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Submission: AEMC Gas Networks in Transition Draft Determination

The Australian Pipelines and Gas Association (APGA) represents the owners, operators, designers, constructors and service providers of Australia's pipeline infrastructure. Our members deliver more than 1,500 PJs of natural gas each year for domestic use and over 4,500 PJs for export markets, underpinned by the highest standards of safety, reliability and operational performance. For decades, this infrastructure has been a cornerstone of Australia's economic strength, providing secure, low-cost energy that has supported growth, sustained long-term trade, and enabled industry to compete globally.

APGA welcomes the opportunity to comment on the Draft Determination of the AEMC's Gas Networks in Transition package of rule change requests. Overall, the package represents a relatively cohesive response to the challenges presented by the energy transition to the economic regulation of gas distribution networks. APGA praises the AEMC for its close stakeholder engagement on this issue and particularly acknowledges the amendments to expenditure provisions which preserve the ability of network service providers to efficiently invest in necessary network maintenance and operations.

APGA recognises that the intent of the AEMC is to provide a framework that answers questions of how service providers and regulators accommodate uncertainty in the face of the energy transition and, particularly the avoidance of stranding of long-lived assets. We acknowledge the AEMC has recognised the importance of tools such as accelerated depreciation in responding to this uncertainty.

But there remain aspects of the proposed framework that bear reconsideration. As drafted, these could result at worst the premature redundancy of capital, which is clearly not efficient nor meeting with the intent of the National Gas Objective. These cover:

- The requirement for service providers to each prepare a longer-term outlook, and for the regulator to have regard to this outlook;
- The introduction of partial capital redundancy using a measure of 'under-utilisation'; and
- The introduction of the concept of 'switching cost'.

Longer-term outlook

The draft Rule will require service providers to prepare a 20-year long-term outlook to inform their Access Arrangement (AA) proposals. As stated in our submission to the Directions Paper, APGA is not opposed to the concept of proposal, noting that the 20-year

timeframe is consistent with the forecast timeframe of the GS00, which will provide some comparability.

But the effect of this draft Rule is to require a level of specificity for a single forecast that even the AEMC considers to be unreasonable, leaving service providers and the regulator unable to acknowledge alternative possible futures.

Mandated single 20-year forecast not fit for purpose

Looking five years ahead for existing Access Arrangements are at best, best guesses, and are best used to assess the quality of current proposals rather than effects of decisions made today on the future. Extending this to 20-years in the future compound the difficulty of this task while providing a false lens of precision to inherently imprecise measurements. A singular forecast cannot realistically accommodate technological development, the expected economic landscape, or changes in policy that may materially affect network simultaneously. For example, had such a 20-year forecast requirement been implemented ahead of Evoenergy's 2021-26 Access Arrangement, it could not (and did not) model the impact of the ACT Government's 2020 policy intention and 2022 decision to phase out gas networks by 2045.

While the AEMC states it is not the intention that these forecasts attempt to predict the future, but rather "improve transparency about how future uncertainty has factored into decision-making," it is difficult to see how these forecasts would *not* be considered future testing especially where service providers are limited to one plausible future. Given that existing Rule 74 explicitly requires forecasts to be the single best forecast or estimate possible in the circumstances, it is also difficult to see how the service provider would not then be assessed either by regulators on the quality of its forecasts in the long term (especially where the regulator must also undertake its own forecast), no matter how challenging the forecasting task or whether there are multiple "best" futures.

The longer the forecast the greater the uncertainty. This includes the very same uncertainty about the future of gas demand through distribution networks that has led to this rule change package. There is risk inherent in relying on uncertain figures for regulatory decisions, not easily addressed in the framework of the Rules. Single "best forecasts" are likely to be wrong, as are sensitivity analyses and other scenarios, which means decision-making based on these forecasts is at best making inherently flawed decisions.

Sensitivity analysis not a replacement for different scenarios

In attempting to accommodate this uncertainty, the AEMC permits the use of a sensitivity analysis in draft Rule 45(2)(d), which only enables the service provider to consider higher or lower demand, and how changes in the price of gas expected to be paid by end users impacts demand. On the surface this appears to give these forecasts the necessary flexibility, but what it actually does is only permits variable assumptions in one defined version of the future. Sensitivity analyses are more properly used to test the robustness of

a given scenario to small changes in assumptions; these type of analyses cannot encompass entirely different futures which is the kind of uncertainty that this entire rule change package attempts to address.

The challenges associated with this uncertainty was acknowledged by the AEMC in its Enhancing Distribution Network Planning and Reporting rule change:

"...a single long-term forecast cannot provide a reliable indicator of anticipated future conditions. The Commission considers it essential to adopt a scenario-based planning approach. Scenario-based planning requires DNSPs to explicitly test their network plans against a range of plausible future pathways, supported by transparent assumptions and inputs."

Given scenario-based planning is considered appropriate for electricity networks, which probably operate under considerably less uncertainty than gas networks at this point in time, APGA considers this should be par for the course for gas.

APGA recommends the AEMC broaden the draft Rule such that service providers are able, with justification, to prepare more than one forecast.

Introduction of partial capital redundancy risks unintended consequences

The AEMC's proposals to amend redundancy provisions are made in the understanding that gas infrastructure assets are at material risk of stranding at some point in the near future, from which two different forms of redundant capital measures are required to protect consumers. APGA does not propose any amendment to the draft Rules concerning full redundancy. As noted in our comments on the directions paper, APGA also supports the draft Rules concerning depreciation and treatment of inflation, noting decision making for the latter should occur as soon as possible in the Access Arrangement process.

The AEMC's proposed introduction of partial capital redundancy, however, risks unintended consequences and particularly making capital redundant prematurely.

Partial redundancy as a tool of last resort

While it is AEMC's clear intention is for partial redundancy to be a last resort tool, there is no specific requirement or link between trigger and remedy provided for in the Rules. The draft Rules do not require the AER to be satisfied that other tools have been utilised before pursuing partial redundancy. Should these provisions remain in the final Rule, additional preconditions are clearly needed to ensure the tool can only be used at a time consistent with the AEMC's intent, toward the end of (but prior to) a network becoming economically unviable.

Definition of under-utilisation

APGA takes issue with the definition of partial redundancy provided in draft Rule 69: "partial redundancy means, in respect of an asset, where that asset contributes to the delivery of pipeline services **but is under-utilised.**" What this actually means for the

purposes of the Rule is left unsaid, implying a level of subjectivity to be applied, presumably by the regulator. If Rule 45(2)(a)(ii), which requires the provision of pipeline capacity and utilisation of pipeline capacity data as part of the long-term outlook, is intended to provide the metric (nameplate capacity and % utilisation, presumably), this is an inappropriate way of gauging redundancy.

APGA considers that the level of utilisation is considered to be optimal (under which capital could be considered redundant) would be different for each service provider and indeed a certain level of under-utilisation can be a feature of efficiently managed networks, where headroom is left for peak demand periods. This issue is magnified for transmission assets, where utilisation can be deliberately lumpy to accommodate peak capacity demand, or to enable bidirectional flow. The draft Rule risks turning ordinary variation of capacity utilisation – whatever the ‘nameplate capacity’ designates – incorrectly into a signal of redundancy.

For example, in the Victorian Transmission System, the Victorian Northern Interconnect towards Melbourne has a capacity of 220TJ/day but is limited to 180TJ/day due to capacity constraints in the NSW network. The Western Outer Ring Main, completed in 2023, has a maximum eastbound capacity of 523TJ/day but this level of utilisation is typically only seen in peak demand seasons (winter). Given these seasonal demand swings or other limitations, it is possible (however unlikely) the normal operation these assets would leave them vulnerable to being considered partially redundant for the purposes of the draft Rules.

For gas *distribution* networks, the concept of utilisation is even more nebulous. For the most part, transmission pipelines are point to point assets akin to arteries. Distribution networks are a network of smaller pipelines branched like capillaries, with different delivery points, different flow rates, and even different materials. “Capacity” for the entire distribution network as a single metric to describe utilisation is effectively meaningless.

Without a further understanding of how the AEMC realistically understands “under-utilisation” it is difficult to suggest how this definition in the Rules be refined to have a practical meaning that reflects what asset owners might consider under-utilisation.

The intent behind introducing these provisions appears to be that network service providers do not have an incentive to identify *network* assets as redundant, based on applying physical redundancy concepts to economic redundancy, hence the conflation between underutilisation and switching cost. Under this framework, regulators are required to identify those assets as redundant in the face of competition from alternative energy sources, as evidenced by underutilisation of an asset, because service providers would not behave rationally in the face of market competition and continue to charge prices at the regulated level, rather than lower to maximise cost recovery.

In a situation where a specific part of a distribution network could be considered underutilised (i.e., a main line that is only partly full on a consistent basis) and hence the

AER considers the *entire network asset* partially redundant, the solution as per the draft Rules is not for the service provider to address the specific case of that main line, which would be reasonable, but for the regulator to reduce the Regulated Asset Base in its entirety.

Switching cost in partial redundancy provisions

The draft Rules introduce the concept of ‘switching cost’ into both a test for partial redundancy, and then as a rule against which to measure the quantum of capital to be made partially redundant: in 85(5)(b) and 85(6)(a).

85(5)(a) refers to “a hypothetical end user who could reasonably switch” which implies a single forecast rather than a consideration of a range of diverse futures. In reality there is no one type of end user for which a certain level of cost would motivate them to switch to a competing energy source.

On this, APGA returns to our comments on the Directions Paper: [capital] redundancy should be a last-resort solution but what that redundancy is based on is also important – it should be based on the redundancy revealed when service providers charge less than the building block price.

Similarly, and more importantly, 85(6)(b) refers to a singular, and uncertain, “hypothetical end user who can readily switch to such a competing energy source or pipeline service,” directly linking this switching cost concept to the component to be removed from the Regulated Asset Base. While this is complicated enough for distribution assets – APGA defers to those service providers for commentary on the specific deleterious aspects of this proposal – for transmission APGA considers this to be both unnecessarily complicated and potentially completely unworkable, when the alternative could simply be reducing the Regulated Asset Base to a point where the building block price is equal to the actual price being charged.

The AEMC’s perspective is that 85(5)(a) is effectively triggered “when it becomes clear that stranding can no longer be averted (i.e. when competition from alternative energy sources becomes evident)” (draft determination p. 42). APGA notes that the existence of this kind of competition in and of itself should not automatically be considered evidence of stranding, as is a feature of the operation of a normal and indeed workably competitive market. Gas service providers have always had to compete with other forms of energy (as well as with other gas service providers) and this perspective, echoed in the drafting of the rules, risks turning ordinary competition into a test of capital redundancy.

On this, APGA again echoes our comments on the directions paper: asset owners already have a strong incentive to avoid charging prices that are so high they would cause disorderly customer exit, and this remains true in the fact of consumer switching behaviour leading to asset stranding. That being said, if it is considered necessary to place guardrails regardless in case some businesses do act against their best interests, or the AEMC

believes there may be cases where interests are not aligned, then this clause must require the AER to consider the *diversity* of customer switching costs, not one singular assumed switching cost, in considering the necessity of partial redundancy of an asset after meeting other preconditions.

Amendments needed to redundancy provisions

APGA suggests the following amendments to improve the partial redundancy provision:

- Refine the drafting of 85(5) to ensure it reflects realistic preconditions influencing service providers, that being
 - In 85(5)(a), amending “a hypothetical end user” to “hypothetical end users”, which would permit service providers and the regulator to consider the diversity of customers, and
 - At a minimum, replacing the “or” between 85(5)(a) and 85(5)(b) with an “and” to provide some assurance that it is necessary to respond to competition *and* replicate what would occur in a workably competitive market.
- Similarly, refine the drafting of 85(6), such that (b) provides a broader and realistic base for considering hypothetical end users, for example:
 - “the price of any competing energy sources or pipeline services to **hypothetical end users who can switch** to a competing energy source or pipeline service, including the costs of switching to such a competing energy source or pipeline service, **and the diversity of those end users**”
- Explicitly require redundancy to be last resort by providing reasonable opportunity for the service provider to first use accelerated depreciation and/or changes to inflation treatment to align capital recovery with expected network use.
- Include a precondition that accounts for material and sustained change (rather than short-term volatility).
- Provide an ability for service providers to reallocate capital from one tariff class to another in situations where competition does not allow the service provider to collect expected revenue from one tariff class, and explicitly state this tool can be used by service providers to manage change before the regulator proceeds to partial redundancy under Rule 85. The Draft Determination implies this is an acceptable order of progression (p. 63, 68).

Averting unintended impacts to transmission service providers

The AEMC’s position on this appears to be that unless there is a compelling reason for the relevant draft Rules not to apply to transmission assets, it does not propose putting distinguishing features into the Rules. APGA opposes this approach for aspects of the rule change package that are not relevant to transmission pipelines. For example, the proposed partial redundancy provisions, considered earlier in this submission, would be challenging to apply to transmission pipelines as determining the “hypothetical end user” for transmission pipelines is not practically workable.

There is precedent in the draft Rules for more specific targeting of Rules – see, Rules 94 and 95, which are specific to distribution and transmission assets, respectively. This approach should be used where the intent is for Rules to apply specifically to distribution assets.

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