

APA: Victorian Gas Transmission System Access Arrangement 2023–27

CCP presentation to AER Public Forum
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Consumer
Challenge
Panel



Acknowledgement of country

APA's facilities and networks traverse the lands of many Indigenous nations. We recognise the traditional owners of these lands and honour their customs and traditions and special relationship with the land



Consumer Challenge Panel – our role

In relation to regulated energy network businesses, our role is to advise the AER:

- Whether a network's proposal is in the long-term interests of consumers
- The effectiveness of network consumer engagement and how consumer interests are reflected in network proposals

CCP28 was appointed in November 2021 to review the following Victorian Gas Access Arrangement resets

- Transmission: APA VTS (2023-27)
- Distribution: AGN (Victoria & Albury), AusNet Services and Multinet (2023-28)

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Context



Uncertain context for this proposal (1)

No consistent view on the future of natural gas

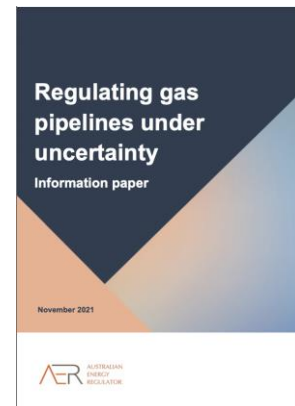
- National Gas Infrastructure Plan (November 2021) identifies a long-term development pathway for gas supply & infrastructure to 2041; national commitment to Net Zero Carbon Emissions by 2050
- Victorian Government interim emissions reduction targets
 - ▷ 28-33% by 2025 and 40-50% by 2030
 - ▷ Infrastructure Victoria's 'Towards 2050: Gas infrastructure in a zero emissions economy (July 2021) notes limited opportunity to repurpose existing natural gas infrastructure over the long term (beyond 2040)
 - ▷ Gas Substitution Roadmap due mid-2022





Uncertain context for this proposal (2)

- Future demand – forecast is flat/falling slightly, but unclear if government policy projections are included in demand forecasts
 - ▶ No assessment of demand flexibility e.g. community tolerance for cold showers
 - ▶ GSOO 2022 due March 2022
- Future supply
 - ▶ Reduced Victorian production
 - ▶ Questions over proposed Port Kembla, Geelong, Avalon LNG terminals
- Various views on future viability and timing of hydrogen as a natural gas replacement – future even more uncertain for gas transmission pipelines
- Questions about electricity network capability to accommodate electrification



AER's Information paper, *Regulating gas pipelines under uncertainty*, discusses some of the issues

Other issues for this proposal

Increasingly communities expect governments (and businesses) to take action to respond to **climate change**

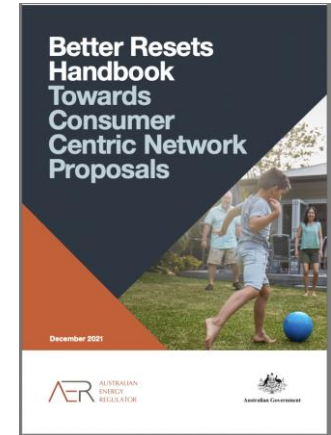
First reset since the AER published the **Better Resets Handbook**

- ▶ While APA is not seeking an 'early signal pathway', the *Handbook* sets out AER's expectations for network engagement with consumers and how networks should present their proposals
- ▶ We review APA's Proposal against the Handbook's expectations

COVID continues to impact businesses undertaking regulatory resets e.g. consumer engagement approaches, demand forecasts etc.

The **current low interest rate environment** delivers a lower than historical rate of return for network businesses

- ▶ This moderates prices for customers, but can also temporarily conceal cost increases, e.g. accelerated depreciation



APA's VTS gas network plans

- **Declining forecast gas volumes** i.e. 206PJ (2023) -> 198PJ (2027)
- \$352 million **capex** (\$2022) – **20% higher than current period**
 - ▷ Continued investment in the Western Outer Ring Main (WORM) - \$49m
 - ▷ Investment in South West Pipeline (SWP) - \$97.2m
 - ▷ Replacement expenditure - \$122.9m
 - ▷ Hydrogen safety and testing - \$37.9m
- **Flat opex** - but APA is proposing **six step changes**
- **Increases in**
 - ▷ **Regulated Asset Base** ~ 14%*
 - ▷ **Regulated revenue** \$553.6m -> \$644.1m (~16%)*

These are not signs of a network in decline

* These figures are estimates due to CCP28 deducing them from the limited information it could readily locate in APA's *Proposal Overview*, December 2021

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APA's consumer and stakeholder engagement

Consumer engagement approach

APA established its first VTS stakeholder engagement group, which worked with APA to develop an **Engagement Plan** (EP) (draft published October 2020)

- ▶ Five principles underpinned APA's engagement: no surprises, clear accurate and timely information, easy to understand, transparent and provides for influence
- ▶ The draft EP, published on APA's website, guided the scope, format and engagement topics – other engagement topics emerged from the Roundtables e.g. hydrogen

APA held **12 roundtable meetings** online between October 2020 and November 2021

- ▶ 20-35 external stakeholder (including consumer advocates, key customers, investors and others)
- ▶ APA published these presentations on its website, including a summary of responses to stakeholders' questions

APA also offered **individual meetings with stakeholders** on request

APA responded to stakeholder suggestion to provide a **Draft Plan – 'First Look'** - released 15 October 2021



Victorian Transmission System
2023-27 access arrangement - engagement plan

October 2020
Draft for comment by end November 2020



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Stakeholder feedback on APA's engagement

APA conducted an online poll at its November 2021 Roundtable, and reported the findings in its Proposal overview, among those who responded to the poll*:

- Most considered the information APA provided was 'easy to understand', and 'transparent'
- 93% considered that they had some level of influence

CCP28 subsequently interviewed several stakeholders who welcomed APA's engagement 'step-up'

Stakeholder positives

- ▶ APA's information was understandable
- ▶ APA was responsive to requests for additional information/sessions
- ▶ APA appeared to value discussions between participants, and generally demonstrated openness and good faith in discussions
- ▶ Overall, well planned and executed

Stakeholder concerns

- ▶ Different views on including industry stakeholders and consumers in the same sessions
- ▶ Divergent views not reflected in APA's Proposal
- ▶ APA's Proposal Overview lacks details
- ▶ Locating more detailed information is too difficult

* The sample size was not reported so it is not clear the extent these findings can be generalised to all stakeholders who participated in APA's Roundtables

CCP28 initial observations – consumer engagement

■ **Significant “step-up” by APA** from previous resets, but room for improvement

■ Roundtable participants **included direct customers and industry stakeholders**

▷ **Diversity of consumer representatives** of the voices of residential and small business consumers – provided elements of ‘breadth’ and ‘depth’ of engagement

■ APA committed to “involving” stakeholders (as stated in roundtable presentations 8 through 12)

▷ Our initial review of the roundtable presentations indicates APA **predominantly informed** (majority of time) and **consulted** (e.g. through predetermined questions)

▷ We found limited detailed examples of **involving** stakeholders

■ **Online engagement** due to Victoria’s COVID restrictions

■ **Engagement gaps**

▷ APA and stakeholders flagged the need for more detailed engagement on tariffs

▷ APA should engage with stakeholders on its proposed carbon credit expenditure

APA’s proposal

- Lacks a clear business narrative to set its plans for the next 5 years within the context of APA’s longer term business plans
- Insufficient detail in APA’s *Proposal Overview*
 - ▶ Detailed information is difficult to find
- Consumer benefits of proposals are not always apparent or clearly stated

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Demand forecasts

Demand and supply were the most contentious issues raised by stakeholders (APA Proposal Overview, p.17)

- APA forecasts based on: AEMO's Gas Statement of Opportunities and Victorian Gas Planning Report (March 2021)
- AEMO includes proposed Port Kembla Gas Terminal (PKGT)
 - ▷ APA does not include PKGT - APA's view is PKGT is not a committed project
- AEMO defers peak day shortfall forecast to at least 2026
 - ▷ APA suggests a possible shortfall in 2023
- Stakeholders, AEMO and APA's consultants (Oakley Greenwood) raised the potential for demand management to defer or avoid significant investment expenditure
 - ▷ AEMO refers to demand options as delivering 'minimal investment regret' (see GSOO 2021, p61)
- High degree of uncertainty around forecasts. Many changes since GSOO 2021
- We encourage APA to update its position at the revised proposal, based on latest forecasts and modelling

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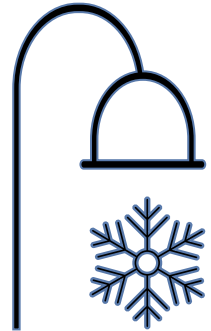
Capital expenditure

Capex – initial observations (1)

CCP28, like other stakeholders, has concerns regarding APA's proposed capex program

South West Pipeline (\$97.2m)

- Will the long term need will be supported by updated demand/supply forecasts?
- If the forecast is a 1 in 20 risk of shortfall in peak demand over a couple of years, has APA considered other options? e.g.:
 - ▶ Community tolerance to bear the risk of a small number of cold showers?
 - ▶ *What is the value of Customer Reliability?*
 - ▶ Demand management as more cost-effective solution for Victorian consumers
 - ▶ Other short term solutions?
- Lack of clarity over who is responsible for identifying and analysing the options and driving the most cost-effective option – to the detriment of consumers



Capex – initial observations (2)

WORM (\$49m in 2023-27)

- Project has experienced significant delays since initial approval
 - ▶ Current expected completion date is mid 2023, however some planning approvals are outstanding
- Stakeholders have raised concern about whether it could potentially face a stranding risk in the future considering changes in community attitudes – is the project still needed?
- Cost estimate has increased from \$126.7m to \$184.5m
- No updated business case for the project
- Should the project be treated under speculative capex provisions until the need is proven?

Hydrogen safety and integrity assessment (\$37.9)

- Stakeholders consider investment in hydrogen testing is premature, with no proven need or clear obligation
 - ▶ Why should customers pay for an investment in APA's future?

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Operating expenditure

- APA has applied a **top-down base-step-trend framework** for forecasting opex consistent with the AER's preferred methodology
- Limited evidence in support of APA's proposals in its *Proposal Overview* and *RIN*
 - ▷ The extent consumers will benefit is not always apparent
- Proposed base (2020) is 4% more than the AER allowed for 2018-2022 - is 2020 an efficient base year?
- Proposed 24% total opex increase on the current period– to what extent can APA justify this increase?
- CCP28 questions why APA not proposing any output growth, but including WORM and SWP opex costs as step changes
- Customer-centric and standard practice is to include a productivity improvement
 - ▷ APA has not proposed any productivity improvements
 - ▷ Yet given APA's scale of operations, "economies of scale" and proposed IT cloud transition leading to efficiency improvements we are unconvinced APA cannot find any productivity improvements

APA is proposing six step changes including some associated with the WORM and SWP opex (covered previously). In relation to other step changes:

- **Land tax** – although APA is proposing a step change, we are unclear whether this is a genuine new regulatory obligation requiring a step change
- **Cyber security** (to comply with Federal legislation) and **IT expenditure**
 - ▷ Is the methodology for assessing the amounts sound? What are the consumer benefits?
 - ▷ Migration of IT expenditure from capex to opex, what are the principles for assessing the amount? Is this proposal reasonable?
- **Carbon offsets** - APA acknowledges it has no formal requirements to purchase carbon offsets but considers it should participate in the Victorian government's scheme
 - ▷ APA has not engaged with consumers on this step change
 - ▷ Is the methodology behind APA's calculations reasonable?

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Accelerated depreciation

NGL/NGR contemplate redundant (stranded) assets, not redundant NSPs

- ▶ This reset represents a test case because Ministers / AEMC / AER have not settled the matter
- ▶ APA is proposing
 1. 30 year instead of 34 (average) existing asset life
 2. guaranteed maximum 30-year life on new assets

No modelling of potential pathways over next 30 years, impact of accelerated payments on prices and demand (noting, historically low WACCs won't last forever)

- ▶ Our concerns include:
 - ▶ Economic disjunction between lower demand, lower utilisation, yet higher prices
 - ▶ 'death spiral' and potential equity impacts
 - ▶ Accelerated depreciation becoming **accelerating** depreciation with price implications

Tension between APA's proposed increased capex and its proposed accelerated depreciation

APA does not address:

- ▶ AER's clearly outlined expectations (re: expected information & analysis) – see *Regulating Gas Pipelines under uncertainty p.45-47*
- ▶ Various concerns identified in AER's AusNet Services Electricity Transmission Draft Decision (2016)

Finally:

- ▶ We know what APA-VTS gets out of this proposal, but **what do consumers get – other than vague references to efficient investment** (ie. in more assets that will eventually be stranded)?
- ▶ Varied consumer support for accelerated depreciation
- ▶ A consumer-centric proposal and regulatory framework would be discussing **accelerated consumer payments** not accelerated depreciation

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Tariffs



APA proposals

- Limit 2023 tariffs to CPI increase from the current approved tariffs
- “[smooth] tariffs as much as possible”
- Apply a single system-wide tariff structure

Average system wide tariffs to increase: \$0.56/GJ (2023) to \$0.72 (2027) -- ie. 6.5% annual increase

- Unclear how this is “without significant impact” (*APA Proposal Overview*, p.10) or “small tariff increases” (*Overview*, p.47)
- Overview focusses on ~2c/GJ impact in 2023 increase (i.e. when limited to CPI) not 2023-27 impact.
 - ▶ No discussion of APA’s pricing strategy (short- and long-term) given its operational objectives, regulatory obligations, consumer needs/demand, etc.
 - ▶ More information/consultation required, noting engagement on tariffs deferred (*Overview*, p.13)
 - ▶ **Core issue:** What should consumers be reasonably expected to pay for?
Who decides?

Conclusion

It is clear to us that:

- Much work remains to be done
- Many questions need to be answered

We are not clear (nor are consumers, stakeholders or APA)

- Who is responsible for answering the big questions?