ATCO
AUSTRALIA

27 March 2018

Ms Anne Pearson
Chief Executive Officer
Australian Energy Market Commission
Level 6
201 Elizabeth Street
SYDNEY NSW 2000

Submitted via email: aemc@aemc.gov.au

Dear Ms Pearson

RE: Draft Report – *Review into the scope of economic regulation applied to covered pipelines*

Thank you for the opportunity to comment on the draft report of the AEMC's Review into the Scope of Economic Regulation Applied to Covered Pipelines (the Review). This letter outlines a submission from ATCO in response to the Draft Report published on 27 February 2018.

Overarching remarks

ATCO would like to emphasise the following key points:

- ATCO has a proud history of working with local communities to deliver long-term, sustainable value to customers, including developing a range of strategies in response to the rapid disruption of the energy sector.

- ATCO is also familiar with the challenges of designing effective market signals during periods of significant disruption – ATCO's experience is that the best form of policy or regulatory intervention is featured by simple, long term objectives, and that the private sector is best placed to design solutions to meet these overarching signals.

- It is also important for rule makers to consider the relative maturity and pace of change in respective markets when reviewing regulatory frameworks – for example, ATCO believes it is important for the AEMC's Review to distinguish between the increasingly competitive environment being faced by gas distribution networks, and the natural constraints that this level of competition places on pricing and access decisions.

- Considered together, the draft recommendations outlined in the draft report represent a further tightening of the economic regulation framework applying to all covered pipelines, including distribution networks. In combination with a soon to implemented binding rate of return guideline and the recent removal of limited merits review, tightening the framework in this way has the potential risk of stifling the innovation required to ensure gas distribution networks' ongoing delivery of reliable and affordable energy to consumers over the long term.

- In this respect, the Review presents a valuable opportunity to refresh the regulatory framework to accommodate and support the changing dynamics in the gas market. A clear trend towards decarbonisation will require gas networks to innovate and adopt emerging and new technologies, such as hydrogen and complementary hybrid solutions, including the support of renewable energy solutions and microgrids. In this market environment, gas networks that are slow to innovate will increasingly be unable to deliver services valued by consumers. The regulatory framework should be sufficiently flexible to allow pipeline businesses to work creatively across platforms to deliver innovative solutions to meet the energy requirements of Western Australians.

This submission addresses specific recommendations outlined in the draft report in Attachment 1 and the importance of incentivising investment in innovation by gas network businesses in Attachment 2.

About ATCO

ATCO is a customer-focussed company that develops, builds, owns and operates a range of energy infrastructure assets, supporting residential, business and commercial consumers across Australia. ATCO's Australian businesses:

- own and maintain two non-regulated gas distribution networks in Albany and Kalgoorlie, together with the largest (Mid-West and South-West) gas distribution network in Western Australia, connecting over 750,000 customers through more than 14,000 km of natural gas pipelines and associated infrastructure;

- own and operate two power generation facilities in Australia (a joint-owned facility in Adelaide and a wholly-owned facility in Karratha) with a combined capacity of 266 MW; and

- manufacture and deliver modular building solutions to a diverse group of customers.

ATCO's Australian operations are part of the worldwide ATCO Group with approximately 7,000 employees and assets of $21 billion. ATCO is engaged in pipelines and liquids (natural gas transmission, distribution and infrastructure development, energy storage, and industrial water solutions); electricity (electricity generation, transmission, and distribution); retail energy; and structures and logistics.

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If you have any questions or would like to discuss any of these issues further please contact me or Amy Stanley, General Manager Human Resources & Corporate Affairs.

Sincerely,

J.D. Patrick Creaghan
Managing Director and Chief Operating Officer

Feedback on specific recommendations

ATCO's feedback on specific recommendations made in the draft report is outlined below. We would be happy to elaborate on this feedback if required.

Framework for pipeline regulation (Chapter 3)

ATCO is broadly supportive of *Draft Recommendations 1 – 3* in relation to the framework for pipeline regulation since they are likely to promote regulatory consistency and may lower regulatory overheads for some pipeline businesses with pipeline assets subject to overlapping forms of regulation.

However, in a practical sense, the proposed changes to the NGR are unlikely to have a material effect on gas distribution network business operations, at least initially. In ATCO's case, for example, the extensions and expansions policy under ATCO's existing Access Arrangement requires that all pipeline extensions with a pressure rating under 1,920 kPa form part of the covered pipeline. This policy also requires that for any pipeline extension with a pressure rating over 1,920 kPa, ATCO must apply in writing to the Economic Regulation Authority to have this included as part of the covered pipeline.

In respect of the broader discussion in the Commission's draft report relating to forms of regulation and a possible modification to the wording of the coverage test to accommodate concerns about denial of access, ATCO agrees with the Commission's conclusion that evidence of a problem in practice is limited.

ATCO also agrees with the Commission's assessment that implementing amendments to the regulatory framework to address denial of access concerns would involve significant changes to the NGL. Such amendments are likely to fundamentally change the regulatory framework that applies to gas distribution networks. In ATCO's view, it is desirable to proceed cautiously and to fully investigate and understand the nature of the problem before developing and implementing such a regulatory response.

Reference Services (Chapter 4)

In ATCO's view, *Draft Recommendations 4 – 6* relating to clarifying and determining reference services should be developed further to fully recognise the differences between gas transmission services and gas distribution services.

Gas distribution businesses provide reference services to retailers, usually relating to the delivery of gas to a specified 'delivery point'. The services provided by gas distribution businesses do not typically include backhaul or park and loan or location or priority. Given these differences, ATCO believes the further testing and development of *Draft Recommendations 4 – 6* to specifically address the differences between gas transmission pipelines and gas distribution networks would provide greater clarity and effectiveness.

In relation to *Draft Recommendation 7*, ATCO submits that while in the past consultation and engagement processes for clarifying and determining reference services in access arrangements may not have been as effective, the current practice adopted by gas network businesses in Australia now includes strong consultation and engagement with customers and stakeholders under the framework outlined in the Australian Energy Regulator's *Consumer Engagement Guideline for Network Service Providers*.

ATCO, like many gas distribution businesses, is focussed on providing gas distribution services that meet the needs of its current and prospective customers. ATCO's understanding of customer needs and priorities is informed through regular and meaningful engagement, both formal and informal, with a broad range of customers and stakeholders, including residential and business customers, retailers, industry groups and community organisations.

ATCO recognises that while the NGR and NGL as applied to the gas distribution network in Western Australia does not specifically mandate formal customer engagement processes, regular, meaningful and transparent engagement with customers and stakeholders is an important aspect of ATCO's approach to operating and maintaining the State's largest gas distribution network.

ATCO's formal engagement process, known as the *Voice of Customer Program*, is modelled on the principles and framework outlined in the Australian Energy Regulator's *Consumer Engagement Guideline for Network Service Providers* and the International Association for Public Participation (IAP2) framework. The insights generated through this engagement help to inform ATCO's draft investment plans and proposed reference services. The business then tests these proposals with customers and stakeholders, and, based on the feedback received, makes necessary refinements to business plans and proposed reference services.

Furthermore, the proposed reference services are tested extensively as part of the current regulatory determination process applying to access arrangements for gas distribution network businesses.

In this context, ATCO considers that as the reference service setting process proposed to be included in the NGR (outlined in *Draft Recommendation 7*) is likely to duplicate, and overlap with, the extensive consultation and engagement frameworks and processes that already apply to gas distribution network businesses, it would be more likely to add to, rather than mitigate regulatory cost and complexity.

Access arrangements (Chapter 5)

ATCO has no substantive comments relating to *Draft Recommendations 9 – 11 and 13.*

ATCO recognises the potential benefits of using consistent and standardised financial models (*Draft Recommendation 8*). However, as our gas distribution network in Western Australia is regulated by the Economic Regulation Authority, we also think there needs to be flexibility in the rules for the Authority to use model assumptions and parameters that suit local conditions and preferences.

ATCO submits that while *Draft Recommendation 12* is directed to clarifying the process for equalising revenue during an interval of delay in a regulatory determination, the proposed clarification is unlikely to help resolve whether forecast revenue or actual revenue, if available, should be considered. As noted in the report, this issue has been the subject of limited merits review proceedings and is currently subject to a judicial review by APA.

In ATCO's submission, *Draft Recommendation 12* should include a consideration of amendments to NGR Part 9 Division 2, in particular rules 72 and 74 to ensure there is consistency and clarity in the approach to determining impacts on price and revenue building block elements and any adjustments to be made as a consequence of an interval of delay.

To improve certainty following the removal of the limited merits review regime and to moderate the impacts of the proposed removal of the limited and no discretion framework, ATCO proposes two additional provisions: implementing a variation of the **'propose-respond'** model that applies to the regulation of the Western Power electricity network by the Economic Regulation Authority; and, introducing a **'financeability' assessment**.

- In Western Australia, the **'propose-respond'** model that is a feature of the *Electricity Networks Access Code 2004* (Section 4.28(b)) acts to prevent the regulator from replacing compliant elements of the access arrangement with something that is deemed 'better'. The intention of the 'propose-respond' model is that, if a proposed access arrangement meets the Code objective and the requirements set out in Chapter 5 (and Chapter 9, if applicable), the Economic Regulation Authority should not refuse to approve it simply because the Authority considers that some other form of access arrangement might be even better, or more effective, at meeting the Code objective and the requirements set out in Chapter 5 (and Chapter 9, if applicable).

- **'Financeability' assessments** are used routinely by a number of regulators in the UK (e.g., Ofgem and Ofwat) and some regulators in Australia (e.g., Independent Pricing and Regulatory Tribunal and the Essential Services Commission) as a means of cross-checking their regulatory decisions. The assessments focus on the financing and credit quality implications of regulatory decisions and help regulators reach decisions that do not adversely affect the ability of regulated businesses to refinance or raise new debt on reasonable terms, which, in turn, undermine the business's ability to attract the capital required to make efficient investments.

ATCO submits that the inclusion of enhanced propose-respond and financeability assessment provisions as outlined above would assist with providing greater certainty in regulators' decision making processes in a manner that will contribute to achieving the NGO.

Determining efficient costs (Chapter 6)

ATCO has no substantive comments on *Draft Recommendations 14 – 20*.

Negotiation and information (Chapter 7)

ATCO has no substantive comments on *Draft Recommendations 21, 23, 24 and 26.*

In respect of *Draft Recommendation 22*, there is an existing requirement for capacity and utilisation information to be included in the Access Arrangement Information under rule 72(d) of the NGR. The rule recognises the practical difficulties faced by gas distribution network operators through the inclusion of the wording 'to the extent it is practicable'. ATCO appreciates that the while the intent is to align the reporting requirements of the non-scheme pipelines with fully regulated pipelines, further consideration should be given to the practical differences relating to the operation of distribution pipelines.

ATCO supports *Draft Recommendation 25*, which proposes to remove the requirement to include key performance indicators (KPIs) in the Access Arrangement Information document. As noted, KPIs have a range of potential purposes and are not comparable across businesses. ATCO agrees that KPIs can be set and collected through existing processes available under the regulatory framework.

Arbitration (Chapter 8)

Except to submit that ATCO does not consider it is a high priority to amend the NGR to better align arbitration arrangements for covered pipelines with those that apply to non-scheme pipelines under Part 23 of the NGR, ATCO has no substantive comments on *Draft Recommendations 27 – 33.*

The proposed timelines in the recommended 'trigger' for dispute resolution processes (*Draft Recommendation 27*), which will enable notification of a dispute when the parties have not been able to reach agreement within the specified time period, could be difficult to meet in a practical and operational sense. For example, the proposed timelines will likely not provide pipeline service providers with sufficient time to perform due diligence on prospective network users before being in a position to make an access offer.

Implementing the draft recommendations in Western Australia will require further consideration as the Energy Disputes Arbitrator is the applicable dispute resolution body for users and prospective users and providers of gas pipeline services and other parties seeking access to regulated gas pipelines in the State.

Incentivising investment in innovation

Holistic updating of the existing regulatory framework is an opportunity to provide a key framework to facilitate and enable innovation by gas network businesses, which although regarded as natural monopolies, operate in an increasingly diverse, contestable and competitive energy services market.

As a consequence, gas distribution businesses including ATCO recognise the need to focus on facilitating upstream and downstream competition by offering services that are valued by gas producers, consumers and retailers. They also need to focus on efficient service delivery for customers consistent with the National Gas Objective set out in the NGL.

Gas network businesses, like ATCO, that are operating efficiently, would benefit from stronger incentives to take measured risk and innovate. The NGR already allow for an access arrangement to include one or more incentive mechanisms to encourage efficiency in the provision of services which are available in addition to those that are implicitly embedded in the regulatory framework, including the price cap tariff variation mechanism.

The incentives for a regulated energy business to invest in innovation are different to those of an unregulated business. The available mechanisms within the current regulatory framework are unlikely to encourage regulated network businesses to invest in innovative technologies because:

- the mechanisms and returns provided under the current framework do not provide sufficient scope or headroom for expenditure that includes research and development risk; and,
- network businesses are generally incentivised to focus on shorter-term projects aimed at containing operating costs and deriving operational efficiencies within a particular access arrangement period, rather than innovation that could deliver benefits over multiple access arrangement periods.

The lack of incentive to invest in innovation that has the potential to provide benefits to consumers over the longer term is a shortcoming of the current regulatory framework, as a consequence of which otherwise beneficial innovations are not able to be pursued by regulated network businesses, or only those innovations that are low cost and have a shorter payback period are considered. This is not in the long-term interests of consumers.

In terms of this review, ATCO submits that incorporating an effective incentive to invest in innovation as part of the final set of recommendations will ensure that pipeline service providers, in the future, are providing services that promote economic efficiency and are sufficient to address future market power concerns as the energy service sector continues to change.