The Hon Tom Koutsantonis MP
Member for West Torrens

Government of South Australia

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MMRE16D0091

Mr Warwick Anderson
General Manager, Network Finance and Reporting
Australian Energy Regulator
GPO Box 3131
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Dear Mr Anderson

The Government of South Australia appreciates the opportunity to provide comment on the Australian Energy Regulator's (AER) Draft Decision on Australian Gas Networks (AGN) Access Arrangement 2016-2021 and AGN's revised proposal. Following review of both documents the Government would like to provide comments on the following areas:

- mains replacement program;
- growth assets, including the Mount Barker;
- forecast volumes for unaccounted for gas;
- approved expenditure on non-compliant meters inside buildings; and
- the Capital Expenditure Sharing Scheme.

Mains Replacement Program
Following the AER's draft decision to reduce AGN's proposed capital expenditure on mains replacement AGN's revised proposal includes its risk assessment methodology and outcomes. The result of this further work is a change in the composition of which mains should be replaced while essentially maintaining the amount of mains to be replaced.

The Government notes that AGN's risk assessment is in response to the AER's draft decision which provided that AGN had not given adequate information about the risk associated with its gas mains. The Government agreed with the AER's concerns and it is for this reason that our initial submission stated that AGN should be allowed sufficient revenue to tackle the most at risk gas mains regardless of their type without representing over investment.

The Government therefore welcomes AGN's risk assessment undertaken in accordance with the Gas distribution networks standard *AS/NZS 4645*, which now provides a clearer picture of the risk facing the gas network than was previously available. Consultation with the Office of the Technical Regulator indicates that while the Technical Regulator is not in a position to assess the financial requirements of the proposed program, it is concerned that the AER's draft decision understates the mains replacement requirements for the 2016 to 2021 period. The Office of the Technical Regulator supports AGN's revised approach to its mains replacement program, particularly as it now prioritises work in order of risk.

Despite AGN's work on identifying at risk gas mains, it is critical that as part of its independent technical engineering assessment the AER examine whether AGN's proposal to replace 1,265 kilometres per annum is achievable. AGN provide that, based on its performance over the last 3 years, it is able to replace around 250 kilometres per annum. However, the AER needs to ensure that AGN has taken into account that replacement of mains in the CBD area may be more complex and could take longer thereby reducing the overall level of replacement that it can achieve.

Growth Assets

The Government is a strong supporter of viable growth opportunities in South Australia which support employment in various sectors and contribute to a productive economy. In line with this, we note AGN's Two Wells growth project and the Murray Bridge augmentation project and ask that the AER reassess AGN's revised information to determine the feasibility of each project.

The Government remains keen to see the Mount Barker extension proceed in line with our previous submission. It is however, important to note AGN's advice that prior to the commencement of construction it will need to undertake a number of complex steps, including commercial negotiations with SEAGas for the construction of a new gate station, land acquisition and formal tender processes for construction activities. It is therefore important that the AER assess whether the Mount Barker extension can be completed within the 2016-2021 regulatory period or whether the approved capital expenditure should be spread into the next regulatory period.

Recognising that the AER is yet to determine whether expenditure for the Mount Barker extension should be approved, AGN has sought to include a 'Significant Extension Event' cost pass through if approval for the project is not granted. We support AGN's approach and note the change in definition from the initial proposal which is now limited to the Mount Barker extension. However, as previously submitted the Government suggests that the AER give consideration to a monetary cap on this proposal as part of the pass through event, which will limit price uncertainty for consumers. Furthermore, noting the complexity of the pre-construction matters as outlined above, the AER should consider whether a cost pass through event may be beneficial in this circumstance. While the Government generally prefers to limit cost pass through events as much as possible, as such events can represent increased risk and can harm price stability for consumers, in this situation the AER should consider whether a cost pass through event provides a more targeted expenditure allowance.

Unaccounted for Gas (UAFG)
In its draft decision the AER provided that it will await AGN's updated UAFG volume forecast in its revised proposal[1].

Noting that the AER's proposed true-up mechanism will only apply to price variations, and the importance of establishing accurate base levels for forecasting purposes, the Government reiterates its initial submission which recommended that the AER engage with South Australia's Office of the Technical Regulator to determine an accurate base level volume for UAFG.

Capital Expenditure – Relocation of Meters
The AER's draft decision approves AGN's expenditure on relocating non-compliant meters inside buildings but reclassifies this expenditure from capital expenditure to operating expenditure.

The Government supports the AER's decision in line with our initial submission. However, as outlined in that submission, to avoid any future costs of this nature AGN must inform customers of their obligations with respect to gas meters and other infrastructure on their premises. For example, AGN should produce a similar document to SA Power Networks' Service and Installation Rules that are used for customers, consultants and electrical and building contractors.

Incentive Arrangements
The Government notes that AGN has accepted the AER's draft decision not to implement an altered Efficiency Benefits Sharing Scheme (EBSS), or introduce a Customer Service Incentive Scheme (CSIS) and Network Innovation Scheme (NIS). The Government notes that AGN has not accepted the AER's position to not implement a Capital Expenditure Sharing Scheme (CESS) to apply to the South Australian gas distribution network.

As highlighted by the AER, the introduction of a CESS for gas businesses should ideally occur through a consultative, informed and industry-wide process. While AGN argue that this has already occurred, it is important to understand that the previous consultation was specific to the electricity framework which has a number of key differences that support and complement the CESS. As identified by the AER, and discussed further below, one important example is the application of a Service Target Performance Incentive Scheme (STPIS). In addition, the electricity framework explicitly encourages electricity distribution businesses to consider non-network options such as demand management to address network constraints which could result in capital expenditure efficiencies. The Regulatory Investment Test for Distribution (RIT-D) under the National Electricity Rules that applies to all network investment planning decisions with an estimated cost exceeding $5 million is another example.

Until there is a complementary scheme of providing incentives for maintaining or improving network reliability levels, such as the STPIS which applies for electricity, there is a greater risk that by achieving capital expenditure

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[1] Attachment 7 – Operating Expenditure, AER Draft Decision, Australian Gas Networks Access Arrangement 2016 to 2021, page 7-42

underspends through an incentive mechanism may undermine network reliability or safety. Noting that the Essential Services Commission of South Australia has determined to not set binding service service reliability standards for AGN's 2016-2012 period, but will be monitoring and publicly reporting on AGN's performance, it is critical that any CESS needs to be introduced alongside quantifiable service reliability measures with appropriate time series measurable data.

Furthermore, it is noted that the National Gas Rules require an ex-post assessment of whether capital expenditure undertaken in an access arrangement is conforming at the time of the next regulatory period. The benefits of the ex-post assessment is that it provides information to other stakeholders regarding the efficiency of the network service provider, contributes to the AER's analysis in setting capital expenditure allowances for the provider's next regulatory period, and provides a further and final check on the efficiency of capital expenditure forming part of the regulatory asset base (RAB).

As identified by the AER, the capital expenditure assessment does not exclusively rely on a revealed cost approach, which differs from the operating expenditure assessment where the incremental calculation of the efficiency carryover amounts and the clear translation of revealed costs into the next regulatory period forecasts ensure that under the EBSS only sustained efficiencies are rewarded. For capital expenditure projects, the relationship between revealed expenditure and future capital expenditure is more difficult to establish.

Accordingly, it is important that the AER carefully consider whether a CESS is appropriate for this regulatory period.

I trust that this information assists the AER with its final determination of AGN's revenue allowance from 2016 to 2021. Should you require any further information on any element of the attached submission, please contact Mr Vince Duffy, Executive Director of the Energy Markets and Programs Division, Department of State Development on (08) 8226 5500.

Yours sincerely

Tom Koutsantonis

Hon Tom Koutsantonis MP
Minister for Mineral Resources and Energy

24th February 2016