Consumer
Challenge
Panel

CCP24 Advice to Australian Energy Regulator on

Australian Gas Networks Final Plan

for AGN Gas Networks (South Australia) Access Arrangement

July 2021-June 2026

Consumer Challenge Panel (CCP) Sub-Panel CCP24

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Acknowledgements

CCP24 wishes to acknowledge the cooperation and support of Australian Gas Network (AGN) and AER staff, and the AGN SA reference groups, both customers and retailers who have generously provided information and insights to assist the sub-panel in its review of the business's Final Plan.

We also advise that to the best of our knowledge this report does not present any confidential information.

1. Introduction

This Statement of Advice is provided to the Australian Energy Regulator (AER) from Consumer Challenge Panel, sub-panel 24 (CCP24) in response to the Australian Gas Networks (AGN) 2021-26 Access Arrangement Proposal (AAP) for the South Australian gas network, which was submitted to the AER in June 2020.

Australian Gas Networks is the energy network business which is a part of the Australian Gas Infrastructure Group (AGIG) which owns and operates the regulated electricity distribution network in South Australia. Every five years, AGN is required to submit an Access Arrangement Proposal to the AER for its gas network, setting out the proposed services, as well as the network investments, revenue and the prices required to deliver gas distribution services for the next period. For the 2021-26 revenue period, AGN refers to its plan as the Final Plan.

CCP24 notes that the Final Plan has been prepared in a time of heightened uncertainty and significant challenge. AGN, along with other gas distribution network businesses, faces fundamental questions about the future of the gas network, driven by jurisdictional governments moving towards net zero emissions policies in a timeframe considerably less than the asset lives of a significant part of the business's asset base.

In addition, the effects of the COVID-19 pandemic began to impact on Australian businesses from March 2020. While AGN had made substantial progress towards preparation of its Final Plan by that time, some activities including important consumer and stakeholder events were affected. COVID-19 is expected to have a longer-term impact on the Australian economy with negative consequences for business viability and unemployment levels in many sectors. It is anticipated that difficulties in paying utility bills will continue for both residential and small business consumers. In this environment, a strong focus on affordability for small customers is more important than ever.

The full effects of the COVID-19 pandemic are not able to be predicted at this stage. CCP24 will be highlighting the need for agility to be displayed by both businesses and regulators in dealing with the changing environment. Clearly the forecasts which underpin the AGN Final Plan, including demand, labour cost, and connections forecasts will require regular review. It is highly likely that consumer and stakeholder perspectives will also change as a result of ongoing events, and continuing engagement with consumers and stakeholders, potentially in the absence of face-to-face engagement, is essential to ensure that business responses continue to match evolving consumer needs. Section 15 of this Advice deals with responding to the pandemic and approaches that we think are appropriate to deal with the uncertainty.

Note: As in the Final Plan, all financial information in this report is presented in real 2020-21 dollars.

2. Summary of CCP24 advice

This Advice from CCP24 deals with three broad themes, as well as considering much of the detail of the AGN Final Plan. These themes are:

1. Uncertainty regarding the future of gas, which includes the risk of customers paying for stranded assets, as well as consideration of a renewable future for gas, specifically through hydrogen as the gas for longer term future reticulated supply.
2. Impacts of COVID-19 and associated uncertainty.

3. Consideration of the AGN objective of lodging a proposal that is 'capable of acceptance.'

The Advice includes sections on each of these topics, but these are also themes that weave through all aspects of our response to the AGN AA proposal.

In considering this Access Arrangement proposal our opinion is that the overarching approach to high levels of uncertainty should be to talk a lot more and only commitment when absolutely necessary. This means that ongoing discussions about the latest developments and the difficulties brought about through uncertainty should be held between consumer interests, network businesses, policymakers, and regulators. In short, consumer and stakeholder engagement is more important than ever.

Consumer Engagement

We conclude that AGN has engaged with a diversity of their customers, has actively listened, and acted on the advice given and preferences expresses by customers. It was an extremely high quality, well implemented engagement strategy, and is continuing. AGN has effectively incorporated consumer and stakeholder input into their Final Plan and has documented their responses to consumer advice very clearly.

Future of Gas

We are generally supportive of the approach that AGN has taken to Future of Gas issues and recognise the leadership that they are playing nationally.

We also conclude that the current rules were developed at a time when Governments were supporting the expansion of gas consumption, and supporting consumers having a choice in their energy supply. The rules were designed to drive efficient asset utilisation and efficient pricing. As we examined the rules for our Draft Plan Advice to the AER it became unclear how much they might be able to cope with the transition to a zero-emissions policy world.

So we recommend that a wider stakeholder review be led by the AER or the AEMC to enable all stakeholders to consider the complex policy options and discuss some of the issues that should be considered in that review which should then inform consideration of the gas rules, given the rapidly changing circumstances for gas.

Capable of Acceptance

In this Advice we identified 5 aspects of the AA proposal that are pending further action:

1. Consumer engagement regarding the market expansion issues and associated stranded asset risk.
2. AGN delivering the commitment to further engagement regarding the proposed vulnerable customer strategy, up to the per customer cost ceiling supported during phase 2 and 3 engagement as well as some demonstrated AGN contribution.
3. AGN delivering the commitment to further engagement regarding the proposed innovation strategy and innovation allowance.
4. Review of the proposed productivity factor by AER.
5. Reasonable revisions of demand forecasts based on further understanding of COVID-19 impacts.

We conclude that if:

- AGN delivers on these commitments outlined above – based on past performance and recent discussions with AGN we expect they will, and
- AER's review of the Final Plan shows that it meets all of the AER rules requirements,

then we believe the AGN AA proposal is capable of acceptance.

3. Context for this AA proposal

The context in which AGN has lodged their regulatory proposal for the 2021-26 period is important and we identify some of the key factors impinging on this regulatory process.

Future of Gas

A number of Australian States and Territories have aspirational policy objectives of zero net emissions to be achieved by around 2050 to accord with Paris targets. It remains to be seen how soon they translate that into legislation such as the ACT Government has enacted, and then set out a detailed pathway to achieve the target - which the ACT Government is expected to do in the next year, if it is re-elected later this year. For AGN, and the SA Government there is a stronger interest in hydrogen as the future renewable reticulated gas. The path to this potential future is still in relatively early stages of development and so there is uncertainty about this future option.

AGN Leadership

Through our engagement with AGN we have been impressed by the national level leadership role that AGN is playing, in particular for the development of a potential hydrogen future. AGN action has already included:

- A hydrogen feed-in trial at Tonsley part in the southern suburbs of Adelaide;
- Installation of an electrolyser and Hype SA (Hydrogen Park SA);
- Part of tender to 'buy' future hydrogen;
- Recipient and applicant for funding through ARENA projects; and
- Active collaborator with other gas businesses and research.

AGN is also an active participant in the Energy Charter and is providing leadership to that process.

Natural Disasters

Nationally, years of drought have left many rural Australian communities struggling emotionally and financially which has impacted on the capacity of some to be able to meet their electricity costs. The drought impacts were seriously exacerbated in many regions, including parts of South Australia by the dreadful fires over the spring and summer of 2019-20. Energy businesses across Australia have rallied strongly to support impacted households, producers and businesses.

How to respond in uncertain times?

We recognise that this Access Arrangement proposal is being considered in a period of unprecedented uncertainty due to the Covid 19 virus and further complicated by policy uncertainty about the role of gas in a de-carbonised energy future with a hope of a hydrogen future for reticulated gas.

In considering this Access Arrangement proposal our opinion is that the overarching approach to high levels of uncertainty should be to talk a lot more and only commitment absolutely necessary.

This means that ongoing discussions about the latest developments in the difficulties of uncertainty should be held between consumer interests, network businesses, policymakers and regulators. In short, consumer and stakeholder engagement is more important than ever.

Dramatically heightened uncertainty also means that decisions about expenditure for the future should be pared back as much is possible so that future expenditure decisions can be made at future times when it is reasonable to expect a somewhat improved climate of predictability.

4. Summary of AGN's Access Arrangement proposal

The table summarises the main features of the Final Plan and the changes since the Draft Plan.

	Current Period		2021-26	
	Final Decision	Forecast	Draft Plan	Final Plan
Total revenue (smoothed excl ARS nominal)	$985.5m	Not provided	$1,162.3m	$1,136.4
Net Capex $20/21		$599.3m	$579.4m	$578.8m
RAB at end of period vs end of current period ($20/21)		$1,769.3m	$2,120.7m	$2,075.9m
Opex ($20-21)	$363.6m	$330.5m	$353.6m	$357.4m
Connections - residential + commercial (end of period)		463,883	496,981	490,692
Average annual consumption residential GJ/yr (end of period)		15.5	14.1	13.9
Total gas usage (PJ)			20.4	19.2
Price path for network charges – weighted average	21.6% cut in year 1 then 6.3% per year (nominal)	Same	7.9% real price cut in year 1 then CPI	8.7% real/7% nominal price cut in year 1 then CPI increases

Figure 1. Source: AGN Draft and Final plans

The main changes since the Draft Plan have been the lower customer numbers and the lower average consumption per customer, and hence total gas consumption. Consumption is falling faster than earlier forecasts. This is both a sign of the future and the key risk for both network and customers.

5. Consumer Engagement

In early 2019, about 18 months before the Access Arrangement proposal was due to be lodged with the regulator, AGN set out its four stage strategy for consumer engagement as indicated in the diagram below, which is taken from the Access Arrangement proposal but could just as readily have been taken from the Draft Plan or from any of the presentations made to the South Australian reference group (SARG) or the forums conducted during consultation events. The strategy was applied consistently.

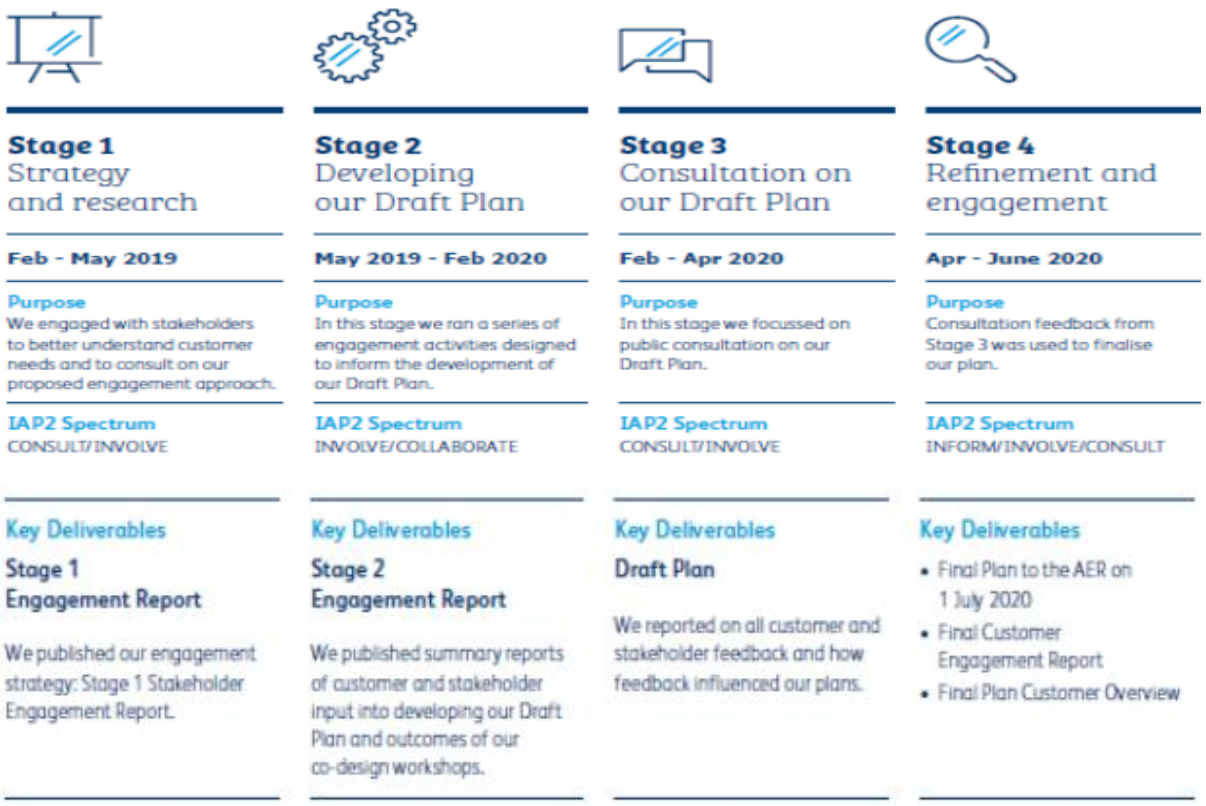

Figure 2. Source AGN Final Plan

CCP24 was able to observe many of the engagement activities undertaken during stages 2 to 4. We were appointed after the stage I work had been completed.

We observe that this engagement strategy is well-defined with each stage building on the previous stage and was very clearly focused on lodging an Access Arrangement proposal that was capable of acceptance.

As an engagement strategy summary this outline identifies clear timeframes, a clear purpose for each stage and importantly links the level of consultation to the IAP2 spectrum. Also important is that each stage has identified "key deliverables."

AGN says that it conducted "22 workshops with customers in five locations over three phases to allow customer input to inform and shape the development of our plan."

Through stage II and stage III workshops, the business engaged with customers and interested stakeholders on a number of questions, with particular focus on the following:

- Price & affordability
- Hydrogen / Future of gas
- Unaccounted for gas
- Education Centre
- Connecting with Customers
- Vulnerable Customers
- Innovation

In February 2020, five months prior to the lodgement of the Access Arrangement proposal, AGN released a Draft Plan upon which it engaged actively as Stage 3.

CCP24 Overview of AGN Consumer Engagement

Since providing feedback to the AER about network business consumer engagement is a core activity of the consumer challenge panel, we provide some observations about each of the elements of the engagement activities that we observed.

a. South Australian Reference Group (SARG) and Retailer Reference Group (RRG)

AGN maintains two ongoing reference groups that were involved in consideration of key aspects of the strategy for the duration of the engagement period. Both the SA Reference Group which comprises a range of consumer interests, household and business and the Retailer Reference Group provided consistency and perspective for the duration of engagement process. We observe that both groups were actively engaged with the discussions and were kept up-to-date with AGN's current performance at the time, as well as discussing current topics related to Access Arrangement proposal development.

b. Workshops

The 22 workshops included discussion at each of the three stages of the strategy with the same groups of people being invited each time to provide consistency of participants and accountability back to each group. Using this approach meant that participants could understand how well AGN was hearing their input and responding to it. Workshops were conducted in 4 regional locations with strong support from the Multicultural Communities Council of South Australia who assisted in the setting up of workshops with a focus on non-English speaking communities. There were also workshops dedicated to small business interests.

Each workshop was highly engaging with participants clearly following the topics being discussed and being keen to share their informed and considered perspectives. We observed a high level of informality with active participation by the CEO and/or senior management who eagerly discussed topics of interest with participants during breaks as well as during the more organised elements of the workshops. Participants and AGN staff clearly enjoyed the workshops and talking with each other.

The purpose of each workshop was clearly described, and the discussion focused on questions that were genuinely open questions about which AGN wanted to hear participant views. Each proposal that found its way into the Access Arrangement proposal had a substantial majority of participants from each workshop supporting it. The one topic about which customers were more equivocal, the suggestion of AGN establishing an Education Centre, did not make it to the Access Arrangement proposal even though a little over 50% of participants from across the workshops were supportive of the idea. AGN was clear that the level of customer support was not strong enough to justify proceeding, we agree.

We also observed that there was overwhelming interest in hydrogen and the future of gas issues in all stage two and particularly stage three workshops.

c. Draft Plan

The draft plan was genuinely a draft plan!

It contained details about the proposals that were being actively considered for the final Access Arrangement and included the best available "numbers" about expenditure levels, demand projections and rate of return parameters. The Draft Plan posed 25 consultation questions that were clearly described and were specific.

For example, questions included:

"Q6. Do you support investment in an Education Centre and learning program, to help position South Australia as a leader in hydrogen technology?

Q18. Do you consider our approach to forecasting demand to be reasonable?

Q24. Do you support AGN continuing to standardise terms and conditions across its networks?"

Specific questions meant that AGN received clear answers that were well reflected in the Access Arrangement proposal. We also note that the Draft Plan is very similar to the Access Arrangement proposal that was lodged, adjusted for consumer input and more up-to-date information.

We consider that the Draft Plan was used very effectively with customers able to clearly see how their input was applied. Tables 5.1, 5.3 and 5.5 from the Access Arrangement proposal each provide a fair summary of stakeholder feedback and AGN's responses

d. Online engagement

The nature of online engagement meant that we were not able to observe it as readily as other aspects of the engagement strategy. We however recognise that online engagement occurred through the Gas Matters portal.

e. The strategy

The overall strategy was well thought out, having been developed in consultation with the reference group and with stakeholders and was applied in exactly the way the plan intended. Each engagement activity included presentation of the strategy with clarification about how the current event was located in the strategy. The upfront documentation of deliverables also meant that repeat participants could see how their input had been used and also provided a discipline for AGN that built high levels of trust and respect.

CCP24 Observations

At the public forum CCP24 made the following comments about the calibre of the AGN customer engagement program:

- "Nothing Flashy" rather a high-quality engagement program very well delivered

We are pleased that AGN understood the "nothing flashy" comment in the spirit with which it was intended. Some consumers are fearful of an 'arms race' style escalation of consumer engagement spending and are concerned that there is the potential for a sector-wide attitude for each engagement program to come up with something new. While there is merit in trying new approaches when circumstances warrant, AGN delivered a very well-planned engagement strategy that was focused, cost-effective (we anticipate) and highly effective. (We note that CCP24 is also considering the Evoenergy Access Arrangement proposal and that this business utilised some very different consumer engagement methodologies including conducting a Citizens Jury. We believe that this strategy was absolutely appropriate for the circumstances that Evoenergy is confronting but would have likely been of less benefit to AGN).

- AGN delivered the engagement program that they have claimed

We are confident that the AGN consumer engagement strategy accurately reflects the preferences and priorities they heard from customers and have reflected this faithfully in the Access Arrangement proposal.

- Obvious and ongoing involvement of CEO and senior staff

When AGN senior staff say that they want to put customers at the centre of their business, they clearly demonstrate this by their active participation in every engagement activity that the business conducts. It is evident that the culture of wanting to engage customers is embedded in the business and what's more, all staff clearly enjoy meeting with their customers - whether they are grumpy or happy with AGN's service. (As CCP members who have observed a number of NSP engagement programs, we suggest that only Essential Energy has similar levels of CEO and senior staff involvement in ongoing consumer engagement action.)

- Consumer and stakeholder input was heard, reflected and acted upon
- Ongoing engagement commitments including re Vulnerable Customers and the future of gas / hydrogen

We note that the Access Arrangement proposal leaves room for some further development of AGN approaches to vulnerable customers and commits to ongoing engagement particularly on future of gas and hydrogen topics. We asked AGN about the plans at the public forum.

We have been provided with the following update from 5/8/2020 that was presented to the SARG.

"SA AA | Engagement update

• Final Plan Customer Overview

• We are continuing to engage with key stakeholders, in particular:- • CCP24 • Energy Consumers Australia

• We are looking to engage further on key initiatives:

- *Vulnerable Customer Assistance Program (scoping underway)*
- *Innovation scheme - industry wide project proposal (commencing August 2020)*

• Future of gas is a key ongoing area of engagement"

We are very confident that AGN will deliver on these commitments because they have delivered on their promises throughout the engagement.

We conclude that AGN has engaged with a diversity of their customers, has actively listened, and acted on the advice given and preferences expresses by customers. It was an extremely high quality, well implemented engagement strategy, and is continuing.

6. Future of Gas

As we noted in our introduction, AGN's Final Plan has been prepared in a time of heightened uncertainty and significant challenge for gas networks. Aside from the COVID challenge, there is the future role of gas as jurisdictions move to consider legislating a net zero emissions target. While this has been the case in the ACT, the South Australian Government is yet to legislate its current aspirational zero net emissions target. This is expected to occur sometime over the 2021-26 period.

We provided an extensive discussion on issues around the future of gas in our Advice on the Draft Plan. This discussion builds on that Advice, providing some additional reflections following further discussions with AGN, the AER and consumer advocates. It supports AGN's decision to not seek accelerated depreciation for 2021-26. Given AGN's decision, they should run a separate stakeholder engagement process on the future of gas including prudent responses to the risks and uncertainties involved.

CCP24, as well as AGN, also support an industry wide review to be led by the AER or the AEMC to enable all stakeholders to consider the complex policy options. There are major considerations that could have a very large impact on consumers as well as networks and they should be comprehensively discussed before major change is contemplated.

The reader is also referred to our discussion of the same Future of Gas topic in our Advice on the Evoenergy AA proposal for 2021-26 where we review the options given the ACT Government policy.

Final Plan

AGN see considerable uncertainty in the future of gas – from Government's net zero emissions policies, and from gas as a fuel of choice facing more competition from renewable electricity as it becomes cheaper – at the same time as networks need to promote efficient investment and operation of the natural gas services in the long term interests of consumers. They discuss two possible approaches to assessing the evolving energy landscape in South Australia:

(i) a binary approach where the regulator makes a one-off decision - is there a renewable gas future for the gas network? If the answer is 'yes', networks continue to invest in network assets, including renewable gas assets, and economic lives of assets are maintained well into the future. If the answer to this question is 'no', there is an effective end date for the network (whether or not renewable gas is viable); economic lives and new investment are limited by the end date.

    AGN argue that this binary approach fails to appropriately consider the variety of options available, locks in a future despite remaining uncertainty, and becomes a self-fulfilling prophecy with potentially significant negative outcomes for customers whose choices will be limited as a result. This approach would only be implemented if there was complete information or no uncertainty given the existing gas $1.7b gas pipeline assets and the investment required in the electricity distribution network.

(ii) A risk assessment approach (or a real options framework) where stakeholders assess future pathways for technological and policy change, the way the market will evolve in response, and what these pathways mean for demand on the network.

The consequences of each scenario are assessed as is the degree to which proposed actions might create more flexibility in dealing with the future (within the constraints of each scenario).

AGN consider that focussing on the depreciation building block is the best way to deal with future risk. AGN also argues that it is too early to adjust depreciation in the current period but developments over the next few years including the various hydrogen trials AGN is involved in, will mean a better-informed discussion leading into the 2026-31 AA period.

CCP24 Comments

Our Advice on the Draft Plan contained an Attachment focussing on issues around the future of gas and stranded asset risk[1]. In summary, we made two recommendations:

Objective	Recommendations
(i) Given AGN is not proposing accelerated depreciation, how should consumers assess AGN's proposed $160m expansion capex where it has an asset life greater that the likely date of a zero emissions target?	Matters that AGN should consider including in the next stage of its consumer engagement to ensure its consumers are supportive of its approach
(ii) Examine at a high level the suitability of the National Gas Law and Rules to consider stranded assets in the changing Government policy environment	A holistic review by the AER of these rules to assess whether they are fit for purpose for the next 10-20 years

The concern in our Draft Plan Advice was, given the potential stranded asset risk, expansion capex in 2021-26 may not be a 'no regrets' decision were the SA Government to formally legislate a net zero emissions target during 2021-26. We are pleased to see AGN has responded positively to our suggestion to undertake additional engagement to ensure consumers are fully informed about that risk. If that were the case then we support AGN's assessment to delay consideration of stranded asset risk until the reset process around the next 2026-31 AA period.

This conclusion emphasises the benefits of the second recommendation which AGN supports. This review could well be led by the AEMC. There are two possible timetables for this suggested review:

- in time for Victorian gas resets for the 2023-27 period, or
- in time for the next 'cycle' gas regulatory beginning with Jemena Gas 2025-30

Under Victorian legislation, the Government was required to set climate emissions target for 2025 and 2030 by the end of March 2020, and then table them in Parliament by August 6th. This has been delayed by COVID-19[2]. We would lean towards the earlier timetable for the proposed review, but it will depend on the timetable for jurisdictions to convert current aspirational targets into legislated targets and this may be delayed by COVID-19.

We make more extensive comments on the impact of a legislated zero net emissions policy in our Advice on the Evoenergy AA proposal and the reader is referred to that. Many of the issues raised there have relevance to AGN. This section discusses one of these issues - decision making under uncertainty and comments on the two approaches suggested by AGN and discussed above. We support the concept of a real options approach – the binary option was really a straw man. The issue is how this preferred approach is applied.

While the SA Government is expected to make a decision to have a zero emissions target in the near future, it has not made the decision. In the absence of that decision we agree with delaying consideration of accelerated depreciation until the next AA period. What are factors to be considered in the review we are recommending?

[1] See https://www.aer.gov.au/system/files/CCP24%20-%20Advice%20to%20AER%20-%20AGN%20Draft%20Plan%20response%20-%20June%202020.pdf

[2] See https://www.smh.com.au/environment/climate-change/victorian-emissions-reduction-target-delayed-again-by-virus-crisis-20200730-p55gx0.html

The policy landscape

A number of jurisdictions have aspirational policy objectives of zero net emissions to be achieved by around 2050 to accord with Paris targets. It remains to be seen how soon they translate that into legislation such as the ACT has enacted, and then set out a detailed pathway to achieve the target - which the ACT Government is expected to do in the next year if it is re-elected later this year.

This raises an interesting issue – should consumers expect some form of compensation from Governments given it is their policy change that has given rise to the stranded assets? This has not been the case so far in the energy market. Government subsidies to renewable generation have assisted it to become competitive with thermal generation, and there is considerable debate about reduced economic life for coal fired generators. Aside from an attempt by the Commonwealth Government a few years ago to negotiate a compensation package in the context of the carbon tax, compensation to asset owners for stranded asset risk seems not to be 'on the agenda'.

Governments seem to be more willing to subsidise households to change from gas and into electricity but not compensate those remaining consumers and asset owners to prevent higher network charges that flow from those consumers taking the government subsidy and leaving gas.

The technical and commercial viability of large scale hydrogen production

We examined this issue in our Advice on the Draft Plan. Drawing on the National Hydrogen Strategy and the work AGN and other networks are doing on hydrogen trials we concluded:

- hydrogen is unlikely to be a competitor for piped natural gas before 2030 given it requires a price of ~$1/kg, and
- the discussion in 2024-25 leading into the 2026-31 revenue reset will be very similar to today – what risk should consumers continue to take on hydrogen development?

That discussion in 2024-25 will be in the context of knowing results from the 10% blending trials for residential and industrial customers and how much the industry has moved up the technological and commercial readiness index. But we will not know whether hydrogen is 'economic' which we defined as commercially viable as a substitute for natural gas for reticulated gas purposes without external subsidy or specific policy direction[3]. That means the discussion will still be one of decision making under uncertainty – but hopefully less than today.

AGN position

We appreciate the position AGN is in for the 2021-26 reset:

- wanting to invest in expansion to grow their business with the rules obliging them to increase customer numbers to increase asset utilisation; obliging them to have declining block tariffs to reflect marginal costs and increase asset utilisation;
- the large depreciation in 2021-26 from the mains replacement programme leading to a lower that otherwise RAB for 2026-31 that provides 'head space' for consideration of accelerated depreciation in 2026-31;
- the desire to give its customers a significant price fall (following the even larger fall in the current period) to support gas consumption that would be reversed if accelerated depreciation were applied; and
- the desire for a smooth price path to the following 2026-31 AA period.

[3] We are aware of proposals for a RET style scheme for hydrogen.

We understand and agree with AGN's position to defer the accelerated depreciation discussion to 2026-31 AA engagement.

Consumers, equity and uncertainty

Average and total consumption over 2021-26 is forecast to continue the declining trend of the current period, despite the increase in customer numbers. This is without a legislated zero emissions target and specific Government pathway. While adding customers helps pay off not just new capex but importantly past capex (and hence reduces the RAB and hence stranded asset risk), eventually if the denominator (customers volume) falls fast enough, RAB/customer will go up. The customers left to shoulder that burden are most likely to be those customers who are unable to afford to get out of gas.

There are many notions of equity in gas pricing. Some may believe that business customers cross subsidising residential customers in inequitable, others may disagree; some may think postage stamp tariffs for all customers is inequitable, others may disagree; some may think that earlier rather than later accelerated depreciation is more equitable because it provides for a greater consumption base to share the cost. In some ways the discussion on stranded assets is a trade-off between the short run interests of consumers and the long run interests of consumers. Some consumers may prefer some accelerated depreciation in the current period given the head room provided by lower WACC and tax – with a smaller price fall. In later periods the introduction of accelerated depreciation may be coincident with rising WACC, so the price rise may be magnified.

Our Draft Plan Advice looked at the option of differential tariffs for Mt Barker customers to reflect the stranded asset risk of expansion capex. We suggested it was inequitable for customers in the existing network to effectively cross subsidise the potential stranded asset risk of new customers at Mt Barker.

A common response on decision making under uncertainty is to 'do nothing until we have more information'. This needs to be balanced against the costs of not doing something – a 'no regrets' approach. The value of waiting for more and more information before making a decision, the value of 'keeping options open' may not always be positive. At each stage we will need to make judgements about the future viability of hydrogen – and this is influenced by where we think we are at each stage on the journey to establish whether hydrogen is economic. The National Hydrogen Strategy said it is very unlikely to be able to provide commercial volumes of economic $2/kg hydrogen before 2030. No timetable was proposed for $1/kg hydrogen.

The cost of delaying a decision on accelerated depreciation is that if it does not prove economic then the recovery of stranded assets has to occur very quickly. At a time when there are many fewer consumers consuming a significantly lower volume, to pay the cost. The cost of not delaying a decision on accelerated depreciation is that if hydrogen does prove to be economic then new consumers have been cross-subsidised by past consumers to have a much lower network charge for hydrogen. Both can be seen as either equitable or inequitable depending on a person's perspective.

AER's decision is governed by the rules

The current rules were developed at a time when Governments were supporting the expansion of gas consumption, supporting consumers having a choice in their energy supply. The rules were designed to drive efficient asset utilisation and efficient pricing. As we examined the rules for our Draft Plan Advice, it became unclear how much they might be able to cope with the transition to a zero emissions policy world.

It is clear that accelerated depreciation is possible as are differential tariffs based on cost, but it is unclear whether a component of that cost differential can be stranded asset risk as well as the cost of drilling harder rock. Ending declining block tariffs may not be consistent with the rules.

All of which is why we recommend a wider stakeholder review to be led by the AER or the AEMC to enable all stakeholders to consider the complex policy options and discusses some of the issues that should be considered in that review.

7. Network prices and revenue requirement

Final Plan

Customer and stakeholder feedback were very clear[4]:

> "…price and affordability are their top priority"

Based on the building block revenue, the real price growth per year is shown in the following table[5]:

Table 13.4: Proposed Price Path, 2021/22 to 2025/26 ($nominal, million)

	2021/22	2022/23	2023/24	2024/25	2025/26
Building Block Total Revenue (excluding ARS)	219.6	221.8	233.3	225.5	234.7
Smoothed Revenue	213.6	220.1	228.1	233.6	241.0
Real Price Path	-8.67%	+1.25%	+1.25%	+1.25%	+1.25%

Figure 3. Source AGN Final Plan

Key drivers of the price path are:

- Revenue growth approximates the real growth in the capital base so revenue is commensurate with forecast changes in funding costs;
- Tariff revenue is as close as possible to underlying costs in 2025-26 so that there is a smoother price path to year 1 of the next AA period.

Overall, this allows AGN to sustain its credit metrics at levels (one third A- and two thirds BBB+) assumed by the AER in setting the return on debt.

AGN propose that the existing pricing structure:

- for residential and commercial customers, a fixed (25%) plus variable declining block tariff structure (75%); consumers have indicated a preference for a large variable component; and
- for industrial customers, a capacity based declining block tariff

continues for 2021-26. The declining block tariff reflects lower marginal cost of provision of higher gas volumes is consistent with the rules promoting efficient pricing and lessen the impact of falling consumption on asset utilisation.

[4] Final Plan p. 137 Table 13.1
[5] Final Plan p.139

In engagement with the two Reference Groups in early April, AGN proposed two price pathways for 2021-26 with price path 2 consistent with supporting the key credit metrics:

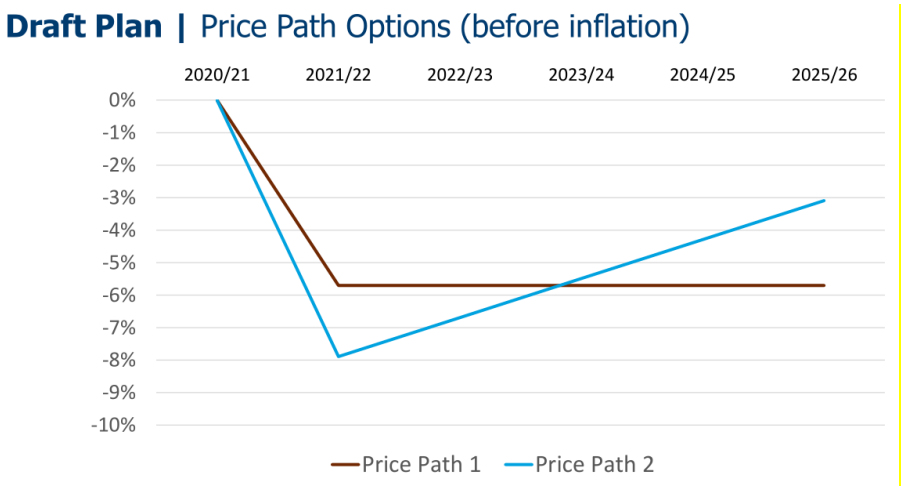

Figure 4. Source AGN Draft Plan

Stakeholders supported price path 2.

CCP 24 Comments

We welcome AGN taking up the suggestion in our Draft Plan Advice to present price changes without taking inflation into account ie the 7% price cut from 1 July 2021 is the nominal reduction in price compared with the price on 30th June 2021. We just note that adding the words "after inflation" may be confusing to the reader.

While the price reductions will be welcome to consumers it was only possible with the lower WACC and tax allowance. With the same WACC as in the current period prices would have risen in year 1 of the next period rather than falling 7%.

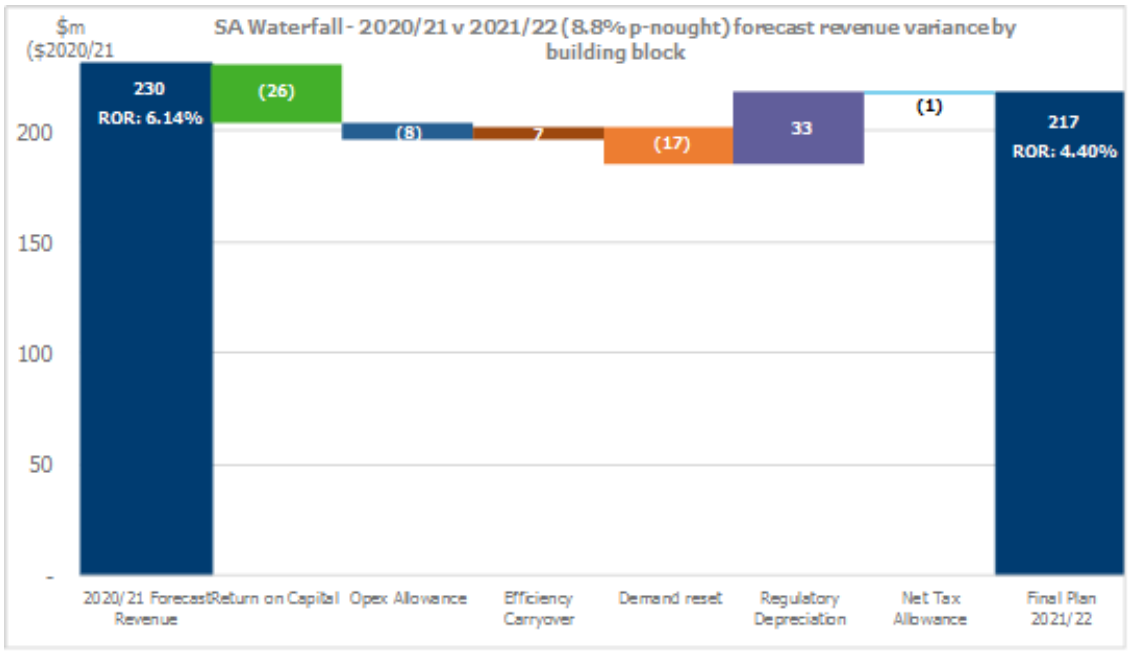

Figure 5. Source AGN

8. Capital Expenditure

Final Plan

The following table summarises the AGN capital expenditure proposal for the next Access Arrangement period and compares these proposals with amounts indicated in the Draft Plan. For clarification of terminology, "safety and reliability" refers to network maintenance and upgrade which is largely cast-iron mains replacement while "customer service" is predominantly about metering.

AGN CAPEX Priority ($2020/21)	Current AA (draft Plan)		Draft Plan	Next AA
Safety and Reliability	388.3	(375.5)	387.4	**389.0**
Growing the Network	175.9	(194.1)	159.9	**159.0**
Customer Service	35.1	(40.3)	32.1	**30.9**
Total	**599.3**	**(609.8)**	**579.4**	**578.8**

Figure 7. Source, AGN Final Plan

Note that the bracketed figures in the second column refer to the current period spending levels that were reported in the Draft Plan. The final AA proposal shows the actual current period expenditure is $10.5 million less than was protected in the Draft Plan.

We accept that AGN undertakes a rigorous capital expenditure planning process which they summarise in the Access Arrangement proposal with the following diagram:

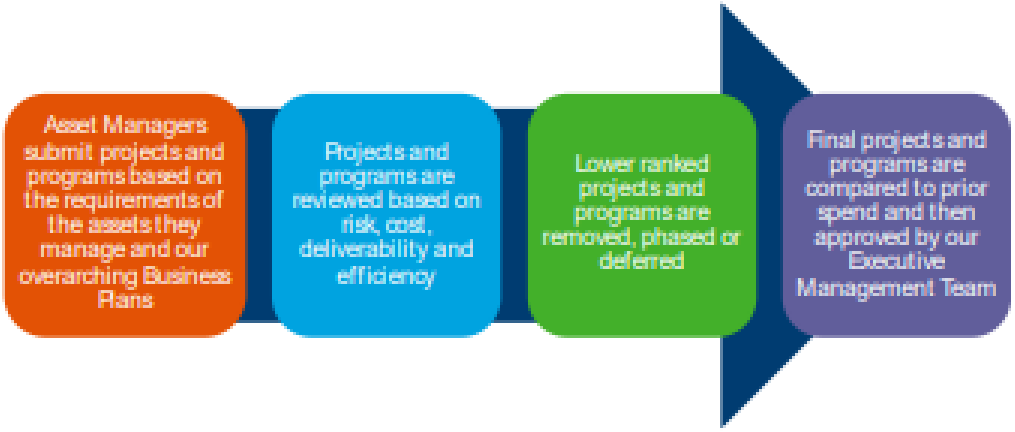

Figure 8. Source AGN Final Plan

This process reflects sound internal review mechanisms, though could more overtly include consumer input for major projects. In practice we suspect that this may have occurred through the SA Reference Group

Safety and Reliability

Network capex (described as "safety and reliability") is the dominant expenditure area across the capital budget accounting for two thirds of proposed Capex. The major element of this expenditure

area is replacement of 860 km of cast iron and first-generation plastic mains that have reached the end of their useful life. This major mains replacement program has been an ongoing program for AGN over at least the past decade and is well understood by consumer interests as it has been a regular item on the SA Reference Group agenda.

The other aspects of this expenditure category are predominantly replacement of essential components of maintaining the network that have reached the end of their useful life. These items include regulators, valves, telemetry and cathodic protection, which we understand are all important for maintaining the network.

Growing network

This aspect of the capital expenditure proposal has been the most discussed element of the proposal by CCP and consumer interests because it links directly with the bigger questions of the future of gas and the risk of stranded assets that could result from government policies to phase out natural gas use, and hydrogen proving to be not viable for reticulated gas supply. These difficult issues are discussed elsewhere in this Advice, section 6.

AGN reports that a significant part of the $159 million proposal for "growing the network" would enable the connection of about 39,000 new residential and industrial customers. A majority of this expansion will occur in outer northern and outer southern suburbs of Adelaide (which can be regarded as something of a linear city located between the sea and the Adelaide Hills). The expansion will occur in the McLaren Vale to Aldinga area to the south and the northern Adelaide Plains north of Elizabeth and in the area loosely described as being between Gulf St Vincent and Gawler.

We also note that both the mains replacement and proposed future network expansion mean that the gas network in South Australia is "hydrogen ready" should that future eventuate.

Taking the gas network to Mount Barker, a major residential and smaller industry development in the Adelaide Hills, has been a keenly tested project over the last five years or so. We understand that the AER has given in principle approval for expansion of the gas network to Mount Barker but that the final decision to invest in the project has not yet been made by the AGN board. We understand the detailed analysis has almost been completed to finalise a preferred path from the Murray Bridge gate to Mount Barker, and to accurately budget the costs of laying the pipe, recognising that some of the route will require digging through granite.

Customer service

This is the smallest aspect of the Capex proposal and predominantly involves meter replacement. The proposal is to replace over 93,000 meters. Given an approximate life expectancy of 15 years per meter this replacement rate seems reasonable given the customer base of about 460,000 connections.

CCP24 Comment

There is a strong case for approaching capital as a finite resource, asking at every point "what impact will this expenditure have on affordability for all customers over the longer term?"

A 3% reduction for the next regulatory period compared to actual expenditure for the current period is clearly a step in the right direction for consumers. The key question is whether the reduction could have been more?

The single largest element of proposed capital expenditure is the conclusion of the mains replacement program. This is an established program over multiple Access Arrangement periods and will result in the completion of this substantial work program.

We understand that consumer groups and the SARG have a good understanding of the merits of the mains replacement program and have been supportive of it for some time and continue to be positive about the merits of the program and the safety benefits, including reductions in unaccounted for gas through leaks from fragile mains. The other aspects of this category of expenditure also appear to be reasonable costs associated with maintaining the network. We have no reason to consider this "Safety and Reliability" category of expenditure to be inefficient and so we accept this category spending proposal, pending checking for reasonableness by the AER capex team.

Market Expansion capex ("Growing the Network") is most likely to be the capital expenditure category where further cost reductions could potentially be achieved. This is largely because market expansion is less predictable now due to the unknown impact on demand of COVID-19. But what is reasonable cost and who is shouldering the cost burden?

CCP 24 asked AGN why would continue to expand the network in uncertain times. We summarise their response as having two main arguments:

- market expansion only occurs where it is cost-effective meaning that additional customers share fixed costs reducing total bills for all customers.
- To cease expanding the network into new developments and subdivisions in the current and next AA period also blocks any capacity for further expansion of the network to developments which would by necessity be further from current mains, in the future. No expansion in the short term (next Access Arrangement proposal) locks in future network decline. This would be deleterious to new customers should future "green" reticulated gas supply options become available.

We ask throughout this Advice what is reasonable cost is and who is shouldering the cost burden?

Falling demand (and COVID uncertainty potentially further reducing demand, industrial in particular) leads to asking whether demand related capex could be pared back further.

The question of network expansion, sunk cost risk and equity in incidence of payment is discussed elsewhere in the Advice (section 6). Given an acceptability of the market expansion that has been proposed by AGN, we would accept an assessment on the appropriateness of this proposed capex amount by the AER capex team.

The expansion of the AGN network to Mount Barker has been closely considered by consumer interests in South Australia over an extended period of time. We understand that should this expansion proceed the main capital costs will be born in the current period. However, potential remains for spillover into the next AA period and so will be a development for ongoing engagement with consumers.

Given current policy settings for South Australia along with the AGN, and SA Government, confidence in a hydrogen future, we are inclined to accept the "growing the network" expenditure proposal should the AER's Capex team assess this part of the expenditure proposal as being efficient.

The "Customer Service" category is largely meter replacement. From our understanding, meters have an approximate life expectancy of 15 years per meter, so the replacement rate seems reasonable for 93,000 meters over a customer base of about 460,000 connections. AGN says that their final Access Arrangement costing for this category is a little higher than the draft plan as a result of an increase in meter costs since the draft plan was produced. We have no argument with this adjustment.

Apart from our expectation that market expansion costs will be reviewed as demand forecasts adjust to COVID-19 impact, the proposed capital expenditure program has been scrutinised by consumer interests who we observe as accepting of the costs. We have no reason to challenge the capex cost package, pending AER acceptance of the network expansion elements.

Non-System capex

Final Plan – IT Capex

AGN's proposed IT capex for 2021-26 is less than the forecast expenditure in the current period as shown in the table below[6].

Driver	Current AA Period	Draft Plan	Final Plan
IT System	41.6	34.2	36.5

Figure 9. Source, AGN Final Plan: Forecast IT capex ($ million, 2020/21)

For the 2021-26 period, the proposed IT investments may be categorized as follows[7]:

Description	Draft Plan	Final Plan
Maintaining and upgrading current applications	18	16
Rationalising IT applications and infrastructure across AGIG	8	15
Asset Investment Planning Tool	2	3
Delivery of more customer services via digital channels	5	2
Total	33	36

Figure 10. Source, AGN Final Plan Forecast IT capex by category ($ million, 2020/21)

We understand that forecasts in the Draft Plan were presented exclusive of corporate overheads, and that other increases between the Draft Plan and the Final Plan were due to refinements in the scope and cost of works for the next AA period.

AGN's planned IT work program for both the current and future AA periods is shown below.

[6] AGN, Final Plan July 2020, p102
[7] AGN, Final Plan July 2020, page 96

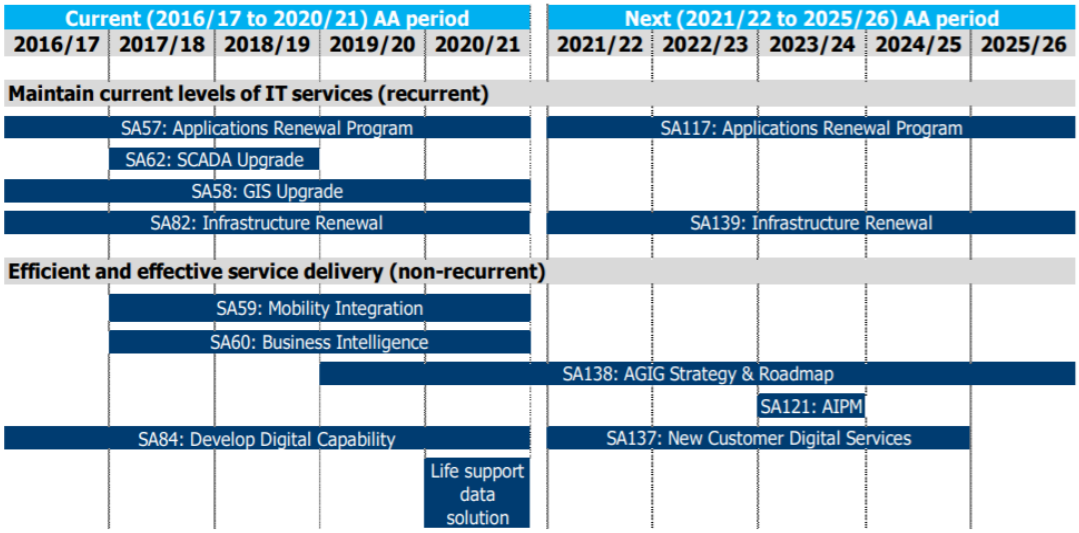

Figure 11: Timeline of the IT program work planned for the next 5 year period, Source AGN IT Investment Plan

CCP24 notes that in 2017, AGN, Multinet Gas Networks and Dampier Bunbury Pipeline came together to form the Australian Gas Infrastructure Group (AGIG). As a result of this development, AGN reports that[8]:

> *'Not least, it allows us to review and rationalise our IT systems and infrastructure across the group, moving to shared platforms where practicable. We have already begun the IT rationalisation journey. During the current AA period (July 2016 to June 2021) we have implemented a program to replace state-based IT systems with enterprise-wide equivalents, which we can use to serve all AGN network businesses. We have also started a program to rationalise our IT systems and infrastructure across AGIG where possible. Under our AGIG IT Strategy & Roadmap, launched in 2019, we will consolidate several IT solutions, including for example moving all AGIG businesses on to a single enterprise resource planning (ERP) system.'*

AGN reports that this strategy of rationalisation of IT systems and infrastructure is targeted at delivering benefits for customers, specifically:

> *'Our aim is to achieve economies of scale, while keeping pace with technology advances …… over the longer term we expect coordinating our IT investment into a national program will reduce the overall ongoing cost for our customers'*[9].

CCP24 Comment

A significant level of new expenditure ($15m) is proposed for the AGIG Strategy and Roadmap Project (SA138). While CCP24 acknowledge the business benefits arising from the AGIG entities rationalising IT systems and infrastructure across a broader business base, it is expected that commensurate benefits will flow to customers. We recognise that AGN has presented well-

[8] AGN, Attachment 8.6, IT Investment Plan – South Australia, page 2
[9] Ibid, page 3

developed IT strategy for the business which is accompanied by supporting business cases. The IT investment program appears modest compared with previous periods and is capable of delivery.

We are reasonably comfortable with the proposed IT System capex investment, however seek assurance from AER's technical staff regarding the following issues.

1. Efficiency benefits deriving from the AGIG Rationalisation Program

   The AGIG Rationalisation Program commenced following the coming together of the AGIG businesses, so did not form a part of the previous AA's IT investment plan. Elements of the proposed AGIG Strategy and Roadmap Project (SA138) are 'transformational', looking to deliver productivity improvements and lower business costs. These projects commenced in 2019 and are ongoing, and would be expected to be delivering benefits over the next AA period. We question whether the proposed 0.4% productivity growth factor, which is largely based on historical performance, sufficiently reflects the resulting and expected efficiency benefits from these investments.

2. Allocation of costs amongst AGIG entities

   As the AGIG was only formed in 2017, this is the first revenue reset process to be faced by AGN under the new organisational structure. A large proportion of the proposed IT work program will be able to be shared across members of the AGIG group to achieve the stated objectives of economy of scale and reduced ongoing costs for customers. CCP24 understands that IT cost allocation arrangements between the AGN gas distribution businesses have previously been confirmed as appropriate by the AER.[10] We advise the AER to review the proposed cost allocations for relevant IT projects across AGIG members, and in particular, question whether cost allocation on the basis of FTEs is appropriate for the AGIG Strategy and Roadmap Project (SA138).

3. Deferred capex from current period

   In the current period, delivery of some IT works in the Application Renewals Project (SA117) has been delayed due to reallocation of resources[11]. We seek confirmation that inefficient deferrals have been excluded from the proposed expenditure, and that customers are not 'paying twice' for the same work.

   Based on the consumer engagement that CCP24 observed, we support the introduction of new digital communication channels for customers, however we seek assurance that the New Customer Digital Services Project (SA137), is sufficiently different from the previous AA's Develop Digital Capability Project (SA84) and the 'Life Support Data Solution' Project to be funded again in the 2021-26 period.

[10] Ibid, page 24
[11] Ibid, page 14

9. Capital base and depreciation

Final Plan

AGN is continuing to apply the asset lives approved by the AER for the current period using the year by year tracking approach. The key impact is the removal of old mains with the completion of the mains replacement programme. This will ensure intergenerational equity as future customers will not pay for assets that are no longer in use. The closing RAB in 2025-26 is 14% higher than forecast closing RAB in the current period.

Table 9.6: Forecast Capital Base, 2021/22 to 2025/26 ($nominal, million)

	2021/22	2022/23	2023/24	2024/25	2025/26
Opening Capital Base	1,769.3	1,826.2	1,890.2	1,955.6	2,024.5
Less Straight Line Depreciation	-99.1	-105.1	-111.2	-110.5	-117.2
Plus Conforming Capex	114.0	125.7	131.7	132.9	120.5
Plus Actual Inflation	42.0	43.4	44.9	46.4	48.1
Closing Value	**1,826.2**	**1,890.2**	**1,955.6**	**2,024.5**	**2,075.9**

Note: Totals may not add due to rounding.

Figure 6. Source AGN Final Plan

CCP24 Comments

As outlined in `Section 6 Future of Gas, we support the approach to not propose any changes to the existing approach to depreciation given AGN's commitment to undertake further stakeholder engagement on the future of gas following the AER Draft Decision.

10. Operating costs

Final Plan

The table summarises the changes over time.

	2016-21		2021-26	
$20-21	Allowance	Forecast	Draft	AA
Excluding UAFG	$340	$290.3	$281.3	$310.2
UAFG	$62.5m ($15)	$40.3	$48.8	$47.2
Overheads capex to opex			$23.4	0
Total	$363.6	$330.5	$353.6	$357.4

Figure 12. Source, AGN Final Plan

Forecast opex in the current period is about 15% below the AER allowance reflecting the one-off benefits of the merger with AGIG in 2017. This was not known at the time of the AER setting the 2016-21 allowance. The Draft Plan, using the standard base (2019-20) step, trend framework, proposed opex (excluding UAFG) slightly lower than the 2016-21 forecast. This seems to have provided headspace for converting capitalised overheads to opex. AGN proposed no step changes saying they intended[12]:

> "…to absorb these step changes into our cost base."

given that there was no productivity improvement.

AGN propose that their base year is efficient – the AER found the 2016-21 opex efficient, the actual opex is 15% below the allowance and Economic Insights modelling shows that since that time AGN has seen the fastest opex partial factor productivity growth in the country. The 2016-21 forecast increased from $281.5m to $290.3m but still significantly below the allowance.

The Final Plan brought a significant change over the Draft Plan in a number of factors. Opex increased due to:

- Updating of the 2019-20 base year for later data that increased the base year cost - $52m increased to $58m
- Three step changes are proposed – vulnerable customer assistance program ($3.8m), digital customer experience project ($1.3m) and an incremental increase on insurance premium ($2.9m) with a total cost of $7.9m,

With this mostly offset by:

- The proposed overheads capex to opex conversion was excluded, and
- Inclusion of a productivity factor of 0.4% per year compared to zero in the Draft Plan which reduces opex by approximately $3m

This results in AA opex excluding UAFG of $310.2m, which is 8% higher than the 2016-21 forecast and 1% above the Draft Plan.

CCP24 Comments

We look to the AER to assess the efficiency of the base year expenditure. In contrast to the situation with electricity networks, the AER has relatively less data at its disposal to assess gas network efficiency. There are revealed costs as the outcome of the incentive provided by the Efficiency Carryover Mechanism but, at best, this is an indicator of relative improved performance over time for the network, not an indicator of either the network's relative efficiency compared with other networks (provided by benchmarking data) nor of the absolute efficiency (all the networks may be inefficient).

In the absence of this AER data, it is encouraging to see the gas networks developing their own benchmark data. It is early days and we need to be cautious about the results, but they do provide a measure of comparability and performance. AGN presents data prepared by Economic Insights[13] (base year efficiency) an ACIL Allen (trend productivity growth) to support its position on both. improvement.

[12] Draft Plan p.65
[13] See Attachment 7.5

Benchmarking – Base year

The Economic Insights analysis compares AGN with a group of 11 Australian and two New Zealand gas distribution businesses. On the opex partial indicator, AGN's comparative performance indicates it is average to below average[14]:

- average opex per customer (in $2010) over the latest five-year period was $110, which was well below the average opex per customer for the six GDBs with lowest customer density ($151) but was the highest among the seven GDBs with higher customer density (which averaged $84 over the latest five-year period). AGN SA's opex per customer was similar to the average for the whole sample ($115).
- AGN's opex per km of mains was $5,920 over the latest five-year period, which is higher than the average of all GDBs in the sample ($4,614 for the latest five-years) and the highest among the GDBs with higher customer density.

Prior to normalisation, AGN SA's average opex per customer was 35.6% above the average opex per customer of the five largest Australian GDBs. However, after normalisation, this difference substantially disappears as the much higher opex per customer can be fully explained by its smaller scale, lower customer density and differences in the other identified cost drivers. After considering the limitations of partial indicator analysis, EI concluded that:

> "…AGN SA appears to have also performed at about an average level among the group of larger GDBs."

We don't think this "average" conclusion provides a strong basis for arguing AGN is "efficient" or, to apply the terminology from electricity distribution networks, 'not materially inefficient". We look to the AER to undertake an analysis of the appropriateness of the proposed base year and the robustness of the EI analysis. We note the AER's conclusions regarding the Economic Insights study on Jemena's base year efficiency[15]:

> "Economic Insights stated that JGN appears to be close to the average across all gas distributors for most of the efficiency measures in its analysis. However, it acknowledged that its comparison does not control for other opex cost drivers that may be relevant; therefore, caution should be exercised in drawing inferences. Economic Insights' findings suggest that JGN does not have any material inefficiency and does not require an adjustment to its base year opex…
>
> We agree with Economic Insights that the conclusions from its benchmarking analysis should be treated with caution. This analysis is limited by the small sample size of gas distribution businesses and it is difficult to test some of the underlying data sources— among other things. However, as set out above, and in the absence of any evidence to the contrary, we are satisfied that the 2017–18 base year opex is efficient."

Benchmarking – Forecast productivity growth

It is welcome to see AGN respond to the consumer feedback that expressed concern about the assumed zero productivity in the Draft Plan. ACIL Allen acknowledged that their analysis had

[14] See Attachment 7.5 p.3

[15] See AER "Draft Decision Jemena Gas Networks Attachment 6 Operating Expenditure" November 2019 p. 26 https://www.aer.gov.au/system/files/AER%20-%20JGN%202020-25%20-%20Draft%20decision%20-%20Attachment%206%20-%20Operating%20expenditure%20-%20November%202019.pdf

limitations eg the small sample size (9) meant they could only use the Cobb-Douglas specification which is more restrictive functional form than the Translog cost function, the model could only control for a limited number of environmental factors, networks had different capitalisation policies that influenced opex cost levels.

The four different models gave a range of 0.1% - 0.4%/year forecast productivity for 2021-26. Based on the simple average of four models' growth was 0.17%/year. Further analysis taking account of customer numbers and network length result in forecast growth of 0.25%/year. AGN decided to apply 0.4% at the upper end of the range provided by the modelling.

We leave the AER to evaluate the usefulness of this modelling. Our main concern is the implicit assumption in the modelling that past performance is the best guide to what should be future performance. This means that if a network has had poor performance in the past this will influence the forecast of future performance. We would prefer a measure to be 'what should be the annual opex productivity of an efficient gas network ie how much should the frontier move out?' and if the network is not efficient in the base year, 'what is the level of catch-up, in addition to the frontier moving out, should be expected?' Unfortunately, however, it seems the data is not available to ascertain these metrics.

Step Changes

AGN is proposing 3 step changes, which we consider in turn

(i) Vulnerable customer assistance programme

AGN is seeking $3.9 million over the 5-year AA period to support vulnerable customers, they estimate this to equate to an increase of $1.50 per customer, per year.

CCP24 observed consideration of this proposal at customer workshops and it was evident that there was strong support for an initiative to assist vulnerable customers with a cost of between $1-$2 per customer per year. The proposal in the final Plan is within the cost range supported by about three quarters of the customers who were directly involved in engagement activities.

We recognise the clear support for a vulnerable customer response which is likely to be more pertinent now with COVID-19 impacts. The Vulnerable customer proposal, we suggest, is in line with the intent of the AER's Statements of Expectation. We consider there to be three aspect of this proposal that require further consideration:

a. The Final Plan does not provide full detail of the intended vulnerable customer strategy and we understand that further engagement will occur before a final strategy is put to stakeholders for support.

b. Both the indicative vulnerable customer plan and the marketing plan provide for rebates for customers to switch to more efficient appliances. We propose that some of the marketing budget be applied to the vulnerable customer plan with reduction in the total amount paid by customers for vulnerable customer assistance.

c. Shareholders can make a contribution to the cost of this program too, it should not be paid for entirely by customers.

(ii) Digital customer experience project

This step change proposal has a proposed cost of $2.2m and is to install a customer relationship management system to enable two-way digital communication between AGN and their customers

AGN says “While customers value the current services, insights gained through customer consultation highlight their desire to engage with us through additional avenues such as our website and other digital means. The primary touch points where our customers expect communication are:

- connections;
- planned maintenance, including meter changes;
- meter readings; and
- outages.”

The platform upgrade would also assist AGN to better engage with their ”life support” customers.

AGN engaged with customers through their engagement activities on this question and were told that a more advanced communication capability, eg text messaging was not necessary due to higher cost and because outages are very uncommon, compared to electricity supply, with text messaging is widely used.

This proposal was supported by consumer engagement and is consistent with AGN’s proven record in actively seeking to improve interaction with customers

(iii) Insurance premiums

Our current CCP activities across all networks have shown increasing insurance premiums in recent years and this has been exacerbated by COVID-19. This pressure is expected to continue in the first two years of the period before easing considerably in the last two years. We look to the AER to review and assess whether the additional costs over trend are justifiable. We look to AGN to inform stakeholders around the potential to lessen cost pressures through taking on higher deductibles given the absence of claims in the current period. Where insurance bill increases are substantially greater than an efficient business would be expected to budget for, then there is justification for a step change.

Trend

Following the recent AER Jemena NSW decision, labour cost assumptions are based on the average of the Deloitte and BIS Oxford forecasts.

Table 7.6: Calculation of annual real labour cost escalation

Labour cost estimates	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
BIS Oxford	1.09%	1.09%	1.26%	1.51%	1.38%	1.18%
Deloitte Access Economics	0.37%	0.37%	0.34%	0.45%	0.44%	0.44%
Average	**0.73%**	**0.73%**	**0.80%**	**0.98%**	**0.91%**	**0.81%**

Figure 13. Source, AGN Final Plan

There is a significant difference between the forecasts, both of which do not reflect COVID impacts. BIS was competed in February 2020 and makes no reference to a COVID impact. Deloitte's report[16] was completed in March 2020 and noted:

> "The full impact of the bushfires, COVID-19 and the related stimulus measures are not captured in the forecasts presented in this report. These forecasts should be treated with caution against a backdrop of heightened uncertainty around the economic outlook."

We expect that revised forecasts will be prepared by both forecasters prior to the AER's final decision. We note the recent Federal Government forecasts of overall economy wages growth out to 2020/21 indicated a significant fall in growth compared to 2018/19[17].

Unaccounted for Gas (UAFG)

The proposed cost of UAFG is $47.2m, up from $40.2m in the Draft Plan. This includes sourcing 20% of the gas from renewable gas in the form of bio-methane. The AGN consumer engagement on this issue involved presentation of the following options showing the increase in the annual bill for each.

How much?	How green?	Bill Impact (Estimate)
Replace 20% lost gas with renewables	• 12 tonnes carbon reduction • 4,000 cars off the road	$1.50
Replace 40% lost gas with renewables	• 21 tonnes carbon reduction • 7,200 cars off the road	$3
Replace 100% lost gas with renewables	• 46 tonnes carbon reduction • 16,000 cars off the road	$5.50

Figure 14. Source, AGN Final Plan

There was strong support for the proposed 20% level both in the regional engagement sessions and the SARG/RRG members. The price of this renewable gas is not disclosed. The total cost of the agreed volume of UAFG is a pass through. AGN takes the risk/benefit on the agreed volume. UAFG is outside of EBSS.

We assume that the 20% increase is a combination of higher volume(?), higher gas price and the additional cost of biomethane. We comment specifically on two aspects of UAFG:

- the incentive on networks to limit the volumes
- the commodity price assumption to procure the forecast level

and suggest that the AER consider ways that might lead to networks having a greater incentive to improve on both given the significant and rising cost.

[16] Deloitte "Labour Price Growth Forecasts"20 March 20 2020 https://www.aer.gov.au/system/files/AER%20-%20Final%20decision%20-%20JGN%20access%20arrangement%202020-25%20-%20Deloitte%20Access%20Economics%20report%20-%20March%202020.pdf

[17] Federal Treasurer "Economic and Fiscal Update – July 2020" https://budget.gov.au/2020-efu/economic-fiscal-update.htm

Incentive on networks to limit the volume

AGN commissioned Asset Integrity Australasia Pty Ltd (AIA) to review the current UAFG level and provide recommendations for UAFG allowances for 2021-26 period[18].

UAFG is defined by the Retail Market Procedures South Australia v16 as the difference between metered injected gas supply and metered / allocated gas at delivery points. UAFG results from a number of factors including metering uncertainty, gas temperature and pressure at variance from that assumed at billing and heating value inaccuracy. UAFG is difficult to break into component parts due to the inherent uncertainty (compared to electricity) of metering a compressible fluid and the lack of data associated with determining physical unmetered losses.

The contributory elements to UAFG are classified as either Measurement UAFG (eg gas delivered at variation to pressure or temperature standard conditions, measurement inaccuracy, own use gas) or Fugitive Emission UAFG eg losses from LP/MP/HP mains and pipelines, losses from service lines – varies with material and pressure, regulator leakage and third-party damage. The figure below shows the estimated relative contributions to the 702TJ UAFG in 2016/17.

Figure 15. Source, AGN Final Plan (Confidential)

AIA discussed controllable (eg cast iron pipe replacement, network pressures, meter accuracy – ensuring compliance with Australian Standard (AS) 4944:2006, and industrial and commercial pressure set point) and uncontrollable (eg meter uncertainty, cast iron/asset deterioration, weather variations, HHV losses, meter bypass and theft).

AIA recommended a flat profile or level UAFG benchmark referenced to historical settled UAFG as the best measure for the AA. Forecasting is simply too uncertain. Three options were proposed:

- 5 Year Average of [redacted] which is below previous Access Arrangement allowances
- 4 Year Average of [redacted] which includes the nearly finalised year of 2017/18 and accommodates some of the usual variation in UAFG experienced with low levels of remaining cast iron and fluctuating network leakage
- 3 Year Average of [redacted] which is very biased to recent years with little accommodation for all the variations in annual UAFG levels experienced in recent years.

The number of leaks has trended upwards even with the recent high level of mains replacement. With LP and MP cast iron accounting for only 3.7% of the network at the start of the 2021-26 period, mains replacement in the next period will no longer be a major factor reducing UAFG with CI replacement only accounting of around 20 TJ per year.

In benchmarking AGN's performance, AIA considers that it can be compared with AGN Vic and AusNet in Victoria given these networks are at, or close to, replacing all their high leakage rate cast iron and unprotected steel pipes. These networks were in a similar position in 2018 to where AGN is now. They found their UAFG flattening out, varying by around +/- 0.3% so AIA expect the AGN rate

[18] See Attachment 7.6

will also flatten out at recent levels. This together with wider ENA benchmarking data – UAFG per km of main and repaired publicly reported leaks per 100kms - lead AIA to the conclusion that[19]:

> "This indicates AGN SA demonstrates comparatively efficient and effective UAFG management, asset performance and asset management."

AGN's selection of the 3 year average is commended as it indicates their confidence in their ability to manage the network. Nevertheless, AIA consider that there is still room for further improvement and recommend consideration of incentive programmes for specific improvement in controllable UAFG elements including temperature and pressure variations, meter maintenance, minimising network pressure and new mains and service replacement technologies to reduce gas releases during operations[20].

We encourage the AER to consider the merits of a UAFG incentive scheme, recognising that capex may be required.

The commodity price assumption

The traditional approach AGN takes to sourcing UAFG is to contract the forecast full amount prior to the commencement of the regulatory period. They use the CoRE forecast as a 'placeholder' in their regulatory proposal until the contract is finalised. The CoRE Energy Report on the price of gas recommends the following price range for 1st July 2021 and notes[21]:

> "Given that the delivery of gas to replace UAFG, involves multiple points throughout the network, CORE is of the view that the Market Price is more likely to be toward the upper end of this range – with $12.25/GJ being the best single point estimate."

AGN have used $12/GJ ($20/21) in their modelling.

Table 2.1 | Summary of Independent Assessment of SA Market Price at 1 July 2021

Price Elements	Price Assessment
Base Wholesale Commodity Price at 1 July 2021	9.50-10.50
Transmission	0.75-0.85
Retail cost and Margin	1.10-1.50
Market Price of UAFG Delivered Gas at 1 Jan 2021	11.35-12.85

Source | Core Energy & Resources

Figure 16. Source, AGN Final Plan

Our comments are focussed on the base wholesale commodity component of the forecast. CoRE draws on the January 2020 ACCC Interim Gas Report[22] data in the following chart and table to

[19] Ibid p. 23
[20] Ibid p.19
[21] Core Energy Independent Assessment of the Market Price for Gas Attachment 7.6 p. 5; we presume the reference to "1 Jan 2021" is meant to be "1 July 2021".
[22] ACCC "Gas Inquiry 2017-25 Interim Report" January 2020 https://www.accc.gov.au/system/files/Gas%20inquiry%20-%20January%202020%20interim%20report%20-%20revised.pdf

support its forecast. The chart shows the gas commodity prices offered by producers and retailers over the period from 1 January 2018 to 22 August 2019 for supply in 2020.

Chart 2.1: Gas commodity prices offered for 2020 supply in the East Coast Gas Market

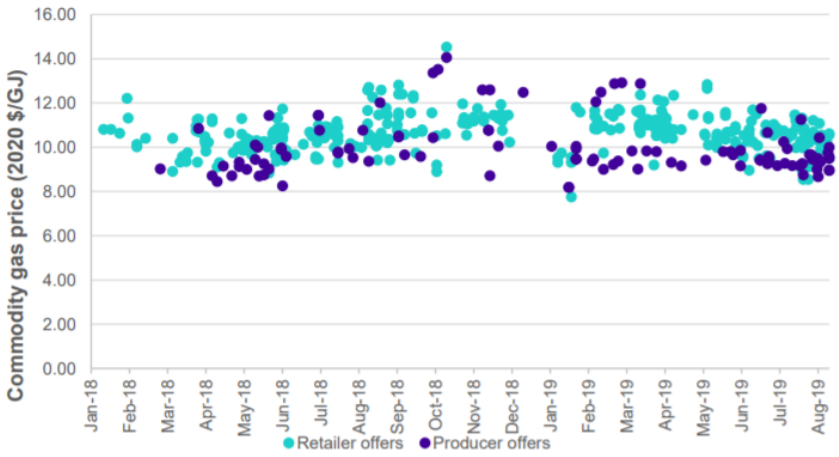

Figure 17

CoRE argues that the retailer offers are more relevant to AGN than producer offers because AGN required delivery of gas to various points in its network – a service not available from a producer.

The table shows the variation in retailer offers by State. CoRE recommends a commodity price range of $9.50-10.50/GJ[23].

Table 2.4: Expected 2020 wholesale gas retailer commodity prices in the East Coast Gas Market (under GSAs executed between 1 January 2018 and 22 August 2019)[123]

Type of supplier	Average gas commodity price ($/GJ)	Gas commodity price range ($/GJ)
Retailers (QLD)	10.33	10.00–10.94
Retailers (VIC, SA and NSW)	10.68	9.19–11.57
Retailer (NSW)	10.95	9.54–11.57
Retailer (SA)	10.22	9.19–11.06
Retailer (VIC)	10.42	9.65–10.79

Figure 18

We are not confident that this forecast is sufficiently robust for forecasting purposes. While CoRE seems constrained to base its forecasts on publicly available information, we suggest the AER look to more recent data that will take into account the impact of the significant fall in oil prices since August 2019 and COVID impacts on gas demand and price. This would include data on offer prices in the next ACCC gas report due in the near future. This will include offers for 2021 gas made in 2020.

[23] We assume the range of $9.50-11.00/GJ on p. 8 is a misprint given the range in the summary table on p. 5.

CCP24 is aware of anecdotal evidence that offers have fallen in the last six months. Also, it would be good to understand the extent to which AGN can source gas from the Adelaide short term trading market. The just published AEMC review on gas market liquidity concluded that[24]:

> "The DWGM and STTMs as compulsory markets continue to enjoy relatively higher levels of liquidity and stakeholder confidence … Overall the Commission considers that progress is being made towards increased liquidity that can contribute to achieving the COAG Energy Council's gas market vision."

The Adelaide STTM market traded 4PJ in 2019. Price history over the last 10 years[25] shows the significant fall in price over the last 18 months as summarised in figure 19.

AGN suggest that they do not have the in-house capability to source gas on the spot market, though we expect that this could be easily sourced as part of the package deal with their selected gas retailer.

We encourage the AER to consider how a network might have a greater incentive to decrease both the volume and the price. There do not seem to be strong incentives on networks to obtain the lowest possible price.

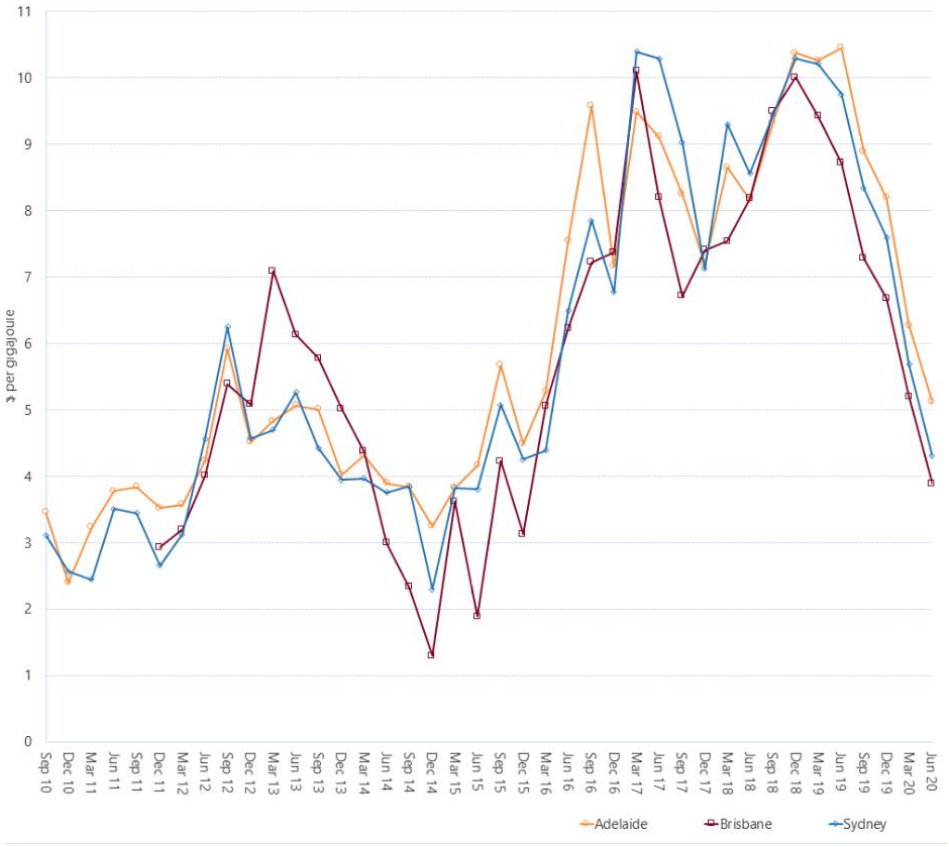

Figure 19

[24] AEMC "2020 Biennial review into liquidity in wholesale and gas Pipeline Trading Markets – Final Report 17 July 2020" p. 9 https://www.aemc.gov.au/sites/default/files/documents/gpr0007_-_biennial_gas_liquidity_review_-_final_report_17_july_2020_for_publication.pdf

[25] See https://www.aer.gov.au/wholesale-markets/wholesale-statistics/sttm-quarterly-prices

11. Incentive mechanisms

Final Plan

In the current period AGN has one incentive scheme – opex efficiency benefit sharing scheme (EBSS) in which the benefits of opex expenditure lower than the AER allowance amount are shared 70% to consumers and 30% to AGN. AGN propose that this continues.

AGN proposes two additional incentive schemes:

(i) Capital efficiency sharing scheme (CESS) - the benefits/costs of capex expenditure lower/higher than the AER allowance amount are shared 70% to consumers and 30% to AGN; it would mirror the 'Contingent CESS' scheme recently approved by the AER for AGIG Victorian and Albury networks

(ii) Network innovation scheme – the current regulatory framework makes it difficult to invest in innovation because the CESS and EBSS schemes provide an incentive to reduce costs; this would be similar to the Demand Management Innovation Allowance Mechanism operating for electricity distribution networks.

On (i) the AER applies service performance measures to ensure that reduced capex spend does not result in reduced service levels. AGN is proposing similar Asset Performance Index (API) measures as their Victorian operations – SAFI, SADI and the number of reported leaks. The network's 30% share falls to zero if these measures fall below 80% of their respective targets.

AGN are proposing a comprehensive AGN and industry wide consultation process on the Innovation Scheme post the Final Plan submission.

CCP24 comments

Incentive schemes are key to the revealed costs regulatory framework to promote the efficient investment in, operation and use of, gas distribution networks. We consider that continuation of the EBSS and initiation of the CESS are consistent with that objective. We agree with the proposed Asset Performance Index constituent parts, targets and weightings.

We support a network innovation allowance in principle and look forward to observing the engagement process and stakeholder views. As we noted in our Advice on the Draft Plan:

- Any innovation expenditure must have a very high probability of providing benefit to customers of greater value than the cost.
- An innovation allowance would need strong support from customers, and ongoing engagement with them.
- Projects funded through innovation allowance should involve a range of stakeholders, where possible, including researchers, consumer interests and other businesses in the gas supply chain, and regulators.
- As with the DMIAM, the rules for gas innovation allowance should be standard across the NEM, and preferably nationally.
- Funding for gas innovation projects should be shared by the relevant gas network customers State and Commonwealth governments, researchers and the relevant renewable energy bodies.

12. Customer numbers and volume forecasts

Final Plan

AGN has utilised the forecasting approach that they have summarised in the following table from their AA proposal.

Figure 12.1: Forecasting method used for residential and commercial customers

Figure 20. Source, AGN Final Plan

We recognise that forecasting is never an easy task and in the current context with uncertainty about energy policy, the future of gas and COVID-19 impacts, forecasting is all the more difficult. In this context a significant input into AGN's forecasts for 2021-26 was the engagement of CoRE Energy to develop independent forecasts. We note that CoRE contextualised their estimates with the following comments.

"CoRE acknowledges that the derivation of mid to longer range forecasts generally, and this customer and demand forecast specifically, involve a significant degree of uncertainty. Accordingly, CORE has taken all reasonable steps to ensure this Report, and the approach to deriving the forecasts referred to within the Report, comply with Division 2 of the National Gas Rules ("NGR") "Access arrangement information relevant to price and revenue regulation", and in particular, parts 74 and 75 as referenced below.

"74. Forecasts and estimates

(1) Information in the nature of a forecast or estimate must be supported by a statement of the basis of the forecast or estimate.

(2) A forecast or estimate:

(a) must be arrived at on a reasonable basis; and

(b) must represent the best forecast or estimate possible in the circumstances.

75. Inferred or derivative information

Information in the nature of an extrapolation or inference must be supported by the primary information on which the extrapolation or inference is based."[26]

Not surprisingly, they agree that forecasting is particularly problematic in the current environment!

Residential Demand

While the AER does not yet conduct benchmarking analysis for gas network businesses in Australia, CoRE Energy produced some benchmarking data in their analysis, including forecasts for residential demand across the gas networks. These results are copied below

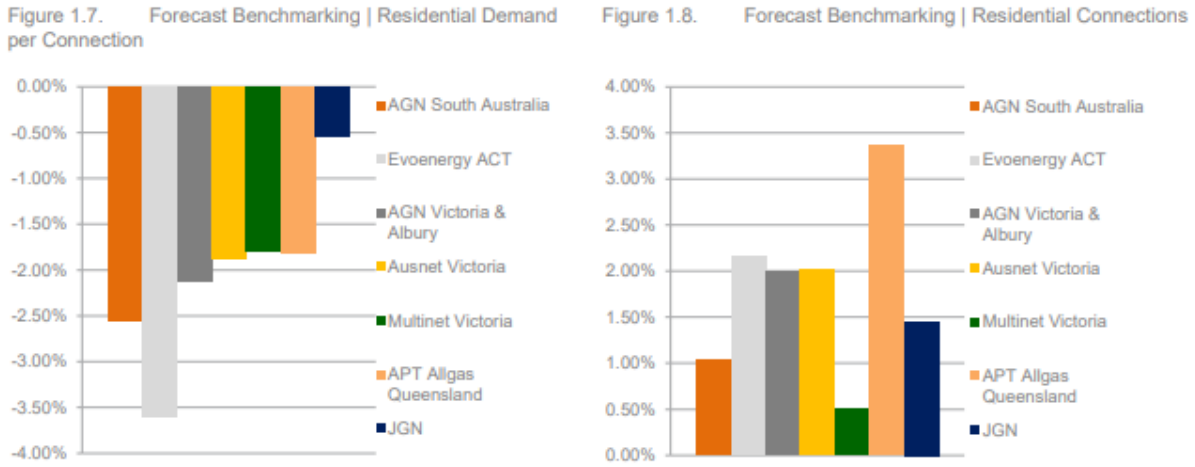

Figure 21. Source, AGN Final Plan, CoRE Energy

All Australian networks for gas are expecting reduced demand per connection over the coming years with CoRE explaining why JGN is something of an outlier, stating “It should be noted that the slowest decline in demand for connection shown for JGN is due partly to growth in a new multi-dwelling meter type whereby one metered connection is typically supporting 50-100 individual dwellings.”

The analysis leads to the forecasts for residential gas use in South Australia for the period 2021 - 26 as given in the chart below. This chart reflects a modest increase in connections of about 1% being offset by reduced demand per connection. We understand that these results factor in assumptions about climate change, with mild winters in South Australia further reducing household demand for gas.

[26] Core Energy Forecasting Plan, Attachment 12.1 of AGN AA proposal

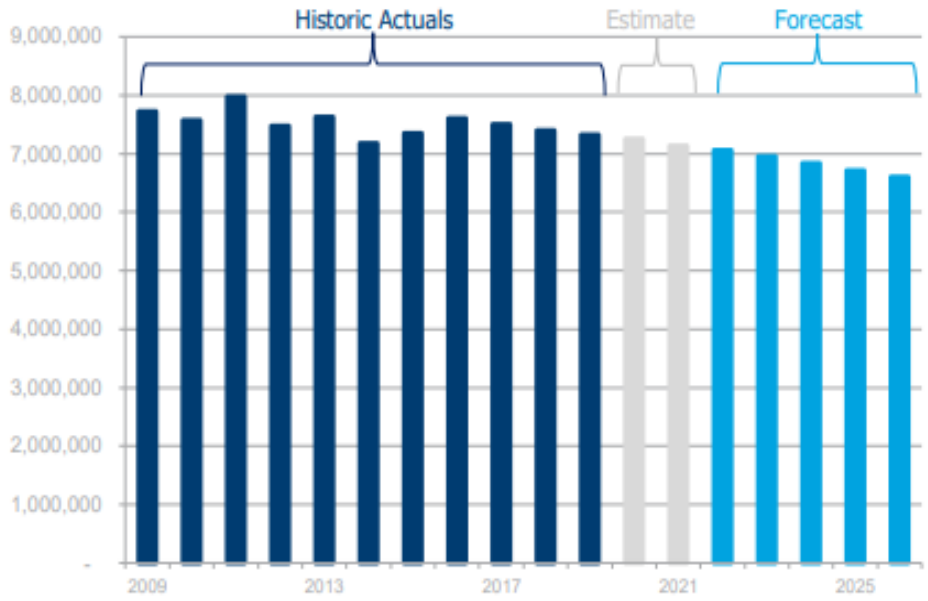

Figure 22. Source, AGN Final Plan

Commercial and industrial (C&I) Demand

CoRE summarises the factors for consideration of future commercial connections with the following:

"The Real GSP conditions for most of the forecast period are forecast to sit above historical levels, but this is offset by a declining ratio of business numbers to GSP and subject to significant downside risk due to the COVID pandemic."

Their forecasts for commercial connections from the end of the current period through the next access arrangement period are summarised in the table below.

Table 7.6. Commercial Connections Forecast | No.

	2019	2020	2021	2022	2023	2024	2025	2026
Opening Connections	11,185	11,233	11,350	11,291	11,231	11,337	11,442	11,544
Disconnections	207	150	151	153	154	156	157	158
Disconnections | Zero Consuming Connections		-	168	168	-	-	-	-
Existing 2019 Connections		11,083	10,764	10,443	10,289	10,133	9,976	9,818
New Commercial Connections		267	261	261	260	260	259	258
Cumulative New Commercial Connections		267	528	788	1,048	1,308	1,567	1,826
Total Connections	**11,233**	11,233	11,350	11,291	11,231	11,337	11,442	11,544
Net Connections	**48**	**117**	**- 58**	**-60**	**106**	**104**	**102**	**100**

Figure 23. Source, AGN Final Plan, CoRE Energy

While the CoRE projections for demand per connection has the weighted average demand per connection in 2019 0f 295.7 Gj/connection slightly reducing to 291.5 Gj/connection in 2026.

These factors combine to yield the following forecast for commercial and industrial demand:

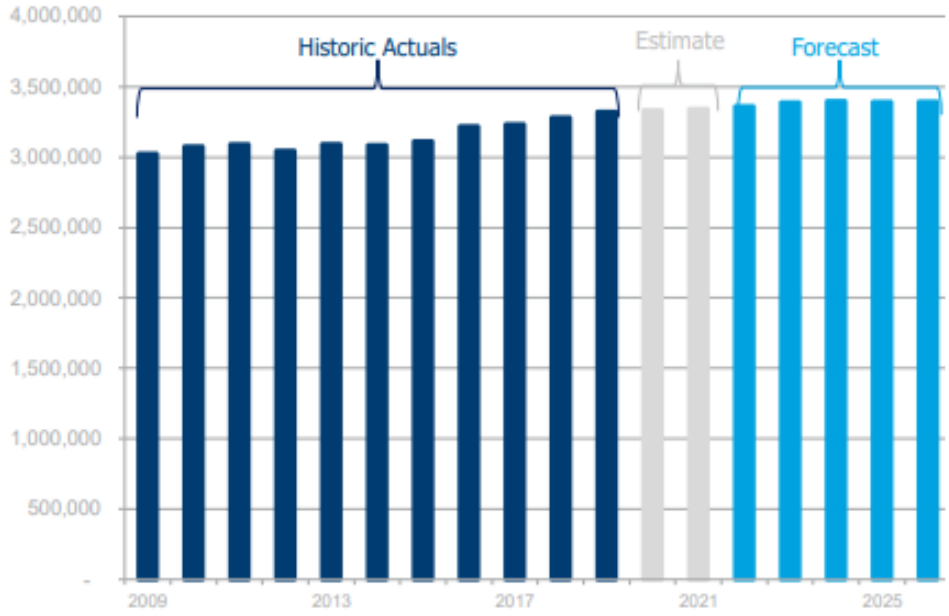

Figure 24. Source, AGN Final Plan

These forecasts show that the gentle increase in demand over the last decade tapers off to an almost flat net commercial and industrial demand through to 2026.

CCP24 Comment

AGN has undertaken a very comprehensive approach to forecasting customer numbers and demand for each of their major customer segments through to 2026. The approach and that adopted by their consultants, CoRE Energy are consistent with the methodology accepted by the AER for current period for AGN's South Australian and also Victorian and Albury networks. We understand that the forecasts are also consistent with AEMO GSOO (Gas Statement Of Opportunities) forecasts.

As expected, the rate of growth of new connections continues to fall as well as average consumption for household customers

From a sample of 7 distribution networks AGN has the second lowest rate of growth of residential connections and second highest annual decline in residential connection consumption, this might suggest that there is strong support in SA for a move to renewable electricity and that this is being reflected in gas consumption trends.

We also note that there is limited consideration of COVID impact in the commercial demand customer forecasts, due to uncertainty and the relatively early timing in the COVID-19 process for the CoRE analysis. CoRE "notes the potential for material downside in commercial connections and demand."(p.44). The forecasts for C&I demand appear to be somewhat optimistic and we look forward to revisions, based on a little more information, particularly relating to possible COVID-19 impacts, in the revised Access Arrangement

CCP24 looks to the AER to make a detailed assessment of forecasts and compliance with the rules. We anticipate that the forecasts are compliant and consider them to be as comprehensive and rigorous as is possible in the current climate of substantial uncertainty particularly for gas.

13. Reference Service Terms and Conditions

Final Plan

In this 2021-26 Access Arrangement Proposal, AGN proposes to continue the harmonisation of reference service terms and conditions across all of its Australian networks. The terms and conditions associated with the Access Arrangement have been the subject of consultation with AGN's Retailer Reference Group since April 2019. Attachment 14.1[27] of the Final Plan sets out the process of consultation undertaken with retailer representatives, and summarises the feedback received and AGN's responses.

A notable addition to the terms and conditions proposed for this AA is the insertion of a clause to enable the requesting of customer details from retailers for the purpose of operating, maintaining or management of the Network or the provision of Distribution Services. This is intended to support the introduction of enhanced digital communication channels for customers, an initiative identified through the AGN consumer engagement program.

CCP24 Comments

CCP24 has had the opportunity to attend meetings involving the AGN Retailer Reference Group and observe their active participation. We are unaware of any other network business in the NEM that hosts a formal standing Retailer Reference Group and consults as widely on reference service terms and conditions as AGN. CCP24 support the process of standardisation of terms and conditions and agree with AGN's assertion[28] that 'the process of standardising our terms across our networks is consistent with achieving lowest sustainable costs for our customers'.

14. Conclusions and Capability of Acceptance

From early discussions between AGN and CCP24, AGN was clear that they intended to lodge an Access Arrangement proposal with the AER that was "capable of acceptance."

At the public forum we raised this intention of capability of acceptance saying that "AGN's aim was to lodge an Access Arrangement that would be 'Capable of Acceptance' by the AER, customers and stakeholders." We concluded our presentation by saying that we would take the question of capability of acceptance very seriously and would give further consideration to what it meant in practice. We presented Indicative criteria that we would use in our Advice in responding to whether the AGN Access Arrangement was capable acceptance, these criteria being:

- Demonstrated consumer support across the diversity of consumer interests, particularly with the 'hydrogen journey'
- Addresses affordability concerns
- Follows AER guidelines and regulatory models
- Efficient business expenditure
- Demonstrated, responsive leadership engagement

[27] https://www.aer.gov.au/system/files/AGN%20-%20Attachment%2014.1%20-%20Engagement%20with%20the%20AGN%20Retailer%20Reference%20Group%20-%201%20July%202020.pdf
[28] reference AGN, Final Plan July 2020, page 151

- Further engagement re market expansion capex, Vulnerable Customer Strategy, Innovation Incentive Scheme

We observed that the notion of a regulatory proposal being "capable of acceptance" is not new, indeed a search of the term "capable of acceptance "on the AER website[29] yielded 4621 results though the full term applied to about 100 of the results generated. From a brief review of the results it is apparent that the term has had currency since about 2016. The term has mainly been used by consumer groups, CCP subpanels and network businesses and has been overwhelmingly associated with network regulatory proposals and was also actively used in the 2017 review of rate of return guidelines.

CCP9 concluded their Advice to the AER in February 2018 regarding the ElectraNet revised revenue proposal for 2018-23

> "we would also like to thank the members of ElectraNet's consumer advisory panel for the work they have put into ensuring that Electra net achieves its ambition of a 'no surprises' proposal, that is 'capable of acceptance' by the regulator."

We note that AGN also presented its Victoria and Albury Access Arrangement proposal in 2017 with the express intent that it be capable of acceptance, which was largely supported by CCP11 (Victorian Gas Reset for 2018-2022) in its response to the AGN Vic AA Proposal said:

> "AGN has stated that 'Our overarching objective is to submit a plan that delivers for customers, is underpinned by effective stakeholder engagement and is capable of being accepted by the AER.' Overall, CCP11 considers that AGN has clearly met its objective of presenting an Access Arrangement Proposal which is underpinned by effective stakeholder engagement."

We are not aware of any specific AER documentation that seeks to specify the practical meaning of 'capable of acceptance' in a network regulatory process though it is our experience that AER decision-makers are eager to see regulatory proposals that are lodged after a development process that has included active and robust consumer engagement and quantifiable indications of consumer support for what is lodged.

We suggest that the notion of 'capable of acceptance' has perhaps been more aspirational than pragmatic to date and that this Access Arrangement proposal from AGN requires active consideration of the meaning of capable of acceptance and then assessment of the extent to which the AGN proposal meets the stated intent as was implications for a proposal that is at or near capability of acceptance.

But what does "Capable of acceptance" mean in practice?

There are some examples of processes that seek to embed consumer engagement in network regulatory process that are worth considering briefly before returning to the praxis question about the practice of 'capability of acceptance' in Australia.

"Other" instances of 'capable of acceptance.'

[29] Search undertaken on 2/8/2020

This is not a comprehensive review of potentially relevant examples but touches base on some of the more widely quoted examples in the current Australian energy network context.

1. Scottish Water and WICS

In regulating the water industry in Scotland, the Water Industry Commission of Scotland (WICS) in agreement with Scottish Water and a key consumer group (now Citizens Advice Scotland) agreed to an approach whereby a Customer Forum, jointly appointed by the three parties, would negotiate a regulatory proposal with Scottish Water. The regulator, WICS advised that a proposal with documented agreement from the Customer Forum, would be accepted provided key parameters were within "tram tracks," the ranges determined through consultation and prior to the commencement of the negotiation process.

2. RIIO 2

The U.K.'s Office for Gas and Electricity Markets, Ofgem, now uses a regulatory process referred to as RIIO, meaning: Revenues = Incentives + Innovation + Outputs.

Under this model a network business that presents a regulatory proposal that has the support from robust consumer engagement, can be accepted and fast tracked through the regulatory process. This approach provides rewards to the network business which include reputational benefit, reduced costs in meeting (standard) regulatory requirements as well as capacity to get to market early particularly for major capital projects with improved capacity to go to market when contractor prices may be more favourable to the network business. Consumers gain much greater transparency throughout the regulatory process and confidence that they are paying an efficient and reasonable price for network services.

3. NewReg

The New Reg: "Towards Consumer Centric Energy Network Regulation" approach paper of March 2018 provided the first objective for this trial as being:

> "to successfully apply the proposed process to produce a revenue proposal that reflects consumer preferences and provides the regulator with a proposal with which it will be able to substantially agree."

To the best of our knowledge the "NewReg" trial did not go to the point of seeking to specify what the practical implications for the regulator were in dealing with a proposal with which it could substantially agree.

It is worth noting that the AER issued 10 guidance papers specifically designed to assist AusNet Services and their Customer Forum in the negotiations

Factors indicating Capability of Acceptance

From the three examples briefly summarised above and from other discussions, we suggest that good regulatory practice would suggest that the AER could regard a network proposal as capable of acceptance where the following minimum criteria were met:

- the business presented a clear business narrative – clearly describing where the proponent wants to take the business, and why this will be good for consumers;
- Meaningful engagement with consumers and other stakeholders. This will include clear descriptions of engagement processes that were undertaken to ensure that a diversity of perspectives was achieved, clear evidence that advice from customers and stakeholders was heard, including the advice that the network may not have wanted to hear. Clear

documentation of how input from customers and stakeholders has been applied in the regulatory proposal.
- Supporting documentation from consumer groups and stakeholders identifying where agreement has been reached, including through negotiation
- Evidence that the network business has critically assessed the options available to it, (e.g. non-network solutions, shorter and longer term options etc), and is looking for the best value for customers.
- Engagement is not always about price reductions, other factor including local differences, service quality and reliability can also be important.
- AER analysis has been undertaken by applying the standard regulatory models including roll forward model, PTRM and other relevant models. Benchmarking is also an important consideration, though this is less of an option for gas businesses.
- Ideally the key parameters of the proposal fall within previously agreed ranges
- The proposal passes the "pub test" i.e. it is reasonable compared to the past performance of the business, comparisons with peers and consumers have reason to be generally accepting of the price and service impacts.

Business Expectations about Capable of Acceptance

Turning attention now towards a business's possible expectations of capability of acceptance, we suggest that a business could expect the AER to ratify the following aspects of an acceptable revenue proposal:

- the proposal is compliant with the rules
- the forecasts for demand and other relevant factors are reasonable
- the expenditure proposed is regarded as efficient and sufficient to provide necessary services
- the outcomes for customers, including indicative price paths are in line with reasonable expectations and benchmark favourably with peers and with historical performance of the business

For a business we opine that the benefits of a proposal being capable of acceptance are that there is not significant further work to be done, so a lighter regulatory 'touch' reduces the costs that it needs to bear, the business can get on with earlier planning for new projects and there is also 'reputational capital' for the business in being able to go to customers and the public more generally as being credible and trustworthy – attaining a 'social license to operate'.

AER options for a proposal that is considered to be Capable of Acceptance

The question that still remains largely unanswered is what the AER is able to do with the regulatory proposal if the capable of acceptance criteria apply that are similar to this set of criteria. We note that whereas Ofgem or WICS have clarity about fast tracking or some other form of preferential regulatory response for a well-developed regulatory proposal with strong customer support, this option does not overtly exist under the Australian energy rules.

So, what are the options that the AER has for the Australian network business that lodges a proposal that is capable of acceptance? We suggest that there are the following options:

1. The AER board can accept that the proposal, as an integrated package, is capable of acceptance and issue a decision to say that the proposal as lodged is accepted as both the draft and final decision.
2. The AER teams (opex, repex, augex, forecasting etc) apply their standard models to the regulatory proposal and the proposal is accepted if the results from applying the various regulatory models fall within an implicit, reasonable range.
3. The AER teams apply the standard models and also conduct more detailed investigation of major expenditure items that are proposed, e.g. opex step changes, major new network capital expenditure, non-network capex, e.g. IT. The AER could then issue a draft decision accepting all elements of the proposal except for a small number of specific items require further consideration and then indicate to the business that would accept the revised proposal once the specific items had either been revised by the network or documented support for the original proposal was provided from a robust consumer engagement processes

Consideration of Capability of Acceptance of the AGN AA proposal.

In considering the question about whether the AGN Access Arrangement proposal is capable of acceptance we return to our initial list of criteria that we said we would use to consider the proposal, at the public forum:

- Demonstrated consumer support across the diversity of consumer interests, particularly with the 'hydrogen journey'
- Addresses affordability concerns
- Follows AER guidelines and regulatory models
- Efficient business expenditure
- Demonstrated, responsive leadership engagement
- Further engagement re market expansion capex, Vulnerable Customer Strategy, Innovation Incentive Scheme

based on the discussion above we add to this list the following 2 additional criteria

- the business presented a Clear business narrative –
- Evidence that the network business has critically assessed the options available to it.

In this advice we have identified 5 aspects of the AA proposal that are pending further action:

1. Consumer engagement regarding the market expansion issues and associated stranded asset risk.
2. AGN delivering the commitment to further engagement regarding vulnerable customer strategy, up to the per customer cost ceiling supported during phase 2 and 3 engagement as well as some demonstrated AGN contribution
3. AGN delivering the commitment to further engagement regarding their innovation strategy and innovation allowance
4. Review of productivity proposal by AER
5. Reasonable revisions of demand forecasts based on further understanding of COVID-19 impacts

This then leads to our assessment of AGN's proposal, against the criteria that we have identified in the public forum, augmented and which we consider to be consistent with both the current standing of regulation in Australia and other relevant processes.

Assessment factor	CCP assessment
Clear business narrative	Criteria met. Note focus on three vision elements and future of gas issues including hydrogen leadership
Demonstrated consumer support with diversity of consumer interest	Criteria met. Consumer engagement applied a number of methodologies and demonstrated very strong consumer support
Demonstrated, responsive leadership re engagement	Criteria met
Addresses affordability concerns	Criteria met with the proposed price path
Evidence of critical assessment of a range of options available to the network	criteria met
Follows AER guidelines, regulatory models across the proposal	To be assessed by the AER
Efficient business expenditure	Criteria met, pending AER assessment of efficient base year and annual productivity rate for opex and efficient capex.
Commitment to further engagement on 4 topics: stranded asset risk, COVID-19 impact on demand forecasts, vulnerable customer strategy and innovation incentive scheme	Criteria met, pending undertaking targeted engagement on the four topics in a timetable that enables engagement output to be included in a revised 2021-26 AA proposal, in January 2021

Figure 25. Source CCP analysis

If:

- AGN delivers on our suggested commitments outlined above – based on past performance and recent discussions with AGN we expect they will, and
- AER's review of the Final Plan shows that it meets all of the AER rules requirements,

then we believe the AGN AA proposal is capable of acceptance.

15. COVID-19 implications

This section deals with some of the questions that arise as a result of Access Arrangement considerations that result from the uncertainties associated with COVID-19. As this advice is written, Victoria is in stage 4 lockdown and has had the worst day for COVID related deaths since the virus was detected in Australia. The ACT and South Australia are tentatively re-opening their economies, but a spectre of uncertainty remains across Australia. The initial optimism that the public health response to the pandemic would be brief and that economic activity would soon bounce back is evaporating. There is a growing community sense that the impacts both from health and economic perspectives will be of a longer duration.

On June 10th Renew Economy[30] reported on the International Energy Agency's global gas outlook reporting:

> "The International Energy Agency has described the start of 2020 as a "meltdown" for the international gas market, with export prices and demand for gas smashed so hard that it puts any prospect of a "gas led" economic recovery into serious question.
>
> In its Gas 2020 report released on Wednesday, the International Energy Agency said that global gas markets are set to become significantly oversupplied, as investments in new gas production coincides with a largest ever decline in consumption see prices tumbling."

While on 22nd July AEMO[31] reported in quarterly energy dynamics for the second quester of 2020:

> "Wholesale gas prices continued to fall, with the Gas Supply Hub (GSH) price averaging $4.10/GJ, its lowest level since Q4 2015. Factors influencing low gas prices included declining international gas prices (and subsequently a reduction in LNG exports and high levels of gas flows south from Queensland), lower electricity prices, and increased supply from Moomba and Orbost."

These quotes indicate some of the uncertainty in post-COVID gas (and electricity) markets. They also indicate that gas prices are likely to plummet and will probably slow the assumed decline in gas consumption and should also reduce the anticipated costs of UAFG gas for the gas networks

This section draws substantially on the work of CCP17 in their recent response to Victorian DNSP regulatory proposals which will be impacted by COVID as will AGN and Evoenergy through their Access Arrangements.

Responding to COVID-19 requires a holistic approach and we recognise that many of the responses to the pandemic need to be "NEM wide", while there are some responses that have more immediate application to the two gas Access Arrangement proposals. In this section we consider both NEM wide and AGN/Evoenergy responses as they are inter-twined for CCP24 considerations.

On page 1 of the Issues Paper[32], Victorian electricity distribution determination, 2021-26, the AER observes "there are unique circumstances for this regulatory reset, namely recent bushfires and timing changes for the reset period. The coronavirus (COVID-19) will impact both our approach to stakeholder consultation and the ability of all market participants to engage." We suggest that the same comments also apply to Evoenergy and AGN AA proposals

The Introduction describes the different approach that was undertaken in conducting the Public Forum due to COVID-19, with an online video link approach being utilised for both AGN and Evoenergy public forums. The AER concluded the Victorian DNSP introduction section of their Issues Paper with the following "we are proposing to adopt a greater degree of flexibility in our approach to requesting and receiving information (from all stakeholders) and how we need to consider the extenuating circumstances in our analysis. We will provide the distributors with a chance to submit on the effect of COVID-19 on their proposals and other stakeholders a chance to respond to the business's submissions. This may also impact on timing of some elements of the process going forward."

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[30] https://reneweconomy.com.au/iea-global-gas-market-in-meltdown-as-demand-and-prices-smashed-by-covid-19-91980/

[31] https://aemo.com.au/-/media/files/major-publications/qed/2020/qed-q2-2020.pdf?la=en

[32] AER, Issues Paper, Victorian electricity distribution determination, 2021-26

We agree that the impacts of COVID-19 have been and will be significant and cannot be reasonably predicted, therefore all stakeholders involved with this reset will wrestle with uncertainty where previously there was at least a reasonable degree of predictability, even if it didn't seem to be the case, at the time.

The next section provides a brief background to key responses to COVID-19 to date and the following section provides some thoughts from CCP24 about some of the areas of impact and processes to deal with the largely unknown impacts of COVID-19 pertinent to this reset.

What has happened?

The COVID-19 pandemic was emerging as Evoenergy and AGN were in final phases of their consumer engagement while only initial impacts were being observed when these two gas businesses lodged their AA proposals. For Australia, responses to the global pandemic started during mid-March and rapidly escalated by the end of March, by which time all Australian residents were being told to self-isolate, working from home where they could and businesses that could not operate with social distancing requirements ceased operation. The Commonwealth Government instituted a JobKeeper payment to enable people with no work, but likely work with their employer post COVID-19, to be retained by employers and still have income while maintaining isolation.

Two of the substantial impacts of the March COVID-19 measures have been:

- a significant number of businesses pausing their operations for an unknown period of time – particularly in Victoria; and
- a substantial increase in the number of people unemployed or underemployed and spending more time at home.

Energy network business responses

Quite early in the COVID-19 isolation phase, on 2nd April, Energy Networks Australia (ENA) released a statement on behalf of energy networks across Australia that recognised the arrival of COVID-19 and committed network businesses to some responses.

ENA CEO Andrew Dillon said, "*Networks understand these are extraordinarily tough times for small business and energy bill relief will really help*".

His explanation of assistance to be provided by networks included:

> *"For small businesses that are mothballed, electricity and gas network charges will not be applied from the start of April to the end of June 2020, if their consumption is less than a quarter what it was in 2019.*
>
> *Networks know it is in everyone's interest to support small businesses through what is an extremely challenging period … Networks will be deferring or rebating electricity and gas network charges for impacted customers.*

This assists impacted customers and helps energy retailers, who administer energy hardship programs."

The ENA has further explained that "*the residential part of the network relief package aims to support energy retailers so that they can better assist residential customers who experience energy bill hardship as a result of COVID-19, networks will work with individual retailers to determine how retailers systems can best deliver assistance to affected customers… Networks are working with*

retailers to develop transparent and easily administered criteria for the application of the relief package."

In early April on the 9th, the AER released a formal "Statement of Expectation" to give guidance to both energy businesses and consumers about reasonable responses to a sudden influx in rates of people experiencing financial hardship, both for households and small businesses. The AER's Statement of Expectations required energy businesses *"to ensure the continued safe and reliable supply of energy to homes and businesses, and to support both residential and small business customers experiencing financial stress*."

The statement included 10 principles intended to both protect customers at risk and to maintain reliability of supply for energy markets, these principles being:

- Offer all residential and small business customers who indicate they may be in financial stress, including small businesses eligible for the JobKeeper Payment, a payment plan or hardship arrangement, regardless of whether the customer meets the 'usual' criteria for that assistance.
- Do not disconnect any residential or small business customers who may be in financial stress (including small businesses eligible for the JobKeeper Payment), without their agreement, before 31 July 2020 and potentially beyond.
- Do not disconnect any large business customer, including businesses eligible for the JobKeeper Payment, without their agreement, before 31 July 2020, and potentially beyond, if that customer is on-selling energy to residential or small business customers (for example, in residential parks or retirement villages).
- Defer referrals of customers to debt collection agencies for recovery actions, or credit default listing until at least 31 July 2020.
- Be prepared to modify existing payment plans if a customer's changed circumstances make this necessary.
- Waive disconnection, reconnection and/or contract break fees for small businesses that have ceased operation, along with daily supply charges to retailers, during any period of disconnection until at least 31 July 2020.
- Prioritise the safety of customers who require life support equipment and continue to meet responsibilities to new life support customers.
- Prioritise clear, up-to-date communications with customers about the issues addressed in this Statement, including by keeping website, social media and call centre waiting and hold messages up to date, so customers can readily access updates when they need them and relieve some pressure on affected call centres.
- Prioritise clear communications with customers about the availability of retailer and other supports, including the availability of payment plans, energy efficiency advice and fault repair.
- Minimise the frequency and duration of planned outages for critical works and provide as much notice as possible to assist households and businesses to manage during any outage.

Some of these principles reflect particular responses required in the current COVID-19 pandemic, while others reinforce existing requirements under energy laws.

The AER also said "We recognise that our expectations in this Statement may add to the risks and costs facing energy businesses. We are particularly concerned about the continued viability of energy businesses and we are proactively working with all stakeholders on options to appropriately balance these risks and costs across the sector and to ensure energy businesses get the assistance they may need in the coming months."

Subsequently the AER submitted an urgent rule change[33] to back-up their Statement of Expectations to allow electricity retailers to defer payments to networks. The AER proposal states that:

"While the Government has taken steps to increase income support, it is clear many electricity customers are facing difficulties in paying their electricity bills. More than 20,000 electricity customers have registered for payment plans since early March 2020 and over a thousand customers per week are seeking assistance from retailers."

The intent of the rule change is summarised as "Notwithstanding any agreement for payment deferrals for customers in financial stress, the National Electricity Rules (NER) currently require retailers to make full payment of network charges as they fall due. The purpose of this rule change proposal is to alleviate cash flow pressure on electricity retailers. In particular, we are concerned that the COVID-19 pandemic could potentially undermine the operation of retail electricity markets leading to multiple retailer failures."

In summary the rule change proposal is stated by the AER as: "We propose network charges for customers on a COVID-19 customer arrangement be deferred by up to 6 calendar months."

The AER explains that some of the aspects of the rule change include:

"Network charge deferrals include distribution and transmission components. Distribution networks would in turn withhold a reasonable amount from transmission networks to account for transmission charge deferrals. At the end of that period, network charges in respect of eligible customers must be paid by retailers regardless of whether the customer has paid the retailer."

We are also aware that signatories to the Energy Charter (which include AGN through Australian Gas Infrastructure Group and Evoenergy through ActewAGL membership) are also actively collaborating on industrywide responses to energy affordability issues related to economic slowdown and social isolation impacts of COVID-19.

More recently, on 1st August, the AER[34] released a second of expectations, basically extending the initial expectations beyond 31st July 2020 for a further 3 months.

Should COVID-19 change the reset process or considerations?

This discussion is a preamble to the question of how, if at all, the processes for consideration of the 2021-26 Access Arrangements should be adjusted to consider all impacts of COVID-19.

CCP24 suggests that we are now at the stage of COVID-19 responses when we are able to identify a significant number of the "known unknowns" relevant to future trajectories of COVID-19 responses, so businesses should be able to better identify many of the potential impacts. and hence some

[33] https://www.aer.gov.au/communication/aer-proposes-new-rule-to-support-electricity-retailers-during-covid-19

[34] https://www.aer.gov.au/system/files/AER%20Statement%20of%20Expectations%20-%20From%201%20August%202020.pdf

reasonably well developed thinking about how the Regulator responds to these, so before the final gas AA decisions are released, the AER should be better placed to respond to some of the COVID-19 impacts, and have discussed these with the networks.

It is quite easy to identify a long list of likely through to possible impacts of COVID-19 on AGN and Evoenergy. These gas network businesses will be impacted operationally in much the same way as other network businesses are affected, however the timing of the AA process arguably means that at least some COVID-19 responses will need to be considered sooner than the impacts are considered for network businesses at 'later' stages in the regulatory cycle.

Likely impacts of COVID-19 on energy distribution businesses include:

- delayed payments from retailers, as per the AER statement of expectations, noting that this will be limited by the AEMC final decision on the AER rule change.
- reduced revenue due to a higher number of customers unable to pay their bills and some sharing of these increased under recoveries with retailers,
- changed cash flow,
- some movement of load from business to households with potential changes in load shape,
- greater uncertainty in demand forecasting,
- greater difficulty in engaging with "end use" customers,
- changing methodologies for consumer and stakeholder engagement,
- potential supply chain delays particularly for major capital expenditure requiring equipment or expertise from overseas,
- deferred or reduced license fees to be paid by network businesses,
- a greater need for more frequent review of all key aspects of business operation,
- changing circumstances for opex step changes including those related to opex cost trend factors, and
- changed global economic circumstances with implications for network business rate of return and depreciation rates.

We also note that some of these impacts will be time-limited, others may play out over months or years or even the entire regulatory period.

General Responses

The following are CCP24 views about options for dealing with COVID-19 uncertainty for the two gas networks.

Consumer Engagement

While consumer engagement processes will be impacted as social isolation and public gathering conditions apply, this is no reason for consumer engagement activity to be reduced. Engagement methodologies will need to be adjusted to approaches that do not require groups of people in the same location. Neither should effective consultative approaches be readily discarded because "there's no time to do them".

The reality is that the network businesses that have well-established relationships with consumers, consumer advocacy groups and other relevant stakeholders, will be best placed to utilise these relationships to maintain engagement and consumer perspective on their decision-making. COVID-19 restrictions will make it more difficult to make new contacts and to establish new relationships, but this is not impossible either.

Consumer engagement should be an ongoing priority for network businesses and the AER should expect to see evidence of consumer support for key network business decisions. Indeed, it is our

opinion that times of heightened uncertainty mean that the best responses are those where there is a greater level of shared understanding of the challenges and shared decision-making. This means more frequent interaction between consumers, consumer interest groups and stakeholders. More consumer engagement should be expected in response to the COVID-19 crisis, not less. We recognise that there are resourcing issues for consumer advocacy groups that could hinder optimal levels of engagement.

Statement of Expectations

The AER's two Statements of Expectation were timely, responsive and appropriate. We suggest that this approach be applied throughout the COVID-19 period with (semi) regular updates of further expectations, from the AER, and developed through nimble engagement with consumer groups and other relevant stakeholders.

The "Statement of Expectations" approach can reduce uncertainty but is most effective in an environment of cooperation. We have seen good evidence of heightened cooperation with the process for this reset.

Embrace mistakes

Some responses to the challenges thrown by COVID-19, made in good faith and on reasonable evidence, will, in hindsight prove to be the wrong decisions. It is critically important that a culture of "no blame" is applied in such circumstances. The crucial process for these unprecedented times is that learning is constantly created and shared, particularly including learning from mistakes. The same principles apply to responding to the uncertainties posed by an unknown future of reticulated gas.

Getting on the Front Foot

CCP24 expect that the AER will carry out sensitivity analysis on the components within the revenue determination building blocks and form a plan to respond to these variations should they arise. This is preferable to scrambling to develop a response after major problems have occurred.
Plan for Incentive Schemes

It is also important that there is a plan on how to manage efficiency payments, in particular CESS and EBSS, in a volatile environment.

Regular Updates

In order to attempt to keep key stakeholders in touch with the rapidly changing circumstances that envelop this reset, we suggest that the AER with the businesses should consider providing updates and briefings for stakeholders. These could occur in the period between the lodgement of responses to the regulatory proposals and stakeholder responses to the Draft Decision and Revised Revenue Proposals. This is a period of 6 months, during which some of the impacts of the initial COVID-19 isolation will become more evident and allow for some nimbleness of approach to be taken to the anticipated changing circumstances. The updates and briefings would deal with substantive issues where circumstances changed, including demand, forecasts, major shifts in capex projects etc.

The updates could be in the form of a videoconference (using a platform such as Zoom, Webex, Skype, or Microsoft Teams) briefing of between 60 minutes and 90 minutes in duration with limited moderated questions for clarification, not debate of content.

This would provide one straightforward mechanism for keeping stakeholders in touch and enabling the relevant AER teams and the five network businesses to be keeping each other informed. This also

responds to an anticipated higher rate of change over coming months than has occurred over similar times in previous resets.

These updates and briefings would be additional to the anticipated October 2020 pre-determination conference in response to the draft decision – a forum whose process remains uncertain, but we are optimistic that this could well be a face-to-face forum. In-person participation is the format we strongly recommend if at all possible.

Alternatively, additional public forums / briefings could be scheduled in addition to the predetermination conference.

Greater Flexibility

The AER, for the Victorian electricity resets have committed to a "greater degree of flexibility in our approach to requesting and receiving information" for this reset. We support this approach for all COVID-impacted regulatory proposals and observe that the impacts of COVID-19 uncertainty have been and should continue to be an attitude of flexibility, even forgiveness, when things do not go as planned or anticipated.

Decision Review

We suggest that in this instance the AER should signal that it will be reviewing COVID-19 impacts, and perhaps suggest a notional timeframe, maybe 18 to 24 months after the final decision is made.