Consumer

Challenge

Panel

CCP28 Advice to Australian Energy Regulator on:

Approach to six-month extension of access arrangements for Victorian gas distributors

Consumer Challenge Panel (CCP) Sub-Panel CCP28

Helen Bartley

Ron Ben-David

Robyn Robinson

7 December 2021

The Consumer Challenge Panel sub-panel CCP28

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

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

CCP28 is a sub-panel of the AER's Consumer Challenge Panel. The AER established the sub-panel in November 2021 to focus specifically on the AER's regulatory determinations for the three Victorian gas distributors for 2023-2028, and the APA Victorian Transmission System for 2023-2027.

Background

This Advice is provided in response to the *Approach to six-month extension of access arrangements – Victorian gas distributors: Position pape*r[1] published by the AER in November 2021. Due to the late establishment of CCP28, we have only had a limited opportunity to assess the proposed extension.

Overall Approach

On balance, CCP28 supports the AER's proposal (p.3) to:

> "…extend 2022 calendar year prices to 30 June 2023. To the extent the expected revenue that would be recovered at those prices is different the building block revenue we approve for that period, any under or over recovery would then be corrected in - and its impact on prices smoothed over - the next access arrangement period commencing on 1 July 2023."

The AER provides sound reasons for its proposal, including:

- "To minimise price volatility for Victorian consumers" (p.3)
- Unlike for the electricity distribution extension in 2020, the Victorian Government Order gives the AER the additional… "option to smooth revenue between the extension period of 1 January to 30 June 2023, and the new access arrangement period commencing on 1 July [2023]." (p.3)
- It avoids unnecessary complexity such as "needing to use an alternative averaging period [when determining the rate of return]." (p.6)

In addition to the above reasons, we have also taken into account the following matters:

- Good regulatory practice suggests the benefits of a regulatory action should outweigh its costs. Although we are not aware of any cost-benefit analysis for this proposal, the AER's paper indicates smoothing will ensure impact on networks will be NPV neutral.
- Networks and retailers should welcome not having to update their tariff schedules twice in six months – given the claimed costs and efforts involved of doing so.

[1] https://www.aer.gov.au/system/files/Position%20paper%3A%20Approach%20to%20six-month%20extension%20of%20access%20arrangements%20for%20Victorian%20gas%20distributors%20-%20November%202021_1.pdf

- It will be difficult for consumers to engage in two simultaneous but separate (though related) regulatory processes throughout 2022 – i.e. review of the networks' extension arrangements as well as their regulatory reset proposals for 2023-28.

Moreover, the proposal is consistent with the precedent for the equivalent extension of the Victorian electricity distribution networks regulatory period in 2020 to align with a financial year rather than a calendar year.[2] We note at that time the AER consulted on the proposed approach, with consumer representatives being broadly supportive of the proposal.

Given these observations, we consider no further consultation with consumers regarding the extension is required by either the networks or the AER.

We note, however, the submissions from AGIG and Ausnet Services on the AER Position paper appear to have misinterpreted the AER's proposal as involving the indexation of 2022 tariffs for application in the extension period. For example, AGIG has submitted:

> "We note the position paper also refers to indexing the 2022 tariffs with inflation when determining the tariffs to apply in the six-month extension period." (p.1)

This is not consistent with the AER proposal and the Victorian Government Order. The Order provides two methodologies for determining a *notional* revenue allowance in the extension period. This notional allowance is calculated solely for the purpose of identifying the quantum of the true-up required in the 2023-28 regulatory period. One of the methodologies described in the Order refers to calculating this *notional* revenue based on 2022 tariffs being indexed for inflation. There is no suggestion that tariffs would, in fact, increase on 1 January 2023. CCP28 supports the approach proposed by the AER which is to avoid the potential for price volatility as a result of the extension, and the risk that prices might change materially twice in six months. We do not support the indexation of tariffs for the extension period.

Outstanding Concerns

Nonetheless, we have a number of **outstanding concerns** the AER should explain and justify more thoroughly in its final decision. These include:

1. Operating Expenditure

   The proposal is to set the operating expenditure forecast at half of the corresponding forecast opex as approved by the AER for the regulatory year commencing on 1 January 2022, adjusted for inflation and rate of change. The paper identifies a risk in using this approach if actual opex in 2022 results in significant underspend compared with the forecast. An explanation of how efficiency carryover amounts are managed so that efficiency gains are not double counted is provided. However, CCP28 suggests a fuller explanation is warranted to assure customers that fair outcomes will be achieved under this methodology. In the final decision, diagrammatic or graphical representations and explanations of the options for dealing with efficiency benefits would be beneficial.

[2] Following the Victorian Minister for Energy, Environment and Climate Change's advice to the AER in April 2019, https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/ausnet-services-determination-2021-26/update

2. Rate of Change applied to Opex Forecast

Application of a rate of change to the opex forecast for the extension period that is three quarters of the rate of change for 2022, rather than half the 2022 rate of change is not immediately intuitive. Further, we understand that the proposal also includes a nine month rate of change for the first year of the new regulatory period, which is not referenced in the paper. CCP28 suggests that a fuller explanation of the rate of change calculation be included in the final decision, preferably with a worked example to aid understanding and improve transparency to consumers.

3. Revenue True-up

The paper describes the AER's approach to account for any under- or over-recovery of revenues in the extension period to account "for the **time value of money**" (by way of an example on p.14). We are unclear *why* the AER is proposing that any under- or over-recovery of revenues in the extension period will be adjusted by the weighted average cost of capital (WACC) when regulated revenues are calculated for the next access period.

The WACC represents the long run, risk-adjusted cost of funding investment in long-lived network assets. The AER seeks to set the WACC at its efficient rate in order to establish appropriate incentives for investments by networks.

The arrangement contemplated in the paper is neither a long-run funding arrangement nor a risky proposition to either of the parties. Full repayment ("true up") is assured in the next access period. Nor does the proposal have any incentive properties or efficiency objectives. Moreover, in the event networks face an under-recovery during the extension period, it is inconceivable this would necessitate any equity raising. This all suggests the time value of money should be set at the cost of debt ('on the day') rather than a long-term WACC which includes elements reflecting the cost of equity and the trailing average cost of debt.

4. Application for Victorian Electricity Distributors

CCP28 understands that the proposed transition period arrangements mirror the arrangements implemented for the corresponding six month extension period for electricity distributors during their 2021-26 revenue determinations. When data from the electricity distributors' transition is available for analysis, we encourage the AER to publish the outcomes of this approach to confirm that the expected outcomes have been achieved, and that results are fair and reasonable, and not biased in favour of either networks or customers.