

2013 – 2017 Gas Access Arrangements Review (GAAR)

SP AusNet's Revised Access Arrangement Proposal (RAAP)

RAAP Overview

Submitted: 9 November 2012

RAAP OVERVIEW

On 30 March 2012, SP AusNet (Gas) Pty Ltd (**SP AusNet**) submitted to the Australian Energy Regulator (**AER**) its initial access arrangement proposal for its Victorian gas distribution network for the fourth regulatory period (2013-17). On 11 September 2012, the AER published its Draft Decision.¹ SP AusNet now submits its Revised Access Arrangement Proposal (**RAAP**) to the AER for its consideration.

This document summarises SP AusNet's response to the Draft Decision and the revisions it has made to its initial access arrangement proposal.

SP AusNet's RAAP comprises the following documents:

- the Access Arrangement Information;
- SP AusNet's response to the Draft Decision, comprising eleven new chapters (called RAAP Chapters) that respond to the issues raised in the Draft Decision;
- the attachments and supporting material to the RAAP Chapters;
- the revised proposed revisions to the Gas Access Arrangement;
- revised versions of the RFM, PTRM, and the capital expenditure, operating expenditure and demand models; and
- a document register.

To assist the AER, SP AusNet has also prepared a table which:

- identifies each of the amendments required by the Draft Decision;
- identifies the RAAP Chapter which contains SP AusNet's response to the required amendment;
- states whether SP AusNet accepts or does not accept the amendment.

Certain documents and models comprising SP AusNet's RAAP are identified in the Document Register as containing information which is the subject of a claim for confidentiality. The information over which the claim is made is identified within the relevant document or model.

To assist the AER to comply with its obligation under clause 60(4) of the National Gas Rules (**NGR**), SP AusNet has prepared redacted versions of its RAAP documents for publication on the AER's website.

¹ Australian Energy Regulator, *Access arrangement draft decision – SPI Networks (Gas) Pty Ltd 2013-17*, Canberra, 11 September 2012.

1 Introduction

SP AusNet has given careful consideration to the amendments required by the Draft Decision. In many cases, SP AusNet has adopted the required amendments. However, there are some aspects of its initial access arrangement proposal which SP AusNet considers do satisfy the NGR and, as such, should be approved by the AER. With respect to these issues, the RAAP provides additional information and documentation in support of SP AusNet's position.

SP AusNet considers its RAAP delivers a regulatory outcome that promotes the National Gas Objective (**NGO**). In particular, SP AusNet's proposal will deliver continued decreasing real prices to customers over the forthcoming access arrangement period, building on its impressive history of sustainable reductions in real gas distribution prices since privatisation.

The remainder of this document highlights the major issues where SP AusNet disputes the Draft Decision.

2 Rate of return

The rate of return continues to be a contentious issue. Setting returns too high inflates reference tariffs, with adverse impacts on customers as illustrated by the current policy debate. Equally, consumers will experience substantial detriment if the rate of return is set too low, discouraging network investment that is critical to maintaining network safety and service reliability.

The Global Financial Crisis continues to affect financial markets. Increased demand from investors for low risk investments is keeping yields on Australian Government bonds at unprecedentedly low levels. Logically, investors contemplating investments in less secure assets would expect a higher market risk premium (**MRP**) to compensate for that risk.

The methodology used in the Draft Decision means the low yields provided by Government bonds flow through to the cost of equity but are not compensated through a higher MRP. This produces a cost of equity that is inconsistent with the prevailing conditions in the market for funds.

SP AusNet's RAAP contains additional technical, empirical and theoretical evidence to support a cost of equity that reflects the current (and forecast) conditions in equity markets.

The response to the Draft Decision on Rate of Return is detailed in Chapter 5 of the RAAP.

3 Capital base and depreciation

The main area of dispute regarding the value of the capital base concerns whether the opening capital base needs to be inflated for six months inflation to bring it from mid-year dollars to end-of-year dollars (a difference between total inflation of the opening capital base for six and a half years or six years inflation). SP AusNet provides further evidence in the RAAP that the opening capital base was valued in mid-year dollars and hence an adjustment for six and a half years inflation is required. SP AusNet's position is consistent with the recent Australian Competition Tribunal Decision on this issue.

2013 – 2017 GAAR: SP AusNet Revised Access Arrangement Proposal

The response to the Draft Decision on Capital Base and Depreciation is detailed in Chapter 4 of the RAAP.

4 Capital expenditure

SP AusNet has a strong history of delivering capital expenditure programs under, or close to benchmark levels. SP AusNet is proud that its forecast capital expenditure program for the 2013-17 regulatory period will again be delivered largely to forecast despite a very large increase in customer connections not foreseen in the last determination.

SP AusNet accepts a number of the amendments required by the Draft Decision to its proposed capital expenditure. However, there are some programs which SP AusNet considers are critical to enabling it to mitigate safety risks associated with ageing networks. The mains replacement program for the medium pressure and low pressure networks are two such programs. The medium pressure replacement program in particular is of a higher priority to ensure public safety than some of the projects approved in the Draft Decision.

Further, the material contained in the RAAP demonstrates that SP AusNet's capital expenditure programs satisfy the criteria for conforming capital expenditure. This includes the proposed expenditure for capitalised overheads and customer connections. The RAAP provides further analysis supporting the need to base forecast overheads on 2011 expenditure levels, consistent with the approach to operating expenditures, and to allow for labour escalation of overheads, consistent with other expenditures.

The Draft Decision proposed a pass through for mains replacement above historical average volumes. SP AusNet rejects this proposal on the basis that it is not consistent with its actual historical performance of delivering approved mains replacement programs. Further, the proposed pass through does not provide an opportunity to deliver necessary mains replacement on the network in the forthcoming regulatory period.

The response to the Draft Decision on Capital Expenditure is detailed in Chapter 2 of the RAAP.

5 Operating expenditure

SP AusNet accepted the majority of the revisions to its base year operating expenditure required by the Draft Decision, including the use of 2011 actual operating expenditure as the basis for forecasting both operations and maintenance expenditure for the 2013-17 access arrangement period.

SP AusNet rejects the Draft Decision's amendments regarding the rate of change and the step changes to operating expenditure from the 2011 base year.

The approach taken to forecasting the rate of change in the Draft Decision has produced a forecast that is too low. This is because the decision uses a labour forecast based on the Labour Price Index (LPI) in combination with the forecast partial productivity adjustment included in SP AusNet's proposal. The RAAP accepts the use of an LPI-based forecast of changes in labour costs on the basis that data is more readily available, but demonstrates that this forecast must only be used if the productivity adjustment is removed from the rate of change forecast. Retaining the productivity adjustment will overstate the impact of productivity gains and understate the overall rate of change in operating expenditure. The

2013 – 2017 GAAR: SP AusNet Revised Access Arrangement Proposal

response also presents evidence that the best LPI forecast is developed using an average of the AER's forecast and the forecast supplied by SP AusNet's consultant.

SP AusNet accepts a number of revisions to step changes included in the Draft Decision, including removing the most material step change associated with the introduction of the National Energy Customer Framework. The RAAP provides further evidence that proposed step changes for the Carbon Tax, and for network operations programs in relation to the use of magnetic tomography, new custody transfer meters and identification of mains and services in drains are justified and consistent with the NGO.

The response to the Draft Decision on Operating Expenditure is detailed in Chapter 3 of the RAAP.

6 Unaccounted for Gas

The RAAP acknowledges that the future operation of the unaccounted for gas (UAfG) scheme and the benchmarks to be set under that scheme for the next access arrangement period will not be resolved in the Final Decision. The RAAP observes that if benchmarks are not set under this scheme, the operation of the scheme will be frustrated and have no substantive effect. As such, the scheme will effectively cease. SP AusNet suggests that the AER utilise section 32 of the *National Gas (Victoria) Act 2008* (Vic) to request the ESC to amend the Gas Distribution System Code so that benchmarks may be set for the forthcoming access arrangement period based on SP AusNet's historical UAfG levels. Alternatively, the 2012 benchmarks should be allowed to lapse.

The response to the Draft Decision on Unaccounted for Gas is detailed in Chapter 6 of the RAAP.

7 Incentive mechanisms

SP AusNet accepts the amendments to its efficiency carryover mechanisms from the 2008-12 access arrangement period. The RAAP makes some amendments to benchmarks to be consistent with the revised base year operating expenditure proposal and forecast customer growth for the revised demand proposal. The RAAP accepts the required amendments to its proposed operating expenditure incentive mechanism for the forthcoming access arrangement period.

However, SP AusNet maintains its view that a capital expenditure efficiency carryover mechanism is an important tool for creating incentives to deliver regulated services to customers at least cost without detriment to service levels. In this way, capital expenditure incentive arrangements contribute to the achievement of the NGO. Similarly, by allowing SP AusNet to retain the benefits of any efficiency gains (and penalising it for efficiency losses), the proposed capital expenditure incentive mechanism creates effective incentives for efficiency improvements. Creating such incentives is consistent with the Revenue Pricing Principles and with the NGO.

The response to the Draft Decision on Incentive Arrangement is detailed in Chapter 7 of the RAAP.

8 Demand

Energy demand has entered a period of uncertainty: upward trends in consumption appear to have stalled but future demand patterns remain unclear.

SP AusNet does not accept the requirement to remove its proposed Demand Risk Adjustment Factor. SP AusNet considers this adjustment factor is necessary to address increased demand uncertainty, particularly as SP AusNet will not otherwise be compensated for the increased risk of lower demand. Therefore, approving the Demand Risk Adjustment Factor as part of the Final Decision is necessary to ensure SP AusNet is provided a reasonable opportunity to recover at least the efficient costs incurred in providing reference services, as is required by the Revenue Pricing Principles.

The RAAP also demonstrates that the forecast of future weather conditions produced by the CSIRO is the best forecast available to use as a basis for gas demand.

The response to the Draft Decision on Demand is detailed in Chapter 1 of the RAAP.

9 Tariff setting and tariff variation mechanisms

The Draft Decision requires changes to the timeframes for the annual tariff submission process. The RAAP rejects these changes and demonstrates that the existing timeframes are both adequate and preferable as they have lower administrative burden and duplication of process.

SP AusNet rejects the required amendments to the Carbon Liability recovery formula on the basis that the approach proposed by the AER is more complex than that proposed by SP AusNet, will create greater price volatility, and impose increased cash flow risks on SP AusNet that are not compensated for.

The Draft Decision required a number of changes to pass through events. SP AusNet accepts many of the required amendments but rejects the amendment to remove the Financial Failure of a Retailer pass through event on the basis that this event is the most efficient way to manage this risk to reduce costs to consumers. Further, removing it would necessitate substantial renegotiations of Access Arrangement Terms and Conditions with retailers.

The response to the Draft Decision on Tariffs and Tariff Variation Mechanisms is detailed in Chapter 8 of the RAAP.

10 Non-tariff components

SP AusNet welcomes the Draft Decision on the non-tariff components of its Access Arrangement. The AER substantially accepted SP AusNet's 'minimal change' approach to its non-tariff components, and the AER supports SP AusNet's proposed approach to address the anticipated introduction of the National Energy Customer Framework during the next Access Arrangement period. In the few instances where SP AusNet is unable to accept a required revision to its non-tariff components, the RAAP provides detailed reasoning to explain its position and, where possible, alternative drafting to propose a mutually acceptable solution.

2013 – 2017 GAAR: SP AusNet Revised Access Arrangement Proposal

SP AusNet has invited further comments from retailers on the proposed terms and conditions of its Access Arrangement. In accordance with the AER's request, SP AusNet has held discussions with some retailers on areas of concern to retailers. As SP AusNet envisages this consultation process as being ongoing, it will continue to engage with retailers to seek to resolve any outstanding issues prior to the Final Decision.

SP AusNet notes there may be need to make consequential changes to the non-tariff components in light of the Final Decision. For example, if the Final Decision revokes the Financial Failure of a Retailer pass through event, it will be necessary to revisit and amend the credit support provision contained in the non-tariff terms and conditions. SP AusNet is committed to working with the AER to identify any necessary consequential changes.

The response to the Draft Decision on Non-Tariff Components is detailed in Chapter 9 of the RAAP.

11 Revenue Requirement and Tariffs

The revisions made in the RAAP result in changes to the Total Revenue Requirement and Reference Tariffs, the updated proposals for which are detailed in Chapters 10 and 11 of the RAAP.