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22 June 2023

Mr Warwick Anderson
General Manager
Australian Energy Regulator
GPO Box 3131
Canberra, ACT, 2601

Submitted via email to: AERPricing@aer.gov.au

Dear Warwick,

Re: Review of gas distribution network reference tariff variation mechanism and declining block tariffs

Red Energy and Lumo Energy (Red and Lumo) welcome the opportunity to comment on the Australian Energy Regulator's (AER) gas distribution network tariffs review 2023.

The AER is conducting this review to determine whether it should continue to apply weighted average price caps and declining block tariffs to the economic regulation of gas distribution pipelines in Australia.

As we understand it, the review has been triggered by the growing perception that there is a misalignment between the mechanisms that incentivise gas distributors to increase the volume of gas they transport and the policy mechanisms in place at the Commonwealth and State level to discourage gas consumption to reduce emissions.

However, the precise form of these policies remain uncertain and there is no strong basis—at least at this stage—for the AER to assess what form the transition away from gas is likely to take, including the timeframe over which it will occur.

Given this context, we recommend the AER retain weighted average price caps and declining block tariffs for the economic regulation of gas distribution pipelines until the policy environment becomes clearer.

A shift to a revenue cap would lead to inefficient outcomes for consumers, especially as the demand for natural gas reduces and there is a corresponding increase in network charges. As a result, our view is that they are not consistent with the National Gas Objective (NGO).

Adopting revenue cap regulation would transfer volume risk to consumers who are not best placed to manage it

We are very mindful of the impact of any change in approach on gas consumers. A shift in the regulation of gas distribution pipelines from a weighted average price cap to a revenue cap will

shift volume risk to consumers who are least able to manage it.[1] Consumers are currently facing historically high energy costs, combined with other cost of living pressures.

Transfering volume risk to consumers by adopting a revenue cap to mitigate asset stranding risk would be illogical especially because this risk is already being managed through accelerated depreciation

We do not support the introduction of a revenue cap to shift asset stranding risk from the gas distributors to consumers. This is because the AER is already managing this risk by approving the accelerated depreciation of gas network assets. Most recently, the AER approved accelerated depreciation in the Victorian gas access arrangements (AA) to allow gas distribution pipelines to begin to recover their investments earlier than previously anticipated. Given this, our view is the AER is well positioned to manage asset stranding risk through accelerated depreciation.

Over recovery of revenues under weighted average price caps would be reduced significantly if demand forecasts were more accurate

The over recovery of revenues under weighted average price caps would be reduced significantly if demand forecasts were more accurate. As the AER is aware, forecasting errors can be problematic for both consumers and gas distributors under a weighted average price caps. If forecasts are too low, then consumers will need to pay more than is necessary for reference services. In contrast, if forecasts are too high the gas distributors will not recover their regulated revenues.

However, in practice the main problem with the regulation of weighted average price caps is the incentive that the gas distributors have to under forecast their demand and charge higher average tariffs over the regulatory period. This has most likely contributed to the significant over recovery of revenues under weighted average price caps. Given this, our view is this problem would be better addressed by improving gas forecasts.

Replacing declining block with inclining block tariffs will not reduce gas demand in a substantive way

Replacing declining block tariffs with inclining block tariffs (or any alternative) will not reduce the amount of gas being consumed in any substantive way. This is because it will incentivise residential customers to consume more gas but at the same time it will provide an incentive for larger customers to use less gas.

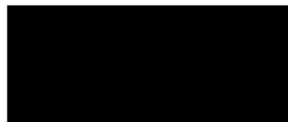
Based upon AEMO's 2021 Victorian Gas Planning Report, households and small commercial users accounted for the largest share of Victoria's gas use (61%). Industrial and large commercial use comprised 31% while electricity generation accounted for 8% of Victoria's gas use. Hence, on balance we are not convinced that this change would have a substantial impact in terms of lowering gas consumption.

[1] Under a revenue cap, as demand reduces it is the consumers that remain on the grid that are exposed to potentially large price increases so the distributors are able to recover their regulated revenues. In contrast, under weighted average price caps consumers would not be required to underwrite volume risk because prices would not be adjusted for reductions in demand.

About Red and Lumo

We are 100% Australian owned subsidiaries of Snowy Hydro Limited. Collectively, we retail gas and electricity in Victoria, New South Wales, Queensland, South Australia and in the ACT to over 1.2 million customers. We thank the AER for the opportunity to comment on the consultation paper. Should you wish to discuss aspects of this submission or have any further enquiries, please contact Con Noutso, Regulatory Manager on [redacted].

Yours sincerely



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