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South Australian Council of Social Service

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Mr Sebastian Roberts
General Manager
Australian Energy Regulator
GPO Box 520
Melbourne, Victoria, 3001

Via email: AGNSA2021@aer.gov.au

16 February 2021

Dear Mr Roberts,

Re: SACOSS Submission on the AER's Draft Decision and AGN's Revised Final Plan for the South Australian gas distribution network (July 2021 – June 2026)

The South Australian Council of Social Service (SACOSS) welcomes the opportunity to provide comment to the Australian Energy Regulator (AER) on its draft decision on the Australian Gas Networks' (AGN) Access Arrangement Proposal for the South Australian gas distribution network, and AGN's revised proposal.

SACOSS is the peak non-government representative body for health and community services in South Australia. SACOSS' purpose is to influence public policy in a way that promotes fair and just access to the goods and services required to live a decent life. We undertake policy and advocacy work in areas that specifically affect South Australian consumers on low-incomes and/or those in vulnerable circumstances.

We support the position taken by the AER in their draft decision to ensure that today's consumers pay no more than necessary for safe and reliable gas services. In response to the AER's Draft Decision and AGN's Revised Proposal, our submission provides commentary on:

- The Vulnerable Customer Assistance Program (VCAP);
- Unaccounted for Gas (UAFG);
- Implications of AGN's decision not to expand into Mt Barker; and
- The future of gas

Operating Expenditure (Opex)

Vulnerable Customer Assistance Program (VCAP)

In its revised proposal, AGN have retained the Vulnerable Customer Assistance Program (VCAP) as an opex step change per the original business case submitted in the AGN SA Final Plan. While the AER did not approve the VCAP in its draft decision, it was open to considering it as a category specific forecast should AGN be able to provide further information demonstrating that initiatives under the VCAP would materially increase the quantity or quality of services provided.[1]

The VCAP is proposed to include:

- A dedicated vulnerable customer service role (1 FTE);
- The development of a priority services register using the upgraded Customer Relationship Management (CRM) system;
- Funding for gas appliance safety checks and emergency appliance repairs; and
- Rebates for customers to access more efficient appliances.

SACOSS supports the AER's draft decision to not include the VCAP as an opex step change. As per the criteria set out in the National Gas Rules (NGR) governing operating expenditure, the AER needs to be convinced that the VCAP "would be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of delivering pipeline services."[2] While we note that AGN's VCAP proposal is relatively modest ($0.75m p.a.), the program should represent efficient expenditure, be aligned with pre-existing programs, and be in the long term interests of consumers. To the extent that the AER's decision on the VCAP sets a precedent around better supporting vulnerable customers for other network businesses to follow, it is important that AER establishes clear thresholds regarding the level of detail required to demonstrate that such programs materially improve the quality and quantity of services provided.

In AGN's Revised Final Proposal, it suggests that further refinement and development of the VCAP is needed, particularly around program design and implementation during the first 18 months of the program.[3] SACOSS attended the workshop hosted by AGN on the 4th of December 2021 and noted that there were questions from some retailers around various pathways of referral and whether the program duplicates retailer offerings. From our perspective, it was clear from the meeting that further work was required to flesh out how the VCAP offerings interface with current ones.

[1] AER (2020) Draft decision – Australian Gas Networks (SA) Access Arrangement 2021-26 - Overview, https://www.aer.gov.au/system/files/AER%20-%20Draft%20Decision%20-%20AGN%28SA%29%20access%20arrangement%202021-26%20-%20Overview%20-%20November%202020.pdf, p. 8

[2] National Gas Rules, r. 91(1)

[3] AGN (2021) Attachment 7.2A Addendum to Opex Business Cases, https://www.aer.gov.au/system/files/AGN%20-%20Attachment%207.2A%20-%20Addendum%20to%20Opex%20Business%20Case%20-%2013%20January%202021.pdf

In its Draft Decision, the AER noted that AGN already offer for rebates for new connections and rebates for gas appliances.[4] Additionally, SACOSS notes that as of 1st of January 2021, the South Australian Government introduced the Retailer Energy Productivity Scheme (REPS), which includes incentives to install energy efficient appliances, albeit in a technology neutral way (i.e. not specific to gas).[5] For example, AGL's website suggests that REPS rebates are available for gas, electric and solar hot water options.[6] Similar to its predecessor, the Residential Energy Efficiency Scheme (REES), the REPS requires obliged retailers to meet annual targets with the objective to improve energy productivity for households, businesses and the broader energy system, with a focus on low-income households.[7] Given retailers have the flexibility to choose which activities and incentives it offers to its customers, it is unclear what the expected uptake of various REPS incentives will be and how this, along with AGN's existing rebates[8], might overlap with some aspects of AGN's proposed VCAP. This will require further engagement between AGN and retailers to ensure that programs are complimentary and a determination from the AER on whether network businesses are best placed to offer these particular initiatives.

Unaccounted for Gas (UAFG)

SACOSS supports the AER's draft decision of incorporating costs of purchasing up to 20% of UAFG as renewable gas in the annual tariff variation mechanism. We note that AGN's Revised Proposal has included renewable UAFG as an opex step change, rather than through annual tariff variations, reasoning that the price of UAFG is largely known. While the unit price of UAFG may be known, SACOSS questions whether there is the same certainty around forecast volumes of UAFG over the 5-year access arrangement period.

For example, progress on AGN's mains replacement program may lead to a decline in the number of leaks in the network and therefore reduction in forecast volumes (which has been based on previous years).[9] Indeed, documentation from AGN's 2016/17 to 2020/21 access arrangement suggests a relationship between mains replacement and UAFG volumes, albeit with a small time-lag.[10] Furthermore, if actual levels of demand on the network vary significantly from those forecast in the revised plan submitted by AGN, this is likely to impact the amount of UAFG required. To the extent that actual volumes of UAFG may differ year on year, this may be better reflected in the annual tariff variation.

[4] AER (2020) Draft decision – Australian Gas Networks (SA) Access Arrangement 2021-26 – Attachment 6 Operating Expenditure, https://www.aer.gov.au/system/files/AER%20-%20Draft%20decision%20-%20AGN%28SA%29%20access%20arrangement%202021-26%20-%20Attachment%206%20-%20Operating%20expenditure%20-%20November%202020.pdf, p. 35

[5] Department for Energy and Mining (2021), REPS Activity Specifications, https://www.energymining.sa.gov.au/energy_and_technical_regulation/energy_efficiency/retailer_energy_productivity_scheme_reps/reps_activity_specifications

[6] https://reps.agl.com.au/residential/hot-water-systems/

[7] ESCOSA, Retailer Energy Productivity Scheme (REPS), https://www.escosa.sa.gov.au/industry/reps/overview

[8] https://www.australiangasnetworks.com.au/gas-explained/benefits-of-natural-gas/promotion/2020-rebate-offer-for-additional-appliances-new-connections

[9] Zincara (2020) Review of AGN Unaccounted for Gas Public Summary, https://www.aer.gov.au/system/files/Zincara%20-%20UAFG%20Summary%20Report%20-%20November%202020.pdf

[10] AGN (2015) Attachment 7.3 Unaccounting for Gas Forecast, 2016/17 to 2020/21 Access Arrangement Information https://www.aer.gov.au/system/files/Australian%20Gas%20Networks%20-%20Attachment%207.3%20Unaccounted%20for%20Gas%20Forecast%20-%20July%202015.pdf

Capital Expenditure

Mt Barker

SACOSS supports the decision by AGN to not fund the expansion of the network into Mt Barker at this point in time, which reduces capital expenditure over both the current and next AA period by approximately $60 million. We note that the Mt Barker extension was subject to an advanced determination under rule 80 of the National Gas Rules (NGR), which was finalised prior to the 2021- 2026 process in December 2018. At that time, the AER determined that the capital expenditure met the criteria of conforming capex as per rule 79 of the NGR[11] and the AER later approved the inclusion of the extension in its Draft Decision released in November 2020. While we recognise the level of work and engagement that has been put into this process by all stakeholders, SACOSS believes that it is prudent not to proceed with such a significant extension of the network when considering potential stranded asset risk of new expansion capex.

AGN's stated reasoning for not proceeding with the Mt Barker expansion is that "the regulatory framework currently does not deliver sufficient returns on new investment to finance such a significant extension of the network" and that "the marginal returns on capital expenditure are extremely low, and as a result discretionary can no longer meet our equity holders opportunity cost of capital given other investment opportunities available internationally with a similar risk profile."[12] In other words, AGN considers that the continued fall in the rate of return since December 2018 has impacted on the ability to attract finance for the project.

AGN's decision to not proceed with the Mt Barker extension underlines an emerging trend of network businesses in the energy sector operating in an environment of increasing uncertainty. SACOSS notes that electricity transmission network businesses TransGrid and ElectraNet have recently made similar arguments around financeability regarding the Project EnergyConnect.[13] Both businesses sought rule changes to allow transmission networks to recover revenue from its customers *before* actionable Integrated System Plan (ISP) projects are commissioned. They suggest that the current regulatory frameworks create barriers to financing large capital investments due to insufficient cash flows and make it difficult for businesses to maintain a credit rating consistent with what is set out in the AER's Rate of Return Instrument (i.e. BBB+).[14]

While we note substantial differences in scale between the ISP projects and the Mt Barker gas network extension, as well as different capital profiles of electricity and gas networks, the AEMC's draft determination may be of relevance to both AGN's business planning and

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[11] AER (2018) Australian Gas Networks - Future capital expenditure determination - Mount Barker gas network extension, https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/australian-gas-networks-future-capital-expenditure-determination-mount-barker-gas-network-extension

[12] AGN Presentation to the South Australian and Retailer Reference Groups, 4 February 2021, p. 28

[13] https://www.aemc.gov.au/news-centre/media-releases/request-change-rules-energy-financing-unnecessary-and-would-cost

[14] https://www.aemc.gov.au/sites/default/files/documents/fact_sheet_financeability_of_isp_projects_0.pdf

the AER's Final Decision. In its draft determination, the AEMC highlights observations made in the AER's submission which suggest that:

> "the regulatory framework does not require service providers to be able to achieve the benchmark assumptions used in making and applying the RORI [Rate of Return Instrument] at all times. It explained that the AER considers sector benchmarks rather than firm specific details in making the RORI and that the regulated firms have flexibility in their capital structure decisions and employ this accordingly."[15]

Further, the AEMC draws on analysis it commissioned from CEPA in its Draft Decision, suggesting:

> "Moody's and other credit rating agencies combine an assessment of both qualitative and quantitative metrics to arrive at an overall rating. While CEPA agrees that FFO/Net Debt is a key factor considered by Moody's, CEPA considers that it is not appropriate for an assessment of the financeability of a notional entity to rely so strongly on this metric."[16]

To be clear, SACOSS supports AGN's decision not to fund the expansion of the network to Mt Barker at this point in time, rather we are simply seeking to interrogate the reasoning behind it. As noted in the technical report prepared by TRAC Partners for ECA's submission:

> "The reliance by AGNSA on this justification [i.e. financiability] for not proceeding with the Mt Barker extension project creates a dangerous precedent that discretionary investments to either grow or maintain the network will no longer be funded by the service provider when the level of the rate of return is low (relative to historical levels) due primarily to the value of the market derived parameters."[17]

Future of gas

SACOSS welcomes the commentary provided by AGN on the Future of Gas in Attachment 9.6 of its Revised Final Plan.[18] The paper provides a useful framework for beginning to understand the key issues around depreciation and scenario planning from a network perspective. SACOSS support AGN's suggestion that a collaborative approach is needed to scenario development, involving consumers, networks, regulators and governments.

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[15] AEMC (2021) Participant derogation – financeability of ISP projects (ElectraNet), Draft rule determination, https://www.aemc.gov.au/sites/default/files/documents/electranet_draft_rule_determination.pdf, p. 19

[16] AEMC (2021) Participant derogation – financeability of ISP projects (ElectraNet), Draft rule determination, https://www.aemc.gov.au/sites/default/files/documents/electranet_draft_rule_determination.pdf, p. 26

[17] TRAC Partners (2021) Technical Report: Response to AER Draft Decision & AGN SA Revised Access Arrangement Proposal – 2021-26, p. 15

[18] AGN Revised Final Plan July 2021 – June 2026, Attachment 9.6 Future of Gas (2021), https://www.aer.gov.au/system/files/AGN%20-%20Attachment%209.6%20-%20Future%20of%20Gas%20-%2013%20January%202021.pdf

AGN have consistently maintained that consumers are at the centre of their planning, and in the case of the future of gas networks, this should be no different. SACOSS believes that a consumer-centred approach should consider:

- the extent to which consumers can make informed choices about the energy mix appropriate for their given situation and preferences;
- Implications for current and future consumers along different timescales and indicative price paths;
- The extent to which various scenarios inadvertently lock in poverty premiums and/or higher costs for people on low incomes.[19]

To interrogate the above, it may be useful to draw upon insights from behavioural economics, and distributional impact analysis, which consider how of costs and benefits are distributed across different consumer classes (low-income, renters, homeowners, business customers). [20] Such analyses could apply to discrete scenarios (such as those suggested by AGN) or specific components (e.g. introducing network entry fees and exit fees to mitigate against stranded asset risk). As evidenced in the retail energy market, consumers are not always rational actors and their decisions will be influenced by heuristics, a tendency to favour short term gains over long term rewards, status-quo biases and different perceptions of risk and probability from the objective risk often applied by decision-makers.[21] As such, thinking around the future of gas networks would benefit from considering a broad range of frameworks and drawing from expertise outside of energy and network regulation. SACOSS looks forward to remaining engaged in these conversations.

We thank you in advance for consideration of our comments. If you have any questions relating to this submission, please contact [redacted]

Yours sincerely,

[redacted]

Ross Womersley

Chief Executive Officer

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[19] Poverty premiums are extra costs which accrue to someone on very low income precisely because they are on that low income – they are costs on those living in poverty that others with higher income or more resources can buy their way out of, avoid or minimise. See: https://www.sacoss.org.au/sites/default/files/public/documents/Reports/APW%20Statements/APW_Fact_Sheet_A4_FINAL.pdf

[20] https://pmc.gov.au/sites/default/files/publications/distributional-analysis-guidance-note.pdf

[21] https://www.aemc.gov.au/sites/default/files/content/c74a8d35-8472-4f81-a2b1-a68d6392a0e9/RPR-0004-Consultant-Report-5-Oxera-Behavioural-insights-into-Australian-retail-energy-markets.PDF