states that this arrangement is common in other jurisdictions, and that there are currently twelve ENPs active in NSW.

JGN states that this proposal provides for cost savings which appear to be material:

The introduction of our boundary metering product in 2015 and the removal of hot water metering for new high-rise buildings from 1 July 2020 has resulted in a forecast cost reduction of \$56M over the 2020-25 period. This comprises a \$26M saving due to the introduction of

¹² ENPs often provide electricity and gas for end use, as well as possibly supplying a hot water service. They may be acting under a retail authorisation from the AER or through an exemption. Here the term ENP is used quite loosely to refer to a provider of hot water / electricity / gas to multiple occupants (dwellings) within a building that is essentially an embedded network. This is the way that JGN uses the term in its regulatory proposal.

*our boundary metering solution and a further \$30M due to the removal our of [of our] hot water metering product for new high-rise buildings.*¹³

As part of this change, JGN says it will provide tariffs that balance between: cost-reflectivity to ensure similar customers pay similar prices; providing incentives for gas ENPs to participate in the market to meet JGN's pricing objective to keep gas competitive; and, a positive experience to customers *"by enabling the end-product delivered by the ENP, be it gas or hot water, to be delivered at competitive prices – reinforcing our pricing objective to keep gas competitive"*.¹⁴

JGN estimates that with this new approach there will be around 106,000 customers serviced by an ENP by 2025, and that if it didn't cease provision of metered centralised hot water around 67,000 customers would be serviced by an ENP by 2025 (based on the natural take up of boundary meters).¹⁵

3.3.2. Outcomes from JGN's consultation process regarding this proposal

In the engagement process undertaken by JGN, consultation with consumers on this matter appears to have been limited to a session in a retirement village and an over 55's session.¹⁶ JGN developed its boundary meter plan following consultation with its Customer Council, a range of developers and strata managers, the NSW Government, City of Sydney, the Public Interest Advocacy Centre (PIAC) and EWON.¹⁷

3.3.3. Responses to the proposal published in JGN's Draft 2020 Plan

The Draft Plan published in January 2019 provided detail of the proposed new approach, and the opportunity for considered comment on the proposal. Stakeholders who attended JGN's "deep dive" session on 19 February 2019, which considered the draft plan, expressed some concerns, which JGN summaries as:

*...primarily centred on end-customer protections and outcomes, and uncertainty over the comprehensiveness and appropriateness of the regulatory arrangements in place for ENPs.*¹⁸

In submissions on the Draft Plan, both PIAC and ECA noted the capital expenditure benefit, but detailed concerns around consumer protections with an ENP supplying this service.¹⁹

3.3.4. CCP19 views on the proposal

Though we had read the Draft Plan and participated in a deep dive on the Draft Plan, we still found the issue somewhat confusing when we came to write up our views in this advice to the AER.²⁰

In particular, the following points were not clear to us:

¹³ 2020-25 Access Arrangement Proposal, Attachment 5.1 Capital expenditure, p.17

¹⁴ JGN 2020 Plan p.41

¹⁵ Ibid. p.42

¹⁶ 2020-25 Access Arrangement Proposal Attachment, 2.2 JGN's customer engagement p.63

¹⁷ JGN 2020 Plan p.42

¹⁸ Ibid. p.43

¹⁹ Ibid. p.43

²⁰ We did not cover this issue in our presentation at the public forum on 7 August 2019. On being questioned by the AER, we stated that we did not think this was a significant issue. Nonetheless, the AER requested we consider this matter and therefore we are providing advice.

- The proposal will reduce JGN's capital expenditure, but the meters will still be required. They will just be provided by another party (or potentially the hot water could be unmetered and its cost apportioned by the body corporate, but this would not seem to be a satisfactory solution). Where is the cost saving?
- The section "The impact on choice" on page 42 of the Plan does not really answer the question as to how the proposed change will impact choice. If anything, it will decrease the options from which a developer / body corporate can choose, by removing the option to choose to purchase a service from JGN that JGN will no longer offer.
- Some of the comparisons with other jurisdictions are not clear, and our experience regarding ENPs suggested that some of the statements regarding other jurisdictions, access to ombudsman schemes, etc. may not be giving the full picture in all circumstances.

We raised these issues with JGN staff, and thank them for spending time discussing these with us in the last few days.

From our discussions, we gleaned the following:

1. It is true that the metering will still likely be required, but there is a theme in the regulatory proposal of wanting to reduce capex and to lower the RAB. This change will achieve that, even though the metering will still be required.
2. Though JGN already services a significant number of hot water meters, JGN does not regard this as a core strength or core business. Consistent with that, the proposal will mean that JGN no longer has to provide new hot water meters, though it will continue to service the existing meters.
3. JGN feels that the numbers of hot water meters it services is not large on a national scale, and it is better for specialist service providers who operate nationally on a larger scale to take over the service for new meters. JGN's call centre and support services are inefficient at dealing with these relatively low volumes of meters, in a complex environment where JGN has a relatively small role.
4. JGN prefers to have a clear commercial boundary at the gate of an embedded network with shared hot water service, rather than also be involved in owning the hot water meters in individual dwellings beyond this boundary.
5. Hot water meters measure hot water flows in litres, but traditionally gas retailers charged for bulk hot water based on the gas that was deemed to have been burnt to heat that quantity of water. This required conversion factors, such that the customer can be billed in cents per MJ of energy based on a meter reading that measured volumes of water rather than energy. This complexity is avoided by the new service providers who are able to charge in cents per litre of heated water delivered.

We understand and take some comfort that JGN developed its boundary meter plan following consultation with its Customer Council, a range of developers and strata managers, the NSW Government, City of Sydney, the Public Interest Advocacy Centre (PIAC) and EWON.

The concerns raised by consumer advocates have not been in regard to the metering responsibility itself, but rather in regard to the appropriateness of the regulatory environment for embedded networks, and whether they operate in the long-term interests of consumers. We consider the appropriateness of that regulatory environment to be well outside the scope of JGN's Access Arrangements review.

All considered, we now understand the reasons why JGN has proposed this change, and considers it to be in the long-term interests of consumers. We are supportive of the change on that basis.

The key issue for us is what effect moving the responsibility to provide metering from JGN to the ENP will have on the overall customer experience. Where a building has a centralised hot water system, it makes sense for an ENP servicing the building to be responsible for the metering within the building, and for JGN’s responsibility to end at the boundary metering.

CCP19 is supportive of the proposed change. However, if further issues with JGN’s proposal are raised in submissions from affected stakeholders, then we suggest that these are considered further in workshops and forums as envisaged in discussion at the public forum on 9 August 2019.

3.4. Augmentation capex

The following table shows JGN’s augmentation capex in the current period and that forecast for 2020-25.

Table 5: Augmentation capex

Table 3-25: Augmentation capex (\$2020, Millions, excluding overheads)

	2015-20		2020-25
	Allowance	Actuals/estimate	Forecast
Addressing peak demand growth	28.1	7.2	2.9
Connections driven	40.2	32.0	33.3
Northern primary main	22.2	0.5	-
Sydney Primary Main Integrity Management (Lane Cove to Willoughby)	-	0.0	24.5
Total	94.2	40.0	60.8

Source: 2020-25 Access Arrangement Proposal, Attachment 5.1 Capital expenditure, p.37

As can be seen from Table 5, this is an expenditure category where there has been a wide divergence between what the AER allowed for the current period and what the actual expense is.

Of the expenses forecast for 2020-25, there are two major items:

- Bringing forward planned construction of new secondary mains costing \$33 million to avoid \$23 million of expense to make the primary main from Lane Cove to Willoughby capable of internal integrity testing (i.e. pigging);²¹ and
- Construction of new secondary mains to supply the planned city around the new Sydney airport (called the Aerotropolis) which involves the installation of three sections of secondary steel pipe for supply to the core of the Aerotropolis, the Sydney Science Park, and the Airport itself (part of the “connections driven” item in Table 5).

3.4.1. Lane Cove to Willoughby pipeline

JGN explains that due to the cancellation of the Northern Primary Main extension (for which the AER allowed \$22.2 million in the current period of a total cost of around 100 million over 20 years), it now expects to install two additional secondary mains in the 2030s to maintain adequate supply. Building

²¹ JGN 2020 Plan p.64

these additional secondary mains earlier allows the operating pressure of the Lane Cove to Willoughby section of the primary main to be reduced, making it safer and to not requiring pigging thus avoiding the \$23 million of modifications.²²

Following publication of the Draft Plan in January 2019, JGN convened a whole day workshop in Sydney with thirty household customers from across the state and non-English speaking customers from Western Sydney, to deliberate on the Draft Plan. The participants had all been involved in JGN's earlier deliberative forums or engagement processes so had some knowledge of JGN, gas related issues and the regulatory process. This workshop was attended by the Chairman of the Board, other board members and senior Jemena staff as well as observers from PIAC, COTA Australia and the ECA.²³

This forum considered the specific issue of the Lane Cove to Willoughby pipeline upgrade versus two new secondary mains as well as the other augmentation matter discussed below, the Aerotropolis.

The Lane Cove to Willoughby pipeline upgrade versus two new secondary mains discussion involved a 15 minute presentation of the issue by JGN staff followed by discuss around each table and voting.²⁴ JGN presented the two options and their respective costs noting that if the pigging up grade was done now and the secondary mains in the 2030s, that the overall cost will be higher. JGN expressed a preference for building the two secondary mains now to provide *"a lower long-term cost, and results in a substantially safer network—mainly by reducing the consequence of a third party hit in a densely populated area—but has a higher capital cost in the short term."*²⁵

80% of the customers voted to prioritise reducing overall costs instead of short term affordability.²⁶

This feedback from a relatively informed customer sample (they had been engaged with JGN several times over the last year) provides some support to JGN's proposal.

CCP19 considers the proposed replacement of the \$100 million Northern Primary Main extension with the \$33 million new secondary mains a welcome development clearly in the long-term interests of consumers. However, just as circumstances changed in the last five years to warrant abandoning the Northern Primary Main, what is the risk that they will change further to not require the two new secondary mains in the 2030s? The risk to consumers is \$10 million additional expense of constructing the two new secondary mains compared to the cost of making the Lane Cove to Willoughby pipeline fit for pigging. A risk that the two new secondary mains may not indeed be required when we get to 2030 appears to have been presented as low in the consumer forum – the following is from the speaker notes for that forum:

*We [JGN] believe it is highly likely that the secondary mains will be required in the 2030s.*²⁷

With JGN's concern that the whole gas network may wither to near extinction by 2050 there must be some risk that the 2030 expansion might not be required. The scale of this risk seems to be important to determine whether JGN's preferred approach is likely to be in the long-term interest of consumers.

²² Ibid. p.64

²³ 2020-25 Access Arrangement Proposal, Attachment 2.2 JGN's customer engagement, p.295

²⁴ 2020-25 Access Arrangement Proposal, Attachment 2.3 engagement materials, p.647

²⁵ 2020-25 Access Arrangement Proposal, Attachment 5.1 Capital expenditure, p.7

²⁶ Ibid. p.7

²⁷ 2020-25 Access Arrangement Proposal, Attachment 2.3 engagement materials, p.648

CCP19 would be comfortable with JGN's preferred approach and consider the consumer feedback more robust if the requirement for the two new secondary mains in over 10 years from now can be shown (on reasonably objective grounds and under various scenarios including a gloomy future for the gas network) to be highly likely. This seems particularly necessary in light of the change in circumstances in the last five years that resulted in the cancellation of the planned Northern Primary Main extension.

CCP19 recommends that the AER have its technical advisor consider this issue and particularly the level of certainty that the two new secondary mains will be required in the 2030s on a range of gas demand scenarios. JGN may also provide additional information on this matter to demonstrate the high level of certainty it appears to have.

3.4.2. Aerotropolis

JGN explains that the Aerotropolis is being developed as a third city for Sydney with the Western Sydney Airport at its centre. The airport is planned to open in 2026 and will be surrounded by industrial, agricultural and residential development. By 2036, the population is expected to grow by 464,000 with an additional 180,000 dwellings. To supply gas to the Aerotropolis, JGN says that it will need to install three sections of secondary steel pipe to supply the core of the Aerotropolis, the Sydney Science Park, and the Airport itself.²⁸

JGN's proposal for the Aerotropolis network extension is set out and justified as:

For the Aerotropolis, we could either install 150mm or 250mm pipes depending on whether we took a medium or longer term approach. The larger diameter pipes will provide additional capacity and greater future proofing for further development of the Aerotropolis. But, this option would add costs and provide additional capacity that might not be required.

However, we believe that there is a high probability that the additional capacity will be used for the mains to the Aerotropolis core and airport – given the indications from NSW Government of a significant amount of industry, agriculture and new dwellings to be built.

To increase capacity in these areas, it is much cheaper to install a larger pipe now than laying another pipe later on once the area is developed.

We are less confident about the prospect of increasing loads in the region around the Sydney Science Park.

As a result, applying a mixed approach (based on customer feedback as outlined earlier) means installing a smaller diameter main to the Sydney Science Park and a larger diameter main to the Aerotropolis core and airport.²⁹

A proposal by a network business to install new capacity which is excess to the short to medium term forecast demand involves risk that the excess capacity may never be required and that nonetheless consumers bear the cost. Whilst anecdotally the new Western Sydney airport is a sound development, strongly supported by both the State and Commonwealth governments, and it appears

²⁸ JGN 2020 Plan p.62

²⁹ Ibid. p.62

likely to stimulate jobs, business and urban development, a robust case must be demonstrated for investment in capacity for the future. It might also be helpful to understand the difference in cost between the build for the long term and building for reasonably likely demand in the short to medium term so that the scale of financial risk to consumers can be understood.

JGN's comment that on building now rather than later is entirely understandable:

*To increase capacity in these areas, it is much cheaper to install a larger pipe now than laying another pipe later on once the area is developed.*³⁰

JGN considers it has consumer support for the plan to include some excess capacity in the Aerotropolis mains extensions based on consumer feedback through the pre-Draft Plan processes as well as specific feedback from the post-Draft Plan workshop.

JGN's consumer engagement, including its three phase deliberative forums held around the State, included consideration at a conceptual level of whether it should invest for the medium or longer term:

At a conceptual level, most (72%) customers expressed a preference for us to invest for the long-term to avoid future cost increases. The remainder preferred that we take a medium-term view, to reduce the chance we build assets that aren't required.

*Customers reacted strongly against the idea of doing rework, and considered it wasteful. They didn't see excess infrastructure as an issue because the spare capacity could always be used in the future. Customers drew parallels with transport infrastructure and told us they preferred projects like the Sydney Harbour Bridge – which provided long-term capacity – rather than temporary 'band-aid' solutions.*³¹

This feedback is noted as support for the Aerotropolis plans. In CCP19's view this position fits a little uncomfortably with the key message from the consumer engagement that affordability and keeping prices down. JGN seeks to reconcile this:

*Customers considered price differently. Many felt that the bill impact between the medium and long-term approaches wasn't significant on an annual bill basis, but recognised that costs added up across all customers and over time. A small number of customers asked us to prioritise the lowest-cost approach now, above all else. Others preferred that we take the medium-term investment approach as they were concerned that vulnerable customers would be left with higher bills as they would be less able to transition away from gas.*³²

The three-phase deliberative forums considered the issue of investment for the short or long term, with a presentation explaining the concept as the difference between "big pipes" and "little pipes", and setting out examples of different billing impacts to an average consumer between the two options.³³ In the later deliberative forums, they used the Aerotropolis as a specific example.³⁴

³⁰ Ibid. p.63

³¹ JGN 2020 Plan p.54

³² Ibid. p.54

³³ 2020-25 Access Arrangement Proposal, Attachment 2.3 engagement materials, p.506 &540

³⁴ Ibid. p.646

From the two deliberative forums attended by CCP19, it was observed that participants appeared to have a reasonable grasp of this issue. In the final of the three deliberative forums that was attended by CCP19, the paradox of wanting lower prices and long-term investment was raised by JGN with the participants and they mostly seemed reconciled to this. With these observations and CCP19's otherwise limited oversight of the engagement processes it seems on this issue that JGN be given the benefit of the doubt.

In the post Draft Plan workshop, the Aerotropolis options were presented and broadly supported:

We outlined in detail our strategy for the Aerotropolis and how we took into account their guidance.

53% voted in support of our mixed approach as outlined in the Draft 2020 Plan. Most customers who did not support our mixed approach told us to adopt a long term approach for all sections of the Aerotropolis, including the Sydney Science Park.³⁵

CCP19 has some difficulty with the inherent inconsistency in JGN's Plan between the foreboding demise of the gas network claimed as a basis for some proposals, and the preference for (and consumer support for) long term investment claimed for other proposals. On the Aerotropolis, CCP19, based on its limited oversight of the consumer engagement process and the documentary materials supplied by JGN, accepts that consumer feedback tends to support the proposed JGN approach. The anecdotal evidence of the prospects for development of this region also support JGN's proposal.

It would be reassuring to better understand the JGN forecasts and the cost differences between the options available to better consider the risks to consumers of JGN's proposal and so, the impact on their long-term interest.

CCP19 recommends that the AER give further consideration to the Aerotropolis forecasts and cost options, taking into account the concerns raised here.

3.5. Information Technology (IT)

IT capex has been a consistently large component of JGN's expenditure:

- 2010-15: \$142million;
- 2015-20: \$119million; and
- \$107 million proposed for 2020-25 (see Table 2 above).

³⁵ JGN 2020 Plan p.63

Table 6: IT capex by categories

Table 3-20: Information technology capex (\$2020, Millions, excluding overheads)

	2015-20		2020-25
	Allowance	Actuals/estimate	Forecast
Maintain	131.6	119.1	101.4
Cost benefit	0.0	0.0	0.0
Compliance	11.4	0.1	0.0
Customer	4.6	0.3	5.8
Total	147.6	119.5	107.2

Table 3-21: Recurrent and Non-recurrent Information technology capex (\$2020, Millions, excluding overheads)

	2015-20		2020-25
	Allowance	Actuals/estimate	Forecast
Recurrent	91.7	59.3	79.5
Non-recurrent	55.9	60.1	27.7
Total	147.6	119.5	107.2

Source: 2020-25 Access Arrangement Proposal, Attachment 5.1 Capital expenditure, p.33

This is a category that JGN materially underspent its allowance in the current regulatory period – particularly in the category “recurrent” expenses. The 2020-25 proposal sees the recurrent expenses materially higher than the current period.

The IT expenses of network businesses are notoriously hard to assess as to their reasonableness and their benefit to the long term interests of consumers. However, they are significant, representing more than 10% of JGN’s proposed capex. While we can examine in some detail the appropriateness of expanding a pipeline or carrying out rehabilitation that may have much lower impact on the RAB, IT costs remain an enigma. This is an ongoing matter of concern for the CCP as a whole.

3.6. Speculative capex

JGN highlights the global and Australian move toward zero carbon as a challenge and threat to its gas network business. It points to the Commonwealth government’s commitment to the Paris climate agreement and the NSW government’s aspirational target of zero carbon emissions by 2050.

JGN sees a risk that the gas network may become unviable:

*Uncertainty around the future of our gas network in a zero-carbon future makes planning difficult. This is because we don’t know who will be using gas and how they will be using it in 2050. For example, will we continue to supply natural gas as we do now, or might we have made the transition from methane to hydrogen? Or will new customers stop connecting to gas? Will the gas network service a declining base of existing customers?*³⁶

JGN is also investigating an opportunity that may transform the gas network for a zero-carbon future with its ‘Western Sydney Green Gas Trial’ (‘Green Gas Trial’) project which will split water to produce hydrogen and inject it into our network to replace UAG.

³⁶ JGN 2020 Plan p.31

JGN optimistically notes that:

other gas networks in Australia and abroad are exploring hydrogen as a potential alternative energy source to natural gas that is predominately methane based. We consider the exploration of how existing gas networks can integrate hydrogen into their systems is now consistent with a prudent service provider acting efficiently, in accordance with accepted good industry practice. This is evidenced by similar trials/pilots being delivered by our peer networks Australian Gas Industry Group, ATCO Gas and Evoenergy.³⁷

This activity across the global gas network industry is commendable in seeking to support a zero-carbon environment and provide consumers with greater long-term certainty which will help control the costs of gas supply and maintain service to consumers.

The cost of this project is being borne by JGN, although if the project is successful, JGN intends to apply for it to be include the Regulated Asset Base (RAB) so that consumers will pay for it.³⁸

³⁷ 2020-25 Access Arrangement Proposal, Attachment 5.1 Capital expenditure, p.46

³⁸ Ibid. p.47

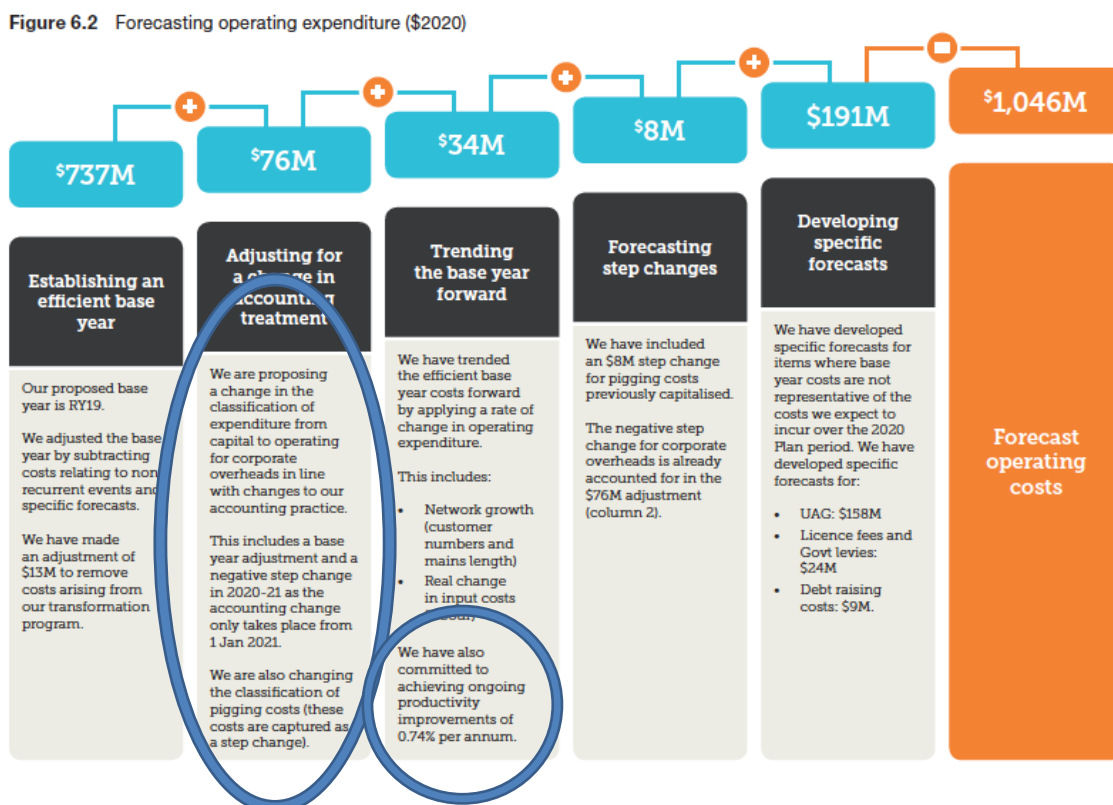
4. Operating Expenditure (Opex)

4.1. Introduction

JGN has forecast its opex for the 2020-25 period using the AER’s preferred forecast method, ‘base, step, trend’. The method forecasts future operating expenditure using a ‘base’ year – where the operating costs are representative of the efficient costs necessary to operate and maintain the network and meet regulatory obligations. They then make specific adjustments for identified issues.

This process is demonstrated in the following JGN figure:

Figure 6: JGN opex forecast



Source: JGN 2020 Plan p.72

Overall the opex proposal, being consistent with the AER “base, step, trend” approach, appears reasonable. CCP19 makes some comments on the two circled items in the following sections.

4.2. Accounting changes

JGN proposes change to the way it treats corporate overheads and pigging costs. Currently a percentage of corporate overheads and the full cost of pigging are categorised as capital expenditure and therefore, added to the RAB and recovered from consumers over the long life of network assets. JGN proposes that from January 2021 these costs be treated as operating expenses and therefore be recovered from consumers in the regulatory period of the expense.³⁹

JGN provides a set of reasonable and plausible justifications for the change, just as the status quo is supported by some reasonable and plausible justifications.

³⁹ Ibid. p.74

4.2.1. Corporate overheads reclassification

CCP19 understands that some gas network businesses capitalise part of their overheads and there may be a consideration of consistency in assessing this proposal. That said, JGN advises that this approach to allocation of corporate overheads has been adopted by its related electricity network company, Jemena Electricity Networks (Vic) Ltd (JEN), and that this was approved by the AER in May 2019.⁴⁰

JGN notes that the ECA submission on its Draft Plan asked for more explanation on why the proposal to expensing corporate overheads is in consumers' interests when it will increase charges in the short term.⁴¹ JGN explains how it believes that the change to treatment of corporate overheads (and pigging, discussed in the following section) is in the interests of consumers:

*We recognise that changing the treatment of these costs places upwards pressure on customers' bills in the short term. However, the additional operating expenditure is offset by our program to deliver operating cost efficiencies (see section 6.4). Additionally, as this change reduces our capital expenditure, it will result in a lower asset base which will lead to lower overall bills for our customers over the long term. This is because we do not earn a return on operating expenditure. This approach is consistent with our strategic initiative to balance customer outcomes now and into the future, and is also consistent with the feedback we heard from customers around fairness, in the short and long term.*⁴²

JGN's explanation of how customer feedback on fairness in the short and long term may be a little tenuous. However, CCP19 can see some merit in the argument that the immediate increase in opex is offset by the productivity dividend proposed (see section 4.3 below).

It may also be beneficial to make this change now, while the business is subject to historically low interest rates (therefore, rates of return) which are delivering lower network costs to consumers in 2020-25 period, before those rates increase and cause higher costs to be incurred by consumers.

CCP19 can see a reasonable basis for the case that this change is likely to deliver long term benefits to consumers.

4.2.2. Pigging cost reclassification

The internal integrity testing of certain high-pressure gas pipelines using a device (a "pig") that travels along the interior of the pipe is required from time to time. To date, JGN has added the cost of undertaking these tests to the regulatory asset value of the pipeline pigged. JGN says the reclassification will more accurately reflect the nature of the activity as pigging does not result in an extension to the pipeline asset life and that in the 2020-25 period it will add approximately \$8million to opex.⁴³

JGN considered this change to be in the long-term interests of consumers for the same reason as quoted above in respect to corporate overheads being reclassified.

⁴⁰ 2020-25 Access Arrangement Proposal, Attachment 6.1 Operating expenditure, p.11

⁴¹ Ibid. p.2

⁴² JGN 2020 Plan p.74

⁴³ Ibid. p.74

On the same grounds that CCP19 sees a reasonable basis for the case that reclassifying corporate overheads as opex, we consider that the reclassification of pigging is likely to deliver long term benefits to consumers.

4.3. Productivity improvements

JGN is currently implementing a business-wide transformation program, which aims to reduce its operating-cost base. The program commenced in 2018 and will deliver benefits of approximately \$8 million per annum. JGN says that the cost reductions achieved through this program will be well in excess of the implementation costs of approximately \$13 million and that these benefits should be incorporated into our base year (2018-19) for the purpose of forecasting its operating expenditure requirements over the five-year 2020 Plan period.⁴⁴

In the JGN Plan, the business is committing to make a 0.74% per annum saving in its operating costs over the 2020-25 period. This represents a saving to consumers of approximately \$19 million over five years.⁴⁵

JGN derived this efficiency gain measure based on advice from Economic Insights (EI)⁴⁶ who benchmarked JGN against other Australian and New Zealand gas distribution businesses using AER's preferred benchmarking techniques.⁴⁷

JGN notes that:

EI's analysis indicates that an efficient gas network business is expected to achieve productivity improvements averaging 0.74% per annum. This compares to the 0.5% per annum opex productivity growth factor supported by the AER in its Final Decision on 'Forecasting productivity growth for electricity distributors', dated 8 March 2019.⁴⁸

JGN had committed in its Draft Plan to an efficiency gain of 0.5% which JGN reports that the ECA, in its submission, sought further justification for the level of gain proposed.⁴⁹ The subsequent work by EI and JGN's preceding comment appear aimed to address this query.

The CCP is always cautious in accepting cost reduction plans proposed by network businesses with the concern that these might not be as deep and challenging as may be possible. CCP19 notes JGN's effort to introduce a level of objectivity to its proposed efficiency gain, and that it measures favourably against the AER's report on electricity distributors' productivity growth. Whether more might be achievable may be very difficult for those outside JGN to readily assess.

However, JGN's cost management achievements in recent years and the plan to deliver further reductions in opex over the 2020-25 period are certainly in the long-term interests of consumers.

⁴⁴ Ibid. p.75

⁴⁵ Ibid. p.76

⁴⁶ 2020-25 Access Arrangement Proposal, Attachment 6.4 Relative efficiency and forecast productivity growth of JGN

⁴⁷ 2020-25 Access Arrangement Proposal, Attachment 6.1 Operating expenditure, p.9

⁴⁸ Ibid. p.9

⁴⁹ Ibid. p.2

4.4. Marketing

4.4.1. JGN comments regarding marketing opex

JGN sets outs.⁵⁰

Natural gas is a fuel of choice in NSW and competes with electricity and other fuels.

With the warmer NSW climate natural gas must be competitive to attract new customers and encourage them to purchase additional natural gas appliances, particularly for services such as heating. Marketing research tells us that potential customers see the upfront costs of purchasing and installing new natural gas appliances as barriers, particularly when they have many alternatives such as reverse cycle air-conditioning and induction cooktops. Incentive rebate programs have proven to be a highly effective strategy in addressing this barrier and can be targeted to influence customer behaviour by helping them with the upfront costs of buying new natural gas appliances.

Our marketing program is focussed on encouraging the sale and installation of natural gas appliances by establishing natural gas as a highly desirable energy option. It does this by promoting natural gas and working with alliance partners to promote the sale of gas appliances via incentive payments.

Marketing promotes greater utilisation of our network, which helps to lower prices for our customers.

JGN also noted.⁵¹

PIAC expressed concern regarding the use and implementation of rebates and incentives to encourage the purchase or replacement of gas appliances, noting that households may choose to purchase lower-efficiency gas appliances because of the rebates.

Overall, PIAC stated in its submission to the Draft Plan:

PIAC does not consider that expenditure on the marketing of gas or the provision of appliance rebates is necessarily in the long-term interests of individual consumers.

4.4.2. Previous regulatory decisions

In the decision-making processes for the current regulatory period, for 2010-2015, the CCP sub-panel at the time (CCP7) did not take a firm stance on whether marketing costs should be allowed by the AER, but left it to AER discretion.⁵²

We believe the AER should consider whether the proposed marketing expenditure is prudent. Will it provide overall benefits for existing customers and for new customers?

In the event, the AER did approve an allowance for marketing.

The decision-making on the Victorian gas distributors' proposals for 2018-22 was complicated by the fact that one of the three Victorian gas distribution businesses (AGN) already had an allowance for

⁵⁰ JGN 2020 Plan p.70

⁵¹ 2020-25 Access Arrangement Proposal, Attachment 6.1 Operating expenditure, p.2

⁵² CCP - Subpanel 7 - Advice on Jemena Gas Network access arrangement review - 3 September 2014, p.10

marketing in its 2013-17 access arrangement, but the other two businesses (AusNet and Multinet) did not. All three businesses proposed a step change in operating expenditure to undertake a joint gas marketing campaign in Victoria in 2018-22.

CCP11 considered in some detail the requests from the Victorian distributors for step changes in their marketing allowances for 2018-22, covering a wide range of views from stakeholders.⁵³

The CCP11 advice included the following statements:

Marketing of gas and provision of appliance rebates may not be in the long term interests of individual consumers under these circumstances.

By its nature, the proposed marketing campaign in large part represents a transfer of wealth (or cross subsidy) from one group of Victorian residential gas consumers to another. It is therefore imperative that the proposed expenditure by each network business has the support of its residential customers.

These proposed marketing step changes should be considered in the light of recent regulatory decisions. Regulated gas distribution businesses that have carried out marketing and had their allowances approved by the AER and the ERA in the last five years include JGN, ATCO Gas, AGN, Allgas and ActewAGL. Marketing allowances have now been approved for regulated gas network businesses in all other Australian jurisdictions, and are included in their base year expenditures. Marketing may now be considered to have become a standard business cost for gas businesses.

... from a customer perspective, we suggest that the AER should consider whether it is prudent to encourage new customers to connect to the gas network, and existing customers to renew gas appliances, at a time when wholesale gas prices, and hence retail gas prices are predicted to rise substantially.

Marketing is not a regulatory obligation, and expenditure on marketing does not directly relate to the provision of a safe, reliable and efficient supply of energy to consumers. Consequently, there is a need for proposed expenditure on marketing to be subject to additional scrutiny. Consistent with the opinions expressed by consumer representatives, we are not yet convinced that such expenditure is prudent.

The AER's Draft Decisions did not include marketing step changes in opex allowances for any of the Victorian gas distribution businesses, on the basis that the businesses had not made a case for marketing being a step change, rather than being in opposition to a marketing allowance per se. All three businesses accepted the Draft Decisions rejecting the marketing step changes.

4.4.3. CCP19 advice on JGN's current proposal

We again suggest that the AER should consider whether it is prudent use of opex to encourage new customers to connect to the gas network.

⁵³ Subpanel 11 - Response to proposals from AGN, AusNet and Multinet for the 2018-2022 Access Arrangements - 3 March 2017, pages 55-61

5. Depreciation

5.1. Introduction

JGN proposes accelerating the depreciation of:

- Network assets including high pressure pipelines, medium pressure pipelines and services, and metering assets; and
- Capex for past pipeline pigging.

The acceleration of depreciation of assets has the effect of increasing the cost to consumers in the short term, and reducing it in the longer term.

5.2. Accelerated depreciation of network assets

5.2.1. JGN's proposal

The following table shows the changes to depreciation proposed by JGN. The changes are proposed to apply only to new assets added to the network from 1 July 2020.

Table 7: Proposed changes to asset lives

Table 7.3 Proposed changes to asset lives for new investments

Asset Class	Current standard lives (years)	Proposed standard lives for new investment (years)	Percentage of capital expenditure in asset class compared to capital program as a whole
Trunks	80	50	0%
High pressure mains	80	50	13%
Meters/meter reading devices	20	15	21%
Medium pressure mains	50	30	15%
Medium pressure services	50	30	32%

Source: JGN 2020 Plan p.84

JGN says that the revenue impact of changing these asset lives is \$22 million in the 2020-25 period.⁵⁴ This means consumers gas bills must increase to recover this additional amount in the next five years and additional amounts for every year following for the new life of these assets.

JGN justifies these changes based on the potential that in a low-carbon energy future, natural gas is no longer a viable energy source:

...it is possible that our network will no longer be viable beyond 2050. Should this happen, we are likely to see customers disconnect from our network in great numbers, meaning that there will be fewer customers over which to spread our largely fixed costs. The customers remaining on the network at this time are likely to be those who are constrained in their ability to switch technologies. This may be due to cost constraints or for practical reasons. This raises an issue of fairness, as those customers who are less able to afford price increases would have price increases imposed on them with little capacity to respond.

⁵⁴ JGN 2020 Plan p.84

Table 8 below shows that the proposed new assets lives benchmark against other gas networks as consistent or somewhat consistent on some assets, and as notably shorter in the case of medium pressure mains and services.

Table 8: Asset lives benchmarked

Table 4–3: Benchmarking standard asset lives

Asset Class	JGN current standard asset lives	JGN proposed standard asset lives 2020-25	AGIG (SA) 2016-21	EvoEnergy (ACT) 2016-21	MultiNet (Vic) 2018-22	AGIG (Vic) 2018-22	AusNet Services (vice) 2018-22
Trunks	80	50	60	80	50	60	60
High pressure mains	80	50	60	80	50	60	60
Meters/meter reading devices	20	15	15	15	15	15	15
Medium pressure mains	50	30	60	50	50	60	60
Medium pressure services	50	30	40	60	60	60	60

Source: 2020-25 Access Arrangement Proposal, Attachment 7.10, Proposed changes to asset lives for new investments p.23

Table 9 below shows the current status of the remaining life of each asset class in JGN’s RAB.

Table 9: Remaining asset lives

Table 5–1: Proposed changes to standard asset lives compared to equivalent remaining asset lives

Asset Class	Current standard asset lives (years)	Current remaining asset lives (years)	Proposed standard lives for new investment (years)
Trunks	80	35.9	50
High pressure mains	80	49.2	50
Meters/meter reading devices	20	8.2	15
Medium pressure mains	50	23.8	30
Medium pressure services	50	37.2	30

Source: 2020-25 Access Arrangement Proposal, Attachment 7.10, Proposed changes to asset lives for new investments p.28

Based on the remaining assets lives, without new investment, much of the current RAB will be depreciated away by 2050.

JGN also sets out a range of options it considered as alternatives to reducing asset lives to mitigate risk of being unable to fully recover its investments beyond 2050:⁵⁵

- Compensating asset recovery risk with a higher rate of return;

⁵⁵ 2020-25 Access Arrangement Proposal, Attachment 7.10, Proposed changes to asset lives for new investments p.14

- Reducing service levels to reduce capex;
- Scale back marketing and growth opportunities;
- Accelerating depreciation of all existing and new assets;
- Increase customer contributions by a new charge for new connections (thus reducing new connection capex);
- Innovating to prove and ready the network for a low carbon future; and
- Charge a network exit fee for customers who disconnect early.

JGN dismisses all these, except for the innovation option which it is pursuing, for reasons that are robust including that they are not possible under the NGL or are contrary to consumer interests and feedback.

5.2.2. JGN's consumer engagement

Through its engagement process, JGN addressed the issue of reducing asset lives expressly with consumers. JGN summarises the outcome of this processes as:

Most customers voted in favour of a change to the asset lives. Customers told us that they want us to take a proactive approach to managing future uncertainty and to minimise any negative customer consequences. They saw this as a way for current customers to do a little bit now to protect future generations from much more significant price implications.⁵⁶

JGN also points out in relation to customer support for accelerated depreciation that this was expressly considered with the concept of investing for the future (this is discussed above in Section 3.4.2 relating to investing in excess pipeline capacity) and when the combined bill impact of these two measures was explained to participants, “very few changed their view”.⁵⁷

In the three-phase deliberative forums held around NSW, there was a good level of support for the change as the following table shows.

Table 10: Deliberative forum support for accelerated depreciation

Table 7.4 Customer support for change in asset lives at deliberative forums

	Goulburn	Griffith	Western Sydney	Bathurst	Newcastle	Total
Voted for the change in asset lives	12	7	14	15	17	65 (81%)
Voted against the change in asset lives	4	4	3	3	1	15 (19%)

The following is extracted from the speaker notes on this issue for the second of the three deliberative forums held in the locations shown in Table 10 and for Workshop 2 of the over 55's study circle (low income) held in Parramatta.

*QUESTION 1: With the uncertainty about whether our pipes will actually be used beyond 2050, **would it be fairer** [emphasis added] for current customers to pay more for new investments we make on the network relative to future customers?*

⁵⁶ Ibid. p.84

⁵⁷ Ibid. p.84

BACKGROUND: Many of our gas assets – particularly the gas pipes – won't deteriorate for around 50. They are made of long-lasting plastic. However, there is uncertainty about whether people will actually use gas in 50 years from now. Therefore, we are considering whether to recover the cost of new investment in gas pipes faster than we have in the past – for example 30 years instead of 50 years. This would mean that bills would rise over the next 30 years – around \$7 per annum on average over the next 30 years. The alternative is that we wait until some point in the future when we are clearer about whether the assets aren't going to be used if that turns out to be the case, and only then move to a faster recovery. This would prove to be the right decision where the pipes did end up being needed beyond 30 years, because we wouldn't need to move to that faster recovery charging the additional \$7. However, if they end up being not used, this might result in future customers receiving a more significant price increase as we move closer that time, because we need to rush the recovery into a shorter period. If this was 10 years, we estimate an additional increase of \$20 per annum over those 10 years to cover the catch-up. With the different impacts on current and future customers, thinking on behalf of the community and both current and future generations, what is fairest way of addressing this uncertainty in whether our pipes will be used into the future in terms of how we recover our investment costs?⁵⁸

CCP19 attended one of the second deliberative forums where this was presented and the Parramatta over 55's forum and observed the presentation to be much as set out in the script above.

This issue of accelerating depreciation was discussed under the overarching topic of “fairness” setting the tone for considering the issue. The speaker notes following describe the session on fairness which preceded the discussion of depreciation:⁵⁹

The aim of this session is to provide information that customers asked for that relates to fairness.

Many of the decisions we make affect how fair things are, particularly around issues of who pays and how. There are many regulatory rules which tell us what we can and can't do.

We'd like you to help us understand what you believe is fair. What does this group believe is fair? We know from last week that this question is too big, so we have split it into four different ways to look at fairness.

You also asked last week for some examples of fairness – on your table there is a diagram showing three kids at a sports game.

The diagram shows that EQUALITY – treating everyone the same – doesn't necessarily mean FAIR: EQUITY is about making sure everyone has access and that may mean different things for different people. We also have a table which tries to demonstrate a Market Justice versus Social Justice Model.

It is understandable that to have a discussion with people new to concepts like depreciation that some framing or context is required. However, the concept of fairness for many people will be morally and ethically charged, so may dispose them to want to appear like “good” people and to err on the side of what they think is “generosity”.

⁵⁸ 2020-25 Access Arrangement Proposal, Attachment 2.3 engagement materials, p.318, 333, 358, 603

⁵⁹ Ibid. p.317

The feedback from the Goulburn forum on Question 1 above is recorded as:

Within Goulburn forums, most customers and table groups responded that yes, it would be fair (19 comments recorded). Next most frequent comment in relation to this question was around more information required to make this decision. Several people indicated there were renewables or alternative energy sources to be considered, and fewer responses indicated they were unsure, and the question is complex. Only one person indicated no.⁶⁰

Clearly some participants observed on the complexity of the issue and thought that more information would have been good. The following summary from the Western Sydney forum's consideration of Question 1 similarly qualifies the feedback:

With this group, many agreed that yes it would be fairer for current customers to pay more. Many participants also wished to have more information prior to making the decision, and many had a comment about future energy sources and the network use. Two indicated that no, it wouldn't be fair. Several other comments were made about being unsure, the complexity of the topic and future supply.⁶¹

From the two sessions attended, CCP19 noted that participants appeared be aware of the inconsistency of their key desire for lower energy costs contrasted to their support for long term investment and accelerated depreciation (both of which increase their gas bills).

This proposal to accelerate depreciation was also expressly considered by the consumer forum held following publication of the Draft Plan in January 2019 where in the context of fairness, it was strongly supported:

We outlined how we had responded to feedback on the key theme of fairness, highlighting that we had incorporated our proposal to the change the asset lives into our plans. We then asked our customers to vote on how well we had responded to their feedback. A significant majority (78%) of customers considered that we had responded very well or quite well to their feedback on the key theme of fairness. Additionally, 90% of our customers strongly or moderately agreed that our Draft 2020 Plan was in their long-term interests.⁶²

5.2.3. Our conclusion

CCP19 has concerns with the proposed accelerated depreciation. For a start it will increase costs to consumers in the short term, at a time when energy affordability is a major community issue and against the feedback from JGN's consumer engagement that affordability is key. The move also appears counter to JGN's apparent confidence in the future with its plans to build excess capacity for the long term.

In CCP19's view, the move may be warranted for the reasons proffered by JGN, but it might be a question of timing. In the future, there should be greater certainty about the longer-term prospects for the gas network. As JGN observes, this should be clear in about ten years:

⁶⁰ 2020-25 Access Arrangement Proposal, Attachment 2.2, JGN's customer engagement p.235

⁶¹ Ibid. p.238

⁶² JGN 2020 Plan p.85

*We expect to have a clearer picture of the future of the gas network in the 2030s. This is when we think we will have a better idea about the feasibility of using hydrogen - a zero emissions alternative - in our network.*⁶³

CCP19 acknowledges that through a thorough consumer engagement process JGN has received feedback supporting its proposed acceleration of depreciation. From the speaker notes quoted above, it seems that the possibility of delaying this move to when there is greater certainty about the future of the network was raised with some of the forums. But the only option apparently raised was to “rush” the recovery over a 10 year period, where it would add \$20 per year to each gas bill instead of \$3 per year if it is done now.⁶⁴ Would consumers have been comfortable with a sum determined in 2025 or 2030, which might have been less than \$10 per year?

It also seems apparent that participants had some difficulty with the complexity of the issue and the level of information they had and in such a circumstance CCP19 thinks that one might err, in the context of a discussion of “fairness”, to want to be generous to future gas consumers.

Although CCP19 considers that it is not the right time to make a call on the future of the gas network and that consumer support might have been explored in a more granular fashion, there may be a case for changing the asset lives of meters and metering services from 20 to 15 years bringing them in line with all other gas networks. Metering capex represents around 16% of proposed capex in the 2020-25 period so by aligning its asset lives to other networks consumers will pay a small additional amount on their bills (as they have said they are prepared to) and the catch-up in the future if asset lives must be reduced, will be lower. This may be a sensible balance of the short term cost (in a period when low interest rates are helping reduce network costs to consumers), and the long term interests of consumers.

CCP19 acknowledges the support for this proposal from JGN’s consumer engagement, however considers that notwithstanding the consumer sentiment it would not be in the long-term interests of consumers to implement the proposed accelerated depreciation until there is greater certainty as to the demise of the gas network. CCP19 suggests that the AER look at the cost of acceleration of depreciation of all future metering assets, and allow alignment of JGN’s life for these assets with other gas networks with the peripheral benefit of reducing the impact on consumers in the future should asset life acceleration be considered necessary to address the demise of the gas network.

5.3. Accelerated depreciation of pigging capex

JGN proposes accelerating the depreciation of high-pressure pipeline internal inspections (undertaken by intelligent pigs) which are currently included in the regulated asset base. These inspections currently have a 72-year remaining asset life which JGN proposes to reduce to 5 years so that they will be fully depreciated by the end of the next regulatory period. The proposal will add \$15 million to the revenue required to be recovered from consumers in the 2020-25 period. JGN states

⁶³ Ibid. p.31

⁶⁴ 2020-25 Access Arrangement Proposal, Attachment 2.3 engagement materials, p.318

that accelerating the depreciation of these assets, so that they are fully depreciated by 2024-25, will better reflect the usage of these assets.⁶⁵

This change is consistent with the proposed change of treatment of pigging costs moving them from capex to opex which change CCP19 considers reasonable (see Section 4.2.2).

This change will result in an increase in cost to consumers in the 2020-25 period. However, this is in the context of a reduction in the network prices to consumers in the same period (around \$150 for a typical residential customer).⁶⁶ In this context, it may be a beneficial to free future users from this relatively small item in the RAB, and provide consistency with the future treatment of this cost as opex.

CCP19 sees a reasonable basis for the case that this change is likely to deliver long term benefits to consumers.

⁶⁵ Ibid. p.85

⁶⁶ Ibid. p.iv

6. Reference Service Agreement

Retailers at the public forum on 7 August 2019 commented that they had some concerns with the Reference Service Agreement proposed by JGN. We have not reviewed the Reference Service Agreement, and we likely do not have the skills that retailers would have to review this document critically.

We may however have views on whether changes proposed are in the long-term interests of consumers. If a forum is being held between retailers and JGN to discuss this document we would consider attending if invited as observers to consider the interests of consumers in any discussion / negotiation between retailers and JGN.

7. Capital Expenditure Sharing Scheme (CESS)

In its Draft Plan, JGN indicated that it believed that a CESS is in the long term interests of consumers as it would help JGN to further improve its efficiency, keeping a downward pressure on bills. It noted that the approach developed by the Victorian gas businesses and accepted by the AER may be a starting point to develop a CESS for its network.

JGN subsequently published a CESS consultation paper⁶⁷ which explained the design of its proposed CESS, and held a deep-dive workshop on the CESS which we attended along with other stakeholders in April 2019. JGN has described this CESS workshop as its richest source of CESS feedback.⁶⁸

As we presented in the public forum on 7 August 2019, we are pleased that subsequent to the workshop JGN has acted on feedback to remove connections from the scheme as these are not under the control of JGN, and to change weightings of elements of the scheme.

We favour incentive schemes in principle, provided they do truly incentivise a regulated business to produce outcomes that are most in the long-term interests of consumers. In regard to this CESS, as we presented on 7 August 2019, we are particularly concerned that the scheme should embody stretch targets for the business to achieve beyond what it would otherwise be expected to achieve, and should not reward efficiencies that should be captured in the base capex allowance.

⁶⁷ The consultation is provided as Appendix A to JGN's Attachment 7.11 Incentive Schemes

⁶⁸ JGN's Attachment 7.11 Incentive Schemes, p.5