SUBMISSION

VICTORIAN GAS DISTRIBUTION RESETS 2023-28 | 09 MAY 2022

EUAA
Energy Users Association of Australia

Introduction and Summary

The Energy Users' Association of Australia (EUAA) is the peak body representing Australian commercial and industrial energy users. Our membership covers a broad cross section of the Australian economy including significant retail, manufacturing, building materials and food processing industries. Combined our members employ over 1 million Australians, pay billions in energy bills every year and in many cases are exposed to the fluctuations and challenges of international trade.

This submission provides a combined response to the Draft Plans by AGN, Multinet, and AusNet Services gas distribution networks in Victoria for the period 2023-2028. Its focus is on two key themes – consumer engagement and the future of gas. While it does not respond to the specific questions asked, the commentary covers many of the issues referred to in the questions.

At the outset we would like to congratulate all three networks on the quality and comprehensiveness of their Draft Plans. The development of a Draft Plan has been a significant factor in improved consumer engagement on network resets in recent years. It has highlighted the benefits of early engagement to allow consumers to better understand the complexities of a network reset, particularly one involving issues around the future of gas in an energy system transitioning to lower carbon.

These Draft Plans are being prepared at a time of considerable uncertainty. While there is broad stakeholder agreement on the need to reduce carbon emissions and that a reduction in natural gas consumption will be a key part of that, there is not broad agreement on the pace of reduction and who pays the transition costs. The Plans were developed based on the 2021 GSOO but the recently published 2022 GSOO has a significantly lower forecast demand in some scenarios.

The Victorian Government is developing its Gas Substitution Roadmap but the policy outcomes are not expected to be announced until mid-year, around the time the three networks are due to make their Access Arrangement submissions to the AER. All that has been publicly released by the Government is some high level results of the modelling:

- a significant fall in gas consumption for all consumers – residential, small business and C&I - is required to meet the interim 2030 targets
- residential gas consumers will make significant savings be switching from gas to electricity.

No details of the modelling assumptions and methodology has been released to give stakeholders any confidence around the results. No results have been released around the impact on C&I consumers like EUAA members. So the Access Arrangement (AA)Proposals may need to be changed to incorporate the Roadmap policy changes.

Our conclusions in this submission are:

- All three networks still have some way to go on engaging with consumers on 'future of gas' issues to a position where they can have any substantive reliance on the outcome of that engagement to support their AA proposal

- This covers matters including the level of accelerated depreciation, capex for mains replacement and capex/opex to prepare the networks for a low carbon future.

Consumer Engagement

The EUAA has been directly involved in three engagement streams:

(i) As a member of the Expert Co-design Panel working with the three networks to:
  - develop a range of scenarios for a 'Future of Gas' model, and
  - to comment on the methodology and outputs of that 'no regrets' customer choice modelling

(ii) As a member of the Victorian Gas Network Stakeholder Roundtable (VGNSR) we have been involved in all four stages of the engagement so far:

(iii) helping facilitate, and participate in, large user workshops to engage more deeply with these users.

This has given us a very good perspective on the overall engagement plan. Our summary comments are as follows:

- We welcome the decision of all three networks to undertake combined engagement with one engagement plan
- All three networks have a strong commitment to best practice engagement shown in a number of ways e.g. the combined engagement, co-design of aspects of the engagement plan including key topics for engagement, regular attendance of senior management at engagement sessions, comprehensive slide packs generally distributed ahead of the actual meeting, the building block detail provided early on in the process, the number and structure of various engagement sessions and the comprehensive Draft Plans
- The networks emphasise that consumers have a choice between gas and electricity and understandably they have a strong incentive provide a proposal that retains that choice
- All three networks still have some way to go on engaging with consumers on 'future of gas' issues to a position where they can have any substantive reliance on the outcome of that engagement to support their AA proposals.

Engagement on the future of gas involves consumers coming to a view on very complex issues such as:

- To what extent should consumers pay for accelerated depreciation on past investments?
- Should this cost be shared between consumers, network shareholders and Governments (given it is their policy changes that are driving potentially stranded assets)?
- If consumers are to pay at least a share, should that start in the 2023-28 period or wait until the next AA period when there will be more information on the business case for network delivery of renewable gas/hydrogen?

- Why is it consistent for a network asking consumers to pay for accelerated depreciation for past investment at the same time as proposing augmentation capex that may well add to the accelerated depreciation cost for consumers in future years?
- How should consumers consider intergenerational equity issues? Is it fair that consumers of today, who may not be consumers in the future because they have electrified, pay their share of past investment or leave consumers in the future to pay?
- Why should consumers, rather than equity owners or potential transporters of hydrogen or renewable gas, pay in 2023-28 to help prepare the network for transporting these zero carbon gases in the future when the business case for network delivery of renewable gas/hydrogen has yet to be established?
- Why should consumers, rather than the equity owners, pay for an education programme to tell consumers about the benefits of renewable gas/hydrogen again when the business case for this has yet to be established?

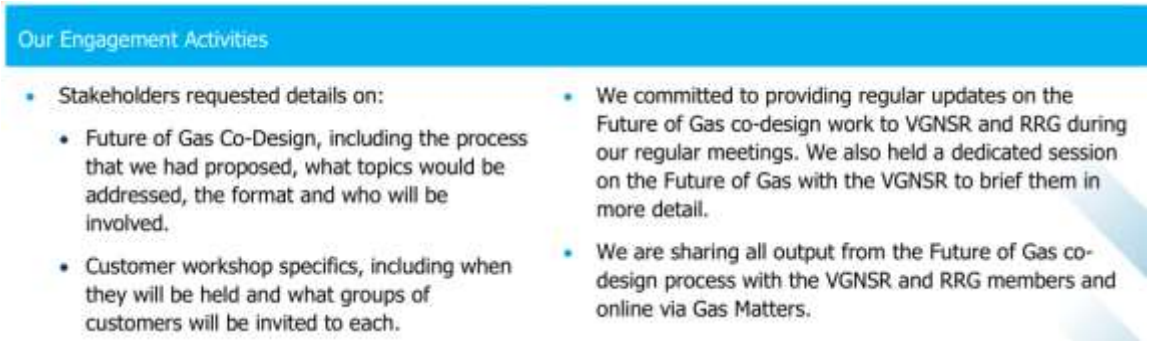
As the AGN Draft Plan notes (p.4):

> "Our Draft Plan recognises that the role of gas networks as the economy moves towards net zero emissions is uncertain. We know that gas networks will continue to play a role for the foreseeable future, but the nature of that role can vary significantly depending on technological developments and government policy."

A key part of consumer engagement is to seek consumer views on how that risk around the future role of the gas networks is allocated between consumers and network owners. The EUAA has been engaged in these debates for some time and is aware of the trade-offs involved. Our membership of the Expert Co-design Panel gave us particular insights into how the broader issues impact on the three networks.

However most other consumer advocates are still coming up to speed with the issues. Our judgement is that more detailed engagement is required on the networks' future of gas narrative to convince a broader cohort of consumer advocates (let alone consumers more generally) that the AA proposals in July are capable of acceptance. Significant 'inform' and 'involve' discussion is required before effective 'consult' and 'collaborate' discussion can be undertaken that would allow any engagement response to support specific expenditure proposals in the AA.

All three networks did provide regular feedback to the VGNSR on the Future of Gas modelling (the EUAA provided one of these briefings as the only party on both the Expert Panel and the VGNSR) and its implications, consistent with the engagement plan e.g. AGN Draft Plan p. 31:



However, this was only ever 'inform' given the complexity of the issues and the level of knowledge of many of the VGNSR members. While some consumer advocates might look to the EUAA's expertise to get some degree of

confidence in the direction the modelling might be heading, there is still the need to bring all VGNSR members along on the journey.

Future of Gas

(a) Introduction

We commend the three networks in undertaking the Future of Gas modelling and the process they used through the establishment of the Expert Co-design Panel. The EUAA appreciated the opportunity to be a member and participate in the debate to develop the scenarios and more recently to review the results now emerging. This modelling was is used, along with judgements around the level of price change consumers are willing to bear, to guide the level of accelerated depreciation the three networks are seeking.

Understandably gas networks want to have a long term future – they have invested in very long life assets. They need to see a future; however uncertain it may be. As the AusNet Draft Plan notes (p.21):

> "There is a real possibility that replacing natural gas with renewable hydrogen will deliver a lower-cost, faster decarbonisation pathway than an electrification one. We also know that our customers place a high value on their gas supply and have a preference to continue using gas if there is a net-zero emissions option available. Our customers have indicated they have no immediate plans to disconnect gas from their homes—in fact, we continue to see strong growth in new gas connections.
>
> For these reasons, we are proposing actions that keep the option of a green hydrogen gas supply open for our customers during the 2024-28 regulatory period. However, we are mindful that a transition to a hydrogen network is by no means certain and so we have not proposed significant expenditure to roll out widespread hydrogen blending in the next regulatory period as this is not prudent at this time. In doing this, we will also seek to minimise the long-term risk and cost for both customers and investors in the event that a renewable hydrogen pathway is not practical."

The key question for all three networks is - why should consumers pay to keep that option open? If yes, why now (2023-28)? Why not wait until the next AA period when the uncertainty is likely to be less? If networks want to start spending now to keep the option open, why shouldn't they (and the promoters of renewable gas/hydrogen) pay the price to keep the option open? Why should consumers take the risk on the future business case for pipeline renewable gas/hydrogen?

(b) The limits of the 'no regrets' argument

All three networks make what they refer to as 'no regrets' expenditure proposals as a key response to their future of gas narrative. There are three separate, but related, aspects:

(i) The level of accelerated depreciation

Drawing on the Future of Gas modelling results, AusNet notes (p.23):

"Mindful of the potential impact of accelerated depreciation on short term affordability, we have proposed a lower amount of $130m of accelerated depreciation than the $200m we modelled. We consider that this amount of accelerated depreciation is a no regrets action because:

- The sooner the action is taken, the more impact it has on keeping future prices low. This helps keep a hydrogen option competitive for the 2030s and beyond.
- It also encourages investment in the network to keep it safe, reliable and ready for future renewable gas options.
- Accelerating capital recovery now also takes advantage of historically low interest rates, keeping the immediate price impact low for customers.
- In a pessimistic scenario for our gas network (i.e. one where the gas load is electrified and our network closed), it protects vulnerable customers who remain on the network from large price rises (noting that the more customers there are to share network charges, the lower the average bill).
- Conversely, if we take this action now and a hydrogen future eventuates, we can simply reverse the action in future and remove accelerated depreciation, leading to lower long-term prices."

(ii) An additional benefit of mains replacement primarily completed for safety and environmental reasons

Mains replacement is a major component of forecast capex spend.

	Current AA Period ($m)	Next AA Period ($m)
AusNet	121	143
AGN	226.9	24.4
MGN	202.5	457.5
Total	550.4	624.9

AusNet argues (p. 21):

"Our ongoing mains replacement program (which is critical for meeting our safety obligations) has the added benefit of replacing pipes that are not hydrogen compatible with pipes that are ready for a hydrogen future. The low pressure mains replacement program will be completed in this next regulatory period and AusNet will then be well placed to rapidly roll out hydrogen blending across our network, if that is shown to be a viable option."

(iii) Additional capex to prepare the networks for a low carbon future

There is both capex:

AusNet	$11.2m "In the future, we expect to deliver renewable gases, like biomethane or hydrogen, through our network. We need to replace a variety of network components in order to facilitate the transition. We call this no-regrets investment." (p. 32)
AGN	$25m "…to ensure the network is ready for the distribution of hydrogen which includes updating procedures, replacement of incompatible parts, renewable gas compatibility studies and a digital ultrasonic residential meter trial in the Albury/Wodonga region" (pp 10-11)

MGN	$21m "…to ensure the network is ready for the distribution of hydrogen which includes updating procedures, replacement of incompatible parts and renewable gas compatibility studies (pp10-11)

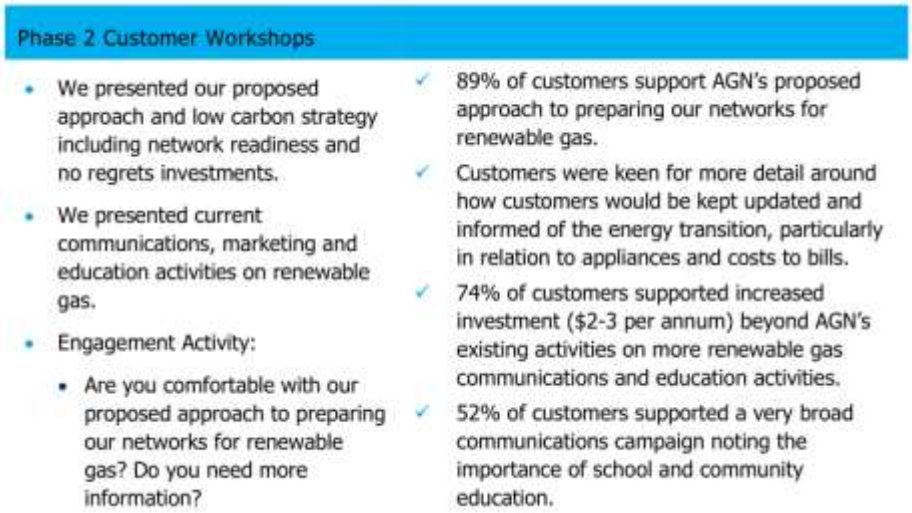
and opex step changes:

AGN	$7.4m "We are investing in a renewable gas communications package, as while 87% of customers consider decarbonisation as important very few know about the decarbonisation plans for the gas networks" (p. 71)
MGN	$7.4m "… new renewable gas communications and education program" (p.71)
AusNet	No step change

MGN argues (pp 89-90):

> "Preparing our network for a decarbonised future is a new initiative for the next AA period, and while it only represents a relatively small proportion of our total investment (around 2.7%) over the next five years, it is a key no regrets step in ensuring our network is compatible with renewable gases to support the transition of the network to a decarbonised future."

AGN/MGN support their Draft Plan expenditure with the following commentary on p.39 of each Draft Plan:



Phase 2 Customer Workshops

- We presented our proposed approach and low carbon strategy including network readiness and no regrets investments.
- We presented current communications, marketing and education activities on renewable gas.
- Engagement Activity:
  - Are you comfortable with our proposed approach to preparing our networks for renewable gas? Do you need more information?

- ✓ 89% of customers support AGN's proposed approach to preparing our networks for renewable gas.
- ✓ Customers were keen for more detail around how customers would be kept updated and informed of the energy transition, particularly in relation to appliances and costs to bills.
- ✓ 74% of customers supported increased investment ($2-3 per annum) beyond AGN's existing activities on more renewable gas communications and education activities.
- ✓ 52% of customers supported a very broad communications campaign noting the importance of school and community education.

We respond to each of the three aspects in turn.

The networks do not provide an explicit definition of 'no regrets' as if the term is self-explanatory. We define 'no regrets' as 'regardless of future developments we are happy with the decision we made today assuming we have to make the decision today'. We argue that the networks have yet to make the case that these self-proclaimed 'no regrets' decisions need to be made now for the 2023-28 AA.

(i) The level of accelerated depreciation

The EUAA accepts the principle of the 'regulatory contract'. We define that as the implicit contract between the network, its consumers, and the regulator that once the regulator has made their decision on the networks' spending proposal, consumers commit to pay an efficient price cap that provides the network with recovery of its capital plus a rate of return on that capital commensurate with the risk allocation between the network and its consumers. This rate of return is set based on the assumption that consumers accept demand risk i.e. networks have no stranded asset risk. The network expects to get return of and on its capital over the regulated depreciation term.

Consumers can regret a decision to move too quickly or too slowly for accelerated depreciation. This is influenced by the level of risk consumers are willing to take. Is it a high risk that pipeline renewable gas/hydrogen will not prove to be economic so that too slow a move by the AER to accelerated depreciation is regretted? Is it a high risk that the AER agrees to accelerated depreciation too early which increases demand destruction and consumers exit gas earlier than they otherwise would have been the case - which leaves the remaining consumers with much higher costs if pipeline renewable gas/hydrogen does not prove to be economic?

The EUAA believes that the 'regulatory contract' concept provides an arguable case on intergenerational equity grounds for accelerated depreciation in the 2023-28. To delay the start of accelerated depreciation to the 2028-33 AA period means that those consumers who reduce their consumption or disconnect from the grid in the 2023-28 period will contribute less to the historical costs of meeting their demand. If those who are least likely to reduce consumption/disconnect are unable to afford electrification (even with the Victorian Government subsidies) it could be considered inequitable if a delay in the start of accelerated depreciation means these 'rusted on' consumers have to pay an even higher price in 2028-33 and beyond. Plenty of regret potential.

The networks have used the Future of Gas modelling to inform their decision on the level of accelerated depreciation. They then sought to validate their chosen level through consumer engagement. However, this was always going to be difficult given the knowledge base of those being asked. As noted above, AusNet chose $130m after the 'modelled' level was $200m. Consumers were asked to select among three options – zero, $130m or $200m. It was not surprising that the middle one was selected but it should not be taken as consumers supporting $130m of accelerated depreciation.

We do not consider that consumer members of the VGNSR have had enough time to fully consider the modelling or its consequences to express an informed opinion on the level of accelerated depreciation in the Draft Plans.

This still leaves the debate around the role of Government – whose policies are, and perhaps increasingly in the future, contribute to the reduction in gas consumption. If the Victorian Government's Gas Substitution Roadmap leads to policies like a ban on new connections that in turn leads to higher gas network prices, what contribution should the Government make to accelerated depreciation costs? Given the Victorian Government's policy to subsidise consumers to move out of gas into electricity, should the Government also subsidise the resulting higher gas network costs caused in part by that subsidisation? We realise that this discussion may be strictly outside of the scope of the AA – but it is an issue that deserves discussion during the engagement process and it helps to get a more informed view from consumers on the share of accelerated depreciation they might be prepared to pay.

(ii) An additional benefit of mains replacement primarily completed for safety and environmental reasons

Considerable concern was expressed in the VGNSR Capex Deep Dive sessions that large mains replacement investments will be made and quickly subject to accelerated depreciation. MGN is considerably behind in its replacement programme compared to the other two networks so the proposed $457.5m expenditure in the next AA period represents 61% of total capex (44% in current period). MGN comments in the Draft Plan (p.91):

> "Customers view safety as a non-negotiable.
> 90% of customers view climate change and reducing carbon emissions as important or very important."

With the MGN view (p.89):

> "…these mains continue to pose a high safety and reliability risk … The program has delivered considerable safety and customer benefits (through fewer supply outages) and has also reduced carbon emissions at the end of the current AA period by 35,000 tonnes of CO 2 -equivalent per year compared to 2017 levels..."

As well as (p.95):

> "… the added benefit of enabling 10% hydrogen by 2030 – a key strategic objective which will put MGN in a better position to play a meaningful role in a low carbon future."

None of the three networks have provided any detailed quantification of the safety risk. If it was an acute safety risk then it seems reasonable to expect MGN would have done a lot more replacement in the current period, irrespective of the cost given MGN's claim (p. 9):

> "We have delivered against our targets in the current AA period by focussing on safety as our top priority."

If it was safety driven, then the need to maintain contractor capacity across AGN and MGN (p.95) should be irrelevant. There is no evidence provided that the replacement is something that Energy Safe Victoria has recommended. There was no evidence provided on the value of the carbon emissions reduced in the mains replacement business case. There is no evidence that the three networks would make the same capex proposal (total $ and timing) as they have in their Draft Plans, if there was no expectation of network renewable gas/hydrogen ever being competitive.

We would suggest that the next round of consultation provides more detail on the safety and environmental case for mains replacement.

(iii) Additional capex/opex to prepare the networks for a low carbon future

These capex/opex expenditures are much harder to justify on a 'no regrets' basis. They will only be 'no regrets' if there is a robust business case for pipeline renewable gas/hydrogen. We are a long way from that now, despite the many confident forecasts from various proponents. Without that business case it could be a Romulus of regret with customers taking renewable gas/hydrogen development risk.

The networks argue that they are not asking customers to take that risk. Rather it is a matter of giving the network the option of a renewable gas/hydrogen future – an 'asset' that gives the network some flexibility to move quicker

to a renewable gas/hydrogen future. We see this narrative as effectively no different to one of consumers bearing development risk. Why should consumers pay to have an option that at this stage of knowledge on the economics of pipeline renewable gas/hydrogen, has an uncertain outcome? We are happy to consider payment when there is much stronger evidence of a potentially strong business case – and this can be assessed in the context of the 2028-33 AA.

Finally, we do not support customers funding an education campaign as proposed by AGN and AGN as an opex step change. We do not think that this meets the AER's opex criteria. The AER in its recent Draft Decision on AGN's SA gas network noted (pp 16-17):

> "We expect the business to provide evidence demonstrating the material impact the change of regulatory obligation has on its opex requirements, and robust cost–benefit analysis to demonstrate the proposed step change expenditure is prudent and efficient to meet the change in regulatory obligations."
> By contrast, proposed opex projects designed to improve the operation of the business, which we consider as discretionary in the absence of any legal requirement, should be funded by base opex and trend components, together with any savings or increased revenue that they generate—rather than through a step change."

The AER rejected the proposed step change in both the Draft and Final Decisions. Customer support was a necessary, but not sufficient, condition for the proposed expenditure to be supported as a step change. Feedback that customers "were keen for more detail around how customers would be kept updated and informed on the energy transition…" is not a basis for saying consumers support spending $7m on an education campaign. The Final Decision (p. 20) noted that it needs to be a "… a genuine step increase in the quality of service provided" rather than just a step change that should be part of general service improvement and captured in the forecast rate of change. Further (p. 20):

> "…to include a customer supported initiative in our alternative estimate, we would further need to be satisfied the customer supported initiative has to be prudent and efficient and is not accounted for in base opex or the rate of change."

We are not satisfied that the step change meets these requirements.

(c) The benefits of continuing to add new customers

The table summarises the proposed capex to supply new customers.

	Current AA Period ($m)	Next AA Period ($m)	Comments
AusNet	249.3	219.6	
AGN	255.7	309.0	This covers 'Growth assets' and 'Augmentation' (p. 89); the latter is $70.4 in the next period vs $17.6 in the current period and reflect demand growth in Melbourne's south east and northern suburbs and regional areas including Wodonga, Traralgon and Echuca

MGN	150.7	99.7	Similar comments to AGN

The Victorian Gas Distribution Code provides a calculation methodology to assess whether new customers are economic to connect and it contains obligations to connect customers under certain conditions. All networks argue that adding new customers lowers the cost to existing customers. AusNet says (p. 37):

> "Connecting new customers to the network benefits all existing customers as it spreads the network costs—which are largely fixed—across a wider base and therefore reduces the burden on each individual customer."

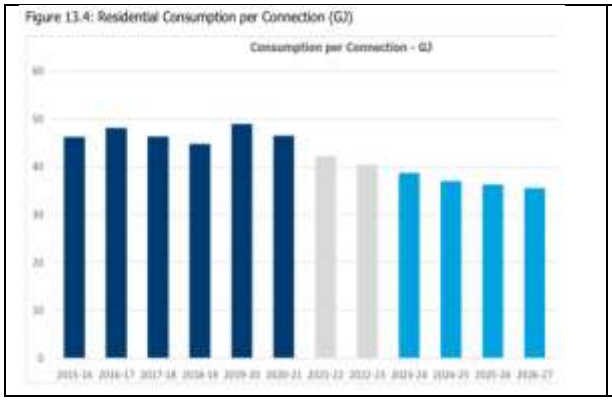
AGN/MGN provided a simple model to justify this argument. Adding new customers means that total network costs are then spread over a larger customer base and this results in lower prices to all – the denominator increase in customer numbers offsets numerator increase in capex/opex.

We are not convinced. We have had a number of discussions with AGN on our concerns about the model which seems to assume:

- ever increasing customer numbers/total consumption which are now not occurring and are not expected to occur in the future, and
- each customer (old and new) consumes the same amount of gas.

While adding customers with infill/expansion capex helps pay off not just new capex but importantly past capex (and hence reduces the RAB and hence stranded asset risk), eventually if the denominator (customers volume) falls fast enough, RAB/customer will go up.

The AGN Draft Plan (Chapter 13) forecast average consumption per customer falling for residential customers and rising for commercial and industrial customers. Total consumption is falling for residential, rising for commercial and falling for industrial customers. Given residential demand dominates total demand, it is trends in residential consumption that are most relevant here.



There is no data provided to support the assumption that old and new customers consume the same amount of gas. Will new residential connections (which have a greater incidence of rooftop solar panels than the existing housing stock) have the same array of gas appliances (heating and cooking) as the existing housing stock? Even if they put in gas heating, the energy efficiency of new housing stock is much higher than the existing housing stock which reduces consumption for new connections. As demand falls over time, it is not clear that existing customers are not cross-subsidising new connections.

We are continuing discussions with AGN/MGN on these matters to see the impact of changed consumption assumptions:

- annual demand for new customers falls over time but existing customers stay the same
- annual demand for existing customers falls in line with annual demand for new customers
- different consumption between existing and new customers

Our proposition is that adding new customers is not always beneficial to existing customers because it can increase the stranded asset risk through two ways - higher costs for new customers e.g. a new gate station is required, and where new customers have lower average consumption that exiting customers (irrespective of the assumption that both new and old customers average consumption will continue to fall).

We understand that the methodology under the Victorian gas code to assess whether to connect new customers – is the NPV of expected revenue over the next 20 years greater than the connection costs? – may be a contributing factor to the ability of networks to flexibly respond to stranded asset risk. This Victorian rule provides for networks to charge a connection fee reflecting any difference between revenue and costs. We assume the $33m AusNet proposes to recover in connection fees (p.32) reflects these costs.

Further, it assumes that new connecting customers are fully informed about the potential future costs of their connection in a world of significant accelerated depreciation. The networks have provided no evidence to believe that this is the case.

However, in the networks defence, it seems the legislation does not allow the network to charge a connection fee that reflects the stranded asset risk some of these new customers will impose on existing customers. This is a matter for consideration in the Victorian Gas Substitution Roadmap. It is incongruous that at the same time as the Victorian Government is seeking to support the switch out of gas into electricity, its gas rules may be doing the opposite and increasing stranded asset risk to existing gas customers, many of whom are likely to be unable to bear that risk in the future. Imagine the Victorian Government paying subsidies to assist existing gas customers who cannot afford to move to electricity even with the government subsides to do so.

Do not hesitate to be in contact should you have any questions.

Kind regards,

Andrew Richards
Chief Executive Officer