

# RESPONSE TO VIC DBS' 2023- 28 ACCESS ARRANGEMENT PROPOSALS



Prepared for



Brotherhood  
of St Laurence

Working for an Australia free of poverty

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# EXECUTIVE SUMMARY



# OVERARCHING OBJECTIVES THAT SHOULD FRAME AUSNET'S AA

In order for any of the Vic DB's AA proposals to be capable of acceptance, they need to at least meet three key objectives:

- Objective #1 - Keeping prices as low as possible for today's household and small business consumers. The importance of this is underscored by:
  - Wholesale gas prices are increasing significantly in Victoria – e.g. the average daily weighted imbalance price for gas in Victoria has increased by more than 100% in the last 12 months.
  - [ACCC](#) is observing that higher international and domestic gas prices are also flowing through to long term wholesale gas sales agreements<sup>1</sup>
  - Increases in the average arrears of gas customers in 2022, which is higher than the monthly average of 2020-21 (based on the Vic ESC Energy Market Report<sup>2</sup>), particularly those customers who can not pay for ongoing usage.
- Objective #2: the costs and risks of transitioning to lower emissions energy sources must be efficient and carefully managed.
- Objective #3: sufficient supporting information must be provided to enable AER to assess whether proposal is capable of acceptance under NGR.

1. [ACCC Gas Inquiry - July 2022 interim report - FINAL](#)

2. [ESC Victorian-Energy-Market-Report-June-2022.pdf](#)

# KEY FOCUS AREAS

In preparing this review, we have also paid close attention to the key focus areas when it comes to energy pricing:

Focus Area	Response
Affordability for consumers	<ul style="list-style-type: none"> <li>- The need to ensure costs are not only efficient but needed for today’s consumers is more important than ever because of escalating cost of living pressures (particularly energy costs), increasing levels of consumer energy debts and the withdrawal of financial support mechanisms for households disproportionately impacted by the pandemic.</li> <li>- Even a “business-as-usual” approach to regulated asset pricing will create further stress for consumers who are already facing increased distress</li> <li>- But, an approach that seeks to transfer more risk, and therefore cost, to consumers will only compound this distress. This is not in the short term or long term interests of today’s or future consumers</li> </ul>
Tariff levels and tariff path stability	<ul style="list-style-type: none"> <li>- There is an inconsistent approach by the three Vic DBs as to the level of the starting tariff and the tariff path for the remaining period of the AAs. While AusNet and MNG’s AA Proposals propose a higher starting tariff followed by increases above CPI in future years, AGNVIC proposes a 6% price cut in year one followed by higher annual increases. There should be consistency across the three AA Proposal in the % reduction for the starting tariff and resultant tariff path.</li> <li>- In all cases though, the tariff path in future years is not certain because:               <ul style="list-style-type: none"> <li>- the annual increases in tariffs will be compounded by expected high annual inflation adjustments for the remaining years</li> <li>- with interest rates expected to rise over the 5 year AA period, the return on capital allowance could also cause the tariffs to increase (through a higher rate of return during the AA period than what is presently being forecast)</li> </ul> </li> </ul>

# KEY FOCUS AREAS (CONT'D)

Focus Area	Response
Future of gas networks	<ul style="list-style-type: none"><li>- In considering whether to allow measures proposed by the VIC DBs to address a perceived uncertainty as to the future of gas, regulators need to:<ul style="list-style-type: none"><li>• recognise that the increased uncertainty is more a function of market forces than on climate change</li><li>• acknowledge that in a competitive market, investors have no guaranteed right to</li><li>• take into account the increased risks to consumers that any measure introduces</li><li>• recognise that the key measure of accelerated depreciation places increased risk on at a time where they are being asked to wear other significant increased cost of living higher wholesale gas prices, higher inflation and higher interest rates.</li><li>• recognise that it should not be a choice solely between whether service providers wear the cost of any measure. Government has a role to play as well.</li></ul></li></ul>
Adjustments to address impact of GSR	<ul style="list-style-type: none"><li>- Adjustments to the AA Proposals that have been made by the service providers to demonstrate the GSR was released should only be allowed if adequate supporting evidence has been provided for each adjustment.</li><li>- The AER should test whether proposed reductions in forecast growth (ie connections) and capex and proposed increases in customer contributions are best estimates arrived at</li></ul>

# KEY FOCUS AREAS (CONT'D)

Focus Area	Response
Investment in renewable gas readiness costs	<ul style="list-style-type: none"> <li>- While MNG and AGNVIC have proposed including forecast capex amounts to prepare their assets for renewable gas, AusNet has not.</li> <li>- For AGN VIC and MNG, it is too premature to be incurring expenditure and seeking to pass it through to today's consumers when hydrogen is not likely to be commercialised for at least another 10-20 years - the NGR does not allow for expenditure relating to assets that will not be used to provide pipeline services in the AA period to be conforming capital expenditure.</li> <li>- Even so, this is R&amp;D type expenditure which is generally not recoverable in a competitive market</li> <li>- To the extent that the AER does not agree with the above reasoning and thinks some amount should be included in as forecast capex, it is not clear why the amount of hydrogen readiness costs being proposed by AGNVIC and MNG should be allowed. It should only be expenditure related to those parts of the network used by commercial and industrial users.</li> </ul>
Prudency & Efficiency of opex and capex	<ul style="list-style-type: none"> <li>- A "business-as-usual" approach to expenditure can not be considered prudent, given the identified stranding risk</li> <li>- Past business cases for investments need to be re-evaluated against the criteria in light of the current market circumstances. The AER should not just accept them because they were accepted 5 years ago.</li> <li>- It should not be assumed that the cost of managing any increased risk to the service provider should be borne by consumers.</li> </ul>
Adequacy of supporting information	<ul style="list-style-type: none"> <li>- Key parts of each VIC DB's AA Proposal do not appear to have supporting information to enable AER to determine whether each AA is capable of acceptance. Further substantiating information should be provided by the VIC DBs.</li> </ul>

# KEY FOCUS AREAS (CONT'D)

Focus Area	Response
Accelerated depreciation as a measure to address uncertainty	<ul style="list-style-type: none"><li>• Each VIC DB has proposed to accelerate depreciation to varying extents. This measure should not be supported on a standalone basis because it:<ul style="list-style-type: none"><li>- transfers risk away from the service provider to consumers</li><li>- incentivises businesses to continue to propose higher risk investments</li><li>- does not replicate how a business would respond in a competitive market</li><li>- raises costs for today's consumers at a time where there is already increasing cost of living pressures</li><li>- impacts disproportionately on today's consumers</li><li>- adversely impacts consumers who either can not already afford to switch to electricity or can not substitute gas for electricity</li><li>- will disincentivise operators from investing once capital is recovered, putting service quality at risk</li></ul></li><li>• It should also not be supported where there are also other measures being proposed that are placing stress on consumers' capacity to afford energy.</li><li>• Addressing the issue of the uncertainty of gas must be considered wholistically and in the case of Victorian regulated energy businesses, consideration needs to be given to such issues as:<ul style="list-style-type: none"><li>- Has the case been made for any form of accelerated depreciation and if so, how much?</li><li>- How to manage any wind down of the use of assets?</li><li>- What is the impact on opex and capex forecasts?</li><li>- What certainty should there be for service quality?</li><li>- Who should own fully depreciated assets?</li><li>- Why is it appropriate for the costs for networks to become ready to receive renewable gas to be borne by today's consumers?</li></ul></li></ul>



**COMMENTS ON  
GSR  
ADJUSTMENTS  
TO AA  
PROPOSALS**



# ADJUSTMENTS TO REFLECT GAS SUBSTITUTION ROADMAP

In response to the GSR, the Vic DBs have adopted very different approaches in their Adjusted AAs:

Building Block	AusNet's Adjustments	AGIG (AGN VIC & MNG) Adjustments
Demand Forecasts	Reduced gas demand and customer consumption forecasts but more in line with the AEMO's GSOO Progressive Change Scenario	Significantly reduced forecasts of gas demand (22% lower) and customer consumption (5% lower) by the end of the AA period. More in line with the AEMO's GSOO Step Change Scenario
Forecast New Connections Capex	Reducing gross and net new connections capex (by 21%) but increasing customer contributions capex (by 87%)	Reduced forecasts of customer connections (16% lower) and growth capex (by 38%) by the end of the AA period
Other Forecast Capex	Reduced Augmentation Change	Reduced Augmentation Change Changed the meter and services replacement program
Accelerated Depreciation	Increased from \$150m to \$200m	AGN – increased
Other Changes	Tariffs increased Increased meter removal charge	<ul style="list-style-type: none"> <li>Introduced an abolishment service and charge for permanent disconnections</li> <li>Tariffs increased</li> </ul>

# ADJUSTMENTS TO REFLECT GAS SUBSTITUTION ROADMAP

## Common Comments all Vic DBs' Adjusted AAs

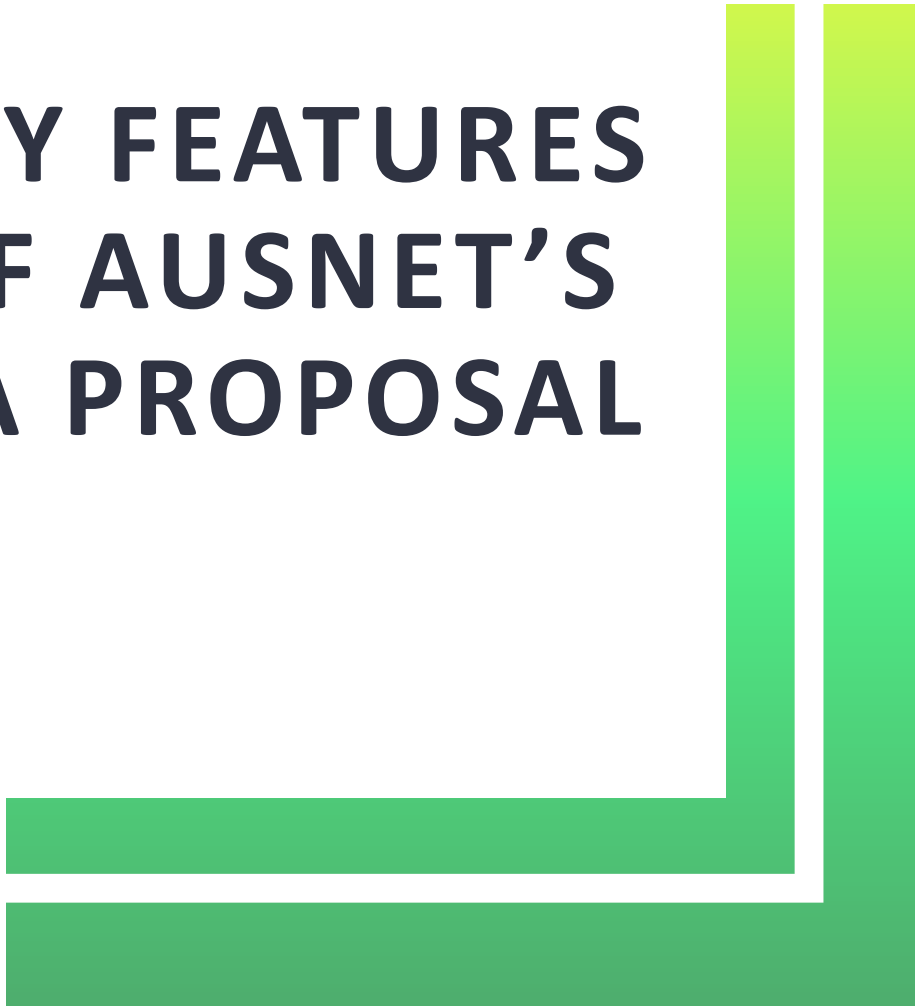
In proposing most of its adjustments, AusNet has not provided detailed justification and so, it is difficult to assess whether the proposed changes are compliant with the NGR., further information should be provided to the AER by all DBs before we could assess whether the adjustments are capable of acceptance by the AER.

While AGIG has provided more justification for AGN and MNG and where AusNet has provided a level of detail to justify the change that is on a par with what has been provided by AGIG – changes to demand forecasts and the amount of accelerated depreciation – in all cases, there are issues that need to be addressed before the revised proposals can be considered capable of acceptance by the AER. We address these issues in the specific building blocks comments sections of this report.

To the extent that the DBs are justifying their adjustments to their AA Proposals – particularly relating to demand forecasts and customer connections - on the basis that the GSR creates increased risk and challenges (both directly and indirectly), this needs to be challenged by the AER because:

- The short term challenges relating to supply and increasing cost of gas – a gas supply shortfall has been forecast by AEMO in its GSOO

# KEY FEATURES OF AUSNET'S AA PROPOSAL






# KEY ELEMENTS OF AUSNET'S AA THAT ALIGN WITH OBJECTIVES

2023-28 AA Proposal Feature	Relevant Objective
<ul style="list-style-type: none"> <li>The methodology to roll forward the capital base – although not the value of the actual capex used in the methodology</li> </ul>	Keeping prices as low as possible for today's consumers
<ul style="list-style-type: none"> <li>Adoption of the AER's Rate of Return guidelines position, corporate tax position and inflation position</li> </ul>	Keeping prices as low as possible for today's consumers
<ul style="list-style-type: none"> <li>Adoption of the base step trend methodology for estimating opex</li> </ul>	Provision of sufficient supporting information to assess capability of acceptance
<ul style="list-style-type: none"> <li>Only include the CESS and EBSS incentive mechanisms and do not include the GNIS incentive mechanism</li> </ul>	Keeping prices as low as possible for today's consumers

However, in our view there are outstanding features of the AA Proposal where there are areas for improvement or aspects which we believe requires further investigation by the AER, before the AA Proposal could be considered capable of acceptance by the AER.

The following slides comment on each of the aspects of AusNet's AA:







-  - consistent with key objectives
-  - further work or analysis required before should accept that it is consistent with key objectives and capable of acceptance by AER
-  - not capable of acceptance based on information provided by AusNet

# HOW MAIN ELEMENTS OF AUSNET'S AA ALIGN WITH KEY OBJECTIVES








We have made the following assessment of how each of the main elements in the proposed AA align with the key objectives, based on the information submitted by AusNet (and refer to the slides in this report where we expand on our comments):

AA Feature	Key Objectives Alignment	Slides
• Introduction of accelerated depreciation of assets	1 <input type="checkbox"/> 2 <input type="checkbox"/> 3 <input type="checkbox"/>	33-39
• Actual capital expenditure 2018-23	1 <input type="checkbox"/> 2 <input checked="" type="checkbox"/> 3 <input type="checkbox"/>	32, 53 & 54
• Forecast capital expenditure – mains replacement, overheads	1 <input type="checkbox"/> 2 <input checked="" type="checkbox"/> 3 <input type="checkbox"/>	40, 55-60
• Tariff path and starting tariff	1 <input type="checkbox"/> 2 <input type="checkbox"/> 3 <input type="checkbox"/>	5
• Customer Connections and Demand forecasting.	1 <input checked="" type="checkbox"/> 2 <input type="checkbox"/> 3 <input type="checkbox"/>	41, 58 & 67
• Implementing a Priority Services Program	1 <input type="checkbox"/> 2 <input checked="" type="checkbox"/> 3 <input type="checkbox"/>	49 & 64
• New Connections capex	1 <input type="checkbox"/> 2 <input type="checkbox"/> 3 <input type="checkbox"/>	41 & 42
• Forecast ICT Capex	1 <input type="checkbox"/> 2 <input checked="" type="checkbox"/> 3 <input type="checkbox"/>	59&60
• Forecast opex – expensing items that used to be capitalised	1 <input type="checkbox"/> 2 <input type="checkbox"/> 3 <input type="checkbox"/>	61-65
• Trend adjustment in the opex forecast methodology	1 <input type="checkbox"/> 2 <input type="checkbox"/> 3 <input type="checkbox"/>	63
• Forecast Cyber opex	1 <input type="checkbox"/> 2 <input checked="" type="checkbox"/> 3 <input type="checkbox"/>	64

# RESPONSE TO AUSNET'S 2023 AA PROPOSAL'S ELEMENTS

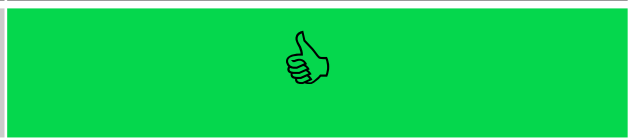
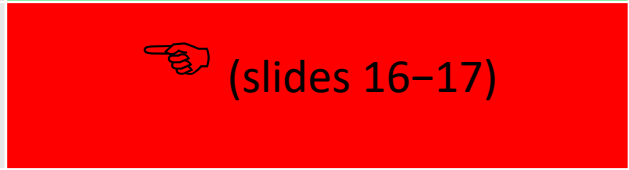


Element	AusNet's Proposal	Our Position
Actual Capital expenditure	<ul style="list-style-type: none"> <li>AER should satisfy itself of the adequacy of the actual capex given the lack of information provided - including cost allocation methodology as a result of AGIG merger, particularly for IT &amp; overheads capex</li> </ul>	 (slides 11 & 12)
	<ul style="list-style-type: none"> <li>Most asset categories' capex needs to be scrutinized more closely because of significant variances from the approved forecast</li> </ul>	 (slides 9 & 10)
	<ul style="list-style-type: none"> <li>The rate of replacement of meters with new meters instead of refurbished ones should be revisited in light of the expectations that customers will choose to leave the network</li> </ul>	 (slides 10 & 11)
Depreciation	<ul style="list-style-type: none"> <li>Inclusion of accelerated depreciation to address uncertainty from Vic Gas Substitution Roadmap</li> </ul>	
Rate of return	<ul style="list-style-type: none"> <li>Accept AER's approach in guidelines</li> </ul>	
Tax (and gamma)	<ul style="list-style-type: none"> <li>Calculated in line with the AER's final tax decision and rate of return instrument</li> </ul>	

# RESPONSE TO AUSNET'S 2023 AA PROPOSAL FEATURES

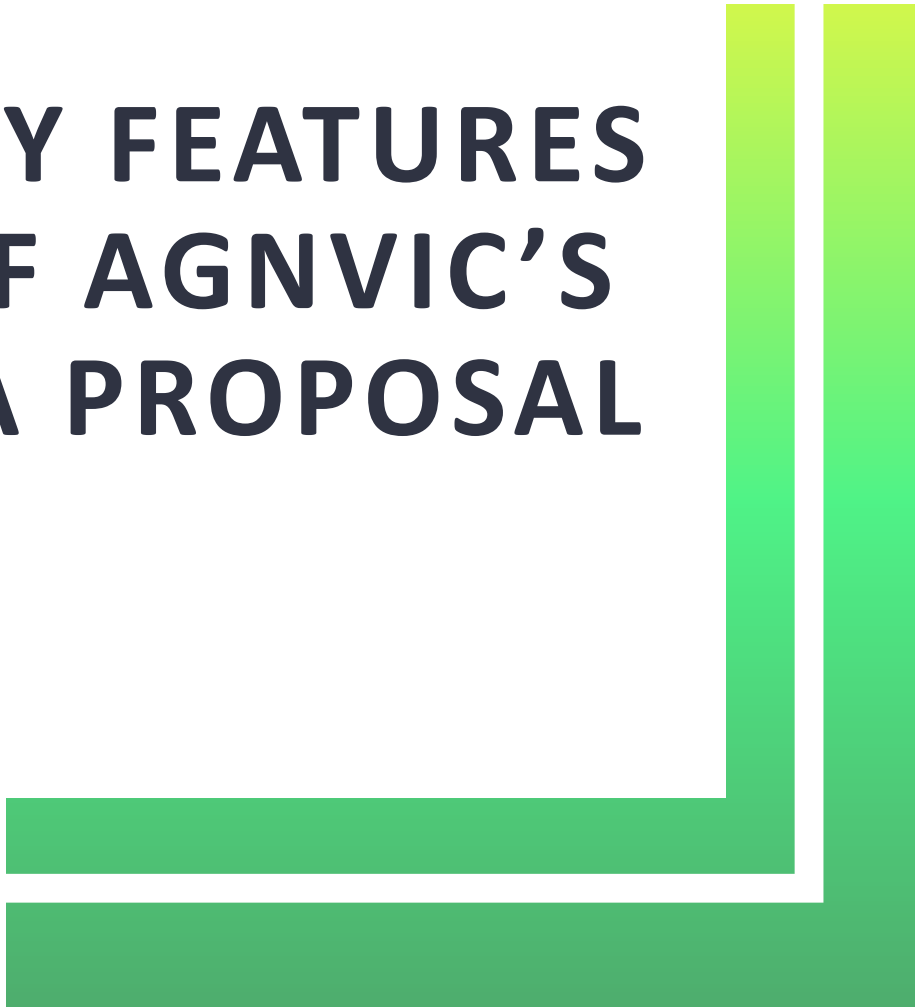
Focus Area	AusNet's Proposal	Our Position
Forecast Capital expenditure	<ul style="list-style-type: none"> <li>Hydrogen readiness capex has not been included.</li> </ul>	 (slide 12)
	<ul style="list-style-type: none"> <li>Capex cost allocation methodology needs to be retested by the AER, particularly with respect to the overheads capex and capex associated with IT projects</li> </ul>	 (slides 11 & 12)
	<ul style="list-style-type: none"> <li>Mains replacement capex needs to be explored further by AER</li> </ul>	 (slide 12)
	<ul style="list-style-type: none"> <li>Augmentations and Growth capex need to be tested as whether they are best estimates arrived at on a reasonable basis</li> </ul>	 (slides 12)
Operating expenditure	<ul style="list-style-type: none"> <li>Total forecast opex is around 13% higher than what AusNet expects to incur in the current AA period even without taking into account ESV levies</li> </ul>	 (slides 13-15)
	<ul style="list-style-type: none"> <li>Case for expensing of items previously capitalised has not been made out</li> </ul>	 (slide 14)
	<ul style="list-style-type: none"> <li>Removing the trend adjustment doesn't appear justified.</li> </ul>	 (slide 14)



# RESPONSE TO AUSNET'S 2023 AA PROPOSAL FEATURES

Focus Area	AusNet's Proposal	Our Position
Operating Expenditure	<ul style="list-style-type: none"> <li>Propose to use 2021 opex levels as the base year in the base-step-trend methodology</li> </ul>	
	<ul style="list-style-type: none"> <li>Priority Services Program is not supported</li> </ul>	
Pricing and service levels	<ul style="list-style-type: none"> <li>upfront price increase of 2.3% for the first year of the AA Proposal but a real increase for the remaining years of the AA Proposal</li> </ul>	
Declining Block Tariff Structure	<ul style="list-style-type: none"> <li>Should be revisited in light of the changed context for gas in Vic</li> </ul>	

# KEY FEATURES OF AGNVIC'S AA PROPOSAL






# KEY FEATURES OF AGNVIC'S AA THAT ALIGN WITH OBJECTIVES

2023-28 Plan Feature	Relevant Objective
<ul style="list-style-type: none"> <li>An upfront price increase of 6% (for the first year), with no real annual price increases for the remainder of the 5 year plan. Consideration should be given to alternative tariff path as it will increase the initial year reduction.</li> </ul>	Keeping prices as low as possible for today's consumers
<ul style="list-style-type: none"> <li>Adoption of the AER's Rate of Return guidelines position, corporate tax position and inflation position</li> </ul>	Keeping prices as low as possible for today's consumers
<ul style="list-style-type: none"> <li>Adoption of the base step trend methodology for estimating opex</li> </ul>	Provision of sufficient supporting information to assess capability of acceptance
<ul style="list-style-type: none"> <li>Only include the EBSS incentive mechanism and do not include the GNIS or the customer service incentive mechanisms</li> </ul>	Keeping prices as low as possible for today's consumers

However, in our view there are outstanding features of the Plan where there are areas for improvement or aspects which we believe requires further investigation by the AER, before the Plan could be considered capable of acceptance by the AER.

The following slides comment on each of the aspects of AGN Vic's AA:








-  - consistent with key objectives
-  - further work or analysis required before BSL should accept that it is consistent with key objectives and capable of acceptance by AER
-  - not capable of acceptance based on information provided by AGN Vic

# HOW AGN VIC'S MAIN FEATURES OF AA ALIGN WITH KEY OBJECTIVES







We have made the following assessment of how each of the main features in the proposed AA align with the key objectives, based on the information submitted by APA (and refer to the slides in this report where we expand on our comments):

AA Feature	Key Objectives Alignment	Slides
• Introduction of accelerated depreciation of assets - \$175m	1 <input type="checkbox"/> 2 <input type="checkbox"/> 3 <input type="checkbox"/>	33-39
• Actual capex – 2018-23	1 <input type="checkbox"/> 2 <input checked="" type="checkbox"/> 3 <input type="checkbox"/>	42, 69 & 70
• Introduction of a Priority Services Program	1 <input type="checkbox"/> 2 <input checked="" type="checkbox"/> 3 <input type="checkbox"/>	49 & 64
• Smoothing of tariffs during AA period to achieve a slight increase in the starting tariffs and then real increases in tariffs in remaining years. Not consistent with approach taken by other DBs	1 <input type="checkbox"/> 2 <input type="checkbox"/> 3 <input type="checkbox"/>	5
• Continued augmentation of network to accommodate new customer connections	1 <input type="checkbox"/> 2 <input type="checkbox"/> 3 <input type="checkbox"/>	41 & 42
• Spending \$10m to ensure network is ready for the distribution of hydrogen	1 <input type="checkbox"/> 2 <input type="checkbox"/> 3 <input type="checkbox"/>	43 & 44
• Undertaking a renewable gas communications and education program	1 <input type="checkbox"/> 2 <input type="checkbox"/> 3 <input type="checkbox"/>	48
• Cyber security related opex and capex	1 <input type="checkbox"/> 2 <input checked="" type="checkbox"/> 3 <input type="checkbox"/>	59 & 60
• Forecast capital expenditure – level akin to “business as usual” levels	1 <input type="checkbox"/> 2 <input type="checkbox"/> 3 <input type="checkbox"/>	40
• Modification of CESS to remove augmentation capex	1 <input type="checkbox"/> 2 <input type="checkbox"/> 3 <input type="checkbox"/>	51






# RESPONSE TO AGNVIC'S 2023 PLAN'S ELEMENTS

Element	AGNVIC's Proposal	Our Position
Actual Capital expenditure in current period	<ul style="list-style-type: none"> <li>AER should satisfy itself of the adequacy of the actual capex given the lack of information provided - including cost allocation methodology as a result of AGIG merger, particularly for IT &amp; overheads capex</li> </ul>	 (slides 11 & 12)
	<ul style="list-style-type: none"> <li>Most asset categories' capex needs to be scrutinized more closely because of significant variances from the approved forecast</li> </ul>	 (slides 9 & 10)
	<ul style="list-style-type: none"> <li>The rate of replacement of meters with new meters instead of refurbished ones should be benchmarked against replacement rates for other networks with similar meters</li> </ul>	 (slides 10 & 11)
Inflation	<ul style="list-style-type: none"> <li>While we support the adoption of the AER's position on inflation, we encourage the AER to 's current consultation process on inflation to be completed in time for the issuing of the Draft Decision</li> </ul>	
Depreciation	<ul style="list-style-type: none"> <li>Inclusion of \$175m of accelerated depreciation to address uncertainty from Vic Gas Substitution Roadmap</li> </ul>	
Rate of return	<ul style="list-style-type: none"> <li>Accept AER's approach in guidelines</li> </ul>	
Tax (and gamma)	<ul style="list-style-type: none"> <li>Calculated in line with the AER's final tax decision and rate of return instrument</li> </ul>	

# RESPONSE TO AGNVIC'S 2023 PLAN FEATURES

Focus Area	AGNVIC's Proposal	Our Position
Forecast Capital expenditure	<ul style="list-style-type: none"> <li>Hydrogen readiness capex can not be supported in the current environment.</li> </ul>	 (slide 12)
	<ul style="list-style-type: none"> <li>Capex cost allocation methodology needs to be retested by the AER in light of the AGIG merger in 2017, particularly with respect to the overheads capex and capex associated with IT projects such as the IT strategy and roadmap</li> </ul>	 (slides 11 & 12)
	<ul style="list-style-type: none"> <li>Question why integrity studies should be undertaken for mains and meter replacement</li> </ul>	 (slide 12)
	<ul style="list-style-type: none"> <li>Augmentations and Growth capex need to be tested as whether they are best estimates arrived at on a reasonable basis</li> </ul>	 (slides 12)
Operating expenditure	<ul style="list-style-type: none"> <li>Total forecast opex is around 13% higher than what AGNVIC expects to incur in the current AA period</li> </ul>	 (slides 13-15)
	<ul style="list-style-type: none"> <li>Purchase of large generation certificates to be questioned further.</li> </ul>	 (slide 14)

# RESPONSE TO AGNVIC'S 2023 PLAN FEATURES

Focus Area	AGNVIC's Proposal	Our Position
Operating Expenditure	<ul style="list-style-type: none"> <li>Propose to use 2021 opex levels as the base year in the base-step-trend methodology</li> </ul>	
	<ul style="list-style-type: none"> <li>Priority Services Program and Renewable Gas Customer Awareness program are not supported</li> </ul>	 (slides 16–17)
Incentive Mechanisms	<ul style="list-style-type: none"> <li>Propose to continue with a modified CESS and will not introduce a Network Innovation Scheme</li> </ul>	 (slide 24)
Disconnection and Abolishment Services	<ul style="list-style-type: none"> <li>Question the appropriateness of introducing a new ancillary reference service</li> </ul>	
Declining Block Tariff Structure	<ul style="list-style-type: none"> <li>Should be revisited in light of changed context for gas</li> </ul>	

# KEY FEATURES OF MNG'S AA PROPOSAL








# KEY ELEMENTS OF MNG'S AA THAT ALIGN WITH OBJECTIVES

2023-28 AA Proposal Feature	Relevant Objective
<ul style="list-style-type: none"> <li>The methodology to roll forward the capital base – although not the value of the actual capex used in the methodology</li> </ul>	Keeping prices as low as possible for today's consumers
<ul style="list-style-type: none"> <li>Adoption of the AER's Rate of Return guidelines position, corporate tax position and inflation position</li> </ul>	Keeping prices as low as possible for today's consumers
<ul style="list-style-type: none"> <li>Adoption of the base step trend methodology for estimating opex</li> </ul>	Provision of sufficient supporting information to assess capability of acceptance
<ul style="list-style-type: none"> <li>Only include the CESS and EBSS incentive mechanisms and do not include the GNIS incentive mechanism</li> </ul>	Keeping prices as low as possible for today's consumers

However, in our view there are outstanding features of the AA Proposal where there are areas for improvement or aspects which we believe requires further investigation by the AER, before the AA Proposal could be considered capable of acceptance by the AER.

The following slides comment on each of the aspects of MNG's AA:








-  - consistent with key objectives
-  - further work or analysis required before BSL should accept that it is consistent with key objectives and capable of acceptance by AER
-  - not capable of acceptance based on information provided by MNG

# HOW MAIN ELEMENTS OF MNG'S AA ALIGN WITH KEY OBJECTIVES







We have made the following assessment of how each of the main elements in the proposed AA align with the key objectives, based on the information submitted by MNG (and refer to the slides in this report where we expand on our comments):

AA Feature	Key Objectives Alignment	Slides
• Introduction of accelerated depreciation of assets	1 <input type="checkbox"/> 2 <input type="checkbox"/> 3 <input type="checkbox"/>	13-14
• New digital customer services	1 <input type="checkbox"/> 2 <input type="checkbox"/> 3 <input type="checkbox"/>	15
• Introduction of a Priority Services Program	1 <input type="checkbox"/> 2 <input type="checkbox"/> 3 <input type="checkbox"/>	16-18
• Smoothing of tariffs during AA period	1 <input checked="" type="checkbox"/> 2 <input type="checkbox"/> 3 <input type="checkbox"/>	19
• Continued augmentation of network to accommodate new customer connections	1 <input type="checkbox"/> 2 <input type="checkbox"/> 3 <input type="checkbox"/>	20
• Spending \$9 to ensure network is ready for the distribution of hydrogen	1 <input type="checkbox"/> 2 <input type="checkbox"/> 3 <input type="checkbox"/>	20
• Undertaking a renewable gas communications and education program	1 <input type="checkbox"/> 2 <input type="checkbox"/> 3 <input type="checkbox"/>	21
• Increase in forecast Security of Critical Infrastructure capex and opex program	1 <input type="checkbox"/> 2 <input type="checkbox"/> 3 <input type="checkbox"/>	27 & 42
• forecast capex and opex	1 <input type="checkbox"/> 2 <input type="checkbox"/> 3 <input type="checkbox"/>	26-28 & 31-34
• capex in light of move to accelerated depreciation	1 <input type="checkbox"/> 2 <input type="checkbox"/> 3 <input type="checkbox"/>	48-49
• forecast network growth	1 <input type="checkbox"/> 2 <input type="checkbox"/> 3 <input type="checkbox"/>	48-49






# RESPONSE TO MNG'S 2023 AA PROPOSAL'S ELEMENTS

Element	MNG's Proposal	Our Position
Actual Capital expenditure	<ul style="list-style-type: none"> <li>AER should satisfy itself of the adequacy of the actual capex given the lack of information provided - including cost allocation methodology as a result of AGIG merger, particularly for IT &amp; overheads capex</li> </ul>	 (slides 11 &12)
	<ul style="list-style-type: none"> <li>Most asset categories' capex needs to be scrutinized more closely because of significant variances from the approved forecast</li> </ul>	 (slides 9 & 10)
	<ul style="list-style-type: none"> <li>The rate of replacement of meters with new meters instead of refurbished ones should be benchmarked against replacement rates for other networks with similar meters</li> </ul>	 (slides 10 & 11)
Inflation	<ul style="list-style-type: none"> <li>While we support the adoption of the AER's position on inflation, we encourage the AER to 's current consultation process on inflation to be completed in time for the issuing of the Draft Decision</li> </ul>	
Depreciation	<ul style="list-style-type: none"> <li>Inclusion of \$175m of accelerated depreciation to address uncertainty from Vic Gas Substitution Roadmap</li> </ul>	
Rate of return	<ul style="list-style-type: none"> <li>Accept AER's approach in guidelines</li> </ul>	
Tax (and gamma)	<ul style="list-style-type: none"> <li>Calculated in line with the AER's final tax decision and rate of return instrument</li> </ul>	

# RESPONSE TO MNG'S 2023 AA PROPOSAL FEATURES

Focus Area	MNG's Proposal	Our Position
Forecast Capital expenditure	<ul style="list-style-type: none"> <li>Hydrogen readiness capex can not be supported in the current environment.</li> </ul>	 (slide 12)
	<ul style="list-style-type: none"> <li>Capex cost allocation methodology needs to be retested by the AER in light of the AGIG merger in 2017, particularly with respect to the overheads capex and capex associated with IT projects such as the IT strategy and roadmap</li> </ul>	 (slides 11 & 12)
	<ul style="list-style-type: none"> <li>Question why integrity studies should be undertaken for mains and meter replacement</li> </ul>	 (slide 12)
	<ul style="list-style-type: none"> <li>Augmentations and Growth capex need to be tested as whether they are best estimates arrived at on a reasonable basis</li> </ul>	 (slides 12)
Operating expenditure	<ul style="list-style-type: none"> <li>Total forecast opex is higher than what MNG expects to incur in the current AA period</li> </ul>	 (slides 13-15)
	<ul style="list-style-type: none"> <li>Purchase of large generation certificates to be questioned further.</li> </ul>	 (slide 14)

# RESPONSE TO MNG'S 2023 AA PROPOSAL FEATURES

Focus Area	MNG's Proposal	Our Position
Operating Expenditure	<ul style="list-style-type: none"> <li>Propose to use 2021 opex levels as the base year in the base-step-trend methodology</li> </ul>	
	<ul style="list-style-type: none"> <li>Priority Services Program and Renewable Gas Customer Awareness should not be approved</li> </ul>	 (slides 16–17)
Incentive Mechanisms	<ul style="list-style-type: none"> <li>Propose to continue with a modified CESS and will not introduce a Network Innovation Scheme</li> </ul>	 (slide 24)
Disconnection and Abolishment Services	<ul style="list-style-type: none"> <li>Question the appropriateness of introducing a new ancillary reference service and why is the level of the disconnection service so different to the MNG charge</li> </ul>	
Declining Block Tariff Structure	<ul style="list-style-type: none"> <li>Should be revisited in light of current environment for gas</li> </ul>	

# COMMENTS ON SPECIFIC BUILDING BLOCKS – ALL AA PROPOSALS



We have identified common issues in connection with the following building blocks of the three DBs' AA Proposals (Common Issues):

- The actual capex used in the roll forward of the capital base.
- The inclusion of amounts for accelerated depreciation.
- General forecast capex issues.
- Customer Connections and Demand forecasting.

We have also identified common issues in connection with the following building blocks proposed in AGN Vic and MNG's AA Proposals (AGIG Common Issues):


- Forecast capex to allow the network to become hydrogen ready
- Other forecast capex issues
- Opex issues
- CESS adjustments

# ACTUAL CAPEX IN ROLL FORWARD OF CAPITAL BASE


- While AGIG has provided more detail in support of its actual capex compared to AusNet, all DBs have provided limited information to explain the significant variances in the total actual capex from 2018-23, in each asset category and in the yearly expenditure profile for each asset category. These divergences call into question how reliable are past capex levels as a guide for assessing the prudence and efficiency of the DBs' forecast capex.
- In the case of AusNet:
  - it has also not provided what makes up the expenditure in each asset category – noting that unit rate information is not disclosed (for confidentiality reasons) nor are business cases provided. AER has to apply the same criteria to assess actual capex as it does for forecast capex; and
  - where particular submissions for certain capex programs (actual and forecast capex) have been provided (particularly the submissions for the forecast capex in each of the asset classes), all of the amounts have been redacted on the basis that they are commercial in confidence, and so, it is difficult to undertake any meaningful analysis. This is a different approach to that adopted by AGIG in its proposals for AGN Vic and MNG.
- In the case of AGN and MNG, there is no mention about how their actual capex benchmarks against peers.
- We expect the AER's capex expert will revisit the business cases and request more detailed information in support of all the DBs' actual expenditure levels and unit rates.
- This is particularly important if a CESS is to apply.




# COMMON ISSUES - DEPRECIATION

Key Element		Comments
Including amounts for accelerated depreciation		<ul style="list-style-type: none"><li>• All DBs' Adjusted AA Proposals include varying amounts for accelerated depreciation and all have increased these amounts since their Original Proposals were filed:<ul style="list-style-type: none"><li>• AusNet - \$200m</li><li>• AGNVIC – \$175m</li><li>• MNG - \$86m</li></ul></li><li>• In the Draft Decision for the APA VTS Access Arrangement, the AER outlined the following criteria needs to be met to enable accelerated depreciation to be considered:<ul style="list-style-type: none"><li>• Reliable and reasonable scenarios showing a spectrum of demand outlooks need to be undertaken and an estimate of the likelihood of each scenario should be assessed and modelled..</li><li>• There is evidence of pricing risk – i.e. capacity of future users to pay for higher prices as a result of deferring accelerated depreciation. It should also be noted that consideration should be give to the capacity of today's consumers to pay higher prices if accelerated depreciation is introduced now, particularly when it is coupled with the impact of rising inflation and interest rates.</li><li>• The forecast capex / investment profile must be limited (ie no growth/expansions and no new connections or significantly reduced replacement and non-network capex)</li><li>• Evidence must be submitted that maintaining the status quo should not be an appropriate default option.</li></ul></li><li>• These criteria are equally relevant to the accelerated depreciation proposals being made by the Victorian DBs.</li></ul>


# COMMON ISSUES - DEPRECIATION (CONT'D)

Key Element		Comments
Including amounts for accelerated depreciation		<ul style="list-style-type: none"><li>• Based on what each DB has submitted in support of their Revised AA Proposals, it is not clear that all criteria have been met:<ul style="list-style-type: none"><li>• Each DB does appear to have presented scenarios showing a spectrum of outlooks and to estimate the likelihood of each scenario.</li><li>• Evidence of pricing risk – there are two components to this:<ul style="list-style-type: none"><li>• capacity of future users to pay for higher prices as a result of deferring accelerated depreciation – DBs don't appear to have provided analysis of the impact on tariffs from 2028 onwards if a decision was made to defer implementing accelerated depreciation by 5 years (ie waiting until the next AA review).</li><li>• capacity of today's consumers to pay higher prices if accelerated depreciation is introduced now – even without taking into account the impact of changes in inflation and interest rates, each DB has proposed an increase in total revenue for the AA period.</li></ul></li><li>• Each DB's forecast capex / investment profile does not appear to have been significantly limited. The Adjusted AA Proposals each includes:<ul style="list-style-type: none"><li>• growth/expansion capex</li><li>• new connections capex</li><li>• replacement and non-network capex</li></ul></li></ul></li><li>• In light of the above, maintaining the status quo on depreciation would appear to be the appropriate default option</li></ul>


# COMMON ISSUES - DEPRECIATION (CONT'D)

Key Element		Comments
Including amounts for accelerated depreciation		<p>There appear to be a few issues with the scenario modelling work undertaken by the DBs:</p> <ul style="list-style-type: none"><li>• The way in which the regulatory building block model and the consumer choice model interact seems to indicate that there is an iterative process which seeks to “goalseek” for the optimum demand and depreciation to match current pricing or thereabouts. It seems like depreciation is being used to recover revenue that would otherwise be “lost” as a result of the reduction in demand in the relevant scenario. This seems problematic on a number of fronts:<ul style="list-style-type: none"><li>• It is transferring all risk to the customer</li><li>• It is counter-intuitive to be increasing prices if there is a reduction in network as this will only increase the rate at which network customers switch to electrification</li></ul></li><li>• The nature of the modelling that appears to have been done to date seems to be based on assumptions that are not very precise estimates. This leads to a series of problems:<ul style="list-style-type: none"><li>• Because there are a number of assumptions in the model, when compounded together, it can lead to very significant differences in the outcomes if each assumption is inaccurate</li><li>• Therefore the reliability of the modelling must be called into question as to whether they are the best estimates arrived at on a reasonable basis (as required under the NGR for all forecasts)</li></ul></li><li>• Again, everything seems to be based on the premise that the service provider must be able to recover all of its investment.</li></ul>


# COMMON ISSUES - DEPRECIATION (CONT'D)

Key Element		Comments
Including amounts for accelerated depreciation – modelling issues (cont'd)		<ul style="list-style-type: none"><li>• In response to the GSR, AusNet has developed two additional scenarios and AGIG has developed one additional one, all of which reflect different views of the possible impact of the GSR. AusNet has discarded two of the scenarios that were used in its Original AA Proposal. But these new scenarios were not developed following the same methodology and process as the original scenarios. Moreover, they have been adjusted by each DB as they didn't deliver suitable outcomes. The adoption of new, untested and modified methodologies must call into question the outcomes from the scenarios as not being best estimates arrived at on a reasonable basis. It is not as rigorous as the methodology adopted for the original scenarios.</li><li>• There is time between now and the time AusNet has to respond to the draft decision to prepare new scenarios following the same methodology as was adopted for the original scenarios. This should be encouraged.</li><li>• All scenarios seem to have adopted options of recovering 2 different amounts of accelerated depreciation over the AA period. It is not explained why the particular amounts have been used.</li><li>• The DBs do not appear to have outlined the assumptions that underpin the modelling that has been adopted to come up with the outputs for each scenario, in particular:<ul style="list-style-type: none"><li>• What is the pace of transition to full electrification?</li><li>• Are consumers being asked to pay for all costs, such as R&amp;D costs for hydrogen etc?</li><li>• What demand assumptions have been adopted in each scenario?</li><li>• What assumptions are made about the wholesale price of gas?</li></ul></li></ul>


# COMMON ISSUES - DEPRECIATION (CONT'D)

Key Element		Comments
Including amounts for accelerated depreciation – modelling issues (cont'd)		<ul style="list-style-type: none"><li>• If the AER is to allow accelerated depreciation, it is noted that each DB has also justified increasing the amount of accelerated depreciation from its Original AA Proposal to the Adjusted AA Proposal by claiming that stranding risk has materially increased. However, the submissions don't provide evidence to support this claim nor do they explain how that increase in risk explains the quantum of the increase in the amount (in the case of AusNet, it is a 33% increase). But:<ul style="list-style-type: none"><li>• The sentiment surveys that the DBs rely on were also prepared before the Original AA Proposal was filed.</li></ul></li><li>• Even if there is an acknowledgement of some increase in the risk, the evidence doesn't appear to support the quantum of the increase in the amount of accelerated depreciation being proposed. For example, AusNet's demand forecasts are only proposing to be reduced by less than 10% and yet it has claimed a 33% increase in the amount of accelerated depreciation.</li></ul>


# COMMON ISSUES - DEPRECIATION (CONT'D)

Key Element		Comments
Including amounts for accelerated depreciation		<ul style="list-style-type: none"><li>• Consideration does not appear to have been given to the additional risks consumers will be faced with as a result of adopting accelerated depreciation:<ul style="list-style-type: none"><li>• Increased costs for gas consumers could make the switch to electrification even more economic, thereby accelerating the voluntary moving away from the use of gas networks.</li><li>• It will result in higher costs for remaining customers who are less able to switch to electrification because of either the cost involved or they are reliant on gas for their downstream operations</li><li>• It exacerbates existing stresses of consumers who are already facing increased debt levels for energy usage</li><li>• It incentivises service providers to continue spending on expansions to the infrastructure and R&amp;D for alternatives to natural gas, which costs are also being proposed to be passed through to consumers</li></ul></li><li>• When combined with the following other features of the Revised AA Proposal, the risk of asset stranding appears to being unfairly transferred wholly to consumers:<ul style="list-style-type: none"><li>• The tariff structures are such that consumers wear demand risk</li><li>• Debt financiers place a significant importance on demand and asset stranding risk and this should already be factored into the allowed cost of debt</li><li>• The costs of assessing alternative (renewable) energy to use the asset is being wholly passed on to consumers</li><li>• Some items of expenditure that have to date been capitalised are now proposed to be expensed</li><li>• Even the costs of managing reputational risk associated with current use of hydrocarbons (ie purchasing carbon credits) is being sought to be passed on to consumers</li></ul></li><li>• Proposed use of accelerated depreciation therefore does not appear to be consistent with the NGR.</li></ul>

# COMMON ISSUES - DEPRECIATION (CONT'D)

Key Element		Comments
Including amounts for accelerated depreciation		<p>Any decision to allow accelerated depreciation in part needs to be part of a total package of measures that should address the above matters, such as:</p> <ul style="list-style-type: none"><li>• A cessation of gas network augmentation – and the establishment of policies (eg electrification programs) that allow gas network augmentation to be avoided. Or, if they are required, that they are not funded by the consumers who do not benefit from them or they are funded by government.</li><li>• Expenditure incurred on research and development into alternative energy sources to natural gas such as hydrogen/biogas research or readiness should not be allowed as part of capital or operating expenditure in any tariff calculation.</li><li>• Appropriate consideration should be given to transfer of the ownership of any potentially useful assets after full depreciation so as to create incentives for ongoing use of the assets</li><li>• Support for consumers unable to manage a transition away from the use of gas infrastructure (eg appliance replacement subsidies, financial support for hardship)</li><li>• Government support for network operators to invest in R&amp;D for alternative, decarbonised energy sources to replace natural gas, rather than seeking to have consumers pay</li><li>• A strategy to fund assets that become underutilised to avoid spiralling costs – this may include asset write downs and government support</li><li>• Other relevant matters to manage consumer cost and risk, addressed through a coordinated consultation process</li></ul>

# COMMON ISSUES - FORECAST CAPEX

Step		Our Comments
Forecast capex is akin to business as usual		<ul style="list-style-type: none"><li>• All of the DBs have proposed forecast capex levels which are higher than was proposed in the current AAs.</li><li>• This suggests that the DBs have adopted a “business as usual” approach to capex investments at a time when they are not only claiming there is significant increased uncertainty about the future of gas and the economic life of its networks, there are also increasing cost of living pressures for consumers caused by a variety of matters including rising energy costs.</li><li>• There does not appear to have been any consideration given by each DB as to how it might change its practices so as to reduce capex levels given these factors. Aspects of its practices that each DB could consider changing to achieve this include:<ul style="list-style-type: none"><li>• Review run lives of assets</li><li>• Changes to maintenance philosophy</li><li>• Pausing mains replacement program</li><li>• Necessity of IT improvements (particular enhancing customer experience)</li><li>• To continue to capitalise expenditure it is now proposing to treat as opex</li></ul></li></ul>



# COMMON ISSUES - DEMAND FORECASTS




Step		Our Comments
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Reduction in connections and demand forecasts since the GSR




- Each of the DBs have submitted adjusted demand forecasts in their Adjusted AA Proposals that indicate quite disparate views about how electrification is forecast to impact new connections and demand. AusNet is proposing a demand forecast that is more aligned with the AEMO's Progressive Change Demand Scenario in the GSOO. However, AGN Vic and MNG have proposed forecasts that are more aligned with AEMO's Step Change Demand Scenario in the GSOO.
- More information needs to be provided before the networks' proposed decreases in demand forecasts & forecast new connections could be considered capable of acceptance.
- While reductions in forecast capex, on their own, result in lower tariffs, when combined with significant reductions in demand, the level of the reference tariffs will increase.
- Further, the AER should consider including one or more of the following mechanisms in its final decision if the actual demand or capex levels vary by more than, say 10%, of the approved forecasts in any year:
  - A tariff variation mechanism which will adjust to actuals (and revised forecasts for the remaining period of the AA)
  - A trigger event mechanism in the access arrangements requiring the businesses to resubmit revised AAs before the end of the 5 year period of the AA


# AGIG COMMON ISSUES - SPECIFIC ACTUAL CAPEX ISSUES

Actual Capex Issue		Our Comments
Connections (Growth assets)		<p>We would expect more information to be made available to substantiate the key reasons for higher unit rates as outlined in the Appendix 2 – Capex Variance document, in particular:</p> <ul style="list-style-type: none"> <li>- Why are actual unit rates in new developments higher. The submission claims there are more onerous development guidelines but no evidence has been provided to outline that there has been a change and that any change is more onerous</li> <li>- Also, given AGIG’s overall program in SA and Vic for connections, AGN should have significant leverage in negotiating rates with contractors for connections.</li> </ul> <p>Also, we would expect the AER to explore how AGNVic’s actual unit contractor rates for new mains capex are higher but yet its rates for mains replacement for forecast capex is lower (compared with the unit rates approved by AER in 2018).</p>
Capitalised overheads		<p>AGN has not provided information to substantiate the overspend against the approved forecast on the basis that the variance is not material. The AER should be requesting justification regardless of the level of overspend</p>
Other		<p>We assume that the customer funded capex that has led to the overrun will not be included in the reference tariff calculation.</p>



# AGIG COMMON ISSUES -FORECAST CAPEX

Key Initiatives		Comments
Supporting a transition of the network to a decarbonised future – capex to allow network to become hydrogen ready		<p>Both AGN VIC and MNG have proposed including forecast capex to enable the network to become hydrogen ready. The following issues should also be explored by the AER in more detail:</p> <ul style="list-style-type: none"><li>• Given the current economics making electrification a more cost effective option than continuing with gas (even with the cost of switching and augmentation of the electricity network), today's residential consumers should not have to pay for the cost of exploring an alternative to natural gas in the pipeline network when a more likely scenario appears to be that most residential consumers will cease using the network in a shorter time frame than it will take to commercialise hydrogen. It would not seem to be intergenerationally equitable to have today's consumers pay for something that they are unlikely to derive a benefit from.</li><li>• There needs to be a reasonably foreseeable likelihood that the commodity will enter the system in the foreseeable future. Current projections envisage 2040s at the earliest. Even if there were some level of foreseeability about hydrogen being commercialised and today's residential consumers do remain as consumers of gas (in whole or in part), it would appear to be sufficiently far away to seriously question the appropriateness of today's residential consumers having to start paying the costs of something which they are not likely to derive a benefit from for some time (if at all).</li><li>• There is plenty of time between now and then to incur capex to be hydrogen ready closer to the time.</li><li>• There is also a risk that, if capex is spent now on becoming hydrogen ready, the assets will need replacing earlier than would be the case had they been implemented closer to the likely time that hydrogen becomes a viable energy source.</li></ul>


# AGIG COMMON ISSUES - FORECAST CAPEX

Key Initiatives		Comments
Supporting a transition of the network to a decarbonised future – forecast capex to allow network to become hydrogen ready		<p>While it is acknowledged that the AEMC has commenced a process to consider changes to the NGR to give effect to a decision of the Energy Ministers in August 2021 to allow hydrogen blends and renewable gas blends to be regulated under the NGR, that, of itself, doesn't justify the allowance of hydrogen related expenditure to be included in AGIG's forecast capex. We would encourage the AER to explore in detail the following in principle issues:</p> <ul style="list-style-type: none"><li>- The NGR only allows capital expenditure to be incurred in connection with providing pipeline services (Rule 79(2)(a)). A pipeline service is defined (amongst other things) by the terms and conditions of the service. Currently, the terms and conditions are likely to define gas by reference to a specification which is unlikely to include renewable gases such as hydrogen. So, given hydrogen is not part of the definition of "gas" in the terms and conditions of service, incurring expenditure relating to a commodity that is not able to enter a pipeline can not be in connection with a pipeline service.</li><li>- Even if there is a likelihood that hydrogen blends will be allowed under the regulatory framework (as a result of the current AEMC process), there are likely to be contractual limitations that prevent hydrogen from entering the pipeline. Presently, a pre-existing contractual right is protected under the NGL (s321) such that an access arrangement must not have the effect of depriving a person of a relevant protected contractual right. So, unless counterparties to all contracts with such contractual limitations in them agree to either waive this right or remove it from the agreement, the AER can not approve this category of expenditure.</li></ul> <p>Finally, it should be noted that AusNet has not proposed any similar capex in its proposal.</p>

# AGIG COMMON ISSUES - SPECIFIC FORECAST CAPEX ISSUES

Actual Capex Issue		Our Comments
Escalation & Overheads		<ul style="list-style-type: none"> <li>• There is very little information given to support not only these amounts but also how they were derived. This is not capable of acceptance – we would expect the AER to ask for more information before accepting these amounts as conforming capex</li> </ul>
Augmentations		<p>AER’s consultants and the AER should be satisfied that the forecasts for augmentations proposed by AGN Vic and MNG represent best estimates arrived at on a reasonable basis. We aren’t satisfied because of the following:</p> <ul style="list-style-type: none"> <li>- AGIG has adopted a simplified methodology to assess the impacts of the GSR on demand and therefore on AGN’s and MNG’s proposed augmentation projects in the AA period. This is not the same as the methodology it adopted in its original plans or that used in past AA’s (and which the AER has accepted is one which would derive a forecast of capex that is a best estimate).</li> <li>- AGIG has relied on demand forecasts which are themselves at risk of not being best estimates (see later). Given demand forecasts are a significant factor used to determine the amount of augmentation capex required, this significantly undermines the confidence in the estimate.</li> </ul>

# AGIG COMMON ISSUES - FORECAST CAPEX ISSUES (CONT'D)

Forecast Capex Issue		Our Comments
Forecast growth expenditure		<p>AER’s consultants should satisfy the AER that this forecast represents a best estimate arrived at on a reasonable basis. This is because of the following:</p> <ul style="list-style-type: none"> <li>AGIG has relied on demand forecasts which themselves do not appear to be best estimates (see later). Given demand forecasts are a significant factor used to determine the amount of growth capex required, this significantly undermines the confidence in the estimate.</li> <li>There seems to be a disconnect between the assumptions relating to demand that AGIG has relied on to determine the revised growth capex submitted in response to the GSR and the revised demand forecasts AGIG has used to determine reference tariffs. In the case of AGN Vic, the demand forecasts used to determine tariffs assume a 16.3% reduction by the end of the AA period in the number of average connections (relative to what was filed in July). Yet, in table 1.6 of Att 9.15, in determining the required growth capex, AGIG has assumed there is a 30% reduction in gross new residential connections (compared to what was filed in July).</li> </ul>
ICT Expenditure		<ul style="list-style-type: none"> <li>It is not clear how much is forecast to be spent on improving cyber security capabilities in light of new requirements and increasing threats. While its appropriate for security reasons that we aren’t provided with access to this, it is important that the AER and its consultants undertake a review, particularly in light of the APA VTS draft decision.</li> <li>It is not apparent that AGIG has considered whether it would be appropriate to defer expenditure associated with supporting remote and digital metering and with providing “a better and more accessible digital customer experience”. This analysis should be done in light of the following factors: <ul style="list-style-type: none"> <li>Uncertainty as to the future of gas</li> <li>Offsetting wherever possible the impact on consumers of the rising cost of living</li> </ul> </li> </ul>



# AGIG COMMON ISSUES - OPEX ISSUES

- We have concerns about the total forecast opex being proposed in the AGN Vic and MNG AA Proposals – our concerns are grouped in two categories:

## General Concerns


- The proposed forecast opex for AGN is \$498.3m and for MNG is \$411.9 over the AA period. Excluding the changes to capitalisation policy, these are 13% (ie \$59.3m) and 17% (\$45m) higher than the expected actual opex in the current AAs. This is inconsistent with AGIG's claim that they are maintaining at current levels, despite the network growing in size and customer numbers.
- There does not appear to have been an attempt to benchmark AGNVIC's opex levels against other Australian & NZ gas network operators. This should be undertaken, as it has been done in the past (through Economic Insights). This is particularly important as MNG's forecast of opex equates to a 12% increase in opex per customer (relative to the current AA period) and this is increasing notwithstanding a growth in customer numbers is being proposed
- We would have expected more analysis to demonstrate how the joining of the MGN, DBP and AGN businesses in 2017 into one business (ie AGIG) has delivered scale and therefore enhanced benefits when capex and opex levels have not reduced. This is particularly important given that, in the case of AGN SA, opex was expected to be 11% below the current AA allowance which reflect one off benefits of the merger with AGIG in 2017. However, this doesn't appear to be the case in the AGN Vic proposal. And MNG claim that the level of forecast opex is expected to be \$35m below the current AA allowance but it doesn't appear that this reduction is at all attributable to the merger.
- Moreover, the merger shouldn't deliver just one-off benefits. Rather, there should have been savings in management expenditure (synergies with having one senior management team managing 3 businesses) which apply each year going forward after the merger.
- While the proposed methodology for setting the forecast opex for the AA is largely consistent with the AER's methodology adopted in current AA, we have some specific comments on the following slides.

# AGIG COMMON OPERATING EXPENDITURE ISSUES (CONT'D)



Step		Our Comments
Renewable gas communications & education program		This program should not be approved. It is outside the scope of gas network business responsibility.
Cost allocation methodology		<ul style="list-style-type: none"><li>We would expect the AER to make further enquiries to be satisfied that the cost allocation methodology appropriately allocates costs as a result of establishing AGIG in 2017 and to ensure that the full benefits of this new business have been passed on to AGNVIC consumers.</li></ul>




# AGIG COMMON OPERATING EXPENDITURE ISSUES (CONT'D)

Step		Our Comments
Priority Services Program		<ul style="list-style-type: none"><li>• There is no analysis included in the supporting information to address the following matters:<ul style="list-style-type: none"><li>• it is not clear why this isn't something that is being done at an AGIG wide level as opposed to for each asset separately, particularly given AGIG owns multiple distribution networks. There should be economies of scale achieved, thereby reducing the amount to be included in each service provider's opex forecast.</li><li>• It is not clear how this amount of opex is built up to fund each of the initiatives listed.</li><li>• More detail is required to outline what line items make up this cost estimate – eg is it consultant's costs or is there also internal labour and if the latter, why the existing internal labour allowance is not sufficient to cover this additional work.</li></ul></li><li>• While we recognise that the program was developed following co-design workshops, we would encourage the AER to require a cost/benefit analysis be undertaken to determine whether it's more efficient to require retailers to expand on their existing programs rather than a network operator. The analysis should consider such issues as:<ul style="list-style-type: none"><li>• Who the customer interfaces with the most on vulnerability issues?</li><li>• Are the current initiatives that AGIG undertakes adequate?</li><li>• Is there a double up between initiatives being undertaken by other organisations (such as retailers and charities) and those proposed by AGIG?</li></ul></li><li>• Assuming that this should be allowed, why should AGIG be proposing a higher amount than AusNet when it is claimed that it is the same program being applied to both businesses.</li><li>• We would encourage the AER to consider whether all of the initiatives being proposed are the most appropriately targeted measures to assist vulnerable customers because there might be others which are more suited to vulnerable customers and which could better align with the Energy Charter.</li></ul>

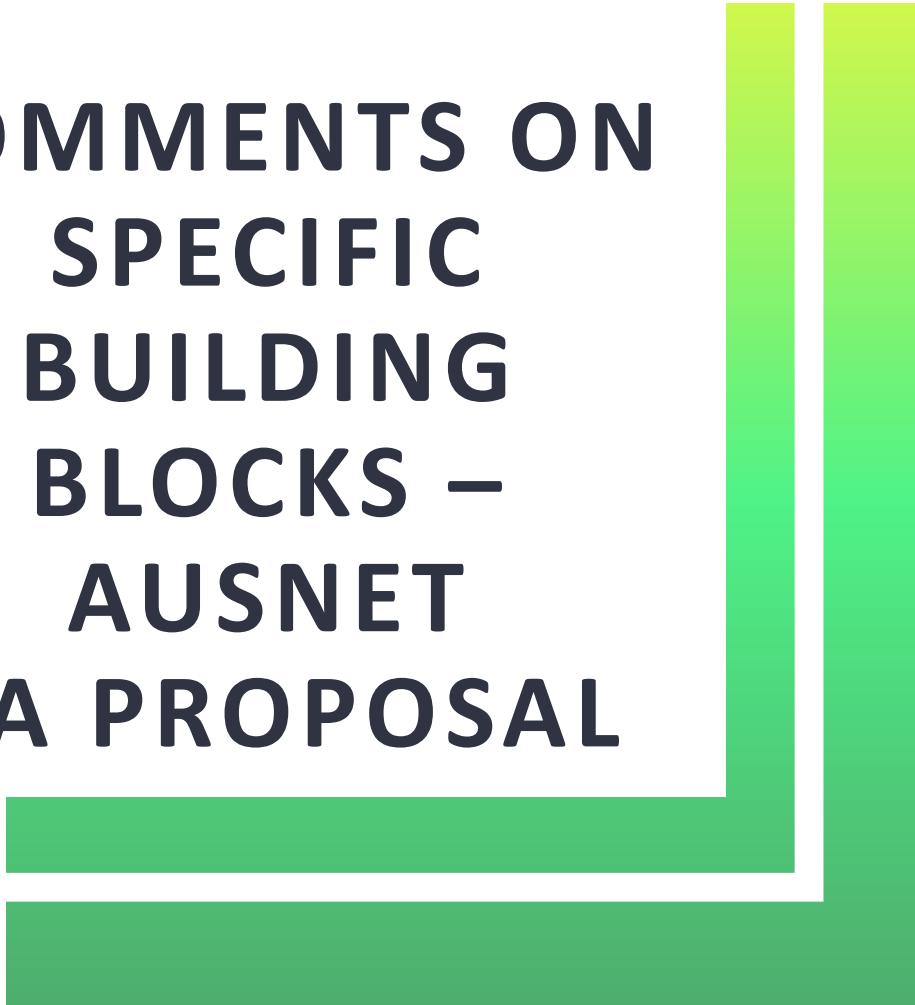
# AGIG COMMON ISSUES - FORECAST OPEX ISSUES (CONT'D)

Forecast Capex Issue		Our Comments
Purchase of Large Generation Certificates		<ul style="list-style-type: none"><li>It is not clear if the purchasing of these certificates by AGN is to be passed through to consumers as part of the opex forecast. If so, this should be challenged by the AER for similar reasons why the AER has not allowed APA to include the cost of purchasing ACCUs in the VTS AA draft decision.</li></ul>
Cyber security related opex step change		<p>We don't have access to the information to substantiate the increase (which is appropriate, given the security issues involved). So, we would expect AER and its consultants to apply the similar level of rigour to reviewing this as it did with the APA VTS AA proposal.</p>

# AGIG COMMON ISSUES - INCENTIVE MECHANISMS

Step		Our Comments
CESS – modification to exclude augmentation capex from its operation		<ul style="list-style-type: none"><li>• There is very little justification included in the supporting information for this change. The justification given doesn't appear adequate and therefore is not capable of acceptance. AGIG should be asked to explain in more detail to justify the change.</li><li>• The justification that AGIG does rely on is that augmentation capex is largely influenced by customer behaviour (ie connections, like growth capex). Because it is not something that AGIG can control, then, like growth capex, it should be removed. However, there are other factors used to determine the level of augmentation capex which AGIG can, in fact control – factors which its own submission on augmentation capex demonstrate. They include:<ul style="list-style-type: none"><li>• options for how to configure the network to ensure pressure levels for customers are maintained at least at minimum required levels</li><li>• the unit rates for engaging contractors and purchasing materials to undertake the augmentations</li></ul></li><li>• By removing augmentation capex from the workings of the CESS, the only mechanism that then exists to ensure the level of capex incurred for augmentations is in the capital base roll forward mechanism when the actual capex gets re-assessed for compliance (at the next re-set). While this should ensure that only efficient capex is rolled into the capital base, there is one less incentive placed on the service provider to ensure that the level of capex is as efficient as is possible (which is what the CESS is aimed at ensuring)</li><li>• This does not appear to be a “minor change” as is contended by AGIG for AGN Vic. Augmentation capex is still a large value in the total of forecast capex – 14%</li></ul>

**COMMENTS ON  
SPECIFIC  
BUILDING  
BLOCKS –  
AUSNET  
AA PROPOSAL**



# ROLL FORWARD OF RAB – ACTUAL CAPEX

While we support the use of the AER’s approved roll forward methodology, we have concerns about the total actual/estimated capex between 2018-23 (net of customer contributions) being proposed – our concerns are in two categories:




## General Concerns

- While the total of \$562.8m (\$m real, 2023) is only \$19.5m (or 3.9%) more than the forecast approved by the AER of \$543.3m (\$m real, 2023), there are significant divergences in most capex categories both in terms of the total and the yearly allowances.

Capex Category	Actual 18-23 Expenditure (\$m nominal)	Variance from AER approved forecast (%)
Mains Replacement	130.5	↓4.3%
Growth assets	296.2	↑12.0%
Mains Augmentation	16.0	↑5.5%
Telemetry	3.6	↑8.4%
Meter Replacement	43.6	↑75.6%
IT	40.6	↑7.3%
Other	32.5	↓62.7%

- These divergences also raise an issue the AER should consider in more detail - how reliable are past capex levels as a guide for assessing the prudence and efficiency of AusNet’s forecast capex in the 2023 AA Proposal?

# SPECIFIC ACTUAL CAPEX ISSUES


Actual Capex Issue		Our Comments
Mains replacement		Very little information is provided to explain the program that was undertaken and what drives the variance from the amount approved by the AER at the last AA review. There is mention that there were higher unit rates and higher ad hoc replacements required but there is no evidence provided to substantiate these claims. This should be explored further by the AER.
Other asset categories		AusNet has not provided any supporting information that is publicly available for any of the other asset categories. Accordingly, the amounts claimed for these categories are not presently capable of acceptance.
Overheads		AusNet's position on overheads is not clear. While the detailed spreadsheets break out the overheads, there is no substantiation given to explain the methodology or justify the amounts. Further information is required to enable us to assess whether the amounts are capable of acceptance.

# FORECAST CAPEX ISSUES

- AusNet is now proposing (in the Adjusted AA) a total forecast capex (net of customer contributions) that is \$18.9m (or 3.0%) less than what was initially proposed in the Original AA Proposal (see table below for the changes in each capex category).
- Notwithstanding this reduction in the level, there are still a number of issues with each capex category that we believe should be raised with the AER.


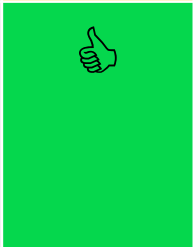
Capex Category	AA Proposal (\$m)	Adjusted AA (GSR Response) \$m	Difference (%)
Mains Replacement	153.1	149.1	-2.6%
Growth Assets	322.6	311.8	-3.4%
IT	44.3	43.0	-2.9%
Meter Replacement	46.7	45.3	-3.0%
Augmentation	18.7	18.4	-1.6%
Telemetry	3.8	3.6	-5.3%
Other assets	37.4	36.6	-2.1%
<b>Total</b>	<b>626.3</b>	<b>607.4</b>	<b>-3.0%</b>

# FORECAST CAPEX ISSUES (CONT'D)


Forecast Capex Issue		Our Comments
Mains Replacement		<ul style="list-style-type: none"><li>• The AER should challenge whether a mains replacement program of a similar magnitude to that incurred in the current AA period should be undertaken at times of uncertainty and increasing cost of living pressures. It also could not be supported if it is being justified to enable AusNet to be hydrogen ready. And even it is being proposed primarily on safety grounds, the AER should test whether AusNet has analysed what, if any, additional risks arise if this program were to be extended over a longer period.</li><li>• It is not clear what exact length of each type of mains referenced in the mains replacement program is to be replaced. Inconsistent figures are used throughout the FP and so, should be clarified. Eg, on p91 and in section 9.5.1 of the FP, it is mentioned that 86km of 1st generation PE HDPE Class 250 pipe will be replaced, whereas on p90, a length of 120km is used for this category of pipe.</li><li>• In relation to the capex associated with the high pressure mains replacement, no analysis or risk assessment appears to have been done to assess whether it is appropriate to move to a proactive replacement program or whether it is more prudent to continue with a reactive replacement program or prolong the remainder of the replacement program. Such an assessment should be undertaken before we could support the proposed expenditure for high pressure (\$11m) and medium pressure (\$29.1m) mains replacement</li><li>• The AER's consultants should also challenge whether the methodology for the reactive service replacement program is appropriate in times of increasing disconnection rates. It may be more appropriate to adopt a different methodology to derive the estimate if there are going to be an increasing number of disconnections in the upcoming AA period.</li></ul>




# FORECAST CAPEX ISSUES (CONT'D)

Forecast Capex Issue		Our Comments
Overheads		<ul style="list-style-type: none"> <li>• There is very little information given to support not only these amounts but also how they were derived. What has been provided does not lend the proposed amounts to be capable of acceptance – we would expect the AER to ask for more information before accepting these amounts as conforming capex.</li> <li>• In particular:             <ul style="list-style-type: none"> <li>• How the level of overheads for AusNet compare with those for other similar organisations (eg AGNVIC and MNG).</li> <li>• How the level of overheads trend against historical amounts (on a like for like basis – noting that the graph in section 6.4.3.6 doesn't appear to be on a like for like basis as it would appear to include corporate overheads in the historical actuals).</li> <li>• It is also not clear whether there are any real increases in unit rates that are being adopted to derive the overheads forecasts and if so, what is driving those increases.</li> </ul> </li> </ul>
Removal of \$11.2m of future of gas capex		<ul style="list-style-type: none"> <li>• We support AusNet's proposal to no longer include any capex to address expenditure for the network to become ready to receive renewable gases. This should be a precedent that is followed by other businesses, particularly in circumstances where it causes the cost of energy to increase and therefore place undue pressure on those consumers who are unable to electrify.</li> </ul>


# FORECAST CAPEX ISSUES (CONT'D)

Forecast Capex Issue		Our Comments
New connections		<ul style="list-style-type: none"><li>• There is uncertainty about just how much expenditure is forecast to be incurred in this capex category because different amounts are used in different supporting documents submitted by AusNet. This should be clarified by the AER</li><li>• While it seems reasonable, as a matter of principle, that less will be spent on customer connections if developers do not fully reticulate new residential estates or if customers' preferences shift towards electrification of homes, based on the information that has been provided by AusNet to date, it is difficult to be able to discern whether the forecast of new connections being proposed by AusNet (\$148.4m) is a best estimate arrived at on a reasonable basis given that it is about a 40% reduction on the forecast included in the Original AA and it is based on demand forecasts which aren't supported by actual demand. More time should be allowed to assess how demand is actually changing before landing on a particular forecast. This should be done at the time of or in response to the Draft Decision.</li><li>• Even though the total amount being forecast is less than what was incurred in the current AA period, there is a lack of information to support the figures being proposed as being efficient. We would expect to have seen analysis to substantiate:<ul style="list-style-type: none"><li>• The unit rates being used – for example, per dwelling type, per km etc</li><li>• The efficiency of the different line items that make up the cost of a customer connection.</li></ul></li></ul>

# FORECAST CAPEX ISSUES (CONT'D)

Forecast Capex Issue		Our Comments
IT expenditure		<ul style="list-style-type: none"><li>• Only a very minor change has been proposed to the level of IT capex in the Adjusted AA (relative to the Original AA). And even then, this would appear to be driven primarily by adopting a different escalation rate.</li><li>• It is not clear how much is forecast to be spent on improving cyber security capabilities in light of new requirements and increasing threats. While its appropriate for security reasons that we aren't provided with access to this, it is important that the AER and its consultants undertake a review, particularly in light of the APA VTS draft decision.</li><li>• It is not apparent that AusNet has considered whether it would be appropriate to defer expenditure associated with supporting remote and digital metering and with providing “a better and more accessible digital customer experience”. This analysis should be done in light of the following factors:<ul style="list-style-type: none"><li>• Uncertainty as to the future of gas.</li><li>• Offsetting wherever possible the impact on consumers of the rising cost of living, particularly when AD is also being proposed.</li></ul></li><li>• We would also have expected to see more information to support the forecast expenditure on IT systems that are specific to the gas network particularly when figure 6.12 of the AAI seems to indicate that there are only 2 such projects.</li></ul>

# FORECAST CAPEX ISSUES (CONT'D)

Forecast Capex Issue		Our Comments
IT expenditure (cont'd)		<ul style="list-style-type: none"><li>• In relation to the forecast that represents the AusNet share of corporate-wide IT projects that benefit both the electricity and gas networks (and which have previously been reviewed and accepted by the regulatory), very little information has been provided to determine the appropriateness of:<ul style="list-style-type: none"><li>• The quantum of each initiative (as per table 6.14 of the AAI);</li><li>• Why 100% of the cost of some of the projects is being allocated to the gas business and not shared amongst the electricity businesses (when they are not being claimed as gas network specific costs); and</li><li>• The appropriateness of the apportionment of the capex between electricity and gas businesses.</li></ul></li></ul>


# OPERATING EXPENDITURE (OPEX) ISSUES

- We have concerns about the total forecast opex being proposed by AusNet – our concerns are grouped in two categories:



## General Concerns

- The proposed forecast opex is \$302m over the AA period which (excluding debt raising costs) is approx. 7% higher than the expected actual opex in the current AA. But AusNet has not compared like for like because:
  - the forecast doesn't include any amount for ESV levies, whereas the actual opex does include \$31m for these levies
  - The forecast includes amounts for overheads which previously have been capitalised (approx. \$11.5m)
- A comparable level of opex seems to indicate a business as usual approach with insufficient regard to the cost of living impact and asset stranding risk.
- While the analysis presented by AusNet appears to show that AusNet is performing above the average efficiency level among the group of larger gas distribution businesses:
  - it is based on data up to only 2019. Since then, AusNet's actual operating expenditure has increased significantly and the proposed base year of 2021 is much higher.
  - More comparators should be provided. It is noted that AGNSA and EvoEnergy had other comparators.
- While the proposed methodology for setting the forecast opex for the AA Proposal is largely consistent with the AER's methodology adopted in current AA Proposal, we have some specific comments on the following slides.


# SPECIFIC OPERATING EXPENDITURE ISSUES (CONT'D)

Step		Our Comments
Base/Step/Trend Methodology		<p>While we support the use of the AER endorsed methodology and the use of 2021 as the base year, subject to the following:</p> <ul style="list-style-type: none"><li>- The following adjustments should be made to the base year opex:<ul style="list-style-type: none"><li>- ESV levies should be removed because AusNet has proposed the recovery of these costs via the control mechanism.</li><li>- Movements in provisions should be adjusted in accordance with the AER's preferred approach.</li><li>- We would expect that the level of opex attributed to UAFG that is to be removed from the base year (as non recurrent item) has been verified. This should be able to be easily done by the ESCV but its not clear that it has been done.</li><li>- Costs associated with the provision of non-reference services should be removed because they are not within the scope of reference services.</li></ul></li><li>- AusNet claims that it has decided to “wear” some opex for some categories of expense such as bushfire insurance premiums step changes and new state taxes and levies step changes. However, we question whether this will in fact be a wearing of the premium increase for two reasons:<ul style="list-style-type: none"><li>- The control mechanism may entitle AusNet to recover as part of a tariff variation process once the annual premiums are known each year.</li><li>- Is it instead being recovered from electricity customers?</li></ul></li></ul>

# SPECIFIC OPERATING EXPENDITURE ISSUES (CONT'D)



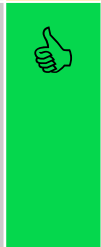
Step		Our Comments
Trend adjustment		<ul style="list-style-type: none"><li>• The Adjusted AA Proposal has increased the “trend” adjustment to the base year opex to \$14.8m. However, this hasn’t been explained with sufficient detail, other than to say it is as a result of the reduction in demand forecasts. This should be tested further by the AER as the information provided isn’t capable of acceptance and also because:<ul style="list-style-type: none"><li>• it doesn’t logically follow that, with net connections reducing (rather than increasing) but network length still increasing (albeit at a lesser rate than was forecast in the original AA proposal), output growth should be declining each year. This seems to be suggesting that while you get economies of scale with increases in demand, you actually get increased costs with decreases in demand.</li><li>• It is not clear why a 0% productivity growth rate should be adopted when a productivity growth rate/factor is set to estimate the rate of technical change. The reduction in demand doesn’t appear to be a driver for a reduction in technical change. And even if this is somehow linked to demand, it is hard to understand how a small reduction in demand results in the reduction in the growth rate to 0% in the revised AA proposal.</li></ul></li></ul>
Ancillary reference service opex		<p>With the increase in disconnections being proposed, AusNet has not explained the extent to which labour costs are included in the forecast opex associated with ancillary reference services. If there are labour costs included, then it is not clear the extent to which this will reduce the amount of labour that would otherwise have been allocated to the reference services and therefore included in base year to determine the forecast of opex. This should be explored further by the AER and its consultants.</p>

# SPECIFIC OPERATING EXPENDITURE ISSUES (CONT'D)


Step		Our Comments
Priority Services Program - \$4.5m		<ul style="list-style-type: none"><li>• There is no analysis included in the supporting information to address the following matters:<ul style="list-style-type: none"><li>• it is not clear why this isn't something that is being done at an industry wide level as opposed to for each asset separately. There should be economies of scale achieved, thereby reducing the amount to be included in each service provider's opex forecast.</li><li>• It is not clear how this amount of opex is built up to fund each of the initiatives listed.</li><li>• More detail is required to outline what line items make up this cost estimate – eg is it consultant's costs or is there also internal labour and if the latter, why the existing internal labour allowance is not sufficient to cover this additional work.</li></ul></li><li>• While we recognise that the program was developed following co-design workshops, we would encourage the AER to require a cost/benefit analysis be undertaken to determine whether it's more efficient to require retailers to expand on their existing programs rather than a network operator (such as AusNet). The analysis should consider such issues as:<ul style="list-style-type: none"><li>• Who the customer interfaces with the most on vulnerability issues?</li><li>• Are the current initiatives that AusNet undertakes adequate?</li><li>• Is there a double up between initiatives being undertaken by other organisations (such as retailers and charities) and those proposed by AusNet?</li></ul></li><li>• We would encourage the AER to consider whether all of the initiatives being proposed are the most appropriately targeted measures to assist vulnerable customers because there might be others which are more suited to vulnerable customers and which could better align with the Energy Charter.</li></ul>



# SPECIFIC OPERATING EXPENDITURE ISSUES (CONT'D)

Step		Our Comments
Expensing items that used to be capitalised		This expensing of items (including overheads) that, until now, have been capitalised, further increases the cost of living pressures for today's consumers. The AER should consider whether this is appropriate as the supporting justification provided by AusNet does not support the case that these items must be capitalised. It only indicates that it would "better fit" being classified as opex. Given there seems to be a discretion as to whether it is classified as opex or capex, in the current circumstances, it would be in consumers' interests that the expenditure remain as capex.
Cyber security related opex		While it is appropriate for security reasons that the information to justify this expenditure is confidential, it is important that the AER and its consultants undertake a review, particularly in light of the APA VTS draft decision on this category of expenditure.
Gas Education opex		It is noted that AusNet, unlike AGIG, has not proposed to include an allowance for renewable gas communication programs. In circumstances where there is uncertainty about the future of gas, it does not seem appropriate to include expenditure for education or marketing campaigns. Expenditure needs to be minimised as much as possible to maintain the affordability of network services (and therefore gas).

# INCENTIVE MECHANISMS

Step		Our Comments
CESS – no proposal to modify the CESS to exclude augmentation capex from its operation		<ul style="list-style-type: none"><li>• We support the fact that AusNet has not proposed the same change to its CESS as has been proposed by AGNVIC and MNG – ie to exclude augmentation capex from its operation.</li></ul>

**COMMENTS ON  
SPECIFIC  
BUILDING  
BLOCKS –  
AGNVIC  
AA PROPOSAL**



# ROLL FORWARD OF RAB – ACTUAL CAPEX



While we support the use of the AER’s approved roll forward methodology, we have concerns about the total actual/estimated capex between 2018-23 (net of customer contributions) being proposed – our concerns are in two categories:

## General Concerns

- The total of \$731.9m is \$147.8m (or 25.3%) more than the forecast approved by the AER of \$584.0m (by 25.3%)
- There are significant divergences in most capex categories both in terms of the total and the yearly allowances.

Capex Category	Actual 18-23 Expenditure (\$m nominal)	Variance from AER approved forecast (%)
Mains Replacement	243.7	↑55.4%
Growth assets	232.1	↑22.4%
Mains Augmentation	15.2	↓58.0%
Telemetry	1.6	↑28.6%
Meter Replacement	31.9	↓7.8%
IT	46.4	↓31.5%
Capitalised overheads	61.3	↑1.6%
Other	99.6	↑166.5%

# SPECIFIC ACTUAL CAPEX ISSUES (CONT'D)



Actual Capex Issue		Our Comments
Mains and Meter replacement		<p>We would expect more information to be made available to substantiate the overrun, particularly in circumstances where less mains have been replaced than was forecast (290km vs 297km) but yet there has been a 55% overspend compared to the AER approved forecast.</p> <p>AGNVic claims that unit rates in the Melbourne CBD are 3-4 times what was assumed in the previous forecast due to the number of services and complexity of works. It's not clear how this could be the case given the significant replacement program that AGN has carried out across all of its assets. This should have given it reliable information on which to base its forecasts.</p> <p>The AER should also look to compare the rates with the replacement rates of other networks that have similar meters to AGNVIC.</p>
IT System capex		<p>While it is noted that actual ICT expenditure levels are 31.5% less than the forecast approved by the AER, we would expect the AER to inquire as to what was involved in nationalising the IT applications and the extent to which the costs have been allocated between the various AGIG businesses given that:</p> <ul style="list-style-type: none"> <li>- Its not clear which of the projects incurred relate to nationalising and consolidating;</li> <li>- It is not apparent that this was an assumption when the AER assessed the forecast for the 2018-23 plan; and</li> <li>- The cost allocation methodology that the AER would have relied upon in assessing the forecasts for 2018-23 would not have assumed an allocation across all of the businesses that now make up AGIG (given that AGIG was not established until 2017).</li> </ul>

# FORECAST CAPEX ISSUES

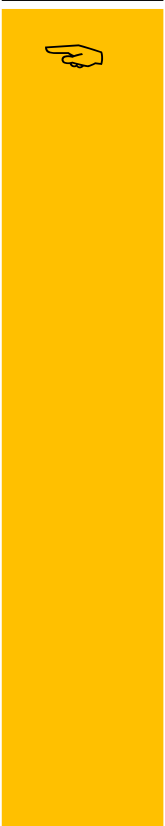
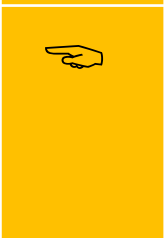
- While AGIG is proposing total forecast capex that is \$97m (or 22.4%) less than what was initially proposed in the Original AA (see table below for the changes in each capex category), in an environment of heightened uncertainty for gas, it doesn't make sense that, notwithstanding AGNVic will have completed the mains replacement program in the current AA, its capex is still \$60m more than what the AER approved in the last AA (excluding the mains replacement capex program), particularly given that:
  - there is about \$23.8m for items that are proposed to be expensed whereas in the last AA, they were capitalised; and
  - the amount of growth assets capex being forecast is \$21m less than compared with last AA's capex for this category .

	Original Plan (\$m)	Amended Plan (GSR Response) (\$m)
Mains Replacement	30.9	29.5
Growth Assets	229.4	166.1
IT	77.5	74.9
Meter Replacement	42.0	39.8
Augmentation	80.4	57.8
Telemetry	4.6	4.5
Other assets	38.5	37.0
Escalation	4.8	4.0
Overheads	23.3	20.7
<b>Total</b>	<b>531.4</b>	<b>434.3</b>

# FORECAST CAPEX ISSUES (CONT'D)



Forecast Capex Issue		Our Comments
Mains Replacement		<ul style="list-style-type: none"><li>• Most of the forecast capex for this category relates to integrity studies and sampling to be undertaken. But AGIG doesn't appear have done an assessment of the risk involved in deferring this expenditure for these 2 projects until the next AA period. This should be done given the uncertainty as to the future of gas and the added cost of living pressures facing consumers in a higher inflation environment.</li><li>• The AER's consultants should also challenge whether the methodology for the reactive service replacement program is appropriate in times of increasing disconnection rates. It may be more appropriate to adopt a different methodology to derive the estimate if there are going to be an increasing number of disconnections in the upcoming AA period.</li></ul>
Augmentations		<p>There appear to be inconsistencies in the amount of forecast augmentation capex forecast in the supporting documents. This should be clarified:</p> <ul style="list-style-type: none"><li>- Att9.11A – forecast of \$55m</li><li>- Att9.15 – forecast of \$58m</li></ul> <p>Because AGIG has forecast a decline in demand (both in terms of average connections and average demand (see below)), it does not seem intuitive that the only change in the forecast of capex is a change in the timing of the incursion of the capex – noting that \$16m is to be deferred to a later time in the AA period than what was initially envisaged in the FP and a further \$10m is to be deferred to the next AA period.</p>

# FORECAST CAPEX ISSUES (CONT'D)


Forecast Capex Issue		Our Comments
Augmentations (Cont'd)		<p>There seems to be a disconnect between the assumptions relating to demand that AGIG has relied on to determine the change required to forecast augmentation capex as a result of the GSR and the demand forecasts AGIG has used to determine reference tariffs. The demand forecasts used to determine tariffs assume a 16.3% reduction by the end of the AA period in the number of average connections (relative to what was filed in July) and a 4.7% reduction in the average consumption per connection by the end of the AA period (again relative to the forecast filed in July 2022), leading to a 22% reduction in demand by the end of the AA period (again, relative to what was filed in July). Yet, in section 1.2.3 of Att 9.11A, in determining the required augmentation capex, AGIG has assumed there is a 25% reduction in new residential connections (compared to what was filed in July) and a 1.8% average annual load reduction for residential customers (compared to what was filed in July)</p> <p>There could therefore be significant additional savings identified if the established methodology were applied. AGIG has time to undertake this between now and the response to the DD. This should be scrutinised by the AER and its consultants in more detail.</p>
IT Expenditure		<p>Why should consumers be wearing the costs of AGIG transitioning its IT systems in house from APA? And event if this is to be allowed, why is there no corresponding allowance to make “redundant” or to remove from the capital base the capex associated with any existing APA IT systems that had not yet been fully depreciated?</p>



# SPECIFIC OPERATING EXPENDITURE ISSUES

Step		Our Comments
Base/Step/Trend Methodology		<p>While we support the use of the AER endorsed methodology:</p> <ul style="list-style-type: none"> <li>- We would expect that the level of opex attributed to UAFG that is to be removed from the base year (as non recurrent item) has been verified. This should be able to be easily done by the ESCV but its not clear that it has been done</li> <li>- A sound case hasn't been given for the expensing of overheads that were once capitalised (as per table 8.4 on p77) – particularly when this is further increasing tariffs for today's customers when coupled with a higher inflation scenario and accelerated depreciation.</li> <li>- AGIG claims that the overhead rate to be expensed (instead of being capitalised) means that their forward looking capitalisation overhead rate is 4% instead of the prior 10% (used in the current AA period) and that this is consistent with the overhead rate that applies to MNG. We understand that the operating model of MNG is different to AGN (ie MNG doesn't rely on services being provided to it by APA (whereas AGN does), and so, it doesn't necessarily follow that the same rate should be applied for both businesses. This should have been assessed by the independent analysis in Att 8.3 but, it doesn't appear to have been addressed in that report.</li> </ul>
Establish an efficient base year		<ul style="list-style-type: none"> <li>• We support the use of 2021 opex as the base year given that it's the year with the lowest level of opex in the current 5 year plan.</li> </ul>

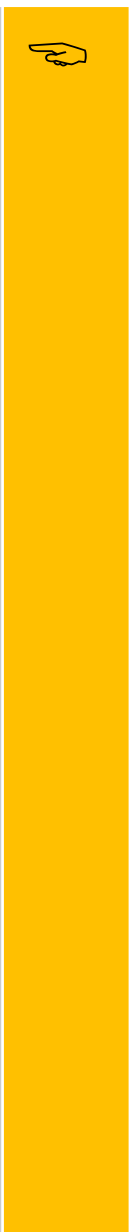
# SPECIFIC OPERATING EXPENDITURE ISSUES (CONT'D)

Step		Our Comments
GSR related changes – net increase of \$9.3m		<ul style="list-style-type: none"><li>• The reduction from \$18.3m to \$10.7m in the “trend” adjustment to the base year opex hasn’t been explained with sufficient detail, other than to say it is as a result of the reduction in demand forecasts. This should be tested further by the AER as the information provided isn’t capable of acceptance and also because:<ul style="list-style-type: none"><li>• it doesn’t logically follow that, with net connections reducing (rather than increasing) but network length still increasing (albeit at a lesser rate than was forecast in the original AA proposal), we should see negative output growth each year. This seems to be saying that while you get economies of scale with increases in demand, you actually get increased costs with decreases in demand. At best, it should be zero change (ie a zero percent output growth rate).</li><li>• It is not clear why a 0% productivity growth rate should be adopted when a productivity growth rate/factor is set to estimate the rate of technical change. The reduction in demand doesn’t appear to be a driver for a reduction in technical change. And even if this is somehow linked to demand, it is hard to understand how a small reduction in demand results in the reduction in the growth rate from 0.4% (as was proposed in the original AA) to 0% in the revised AA proposal.</li></ul></li></ul>

# DEMAND FORECASTS

Step		Our Comments
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Reduction in demand forecasts since the GSR – to align with Step Change Scenario in GSOO



- While there are inconsistencies in the forecasts in various supporting documents, the Revised AA Proposal modelling reduces the demand forecasts from the Original AA Proposal as follows:

Final Plan vs Revised Final Plan (%)	2023/24	2024/25	2025/26	2026/27	2027/28
<b>Residential demand</b>					
Average Connections (no.)	-4.36%	-5.87%	-8.32%	-11.81%	-16.37%
Consumption per connection (GJ)	-0.95%	-1.75%	-2.85%	-3.69%	-4.74%
<b>Demand (TJ)</b>	<b>-5.42%</b>	<b>-7.69%</b>	<b>-11.31%</b>	<b>-16.02%</b>	<b>-22.03%</b>
<b>Commercial demand</b>					
Average Connections (no.)	-3.99%	-4.03%	-4.02%	-4.02%	-4.01%
Consumption per connection (GJ)	-0.52%	-2.20%	-3.89%	-5.38%	-6.87%
<b>Demand (TJ)</b>	<b>-4.52%</b>	<b>-6.30%</b>	<b>-8.10%</b>	<b>-9.61%</b>	<b>-11.15%</b>

- These reductions are much more significant than have been forecast by AusNet in its Adjusted AA Proposal.

**COMMENTS ON  
SPECIFIC  
BUILDING  
BLOCKS – MNG  
AA PROPOSAL**



# ROLL FORWARD OF RAB – ACTUAL CAPEX


While we support the use of the AER’s approved roll forward methodology, we have concerns about the total actual/estimated capex between 2018-23 (net of customer contributions) being proposed – our concerns are in two categories:

## General Concerns



- While the total of \$442.7m (nominal \$) is only \$14.99m (or 3.3%) less than the forecast approved by the AER of \$457.7m (\$nominal), there are significant divergences in most capex categories both in terms of the total and the yearly allowances.

Capex Category	Actual 18-23 Expenditure (\$m nominal)	Variance from AER approved forecast (%)
Mains Replacement	195.5	↓4.3%
Growth assets	124.7	↑12.0%
Mains Augmentation	16.5	↑5.5%
Telemetry	4.7	↑8.4%
Meter Replacement	14.5	↑75.6%
IT	43.5	↑7.3%
Capitalised overheads	25.4	↑0.5%
Other	18.0	↓62.7%

# SPECIFIC ACTUAL CAPEX ISSUES

Actual Capex Issue		Our Comments
Connections (Growth assets)		<p>We would expect more information to be made available to substantiate the key reasons for higher unit rates than is in the Appendix 2 – Capex Variance document, in particular:</p> <ul style="list-style-type: none"><li>- Why the unit rate for connections per customer is much higher in MNG’s case than in the case of AGNVIC?</li><li>- Why were there more unknown issues for connections in higher density areas? MNG’s network covers high density areas and so there should have been good experience of connections in the past that should have meant MNG was able to reliably estimate.</li><li>- MNG claims that the impact of the COVID-19 pandemic drove up unit rates in the latter years of the AA period but the actual expenditure in these latter years was no different to those in the pre-pandemic period and connection rates also didn’t vary.</li><li>- Also, given AGIG’s overall program in SA and Vic for connections, MNG should have significant leverage in negotiating rates with contractors for connections.</li></ul> <p>Also, we would expect the AER to explore how MNG’s actual unit contractor rates for new mains capex are higher but yet its rates for mains replacement for forecast capex is lower (compared with the unit rates approved by AER in 2018).</p>

# SPECIFIC ACTUAL CAPEX ISSUES (CONT'D)

Actual Capex Issue		Our Comments
IT System capex		<p>MNG has not provided any information to substantiate its actual capex in this category because it is within 10% of the approved forecast. Yet it is not clear to what extent the actual capex includes expenditure for nationalising the IT applications as a result of the AGIG merger in 2017/8. If it does include capex for these activities, MNG should provide the explanation and also, information about the extent to which the costs have been allocated between the various AGIG businesses because it is not apparent:</p> <ul style="list-style-type: none"> <li>- that this was an assumption when the AER assessed the forecast for the 2018-23 AA; and</li> <li>- Whether the cost allocation methodology that the AER would have relied upon in assessing the forecasts for 2018-23 assumed an allocation across all of the businesses that now make up AGIG (given that AGIG was not established until 2017).</li> </ul>
Capitalised overheads, Mains replacement, Telemetry and Overheads capex		<p>MNG has not provided information to substantiate the expenditure in each of these categories because the variance is within 10% of the AER approved forecast and as such, in MNG's opinion, the variance is not material. The AER should be requesting justification regardless of the level of variance.</p>


# FORECAST CAPEX ISSUES

- While MNG is now proposing (in the Adjusted AA) a total forecast capex (net of customer contributions) that is \$52.9m (or 7.3%) less than what was initially proposed in the Original AA Proposal (see table below for the changes in each capex category), in an environment of heightened uncertainty for gas, it doesn't make sense that its forecast capex is still \$211m (or 46%) more than what the AER approved in the current AA in 2018. This also doesn't take into account the fact that \$21m is now being proposed to be expensed (ie as forecast opex) when in the past it was capitalised.


Capex Category	AA Proposal (\$m)	Adjusted AA (GSR Response) \$m	Difference (%)
Mains Replacement	424.8	408.3	-3.9%
Growth Assets	115.8	93.7	-19.1%
IT	73.9	71.4	-3.4%
Meter Replacement	23.7	22.4	-5.5%
Augmentation	9.1	1.5	-83.5%
Telemetry	4.7	4.5	-4.3%
Other assets	32.9	31.8	-3.3%
Escalation	5.7	5.3	-7.0%
Overheads	31.0	29.7	-4.2%
<b>Total</b>	<b>721.6</b>	<b>668.7</b>	<b>-7.3%</b>




# FORECAST CAPEX ISSUES (CONT'D)

Forecast Capex Issue		Our Comments
Mains Replacement - \$408.3m		<ul style="list-style-type: none"><li>• The AER should challenge whether the mains replacement program of this magnitude (ie \$408m) should be undertaken at times of uncertainty. It could not be supported if it is being justified to enable MNG to be hydrogen ready. If it is being proposed on safety grounds, the AER should test whether MNG has analysed what, if any, additional risks arise if this program were to be extended over a longer period.</li><li>• It is not clear what exact length of each type of mains referenced in the mains replacement program is to be replaced. Inconsistent figures are used throughout the FP and so, should be clarified. Eg, on p91 and in section 9.5.1 of the FP, it is mentioned that 86km of 1st generation PE HDPE Class 250 pipe will be replaced, whereas on p90, a length of 120km is used for this category of pipe.</li><li>• The AER's consultants should also challenge whether the methodology for the reactive service replacement program is appropriate in times of increasing disconnection rates. It may be more appropriate to adopt a different methodology to derive the estimate if there are going to be an increasing number of disconnections in the upcoming AA period.</li></ul>



# DEPRECIATION

Forecast Capex Issue		Our Comments
Creation of new asset class for hydrogen		<p>We oppose the creation of a new asset class of “Future of Gas” and for that class to have an asset life of 5 years.</p> <p>Instead, it should have a life that is consistent with the life for the pipelines asset class. This is consistent with the approach adopted by the AER in connection with the Victorian Transmission System AA.</p>



# SPECIFIC OPERATING EXPENDITURE ISSUES

Step		Our Comments
Base/Step/Trend Methodology		<p>While we support the use of the AER endorsed methodology:</p> <ul style="list-style-type: none"><li>- We would expect that the level of opex attributed to UAFG that is to be removed from the base year (as non recurrent item) has been verified. This should be able to be easily done by the ESCV but its not clear that it has been done</li><li>- MNG claims that the overhead rate to be expensed (instead of being capitalised) means that their forward looking capitalisation overhead rate is 4% instead of the prior 10% (used in the current AA period) and that this is consistent with the overhead rate that applies to MNG. We understand that the operating model of MNG is different to AGNVIC (ie MNG doesn't rely on services being provided to it by APA (whereas AGN does)), and so, it doesn't necessarily follow that the same rate should be applied for both businesses. This should have been assessed by the independent analysis in Att 8.3 but, it doesn't appear to have been addressed in that report.</li></ul>

# SPECIFIC OPERATING EXPENDITURE ISSUES (CONT'D)

Step		Our Comments
Establishment of an efficient base year		<p>It is not clear whether the proposed base year for setting the forecast opex is efficient given the following matters:</p> <ul style="list-style-type: none"> <li>- The current year's actuals are much lower</li> <li>- There should have been significant savings delivered from the merging of AGN Vic and MNG to form AGIG in 2017/18. This doesn't seem to be explained or factored into the base year</li> <li>- There is no explanation of what the higher safety levies relate to</li> <li>- It is not clear what the network development costs are</li> <li>- It is not clear whether the allowance for higher call centre costs is the net increase – and if so, what is the business case to change the call centre operating model if it is going to result in higher costs</li> </ul>
Expensing items that used to be capitalised		<p>This expensing of items (including overheads) that, until now, have been capitalised, further increases the cost of living pressures for today's consumers. The AER should consider whether this is appropriate as the supporting justification provided by MNG does not support the case that these items must be capitalised. It only indicates that it would "better fit" being classified as opex. Given there seems to be a discretion as to whether it is classified as opex or capex, in the current circumstances, it would be in consumers' interests that the expenditure remain as capex.</p>

# SPECIFIC OPERATING EXPENDITURE ISSUES (CONT'D)

Step		Our Comments
Trend adjustment - \$5.9m		<ul style="list-style-type: none"> <li>The reduction from +\$1.9m to -\$5.9m in the “trend” adjustment to the base year opex hasn’t been explained with sufficient detail, other than to say it is as a result of the reduction in demand forecasts. This should be tested further by the AER as the information provided isn’t capable of acceptance and also because:               <ul style="list-style-type: none"> <li>it doesn’t logically follow that, with net connections reducing (rather than increasing) but network length still increasing (albeit at a lesser rate than was forecast in the original AA proposal), we should see negative output growth each year. This seems to be saying that while you get economies of scale with increases in demand, you actually get increased costs with decreases in demand. At best, it should be zero change (ie a zero percent output growth rate).</li> <li>It is not clear why a 0% productivity growth rate should be adopted when a productivity growth rate/factor is set to estimate the rate of technical change. The reduction in demand doesn’t appear to be a driver for a reduction in technical change. And even if this is somehow linked to demand, it is hard to understand how a small reduction in demand results in the reduction in the growth rate from 0.4% (as was proposed in the original AA) to 0% in the revised AA proposal.</li> </ul> </li> </ul>
Ancillary reference service opex		<p>With the increase in disconnections being proposed, MNG has not explained the extent to which labour costs are included in the forecast opex associated with ancillary reference services. If there are labour costs included, then it is not clear the extent to which this will reduce the amount of labour that would otherwise have been allocated to the reference services and therefore included in base year to determine the forecast of opex. This should be explored further by the AER and its consultants</p>

# DEMAND FORECASTS

Step		Our Comments
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Reduction in demand forecasts– to align with Step Change Scenario in GSOO



- While there are inconsistencies in the forecasts in various supporting documents, the Adjusted AA Proposal modelling forecasts reduced demand compared with the Original AA Proposal as follows:

Final Plan vs Revised Final Plan (%)	2023/24	2024/25	2025/26	2026/27	2027/28
<b>Residential demand</b>					
Average Connections (no.)	-4.18%	-5.54%	-7.68%	-10.56%	-14.07%
Consumption per connection (GJ)	-0.94%	-1.72%	-2.77%	-3.56%	-4.53%
<b>Demand (TJ)</b>	<b>-5.14%</b>	<b>-7.14%</b>	<b>-10.16%</b>	<b>-13.81%</b>	<b>-18.05%</b>
<b>Commercial demand</b>					
Average Connections (no.)	-3.84%	-3.87%	-3.87%	-3.86%	-3.86%
Consumption per connection (GJ)	-0.51%	-2.16%	-3.75%	-5.11%	-6.43%
<b>Demand (TJ)</b>	<b>-4.32%</b>	<b>-5.93%</b>	<b>-7.49%</b>	<b>-8.77%</b>	<b>-10.03%</b>

- These reductions are much more significant than have been forecast by AusNet in its Adjusted AA Proposal.

# OTHER ISSUES



# REFERENCE SERVICE AND TARIFF MATTERS

Step		Our Comments
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Declining Block Tariff Structure



- Given the changed context for gas in Victoria, consideration should be given to a tariff structure that doesn't incentivise consumers to use more gas.

Disconnection Service – ancillary reference service and tariff



- The proposed charges that each VIC business has set for the disconnection and meter removal services vary quite significantly.

Relevant AA	Level of tariff (\$nominal) for 2023/24	
	Disconnection Service	Meter Removal Service
AGN Vic (see attachment 14.1 – table 3.4)	\$87.00	\$124.00
MNG (see attachment 14.1 – table 3.4)	\$62.72	\$72.15
AusNet (see Access Arrangement Information – table 17.9)	\$66.13	\$825.90

- In its Adjusted AAs for AGNVIC and MNG, AGIG has explained that the disconnection service is only used for temporary disconnections and so, if someone is to permanently disconnect, they must pay for the new abolishment service and for both DBs, that charge is proposed as \$950.
- We support the retention of the disconnection service and the meter removal service as ancillary reference services but do not support the requirement that only an abolishment service must be paid for if a consumer seeks to permanently disconnect from the network.
- It makes sense that the disconnection charges for these services should only recover operating expenses. So, it is not clear why AGNVIC's tariff is almost 50% more than MNG's tariff for the same service (and why AusNet's is 7-10 times more expensive)
- The AER needs to obtain further information from each of the businesses to understand the assumptions made in relation to disconnection rates and explore whether there are any economies of



# REFERENCE SERVICE AND TARIFF MATTERS (CONT'D)

Step		Our Comments
Additional Reference Service – Service Abolishment – Residential		<p>After the release of the GSR, both MNG and AGNVIC have adjusted their AA Proposals to include a new ancillary reference service to deal with abolishment or to change the definition of the disconnection service. AusNet, however has retained a single abolishment service. It would be prudent for the AER to adopt a consistent approach amongst all three businesses on this point and that it should allow both an abolishment service and a disconnection service as ancillary reference services for the following reasons:</p> <ul style="list-style-type: none"><li>• The current ancillary reference service for disconnection appears adequate for today</li><li>• No adequate case has been made as to what additional work and cost is required for a permanent disconnection as opposed to a temporary disconnection</li><li>• Allowing a consumer the option to disconnect or permanently abolish gas supply affords greater flexibility for consumers into the future, and reduce costs, if they subsequently decide that they want to have energy re-supplied to them from the network.</li></ul>

# FINANCEABILITY OF PRICING

- AGNVIC claims that it needs its proposal to deliver an average FFO to debt ratio of 9% in order to maintain a weighted average credit rating of between A- and BBB+. However, it notes that its proposal only delivers a 7% ratio.
- We would expect the AER to test this and to focus on a number of factors, including:
  - The extent to which other revenue earned by AGNVIC is factored into this assessment (in addition to reference service revenue) – eg revenue from the application of any incentive mechanisms.
  - The tax treatment to be adopted in this analysis – noting that “FFO” is revenue less opex and tax.
  - How AGN’s actual financing arrangements are structured.

# GLOSSARY

Term	Meaning
AA	Access Arrangement
AAI	Access Arrangement Information
AA Period	The 5 year period that the AA remains in place, in this case, from 2023 to 2028
AA Proposal	The proposed revised Access Arrangement submitted by AusNet on 1 July
Adjusted AA	The adjusted proposed revised Access Arrangement submitted by AusNet on 1 September to address impact of the GSR
AER	Australian Energy Regulator
AGIG	Australian Gas Infrastructure Group
AGN Vic	Australian Gas Networks Victoria, the service provider of the AGN Vic and Albury AA
AusNet	AusNet Gas, the service provider
GSR	The Victorian Government's Gas Substitution Roadmap
MNG	MultiNet Gas, the service provider
NGR	National Gas Rules
NGL	National Gas Law
NGO	National Gas Objective under the NGL