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Contact Officer: Dale Johansen

30 April 2026

Alisa Toomey
AEMC Project sponsor

Dear Ms Toomey

Re: Gas networks in transition

The Australian Energy Regulator (AER) welcomes the opportunity to provide a submission to the Australian Energy Market Commission (AEMC) in response to its Directions paper for the National Gas Rules (NGR) change process – *Gas networks in transition*.

As the economic regulator for major scheme (full regulation) gas distribution networks in New South Wales (NSW), Victoria, South Australia and the Australian Capital Territory (ACT), and for scheme gas transmission pipelines in Victoria, Queensland and The Northern Territory, we are uniquely placed to provide perspectives on this rule change process.

We support many aspects of the Directions paper

We are pleased to see, in the Directions paper, proposals to remove the regulatory framework's existing bias towards ongoing growth of gas networks. That assumption underlying the current NGR is increasingly outdated and we welcome reforms to update the framework for the gas pipeline sector's current and future challenges. Perhaps the most significant challenge is the long-term outlook for customers remaining connected to gas networks as others electrify.

As the volume of gas carried by networks declines and the customer base shrinks, the per unit cost of providing network services will grow. The Directions paper focuses on remaining residential customers, but we note that commercial and industrial customers may face even bigger challenges in diversifying their energy or feedstock supplies away from reticulated gas. While views can vary on how regulators, or the regulatory framework, may best mitigate those long-term price increases, shared appreciation of the challenge is a first step towards alignment.

Mandating in principle longer-term outlooks for gas network service provider (NSP) access arrangement proposals with respect to network expenditure and tariffs will help to clarify for stakeholders the issues that may arise as the energy transition continues to impact the gas sector. Associated regulatory burden is, we consider, a worthwhile trade-off in this context.

Proposed reforms to give regulators improved regulatory toolkits to manage the size of the capital base are also welcomed. Removing legacy NGR weightings towards growth in gas consumption or gas networks themselves to a neutral stance, will modernise the regulatory framework.

We also agree that NSPs must continue to be incentivised to maintain their networks while customers still need them for safe and reliable services during the energy transition.

Balancing this ongoing incentive with the long-term interests of consumers is a consistent theme of our access arrangement decisions.

The need for effective but agile regulation has never been greater

On the critical issue of capital base cost recovery, for which the Directions paper flags prescribing a new regulatory framework giving significant weight to NSP proposals and limiting regulatory discretion, we have a different view to the AEMC. Our role, guided by the National Gas Objective (NGO), is to ensure that gas consumers pay no more than necessary for network infrastructure, which is charged to them as network costs in their gas bills. We fulfill this role because gas networks are natural monopolies, subject to operational and financial incentives that mean their interests do not always align with the interests of consumers.

The Directions paper proposes a series of framework changes that would open the door for NSPs to propose significant price increases for gas consumers in the short-term, while limiting the ability of the economic regulator to intervene.

As the energy transition accelerates and access arrangement proposals increasingly reflect a market in decline, the regulatory framework must be capable of responding to heightened uncertainty and changing incentives. We caution against tipping the weight of the regulatory framework in favour of NSPs who have strong financial incentives, and without effective regulatory oversight – the opportunity, to impose unjustified price burdens on their customers while they continue to have monopolistic power. There remains need for effective economic regulation during this period of transition and uncertainty.

Regulatory discretion is key

While full economic regulation of monopoly gas networks remains appropriate, so too will the need for regulators to demonstrate judgement to deliver prudent and efficient outcomes in the long-term interest of consumers. A regulatory framework prioritising effective regulatory decision making in changing contexts is principles-based and agile. With the above in mind, we urge the AEMC to place weight on regulatory flexibility and to avoid prescribing particular outcomes within the NGR.

We note too that AER resources are currently fully deployed in delivering our existing functions. A material increase in our workload, such as a new workstream around assessing NSP switching point analysis, would require us to divert resources from other high priority functions.

Attachment A to this letter provides our detailed views on the key issues raised by the Directions paper. We look forward to continuing to engage with the AEMC and others as this rule change proceeds.

Your sincerely



Matt Garbutt
Chief Executive Officer

Attachment A

This attachment sets out our views under headings that align with the AEMC's *Gas networks in transition* workstreams.

Employing a longer-term outlook for network expenditure

The Directions paper proposes to mandate that NSPs must submit to regulators, ourselves or the Economic Regulatory Authority of Western Australia, long-term (20-year) outlooks for demand, building block proposals, tariffs, asset and risk management plans, and strategic decommissioning plans. This analysis would be submitted every 5 years as part of NSP access arrangement proposals.

Some of the long-term analysis already appears in access arrangement proposals. In particular, we expect NSPs to provide targeted long-term modelling to support proposals for accelerated depreciation. However, we support the proposal for rules-based establishment of consistent expectations for long-term analysis to be made available to both regulators and stakeholders, despite the increased cost for NSPs to develop this analysis. Any increase in regulatory burden on NSPs has implications for cost recovery from consumers, so cannot be considered lightly, but in this case we consider the increased cost will be outweighed by the benefits. We note too, that uncertainty would accompany long-term forecasts, but even uncertain forecasts will highlight issues of interest to regulators and stakeholders.

We understand that the rule change proponents, Energy Consumers Australia (ECA) and the Justice and Equity Centre (JEC), are interested in annual publication by NSPs of their network plans. However, the benefit of such reporting in the public domain is likely to dip sharply as the frequency increases from 5-year to 12-month intervals. In short, it's unclear that the rate of change in the gas pipeline sector, while accelerating, is sufficient to warrant the further increase in regulatory burden that would accompany annual reporting. We note too that the equivalent reporting framework for electricity network providers serves an important purpose in identifying opportunities for non-network options to efficiently substitute for electricity network augmentation. In that context, annual reporting is justified. For gas networks, we consider 5-yearly reporting is a preferable cadence, more likely to provide long-term insight, than annual reporting.

Closely related to the NSP's obligation to report, is the Directions paper's proposal to require that regulators consider, assess and report on the long-term consequences of decisions on access arrangement proposals. Again, while we are cautious about the impact of this new obligation on our own resources, on balance we consider it is a supportable initiative that will again help stakeholders understand what the future may bring. We routinely undertake some of this long-term analysis already. The increased administrative burden associated with broadening our existing outputs is, on balance, worthwhile.

Amending capital cost recovery provisions

A new, more prescriptive, framework for determining capital base cost recovery

The Directions paper proposes a new framework for determining the pace of NSP capital base cost recovery – depreciation – and therefore the accompanying bill impacts on consumers. In effect, NSPs would determine their own levels of accelerated depreciation with an underlying assumption that they face sufficient competitive pressures from alternative energy sources to reign in price impacts for consumers. Regulatory discretion would be curtailed, to varying extents depending on which of 2 reform options posed by the Directions paper is chosen by the AEMC. To intervene, regulators would either need to find

that an NSP's depreciation proposal is inconsistent with the NGO and the National Gas Law's (NGL) revenue and pricing principles (RPP), or that an alternative approach would better promote the NGO and RPP. While both approaches represent high thresholds, the latter option would appear to preserve more regulatory discretion.

From the Directions paper, it's unclear how the AEMC sees regulators applying the NGR depreciation criteria in assessing NSP proposals in the future. Under the current NGR framework, the depreciation criteria guide development and regulatory assessment of depreciation proposals, but the Directions paper focuses on higher-level elements of the broader regulatory framework. If regulatory oversight of depreciation became based solely on the NGO and RPP, that would seem to mean the depreciation criteria no longer applied. In our experience, the depreciation criteria establish important principles for setting depreciation schedules.

Switching point analysis determining capital base cost recovery

Underpinning AEMC considerations on capital base recovery is "switching point" analysis developed for the AEMC by Cambridge Economic Policy Consultants (CEPA). As described by the Directions paper, the approved quantum of depreciation for an upcoming 5-year access arrangement period would be determined by when gas retail prices reach a level at which consumers would be incentivised to switch away from reticulated gas to either bottled gas or electricity. Any further capital base value that would, if depreciated, drive gas retail prices higher than the switching point could be subject to a new capital redundancy mechanism – economic stranding. The Directions paper describes NSPs as potentially choosing, or agreeing, to economically strand some capital base value to maintain competitiveness with electricity and so keep their networks in use for longer, facilitating more capital base recovery than otherwise.

While the Directions paper refers to switching point analysis as the primary driver of depreciation and capital redundancy decisions, it does not define how a switching point should be calculated or what evidentiary standards should apply. The paper contemplates that switching-point analysis would be developed by NSPs with regulators assessing those proposals.

The switching point concept would, under the Directions paper's approach, be embedded in the regulatory framework through interrelated NGR changes to provisions for capital redundancy and tariff-setting. Collectively, these proposed framework changes would materially constrain the scope of regulatory discretion in decisions on one of the most important issues facing the gas pipeline sector and its customers today and into the future.

While switching point analysis can be informative for understanding the relationship between prices and customer switching incentives, we have significant reservations about the Directions paper's approach. Switching point analysis relies on assumptions about customer behaviour, prices, costs and discount rates, and does not represent a precise real-world trigger. CEPA's illustrative modelling does not incorporate a range of real-world influences, such as partial electrification, changes in electricity prices, technology changes, government policies and subsidies. Nor does it account for the potential for network tariff increases below an estimated switching point to contribute to a disorderly transition when combined with broader cost of living pressures and other drivers of customer switching.

In circumstances where customer switching points vary, demand elasticities are uncertain, retail gas prices are affected by volatile wholesale market dynamics, and policy signals are encouraging electrification, using switching points as a determinative benchmark for depreciation or capital redundancy decisions would involve elevated regulatory risk. Estimating switching points inaccurately could, under a deterministic framework, lead to poor customer or network outcomes with regulators left unable to effectively intervene.

Throughout recent access arrangement assessments we have consistently seen NSP proposals to accelerate the recovery of their capital bases (accelerated depreciation) by proposing to set network tariffs at higher levels than if the energy transition were not occurring. In almost every case, we have determined lower levels of capital recovery and lower network tariffs – around half of the total accelerated depreciation proposed by NSPs. Our measured start to accelerated depreciation has considered the regulatory framework’s principle that NSPs have a reasonable opportunity to recover their efficient costs, in addition to jurisdictional policy settings and the price impact that gas consumers could reasonably be expected to bear.

Some NSP depreciation proposals would have led to significant network tariff increases. As part of its long-term plan to fully recover its capital base, Evoenergy’s initial 2026—31 access arrangement proposal, if approved, would have seen its network tariffs increase by more than 100% over 5 years.¹

Other NSPs are signalling that their own proposals for accelerated depreciation are only the beginning. AusNet’s proposal to reopen its 2025—30 access arrangement for an additional \$75 million (we had already granted \$105 million) in accelerated depreciation was accompanied by the following statement:²

“...given long term network decline is now inevitable, that an accelerated depreciation well above \$200 million is justified on purely economic grounds.”

Even AGN SA, which in its initial 2026—31 access arrangement proposal indicated it did not have concerns for its future viability, proposed \$30 million in accelerated depreciation, increasing to \$70 million with its revised proposal.

Accelerated depreciation may not improve outcomes for customers in all situations’

We accept that, in theory, front-loading depreciation may help align capital cost recovery with expected pipeline use in an environment of declining demand. However, this principle should be applied with caution and balanced against other relevant considerations.

We note that while an overall downward trend is likely, the exact future trajectory of gas demand throughout the energy transition is highly uncertain, which means there is significant uncertainty about expected pipeline use at various points in the future. Accelerating depreciation results in immediate price increases for today’s customers, which could accelerate the loss of throughput and disconnections, affecting NSPs’ ability to recover costs in the longer term and worsening impacts on customers tomorrow. While it is possible to fine-tune depreciation schedules as uncertainty resolves over time, customer disconnections will not easily reverse.

Further, our long-term modelling of NSP capital bases demonstrates that adjusting depreciation profiles alone will not achieve long-term price stability or mitigate significant increases in network prices over time. Bill savings for future customers from bringing forward capital base recovery would be marginal in comparison to total network tariff increases driven by declining demand. NSP proposals to increase gas network tariffs in the short term, potentially significantly, require effective regulatory oversight. We urge the AEMC to preserve regulatory discretion on this critical aspect of the energy transition, for both NSPs and consumers. Principles-based regulation is, and will remain, preferable to prescription aimed at securing particular outcomes.

¹ AER, *Overview – AER Draft decision – Evoenergy 2026—31*, p.vi.

² AusNet, *2023—28 Access arrangement variation proposal cover letter to AER*, September 2024, p.1.

Capital base indexation

We hold similar concerns about the Direction paper's proposal to prescribe in the NGR when an NSP's capital base should or should not be indexed for inflation. Removing capital base indexation effectively brings forward the NSP's recovery of its capital base. We note that, to the extent bringing forward capital base recovery is desirable, it can be achieved by accelerating the NSP's asset depreciation. Further, there are many ways to shape capital base recovery by selecting a depreciation profile, as opposed to only one stemming from removing capital base indexation that would bring capital base recovery forward by an uncertain amount driven by inflation outcomes.

To the extent adjustment to the speed of capital base recovery is required, this should be done explicitly and deliberately by modifying an NSP's depreciation profile. Also, NSPs have an incentive to opportunistically alternate between the two approaches, depending on inflation at the time, with implications for price stability.

This aspect of the Directions paper is one more element of a series of framework reforms that would, collectively, significantly tilt the regulatory framework in favour of accelerated capital base recovery and removal of regulatory discretion.

A new capital redundancy mechanism

More positively, the Directions paper proposes to establish a new, broader, capital redundancy mechanism to replace the existing NGR mechanism which was conceived at a different time for a very different purpose. Regulators are no longer contemplating individual pieces of pipeline that may fall into disuse. We now face network decommissioning at scale equivalent to the size of the networks themselves. This new context requires an appropriate regulatory toolkit. We strongly support the proposal to establish a new capital redundancy mechanism.

However, the Directions paper again raises the potential to constrain regulators by overly prescribing the conditions under which capital redundancy could be applied. We encourage the AEMC to apply any such prescription with broad parameters to facilitate the effective exercise of regulatory discretion in changing circumstances.

We support the proposal for new NGR provisions enabling regulators to re-establish capital base values if the opportunity arises. This is a sensible reform promoting regulatory flexibility.

Amending capital and operating expenditure provisions

The Directions paper describes several NGR reforms to promote only efficient network expenditure into the future. We support these proposed framework changes, including a new rules-based mandate that NSPs must justify capital expenditure proposals with quantitative assessment of all credible options. While in practice this already occurs, we do not oppose formalising the requirement in the NGR. Proposed amendments to NGR capital and operating expenditure provisions to remove biases towards network growth, or even to maintain the existing size of networks, are also sensible.

We expect long-term benefit from these reforms to be relatively minor, but these changes will bring the framework up to date. More immediate and significant benefits, in the form of smaller NSP capital bases than otherwise, will accrue from NGR reforms already made to the pricing of new gas connections. Mandating cost reflective upfront tariffs for new connections, where connections are still permitted, will protect other customers from the cost of connecting new customers to gas networks with uncertain futures.

The Directions paper seeks stakeholder views on the merits of removing the NGR r.79 net present value (NPV) test for new investment. While we appreciate the initiative to clean up NGR provisions appearing anachronistic, we support retaining the NPV test. It will likely remain relevant to gas transmission investments and is doing no harm with respect to DNSP access arrangement proposals or to our assessments.

Amending reference tariff provisions

The Directions paper proposes reforms to NGR provisions for reference tariff setting and tariff variation mechanisms. While some of these proposals are straightforward, such as clarifying that long run marginal cost (LRMC) need only be considered when useful in designing tariffs, other proposed changes appear to have less value.

We do not see benefits that would flow, for example, from additional rules-based prescription on estimating avoidable and stand-alone costs. The current NGR provisions provide broad heads of power for NSPs and regulators. Where a problem isn't apparent, more detailed guidance risks unintentional outcomes that may not align with the long-term interest of consumers. Equally, basing tariff provisions on the switching point concept would again risk locking-in poor consumer outcomes by limiting scope for regulators to intervene.

The Directions paper proposes to mandate description by NSPs and regulators of how tariffs, tariff variation mechanisms and tariff classes would impact consumers in the short and long term. In general, we see this as a positive proposal but also see risk of this obligation imposing additional regulatory burden or devolving into formulaic statements without much benefit to stakeholders. We recommend the AEMC consider the scope of this new mandate, to balance benefits and costs.

Flexibility mechanisms, incentive schemes and access arrangement assessment processes

We note the Directions paper's message that the AEMC is not considering new flexibility mechanisms, such as providing regulators with opportunity to themselves reopen approved access arrangements. While we are sensitive to the rate of sectoral change and the increasing pace of policy interventions, we accept the AEMC's decision to rely on existing flexibility mechanisms.

The Directions paper did not canvass incentive schemes in a meaningful way. We note the AEMC's intention to engage with incentive scheme issues in the context of its draft determination. We look forward to engaging with the AEMC on those issues.

The Directions paper also did not reference the NGR-based administrative process of assessing NSP access arrangement proposals. We consider some process improvements may be made, related to the timing of actions required by regulators in undertaking regulatory assessments. We also look forward to engaging the AEMC on those issues.