Jemena Limited

Gas Networks in Transition

Submission to the AEMC Directions Paper: National Gas Amendment (Gas Networks in Transition) Rule (GRC0082)

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Contact Person

Chris Stewart

Jemena Limited

ABN 95 052 167 405
Level 39, Liberty Place
161 Castlereagh Street
Sydney NSW 2000

Postal Address

Via Loading Dock
242 Pitt Street
Sydney NSW 2000
Ph: (02) 9867 7000
Fax: (02) 9867 7010

1. Overview

Jemena welcomes the Australian Energy Market Commission's (**AEMC**) Gas Networks in Transition Directions Paper (**Directions Paper**). The Directions Paper represents a constructive and considered step toward updating the gas regulatory framework to reflect an energy transition that will unfold over the coming decades. In this context, it will be important that the key elements articulated within the AEMC's proposed directions are well reflected into the draft rules, and that the AEMC optimally designs features it is still considering and consulting on, ensuring they are internally consistent with the overall framework being proposed.

Jemena welcomes the AEMC's recognition of several foundational principles that are critical to managing the transition in a way that promotes the National Gas Objective (**NGO**) and gives effect to the Revenue and Pricing Principles (**RPPs**). Jemena supports the AEMC's:

- recognition that the use of depreciation and compensation for inflation are appropriate tools for use at the point that stranding risks are identified, and that they can assist in managing longer-term price and service impacts for gas customers and minimise stranding risks for service providers.[1]
- position that capital redundancy should remain a tool of last resort,[2] to be applied only where asset stranding cannot reasonably be avoided through other regulatory mechanisms.[3]
- direction that service providers and regulators should demonstrate how they have taken a longer-term view on how the demand-related risks for gas consumers and service providers should be managed across the Access Arrangement (**AA**) for which a decision is being made.[4] Embedding a longer-term perspective within the regulatory framework should help ensure that short-term decisions do not inadvertently exacerbate long-term risks for consumers or undermine confidence in the regulatory regime.

Through this submission, Jemena seeks to support the AEMC in implementing its proposed direction into the National Gas Rule (**NGR or rules**) in a way that best meets the NGO and the RPPs. This includes ensuring that the directions identified by the AEMC are translated into appropriate, workable and internally consistent rules, and that the framework continues to support efficient investment by preserving confidence, predictability and appropriate regulatory discretion as the energy transition progresses.

To support the draft decision, we consider the AEMC should undertake:

- An assessment of potential alternative mechanisms that could address stranding once redundancy is revealed – including the use of a loss capitalisation account as an alternative (or volatility-limiting intermediary step prior) to writing down (and potentially returning) value from capital bases.
- A reassessment of incentives on service providers to develop proposals aligned to the NGO. This would support the AEMC's draft decision on the decision-making models.

Jemena considers the draft rules should include:

- Clear objectives for each of depreciation, treatment of inflation and capital redundancy.
- Capital redundancy provisions that adequately reflect the AEMC's intent of last resort use, including that economic asset stranding has already occurred.
- Guidance that a switching point, if used for capital redundancy, should be estimated using assumptions that err on the side of a higher price ceiling (such as maximum willingness to pay) given the practical difficulty to estimate and the asymmetric risk and consequences of getting this wrong.
- Appropriate limitations to regulator discretion that recognises the new framework and incentives faced by service providers. We consider this is Option B or Option C(i) of the AEMC's potential decision-making models, which should be applied to each of depreciation, treatment of inflation and capital redundancy.

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1 AEMC, Directions Paper, p. 17.

2 AEMC, Directions Paper, Table B.2, p. 77.

3 AEMC, Directions Paper, p. 17.

4 AEMC, Directions Paper, p. 17.

- Guidance on tariffs that ensure internally consistent decisions.
- A shift from focusing on a single ‘best estimate’ of a 20-year outlook and ‘explaining how AA proposals reflect this outlook’ to focus on how the long-term scenario analysis informs decision-making under current uncertainty to ensure the AA proposal is most resilient to a range of potential futures. Additionally, a balance is required within the rules to best achieve the intent without exacerbating the administrative and legal burden on service providers and regulators.

We do not consider that the rules should include guidance that would lead to standalone costs being set by reference to a switching point. This would incorrectly shift its critical function from one that prevents one tariff class from cross-subsidising another to becoming focused on price setting. Standalone cost should be attached to the cost of the network and not attached to the customer.

Our submission also addresses specific areas of detail across the questions posed by the AEMC, including across expenditure assessments.

2. Capital cost recovery

2.1 Summary

Capital cost recovery settings are central to whether the regulatory framework supports an orderly energy transition or, alternatively, amplifies investment risk in long-lived infrastructure assets. Getting these settings right is critical not only for gas network service providers, but also for maintaining confidence in economic regulation of essential infrastructure more broadly.

This requires:

- For capital redundancy:
  - Replacing the concepts of full and partial redundancy with a clear delineation between economic redundancy and physical redundancy, with the provisions seeking to address economic redundancy
  - Consideration of whether there are better or intermediary mechanisms to address economic redundancy than capital redundancy provisions, including consideration of a loss capitalisation account
  - Giving effect to the AEMC's stated direction that capital redundancy should be a tool of last resort—used only when asset stranding cannot be averted[5]—and this should only be triggered following revealed redundancy. This includes the following considerations:
    - Establishing clear objectives for capital redundancy provisions, consistent with the NGO and RPPs
    - Recognition that there are better mechanisms to achieve customer protections than seeking to do this through capital redundancy provisions
  - Recognition it is inherently difficult, and potentially impossible, to accurately establish ex-ante switching point(s) and the asymmetric risks of 'getting it wrong' means the AEMC should provide guidance to err on the side of assumptions that imply higher switching costs
  - If retaining a Regulated Asset Base (**RAB**) write down mechanism (as opposed to any more preferable alternative), there should be use of simple criteria to remove and add back 'value' from the capital base, including parked capital being carried forward by Weighted Average Cost of Capital (**WACC**)
- For depreciation:
  - Guidance that reasonable early action is preferable to action that is too late
  - Establishing clear objectives for depreciation schedules, consistent with the NGO and RPPs
- For treatment of inflation:
  - Establishing clear objectives for the treatment of inflation, consistent with the NGO and RPPs
  - Allowing for both a real indexed method or a nominal (non-indexed) method
  - A reduction in barriers to remove RAB indexation, including within the regulators' models.
- For the decision-making models for each of capital redundancy, depreciation and treatment of inflation:
  - Limited regulator discretion that recognises the new framework and incentives on service providers to develop proposals aligned to retaining customers
  - Recognition that historical evidence supports the presumption that:

[5] AEMC, Directions Paper, p. 17.

  - service providers do not have incentive to advance depreciation when there is no risk of asset stranding
  - service providers' profit maximising incentive, that regulation of natural monopolies seeks to address, does not evaporate when stranding risk materialises and competitive forces limit prices
  - regulators may have incentive, evidenced by historical decisions, to limit the extent to which service providers are permitted to bring forward depreciation, even when there is an asset stranding risk, to deliver lower prices in the short term.

- We discuss each in the following sections, including providing suggestions to support rule drafting.

2.2 Capital redundancy

The implementation of the AEMC's intended direction on capital redundancy is the single most important determinant of how investment risk is contained and whether contagion risks to other regulated industries with long-lived infrastructure assets are avoided. Getting this element of the framework wrong would have consequences that extend beyond gas networks, by undermining trust in the stability and predictability of Australia's economic regulatory regimes more broadly.

The following sections focus on the directions related to the operation of capital redundancy. We discuss an appropriate decision-making model for capital redundancy in section 2.5.

2.2.1 Focus on economic stranding

The current capital redundancy provisions have historically been framed around physical asset stranding. The discussion on capital redundancy provisions within the Directions Paper is focused on dealing with economic stranding. It is seeking to address the issue of capital *value* being stranded rather than physical asset stranding. However, the AEMC does not clearly articulate this is the case, referring to notions of full or partial redundancy.

If would be helpful for the AEMC to replace the concepts of full and partial redundancy with the concepts of physical and economic redundancy.

2.2.2 Consideration of other mechanisms for addressing economic redundancy

The AEMC should satisfy itself that the chosen mechanism to address economic stranding would best meet the NGO and RPPs. There are other potential mechanisms to deal with economic asset stranding, rather than using reversible write downs as suggested by the AEMC. This approach discussed by the AEMC effectively 'parks' unrecovered capital to potentially be brought back at a later date.

The AEMC's approach does not appear to consider service providers have incentive to charge less than the regulated price, even when doing so would be profit-maximising. The AEMC state that this incentive for service providers to not use the capital redundancy provisions manifests because it would result in the capital base effectively being written down.[6] However, this must imply that a service provider would knowingly create or hasten its own demise and will choose to ignore profit-maximising incentives when economic stranding occurs. The profit-maximising incentive upon which economic regulation of natural monopolies is based cannot be selectively assumed. It should not be ignored when competitive market forces draw nearer. A profit-maximising service provider would seek to price to retain customers and maximise the return of its investments, including where this involves pricing below a regulated price outcome. Service providers will always be best placed to assess competitive pressures, customer behaviour, and local market conditions.

Jemena therefore does not consider the AEMC view on service provider incentives to price below the regulated price when stranding is imminent is economically robust and recommends the AEMC should reconsider its assessment.

[6] AEMC, Directions Paper, p. 75.

Should the AEMC remain concerned that service providers would become blinded by an aversion to RAB write downs or pricing below the regulated price (in the face of its own demise), then the AEMC should consider an alternative mechanism to writing down the RAB or to be used as an intermediary step prior to writing down.

Alternatives could include capitalising any revenue shortfall associated with pricing below the regulated price, potentially via a loss capitalisation or "unders and overs" account.[7] This approach is economically equivalent in present value terms to the use of capital redundancy provisions envisaged by the AEMC and has precedents.[8] It aligns closely with the AEMC's stated objectives but avoids large, premature, and potentially speculative RAB write-downs driven by uncertain long-term forecasts. Importantly, it would reduce potential for RAB volatility compared to the use of capital redundancy provisions that remove and add back in RAB.[9]

Reasons the AEMC may consider an alternative mechanism to address economic asset stranding risk include:

- Switching points are inherently dynamic and will need to be considered at a retail price level, not a distribution level (establishing a corresponding 'net back' price for pipeline services). The service providers' portion of a customer's gas bill will vary across different networks. However, in NSW they are around 37 per cent for a residential customer. High gas prices may be driven by highly volatile factors outside a service providers' control, such as commodity prices or export dynamics. It needs to be considered whether it is efficient and equitable for service providers to absorb cost fluctuations from external drivers through asset write downs, given that retailers don't charge network reference tariffs directly to end-users.
- Risk of complete RAB write down or negative RAB outcomes—if electricity prices are sufficiently low, the required RAB write down to match standalone costs could drive the RAB to zero or below. This would effectively expropriate network assets, even where some customers are willing to pay higher prices for gas services, and could rationally lead service providers to cease offering the service altogether, an outcome which would be clearly inconsistent with gas customers' long-term interests.
- Increased investment risk—regulated infrastructure attracts capital because it offers stable, predictable cash flows. By linking revenues and asset values to volatile commodity prices, the use of switching points materially increases risk. This would inevitably raise required rates of return, increasing long-term costs to consumers.
- Addressing temporary and volatile switching points—it is questionable whether a first response to a regulated price rising above a switching point should be to write down RAB. There is clear risk that the competing energy source becomes cheaper only temporarily. This situation may reverse in later years due to rising electricity network costs, increased demand from electrification, or lower gas commodity prices. In such cases, discounting regulated prices below the maximum is best characterised as short to medium term price smoothing rather than evidence of permanent economic stranding. Immediate RAB write-downs in response to temporary market conditions introduce unnecessary volatility and risk irreversibility errors by sending incorrect price signals to gas users. This is removed with mechanisms that ensure write downs truly are a last resort.

[7] A loss capitalisation account is where foregone revenue (from pricing below the regulated maximum) is treated as a loss capitalisation or revenue smoothing mechanism, rather than as an immediate asset disposal. This type of approach could work as follows:

- The service provider determines (ex-ante) the extent of any price discount in response to competitive pressures.
- The revenue foregone (not the present value of all hypothetical future losses) is capitalised as a loss reserve.
- At the next access arrangement review, an assessment is made as to whether these capitalised losses are recoverable over time.
  - If recoverable, they remain in the RAB.
  - If not, only then should disposal provisions be considered.

Disposal decisions should remain reversible if market conditions change (carried forward by the regulatory WACC).

Such an account can work differently to a revenue cap as unders and overs do not necessarily get washed up each year. Instead, they can remain in the loss reserve until such point they can be recovered or a decision is made for disposal.

[8] For example: the ACCC introduced and unders and overs account for State Water's regulated charges in its 2014-17 review; The NSW Rail Access Undertaking includes an Overs and Unders Account to be introduced to manage average deviations around a maximum rate of return (currently used for the Hunter Valley Rail Network).

[9] Lower RAB volatility can be expected given:

- Loss capitalisation reflects annual adjustments only.
- Asset write downs capture the present value of all future regulated price discounts.

- Forecasting and substitution errors—forecasting gas and electricity costs over a 20-year horizon is highly uncertain. Current electricity prices reflect historic capital expenditure, not the long-run marginal cost of expanding the electricity network to accommodate large-scale fuel switching. Any serious assessment of substitutability must account for these future network augmentation costs.
- Consistent application of competitive logic—the switching point approach reduces service provider allowed revenues when alternatives are cheaper, but does not symmetrically increase revenues when gas is the lowest-cost energy source and when service provider replacement costs rise.
- Consistent treatment of sunk costs—the switching point approach to capital redundancy, especially any switching point established with 'no impediment'[10] to switch, effectively protects gas users' sunk costs while the service providers' sunk investments are not protected. In workably competitive markets, sunk costs are borne by both sides, whereas the proposed approach would insulate users from risks they would bear in a workably competitive market. A switching point approach to capital redundancy provides certainty to neither party and raises questions about consistency—particularly whether similar logic (to limit electricity prices at a switching point to gas or an alternative) would ever be applied to electricity networks.

While we expect the AEMC will give this due consideration, we recognise this introduces a new element to the framework not addressed in the Directions Paper. The remainder of our submission therefore addresses the AEMC's published directions, noting that these assessments may change should an alternative or intermediary mechanism be progressed.

2.2.3 Implementing capital redundancy provisions as the last resort

To give effect to the AEMC's stated direction that capital redundancy should be a tool of last resort—used only when asset stranding cannot be averted[11]—the rules should establish a clear, transparent and measurable set of thresholds and triggers for its application.

Where accelerated depreciation or other capital cost recovery tools remain viable, the rules should make it unambiguous that these tools must be initiated and exhausted before capital redundancy is triggered. This sequencing is essential to preserve cost recovery opportunities while customer numbers remain sufficient to spread fixed costs efficiently.

The rules should:

- Establish clear objectives for capital redundancy provisions consistent with the NGO and RPPs
- Be clear that capital redundancy provisions are applied ex-post of economic stranding occurring (that is, "revealed redundancy" that is reasonably expected to continue).

For the first, a reasonable objective for capital redundancy provisions could be to adjust the value of the capital base to align with the ability of the service to recover capital costs in prices for pipeline services under prevailing market conditions.

For the second, revealed redundancy could clearly be defined as the point of observing the network service provider charging for its reference services below the regulated price,[12] which as noted above it is incentivised to do at the point that customers are no longer willing or able to pay the regulated price. This ex-post approach would be consistent with the AEMC's description that (our emphasis): [13]

> *the use of the redundant capital provisions recognises that stranding has occurred and that service providers are unable to recover a full return of and on capital*

10 AEMC, Directions Paper, p. 123.

11 AEMC, Directions Paper, p. 17.

12 Excluding prudent discounts applied to single large industrial customers.

13 AEMC, Directions Paper, p. 55.

Importantly, the threshold must be sufficiently precise and auditable to minimise scope for divergent interpretations of when stranding is unavoidable and the evidentiary bar that must be met to reach that conclusion. This is critical to maintaining confidence that redundancy decisions reflect genuine demand-side realities rather than endogenous regulatory outcomes.

An ex-post threshold would ensure capital redundancy is grounded in demonstrable market outcomes, rather than forward-looking speculation or regulatory discretion alone. Without this intent being clearly translated into the rules, there is a risk that redundancy provisions could be applied prematurely or inconsistently with the broader framework, with stranding risk deriving from the regulation rather than true market forces.

When translating its directions into draft rules, the AEMC should recognise and have regard for the following:

- As noted in section 2.2.2, service providers have the ability and incentive to recover revenues below the maximum allowable revenue under an AA.[14]
- The longstanding regulatory practice that asset stranding risk has been managed through cash-flow adjustments, such as through accelerated depreciation, rather than through a higher allowed return on equity. Both the Australian Consumer and Competition Commission (**ACCC**)[15] and the Australian Energy Regulator (**AER**)[16] have consistently maintained this approach since the early 2000s, meaning stranding risk has not been compensated through WACC. That established treatment must inform any assessment of what constitutes a reasonable opportunity to recover efficient costs within the draft rules.
- Investors have historically been attracted to energy infrastructure because it delivers stable, predictable cash flows. This stability underpins the low systematic risk of these assets and, in turn, supports a low beta and a relatively low allowed WACC. If the RAB is prematurely adjusted based on whether total gas prices are competitive with substitute fuels, the risk profile of gas distribution cash flows changes fundamentally. In effect, the service provider is exposed to commodity price and demand-substitution risks that are not characteristic of regulated network assets. This materially increases the riskiness of the cash flows and, if reflected appropriately, would require a higher allowed WACC.
- There is an interaction between capital redundancy, downstream decommissioning costs and operating expenditure allowances, particularly when applying a 20-year outlook. Removing value from the RAB does not remove the real, ongoing costs associated with safely operating, maintaining or ultimately decommissioning infrastructure. While decommissioning falls outside the scope of this rule change, these cost implications should be explicitly recognised as something that will need to be addressed at an appropriate time to avoid unintended consequences for consumers and service reliability.
- The objectives of capital redundancy should not encompass the protection of vulnerable customers. This risks regulators' imposing capital redundancy earlier than necessary for the purpose of reducing prices, risking capital recovery contrary to the NGO and RPPs. There are better mechanisms to achieve customer protections through retail gas price regulation or targeted assistance to vulnerable customers.

Additionally, the AEMC has not yet considered what would be the appropriate timing and process for determining whether capital redundancy clauses are to be triggered. One option is for this assessment to occur early, at the reference service proposal stage. As noted above, any trigger should be based on clear, measurable and non-debatable criteria with regulatory action taken ex-post to asset stranding being observed (such as service providers pricing below regulated price). Where the trigger is deemed met at the reference service proposal stage, service providers should be able to propose, as part of their AA, the relevant switching points and the associated value of any redundancy.

Where the trigger is not met, the question of capital redundancy would be reconsidered at the next reference service proposal. In the interim, service providers would retain the ability to price below levels that provide allowed

[14] While this may result in recovery below building block allowances in the short term, it provides value for service providers and customers as it allows timelier within-period annual decisions to be made on pricing below the regulated price as opposed to potentially overshooting a reduction in prices based on forecasts up to seven years ahead of subjectively-determined switching points. Should it be combined with a loss capitalisation account mechanism, the service provider incentive to price below the regulated price increases.

[15] ACCC, *Final Decision – Access Arrangement proposed by NT Gas Pty Ltd for the Amadeus Basin to Darwin Pipeline,* 4 December 2002, pp. vii, 91.

[16] AER, *Rate of Return Instrument: Explanatory Statement*, February 2023, sections 2.4.1 and 8.3.5. This position has been consistently adopted for over 20 years, since the ACCC's 2001 access arrangement decision for the Amadeus Gas Pipeline.

revenues if required to respond to emerging risks of disorderly exit earlier than anticipated.[17] This approach would improve transparency, reduce regulatory risk and better align capital redundancy outcomes with underlying demand conditions rather than regulatory discretion alone.

2.2.4 The "switching point" – theoretically appealing, but guidance needs to recognise its practical limitations

While the concept of a customer "switching point" has theoretical appeal, the rules should recognise the practical limitations in estimating a single switching point across an entire tariff class and doing this across multiple tariff classes.

The notion of a single, clearly identifiable "switching point" for a group of customers does not reflect how energy markets operate in practice. Customer decisions to switch away from gas are influenced by a complex and heterogeneous set of factors, including the age and condition of existing gas appliances, upfront capital costs and household liquidity constraints, government policy settings and support mechanisms (and the timing of these), the cost, performance and availability of alternative technologies (such as electric appliances, batteries and rooftop solar), and customer behaviour, preferences and sentiment toward gas.

Switching pathways themselves also differ materially: for residential and small commercial customers this may involve electricity or LPG, while for large industrial customers alternatives may include coal, biofuels, or bypass to transmission pipelines.

Switching points are also inherently dynamic and will need to be considered at a retail price level, not a distribution level (establishing a corresponding 'net back' price for pipeline services). Relative retail prices of electricity and gas are non-stationary and subject to ongoing structural change. In electricity, significant investment is underway or envisaged across generation, transmission, distribution and grid-scale storage. At the same time, demand for electricity is increasing due to electric vehicles, heat pumps, data centres and electrification of space and water heating. The AEMC's envisaged direction for electricity network pricing includes higher fixed network charges,[18] which would temper savings available to customers from using their own consumer energy resources. Wholesale market conditions, fuel input costs and geopolitical factors continue to evolve. All these dynamics point to switching points being difficult to establish, shifting over time, and not converging on a stable or reliable estimate.

These factors vary significantly across and even within customer cohorts and cannot be captured by a single simplified price threshold. It includes a wide range of assumptions and inputs that are outside a network service providers control and, in many cases, outside its reasonable knowledge. It would be very difficult, if not impossible, to derive a redundancy-minimising price with any precision for a service provider. This would be even more difficult for a regulator who likely has access to less customer-specific information than the service provider. As such, a switching point cannot serve as a precise or objective trigger for imposed capital write-downs.

This complexity is acknowledged by the AEMC's consultant, CEPA, who recognises that incorporating switching behaviour into modelling is challenging in practice.[19] CEPA adopts a simple static approach and highlights that not all customers will disconnect when an estimated switching point is reached due to imperfect information, differing expectations, appliance vintages and customer preferences, and that switching points themselves may not be stable and can be affected by prior price changes.[20]

This raises serious questions about how regulators would be expected to translate such uncertainty into a single estimate that carries high-consequence implications for the reasonable opportunity to recover efficient costs—particularly under decision-making models that exclude any formal role for service provider input (such as Option D).

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17 We recognise that voluntarily pricing below the regulated price becomes foregone revenue compared to the approach to remove value from the RAB via the capital redundancy clauses (which include provisions for adding this back in). However, this also may have value for service providers as it allows within period annual decisions to be made on pricing below the regulated price as opposed to reducing prices based on forecasts up to seven years ahead of subjectively determined switching points. Should it be combined with a loss capitalisation account mechanism, the service provider incentive to price below the regulated price increases.

18 AEMC, *The Pricing Review: Electricity pricing for a customer-driven future*, Draft Report, p. x, 36, 41-42.

19 CEPA, *Gas Networks in Transition: Modelling results*, 17 March 2026, p. 7.

20 CEPA, *Gas Networks in Transition: Modelling results*, 17 March 2026, p. 7.

Errors will always occur in forecasting. However, errors in setting the switching point have asymmetric consequences:

- If a switching point is set too low, any associated write-down of the RAB risks permanently foreclosing cost recovery opportunities at a time when customer numbers are still relatively high.
- By contrast, if a switching point is set too high, this can be managed through service providers deciding to price below regulated levels at any time as required.

Given this asymmetry, the rules should provide guidance that, where capital redundancy is being considered as a last resort, regulators and service providers err on the side of assumptions that imply or result in higher switching point estimates. This enables more of a trial-and-error approach where service providers can observe how price changes impact demand and adjust so as to converge at an approximate optimal switching point over time.

This asymmetry of outcomes also reinforces the need for service providers to have a role in informing and establishing switching point estimates, especially where they are to be used to write down the asset base.

Finally, there is a practical lower bound to any switching point. Where resulting revenues become insufficient for directors of the service provider to meet safety and statutory obligations, a prudent service provider would need to consider its options for shutting down or otherwise disposing of the network. While such outcomes sit outside the scope of this rule change, they underscore the importance of erring on the higher side when setting switching point assumptions, consistent with an orderly transition and the long-standing regulatory principle of providing a reasonable opportunity to recover efficient costs.

2.2.5 Simple criteria for applying capital redundancy required

Should the AEMC retain an approach for RAB write downs as a last resort with the ability to reverse this should circumstances change (as opposed to a different mechanism as discussed in section 2.2.2), then the AEMC should include in the rules simple criteria for the removal and adding-back of capital value consistent with the concept of financial redundancy. This could include being clear the approach would be to:

- Remove value from the capital base when it is not recoverable (‘parked’ value)
- Adding value back into the capital bases when it is recoverable
- For the amount that is ‘parked’ in the redundant account, that this is carried forward by the regulatory nominal WACC.

2.3 Depreciation

Jemena supports the use of changes to depreciation schedules - particularly the use of accelerated depreciation in the current environment - as an appropriate, prudent and efficient cost recovery tool. It is the primary tool for managing stranding risk.

When applied while there remains a sufficiently large customer base, accelerated depreciation can help mitigate the risk of placing an inequitable cost burden on future customers, who are likely in many cases less able to switch energy sources. Importantly, the AEMC has recognised that use of accelerated depreciation does not represent a transfer of risk from networks to consumers - rather, it improves alignment between capital cost recovery and the expected utilisation of networks.[21]

Early and timely action is important. Acting “too early” would be undertaken on a ‘no regrets’ basis and can be addressed through subsequent adjustments, including decelerated depreciation if conditions improve. By contrast, acting too late cannot be remedied, as the opportunity to recover efficient costs while customer numbers remain higher will already have been lost. This asymmetry reinforces the importance of depreciation being actively used as the first line of defence ahead of capital redundancy.

[21] AEMC, Directions Paper, p. 23.

It would be helpful for the NGR to set out clear objectives for establishing a depreciation schedule, consistent with the NGO and RPPs that have clear relevance to a declining gas market. These objectives could include:

- maintaining a reasonable opportunity to recover cost over the remaining economic life of the assets
- maintaining incentives for the investment in, and efficient use of, pipelines over the remaining economic life of assets, and
- subject to the above, enabling stability in long-term prices over time given the outlook for demand for services.

There would also be benefit from removing potential for contention on establishing economic lives. Approaches that use statistical expectation of economic lives or median scenarios cannot provide a reasonable opportunity to recover efficient costs as by their mathematical nature it would only expect to do this half of the time. The alternative where there is uncertainty is to seek that cost recovery occurs in most plausible scenarios. This would reduce risk and acknowledges that asset lives can later be adjusted upwards as needed.

We discuss an appropriate decision-making model for depreciation in section 2.5.

2.4 Inflation treatment

Jemena supports the introduction of a clear decision point in the rules to allow each service provider to propose a treatment of inflation that is appropriate for their network at the time of an AA proposal. Demand conditions, stranding risk and customer composition vary materially across networks and over time, and a single mandated approach is unlikely to be efficient in all circumstances. Allowing case-by-case proposals, assessed against the NGO and the RPPs, would better align inflation treatment with prevailing network conditions.

It would be helpful for the NGR to set out clear objectives for establishing changes to the treatment of inflation, consistent with the NGO and RPPs. These objectives could include:

- maintaining a reasonable opportunity to recover the compensation for inflation over the remaining economic life of the assets
- encourage efficient use of the pipeline or network, and
- encourage stability in prices over time.

Additionally, to practically give effect to enabling a workable decision point, the rules should require the regulator's post-tax revenue model (**PTRM**) to permit both real and nominal inflation approaches.[22] This would allow the model to calculate either an indexed or an unindexed RAB, consistent with the service provider's proposed and justified inflation treatment under the rules.

We discuss an appropriate decision-making model for the treatment of inflation in section 2.5.

2.5 Regulator discretion should be consistent with incentives in the new framework

The AEMC is considering alternative options for the level of regulator discretion in decisions relating to depreciation, inflation treatment and capital redundancy.[23] In establishing regulator discretion across depreciation, inflation treatment and capital redundancy, it is important to consider how these elements interact within the new framework as a whole. The preferred approach should be one that is internally consistent with the broader framework the AEMC is proposing, properly recognising the incentives.

That framework includes tighter capital expenditure controls, the exclusion of new customer connection capital expenditure from the RAB,[24] and a requirement for service providers and the regulator to demonstrate internal consistency with a 20-year outlook. It also envisages a clear, service-provider-initiated decision point on inflation

22 NGR, rules 75A and 75B.

23 AEMC, Directions Paper, p 71-76.

24 AEMC, Final Decision, *Updating the regulatory framework for gas connections – GRC085*, 11 December 2025

treatment—potentially tied to observed demand deterioration—and the systematic use of depreciation until capital redundancy is triggered once stranding can no longer be averted.

Importantly, and despite all these changes, the AEMC acknowledges this framework cannot remove economic stranding risk for service providers.[25]

Therefore, strong incentives remain for the service provider to endure and to provide a service that customers continue to want and are willing to pay for so as to obtain the return of its efficient investments (or at least minimise final stranding). That is, service providers retain strong commercial incentives to avoid disorderly customer exit.

We note that the AEMC suggests that service providers do not have an incentive to identify assets as redundant and that this is a reason to support decision-making model Option D.[26] It also suggests that the regulator making assets redundant and reducing the asset base and regulated prices would make the service provider better off by reducing stranding risk of the remaining capital by having customers connected to the network for longer.[27]

It's not clear how the AEMC has reached this conclusion as it implies the service provider would not want to maximise its long-term profits. Full regulation of scheme pipelines is founded on addressing the assumption/market failure of natural monopolies seeking to profit maximise. The profit maximising incentive cannot be selectively assumed when there is a natural monopoly, then ignored when competitive market forces draw nearer. A profit maximising service provider would seek to price to retain customers and maximise the return of its investments. The AEMC have not identified a market failure that requires intervention.

The incentive to price below a regulated price might only become skewed with an expectation of opportunistic regulator treatment of capital redundancy provisions. However, that would be a regulatory failure rather than a market failure.

With regard to depreciation, the AEMC states that:[28]

> *Where service providers' are **not** facing the risk of stranding, their incentives may not be as well aligned with the NGO and RPPs, so greater regulatory oversight might be required.*

However, the commercial incentive when there is risk of asset stranding is to preserve value in the capital base consistent with expectations of economic life and forecast future demand. This incentive has been borne out as true from the history of economic regulation of gas pipelines in Australia where demand forecasts and depreciation schedules were proposed and accepted by regulators without acceleration. There is no evidence of service providers seeking to inefficiently bring forward depreciation in circumstances where there is no identified stranding risk. The history of evidence shows the preference for service providers to preserve value in RABs by depreciating over long economic lives. This observed behaviour has been consistent with the NGO, RPPs and the depreciation criteria within the NGR. Additionally, as we enter a period where stranding risk is becoming more common, if not already pervasive, AEMC concern and needing to address incentives for networks not facing stranding risk should not be a driving force for the determination of the decision-making framework.

Jemena also notes that the decision-making framework in electricity regulation has, and that which previously existed within the NGR had, very limited regulator discretion in relation to depreciation schedules. In the current environment, gas service provider incentives are more aligned with the NGO and RPPs. A consistent assessment supports no or more limited regulator discretion.

2.5.1 A fair assessment of incentives supports limited or no regulator discretion

The incentives of this new framework are consistent with allowing a service provider control over its destiny. Regulatory discretion should complement, rather than inhibit, these incentives.

25 AEMC, Directions Paper, p. 81.

26 AEMC, Directions Paper, p. 75-76.

27 AEMC, Directions Paper, pp. 44-45.

28 AEMC, Directions Paper, p. 73.

Consistent with this is a decision-making model that limits regulator discretion across all the capital recovery provisions (depreciation, treatment of inflation and capital redundancy) to ensuring that the service provider's proposals are consistent with the NGO and RPPs. In particular, there is no credible reason to consider the service provider incentives for capital redundancy differ to those arising for depreciation and the treatment of inflation.

We encourage the AEMC to reconsider Option B of the AEMC's potential decision-making models following a reassessment of the incentives and their consistency with the NGO and RPPs. Of the two options the AEMC has currently identified and consulted on, Option C(i) is clearly better aligned to incentives and would better meet the NGO and RPPs than Option C(ii).

Option C(ii) provides weakly constrained discretion across these capital recovery tools. It risks creating endogenous stranding outcomes driven by regulatory interventions rather than underlying demand trends. In those circumstances, redundancy outcomes may not reflect genuine, unavoidable declines in demand. Such outcomes would undermine the reasonable opportunity to recover efficient costs. Applying more interventionist regulator models would result in service providers bearing additional risks that those regulators become captured by short-term political motivations for low energy prices today.

2.5.2 Service providers' views need to be included in any decisions on capital redundancy

We consider that the incentives on service providers, as acknowledged by the AEMC for depreciation and treatment of inflation, apply equally for capital redundancy provisions and therefore the same decision-making model (Option B or Option C(i)) should apply.

In saying that, we recognise that the initial AEMC direction for regulator discretion for capital redundancy is for decision-making model Option D. This is full regulator discretion guided by the rules and does not appear to indicate any service provider input.

Jemena has concerns with rules that provide the regulator full discretion to determine the value to be removed from the RAB once capital redundancy provisions are triggered, without any formal input from the service provider, as it presents a heightened investment risk from the framework. This is heightened by the subjective and inevitably contentious nature of establishing switching point estimates.

Any decision on determining switching points and therefore revenue to be removed from the RAB requires heavy input from the service provider.

This aspect of the framework is most likely to heighten perceived regulatory and investment risk if not carefully designed—particularly when combined with recent regulatory approaches that have constrained revenue allowances through arbitrarily determined price paths.

Correspondingly, if the AEMC remains minded for decision-making model Option D to apply to capital redundancy provisions, it provides even more reason to have no regulator discretion over compliantly proposed depreciation schedules and inflation treatment (Option B), to enable service providers the best opportunity to recover efficient costs and preserve investment confidence.

3. Reference tariffs

Jemena broadly supports the AEMC's proposed direction to strengthen guidance on reference tariff design in an environment of uncertain and potentially declining demand.

Jemena considers the appropriateness of the proposed direction on standalone costs would benefit from further exploration and assessment, particularly given the standalone cost becomes a price limiter with potentially the same outcomes as applying capital redundancy provisions, but without the concept of last resort use.

We also consider that guidance on tariffs needs to be strengthened to ensure internally consistent proposals and regulator decisions.

3.1 Standalone costs and switching point

Jemena has concerns that any methodology that anchors standalone cost estimates to a hypothetical "switching point" at the retail price level do not represent an appropriate upper limit for setting distribution tariffs.

3.1.1 Intent of standalone cost as an upper revenue bound

The framework provides for a determination of a total revenue requirement as the forecast costs of service provision by a building block calculation.[29] NGR rule 94 then allocates this revenue requirement to reference services and reference tariffs. This includes ensuring that tariffs will be set such that expected revenue will be met.[30]

The AEMC should recognise that the standalone cost is meant to represent the cost for distribution networks to serve a tariff class—it is therefore 'attached' to the cost of the network. Its widely recognised critical function is to ensure one tariff class is not cross-subsidising another.[31] In contrast, switching points are attached to the customer and focused on the cost structure or price of a competitor and is therefore directly relevant for price setting, not broad price limits.

3.1.2 Difficulty establishing switching points

Standalone cost has traditionally been assessed at the tariff class level, based on the collective feasibility of a third party bypassing the network to serve that class. By contrast, a switching point is inherently (individual) customer-specific and reflects a nuanced set of circumstances that are difficult to aggregate meaningfully across a tariff class.

As outlined in section 2.2.4, there are significant challenges in estimating switching points at a tariff class level, particularly where customer behaviour, technology costs and policy settings vary widely and evolve over time. It is not practical for the standalone cost for each tariff class to incorporate these external factors in a way that is robust or with reasonable certainty over a 5-year time horizon or longer. These challenges are amplified where switching points are expected to play a determinative role in both tariff setting and capital recovery outcomes.

3.1.3 Standalone cost is not the place to seek customer protections

The purpose of the revenue limits is not to enable benefits of competition to be passed on to all consumers in a tariff class. Calibrating switching points to a hypothetical customer with 'no impediment'[32] to switching risks understating true switching costs and therefore should not inform the switching point. In practice, a typical customer is likely to face material frictions, including upfront appliance replacement costs, practical constraints

[29] NGR 76.

[30] NGR 94(5).

[31] Faulhaber, Gerald R., "Cross-Subsidization: Pricing in Public Enterprises," *American Economic Review* 65 (1975), 966-77. Baumol, William J., Panzar, John C. and Willig, Robert D., 1982, *Contestable Markets and the Theory of Industry Structure*. Baumol, William J. and Sidak J. Gregory, 1994, *Toward Competition in Local Telephony*, AEI Studies in Telecommunications Deregulation MIT Press.

[32] AEMC, Directions Paper, p. 123.

and behavioural factors. Additionally, there should be clear differentiation between concepts of switching costs and a switching point, with the latter potentially based on willingness to pay, which is more nuanced than a simple assessment of switching costs.

Even if using a 'typical' customer (or other form of median or average), then, by definition, the outcome would be setting the switching point at a price where approximately half would, if acting rationally, switch. This is unlikely to be a true reflection of the revenue ceiling for the tariff class as a whole, which may be significantly higher due customers considering factors other than financial rationality and given certain customers with relatively higher willingness to pay. Standalone cost is meant to represent the cost for distribution networks to serve a tariff class and not a balancing item to address risks brought by commodity prices, policy settings and appliance costs. As noted in section 2.2.3, this is not the appropriate place to be supporting vulnerable customer outcomes when there are better mechanisms available. It is worth noting that all customers will benefit from the nearing of competition because service providers will be trying to retain customers and have limited practical ability to price discriminate. Therefore, a customer does not necessarily need to switch to become a beneficiary.

3.1.4 Using switching point estimates would be inconsistent with the NGO and RPPs

An immediate effect of the AEMC's suggestion is that regulators under the NGR would be given a new tool to apply price caps for sub-groups of consumers based on the regulator's judgement about the switching point and without regard to the networks' cost. Enabling a regulator to apply potentially low switching points (by reference to 'no impediment' to switch) to limit revenues would risk limiting depreciation or bringing forward capital redundancy via tariff mechanisms inconsistently with the protections and 'last resort' nature the AEMC is considering for capital redundancy. It also risks imposing the uncertainties in other components that make up a switching point, such as wholesale gas and electricity prices, in customers switching decisions to gas distribution networks.

Further, imposing a cap on reference tariffs by reference to a switching point (which is unrelated to a service provider's costs) is contrary to the longstanding scheme of regulation set up in section 3.1.1 and would potentially result in the premature setting of reference tariffs at levels insufficient to recover costs. This is inconsistent with the NGO and RPPs.

We therefore do not support guidance that would drive network service providers and regulators to move away from a standalone cost estimate that represent network costs and which service providers can reasonably forecast, to one that relies on highly uncertain and speculative inputs at a customer level—especially where this may limit prices. In particular, regulators should not be able to replace or require the service provider to replace its chosen methodology for standalone costs.

3.2 Economically efficient tariffs

The AEMC note that reference tariff provisions lack guidance on how to apply efficiency concepts when designing reference tariff arrangements for a wider range of demand scenarios.[33]

Tariff guidance needs to provide for internally consistent proposals and regulator decisions. Regulatory intervention in network tariff design has been increasing in recent decisions. For example, the AER's most recent Jemena Gas Networks (**JGN**)[34] and Evoenergy[35] decisions place a significant focus on the concept of "flattening tariffs", based on the view that this may support the emissions reduction limb of the NGO by reducing incentives for higher gas consumption.[36]

This type of intervention raises several considerations for how to approach tariff rules:

[33] AEMC, Directions Paper, p. 110.

[34] AER, Final Decision, *JGN Access Arrangement 2025-2030, Attachment 9 - Reference tariff setting,* May 2025, pp 1 & 4.

[35] AER, Draft Decision, *Evoenergy Access Arrangement 2026-2031, Attachment 5 - Reference services, tariffs and non-tariff components,* November 2025, pp 14-15.

[36] Another example of regulatory intervention includes the imposition of lower side constraints on network tariffs, despite increasing demand uncertainty and the need for networks to manage a wide range of future demand scenarios.

- **Economic efficiency and cost reflectivity**: Distribution network costs do not increase proportionally with consumption, and flatter tariffs weaken the link between prices and underlying network costs.

- **Efficient utilisation of infrastructure**: Flattening tariffs may discourage efficient use of existing gas networks by disincentivising higher utilisation.

- **Cashflow and financeability risks**: Charging higher prices for higher consumption exposes service providers to increased seasonal variability and uncertainty in revenue recovery, as higher consumption is more strongly driven by temperature and weather conditions, which are inherently difficult to forecast. This can destabilise network cashflows and create financeability risks, in addition to the significant demand uncertainty networks already face.

- **Inhibiting the reduction of greenhouse gases**: Gas can play an important role in the decarbonisation of larger customers transitioning away from higher-emissions fuels, such as coal. Flattening tariffs can inefficiently lower incentives for customers to choose a gas decarbonisation pathway, thereby raising the cost of decarbonisation, rather than reduce emissions.

- **Internal consistency**: Continuing regulatory intervention to flatten tariffs may expose service providers to significant demand risk under a price cap or hybrid tariff variation mechanism. Given the application of side constraints acting as a customer protection mechanism, service providers should be allowed more flexibility to manage demand risks.

The AEMC should provide clear guidance on the role of network tariffs and avoid conflating network tariff objectives with those of retail tariffs. Customer behaviour is driven primarily by retail prices, which may not reflect network tariff signals. Network tariffs are not designed to directly influence end use consumption decisions in the same way as retail prices. Care should be taken not to impose behavioural signals through network tariffs, especially where this may increase distributors' stranding risk and limiting their ability to manage demand uncertainty.

Ultimately, the guidance should recognise that service providers are best placed to design tariffs that manage demand risk in light of their customer mix, operating conditions and potential decarbonisation pathway. It should provide networks with sufficient flexibility to manage demand uncertainty and stranding risk, rather than tying distributors' hands in a manner inconsistent with the other incentives within the new framework.

4. Long-term outlook

Jemena supports the introduction of a long-term (20-year) outlook as part of the AA framework. Requiring greater discipline in considering longer-term impacts should improve the quality and internal consistency of decisions made for each AA period, particularly in an environment of uncertain demand.

Issues of intergenerational equity, price stability and orderly transition outcomes are more likely to be achieved where both service providers and regulators are required to consider the longer-term outlook when making AA proposals and decisions.

Jemena has consistently supported long-term thinking in regulation, particularly to better understand the future role of gas and the timing and nature of transition risks. This approach underpinned our 2025–30 proposal across tariffs, depreciation, capital expenditure and operating expenditure.

4.1 The rules should focus on AA decisions that are resilient to a range of plausible futures and not attempt to predict which future is most likely

The most beneficial use of a 20-year scenario analysis in the context of a five-year AA proposal is not to predict demand outcomes, but to inform decision-making today. Given the high uncertainty surrounding long-term gas demand, scenario analysis is intended to test how investment and capital recovery decisions made in the forthcoming five-year AA period affect the network and customers under a range of plausible future demand trajectories over 20 years. Scenarios can be used as illustrative tools to test book-end outcomes, sensitivities and the robustness of proposals and regulatory decisions. It is most valuable when used to explore uncertainty, not to predict a single future state.

This process enables networks to identify “no-regret” decisions, actions taken now that improve outcomes, or at least do not worsen outcomes, across most or all plausible demand scenarios, and to retain network resilience in the face of uncertainty.

However, the AEMC framing appears to indicate a single outlook should be used with an approach to assign probabilities to scenarios.[37] The AEMC refers to the “best forecast or estimate”.[38]

The AEMC also suggests that service providers should: “explain how their AA proposal reflects the 20-year outlook…”[39]

This risks a false sense of precision and taking decisions that would, in hindsight, be sub-optimal if the best forecast or estimate does not eventuate. Additionally, assigning probabilities to long-term demand scenarios, as suggested by the AEMC,[40] would undermine the benefit of using scenarios. Probability-weighting shifts the focus away from assessing current decisions across multiple futures, and towards attempting to predict which future is more likely to occur. Given the inherent uncertainty over a 20-year horizon, this risks false precision and detracts from the core value brought by long-term scenario analysis. It also increases the legal risk attached to the making of future representations under the Australian Consumer Law, should such a future state not eventuate.

Instead, the focus should be on making current decisions resilient to multiple plausible futures, rather than attempting to predict which future is more likely to occur.

The AEMC’s draft rules should reflect that the core value brought by long-term scenario analysis, is to inform 5-year decision-making under uncertainty.

The requirement for explanation should not be ‘*how the AA proposal reflects the 20-year outlook’*, but something like ‘*how the AA proposal is most resilient to a range of potential futures*.’

37 AEMC, Directions Paper, Table A.1, p. 33.

38 AEMC, Directions Paper, Table A.1, p. 32.

39 AEMC, Directions Paper, p. 32.

40 AEMC, Directions Paper, Table A.1, p. 33.

The value of the long-term outlook lies in strengthening coherence and discipline in proposals and decisions, rather than locking-in outcomes or constraining future judgement. Consistent with this, the long-term outlook should inform current AA decision-making and improve transparency around longer-term implications. It should not be used to re-litigate past forecasts or prior regulatory determinations.

4.2 Limit administrative burden and implementation costs

It is important that the rules supporting the 20-year outlook remain flexible and principles-based, rather than overly prescriptive. While the outlook should be sufficiently robust to inform decision-making, it should allow for proportionate simplification where additional detail would materially increase administrative and legal burden without commensurate benefit—especially where multiple scenarios are required.

An effective approach is to focus on the information that delivers the greatest decision-making value and avoid excessive granularity that adds limited insight over a long timeframe. Over a 20-year horizon, information and assumptions should be high-level and strategic, focused on key drivers, book-ends and trends rather than detailed operational forecasts with guaranteed outputs.

The AEMC's rule drafting should seek to avoid the requirement to provide a 20-year outlook being treated as an extension of the five-year AA decision or as a de facto 20-year AA. Its purpose should be clearly defined and appropriately limited. Specifically, this should be to support decision-making for the immediate five-year period by assessing the longer-term implications of those decisions having regard to likely or assumed (but necessarily uncertain) scenarios. The requirements should therefore be sufficient to inform this assessment, without introducing unnecessary complexity, granularity or administrative and legal burden.

Service providers should therefore retain discretion in how they develop the 20-year outlook, within a broad framework set by the rules, to avoid the outlook evolving into a de facto extension of the AA decision.

4.3 Decommissioning within a long-term outlook

While the AEMC has stated that the proposed rule change does not consider decommissioning, it may become an unavoidable consideration when networks are expected to develop a 20-year outlook.[41] Developing such a long-term outlook may necessarily require consideration of decommissioning in expenditure forecasts, revenue building blocks and tariff design.

It also requires careful consideration of how decommissioning costs can be reasonably recovered from current and future customers, to avoid inequitable outcomes where future customers bear the costs associated with current customers exiting the network. This raises broader questions about whether mechanisms, such as setting aside decommissioning provisions as part of revenue building block or network exit charges, should be considered in the 20-year outlook to support fairer cost sharing between current and future customers.

[41] For example, it may depend on Government policies at the time and any updates to the rules between now and the scenarios being established.

5. Expenditure assessments

5.1 Capital expenditure

Jemena does not consider that the existing capital expenditure criteria materially constrain the AER's ability to make appropriate ex-ante capital expenditure allowance decisions or to undertake effective ex post review of conforming capital expenditure. However, we acknowledge the AEMC's intent to tighten and clarify the criteria, particularly where this reflects current regulatory practice, supports more consistent application and supports customer confidence in the framework.

5.1.1 Quantitative assessment of credible options

Jemena supports the requirement for a quantitative assessment of credible options where there is a need to assess trade-offs between multiple credible options. The rules, or the AEMC's final decision, should make clear that this does not imply there will always be multiple credible options. In some circumstances, including where a 'do nothing' option is not credible, a single option may reasonably meet the prudency and efficiency tests once constraints such as safety, regulatory obligations or asset condition are considered.

5.1.2 Linking capital expenditure to the relevant rule

We support explicitly linking each capital expenditure category or project to the relevant limb of rule 79(2) that it is justified under, noting that service providers often do this already.[42] This would improve transparency and regulatory clarity.

However, it should also be clear that incorrectly identifying the relevant limb (or different views on which is the correct limb) is not, of itself, grounds for capital expenditure to be treated as non-conforming where the expenditure otherwise meets the requirements of rule 79.

5.1.3 Capital expenditure for safety

Jemena supports the proposed amendment to rule 79(2)(c)(i) to replace "maintaining and improving the safety of services" with "necessary for the safe operation of pipelines and use of services".

Relevant safety standards impose safety risk levels by reference to what is 'reasonably practical'. This reflects that safety expectations[43] and the associated social licence are not static as technology and industry practices evolve. It is also capable of recognising that there is not always a clear line where safety switches from being met to not being met. What is 'reasonably practicable' is determined with regard to a range of circumstances and considerations, and the safety controls that are implemented by the service provider are based on their specific understanding of those circumstances, their knowledge and expertise.

We consider the revised wording appropriately recognises that safety-related capital expenditure must enable compliance with evolving industry standards and jurisdictional or legislative requirements. It also accommodates situations where replacement of ageing assets results in incidental safety improvements due to technological and design advances over time.

5.1.4 Changes to what demand service providers need the capacity to meet

For the purposes of setting ex-ante capital expenditure allowances as part of the AA, Jemena supports the proposed change to amend rule 79(2)(c)(iv) from "demand for services existing at the time" to "forecast levels of demand". This change better reflects how investment decisions are made in practice and is appropriate in an

[42] We note some service providers already provide this information – our support for clearer linkage is intended to reinforce and standardise good practice.

[43] Safety judgments are made within the context of jurisdictional safety and licensing frameworks.

environment of demand uncertainty. Importantly, it should be recognised that any forecast must include the demand for services existing at the time, as immediate demand needs will always need to be met.

However, greater clarity is required on how "forecast levels of demand" are intended to operate in an ex-post review context. In particular, it needs to be clear that the forecast reasonably relied upon by the service provider at the time the capital expenditure decision was made is the relevant forecast. This distinction is important because the regulator will consider the AA proposal demand forecast for assessing ex-ante capital expenditure allowances. But the same rule provision is currently relied upon in ex post reviews to determine the conforming capital expenditure for inclusion in the opening RAB, where there is less clarity on what an appropriate forecast is to use.

Service providers' internal demand forecasts will necessarily evolve over time and may be location-specific . The rules, or at least the AEMC's final decision, should make clear that ex post assessment is directed to whether the capital expenditure decision was prudent and efficient based on the forecast information reasonably available to the service provider at the time. This clarity is necessary to avoid the risk of hindsight bias being applied, intentionally or otherwise.

5.1.5 Retention of the NPV test as a means to justify capex

Jemena considers it critical that renewable gas and other decarbonisation-related capital investments are not excluded through an overly narrow application of the amended capital expenditure criteria. Where such investments are prudent, efficient and in the long-term interests of consumers, they should remain clearly permissible under the framework, consistent with the NGO.

Should the AEMC remove the net present value (**NPV**) test (rule 79(2)(b)), it should ensure that this is retained within transitional rules for the purposes of the AER's potential for ex-post review of network service providers conforming capex to be included within the opening capital base for the next AA period. This is to ensure any ex-post review applies the conforming capex criteria applicable at the time that those capex decisions were made.[44]

The capital expenditure criteria should be applied in a manner that supports, rather than inadvertently constrains, efficient transition-enabling investments. In particular, it should provide a pathway for renewables connections capital expenditure that provides overall economic benefit. This is what rule 79(2)(a) provides. While not explicit within rule 79(2)(a), by implication this will often mean assessments and business cases are undertaken using NPV analysis. When considering the removal of 79(2)(b), which the AEMC refers to as 'the NPV test', it should be clear that this does not also envisage removal of NPV tests validly being used within the economic assessment of 79(2)(a).

The use of the different criteria has caused some confusion in the past. The AER's final decision for JGN's 2025-30 AA indicated that JGN's proposed renewable gas connections would likely be justifiable under the economic test (rule 79(2)(a)).[45] However, JGN was not provided an allowance on the basis there was significant uncertainty surrounding whether the biomethane projects would take place (rule 79(1)(a))[46]. It its final decision, the AER noted that (our emphasis):[47]

> *We note that our final decision does not prevent JGN from undertaking the capex in the access arrangement period, and seeking to either have the capex included in the opening capital base for 2030 as part of the conforming capex element of the opening capital base calculation under rule 77(2)(b) of the NGR, or by using the speculative capex account (from which an amount can be added*

[44] Or in the case of connections capex, at the time the customer accepts an offer where this is prior to the 1 October 2026 implementation date of the updating the regulatory framework for gas connections rule change. AEMC, Rule determination, *Updating the regulatory framework for gas connections*, 11 December 2025.

[45] AER, *Final Decision, Jemena Gas Networks (NSW) access arrangement 2025-2030, Attachment 5 – Capital Expenditure*, May 2025, p 21.

[46] AER, *Final Decision, Jemena Gas Networks (NSW) access arrangement 2025-2030, Attachment 5 – Capital Expenditure*, May 2025, pp 21-22.

[47] AER, *Final Decision, Jemena Gas Networks (NSW) access arrangement 2025-2030, Attachment 5 – Capital Expenditure*, May 2025, pp 21-22.

to the opening capital base under rule 77(2)(c) of the NGR if the requirements in rule 84 of the NGR are met).

The AER is therefore suggesting that the NPV test clause the AEMC is considering removing would be the justification for these renewable gas connections when establishing JGN's next opening capital base. While the AER may have provided an incorrect reference and should instead refer to rule 77(2)(a) (indeed, Jemena would consider it would fall within the economic test of rule 77(2)(a)) the AEMC should ensure there would be no potential future uses of rule 77(2)(b) envisaged by the AER prior to its removal.

5.2 Operating expenditure

Jemena supports adopting more neutral language in the definition of operating expenditure, provided it is clear that this does not preclude prudent and efficient operating expenditure that either supports demand growth or mitigates demand reductions. In particular, the definition should not be interpreted as ruling out operating expenditure that facilitates emissions-reduction outcomes (for example, supporting gas-powered generation or customers transitioning from coal to gas supplied by renewable gases), or expenditure consistent with retaining customers under a hybrid or price cap framework where this promotes efficient cost sharing and more orderly transition outcomes.

6. Other

6.1 Incentives

Jemena does not consider there is any need to change or introduce new incentive schemes as part of this rule change.

6.2 Barriers to implement, costs or transitional arrangements required

Depending on the level of granularity required within the rules, the 20-year outlook may require extensive additional resources, planning and modelling.[48] This may be of sufficient materiality to require a corresponding cost pass through. We may also expect the regulator may need additional resources, depending on the final design of the rules.

As noted in section 5.1.5, removal of the NPV test from the conforming capital criteria requires appropriate transition.

6.3 Application to transmission and distribution

Jemena notes the AEMC's proposed direction is intended to apply to both distribution and transmission pipelines, notwithstanding that the direction is aimed at addressing issues raised in relation to distribution. While we acknowledge that the approach to the economic regulation of scheme distribution and transmission pipelines is broadly consistent under the current NGR, we note that there are differences between the commercial frameworks used for access to distribution and transmission pipelines, with the 'contract carriage' model used on many transmission pipelines tending to result in a greater degree of bilateral negotiation between service providers and users than on distribution networks where the 'market carriage' model is used. We also note there may be different market circumstances facing these types of assets, with some transmission pipelines potentially having more diverse types of demand (including for very large industrial users, gas powered generation and gas exports) but also facing greater supply risks (due to their point-to-point nature) than distribution pipelines.

At a conceptual level, we support the AEMC's approach of maintaining consistency in the NGR between the economic regulatory arrangements for scheme distribution and transmission pipelines except in cases where there are reasons not to. Jemena will further consider whether such circumstances may exist and expects to provide feedback on this matter in response to the draft rule once further detail on the AEMC's proposed direction is provided. For example, further to our comments in section 2.2.2 in relation to the influence of factors beyond a service provider's control on the 'switching point' approach, we note that this issue would be magnified for gas transmission pipelines, where costs make up an even smaller proportion of the delivered price of gas for many users. Depending on the approach adopted by the AEMC in the draft rule, there may be need to further consider the appropriateness of such arrangements for transmission pipelines.

[48] More detailed long-term analysis and scenario-based disclosures are likely to require enhanced internal governance and legal review processes, including to ensure compliance with obligations under the Australian Consumer Law and to mitigate risks associated with forward-looking statements.

Appendix A
Cross reference of Jemena responses to AEMC questions

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A1. Cross reference of responses to questions

Table A1–1:Submission cross-reference to AEMC consultation questions

AEMC consultation questions	Submission section(s)	Page ref
Question 1: Our proposed package of reforms 1. What are stakeholder views on our assessment of the proposed direction and how it better promotes the NGO and is consistent with the RPP, in comparison to the status quo and the ECA and JEC rule change proposals?	1 - Overview (and throughout submission)	1-21
Question 2: Implementation considerations 1. Do stakeholders consider that there are any barriers to implementing our proposed package of reforms considering the planned publication of the final determination in December 2026? Do you consider some form of transitional arrangements are required for any element? 2. Do stakeholders consider there are any significant implementation costs associated with our proposed package of reforms that the Commission should consider?	4.2 - Limit administrative burden and implementation costs 5.1.5 - Retention of the NPV test as a means to justify capex 6.2 - Barriers to implement, costs or transitional arrangements required	17, 19, 21
Question 3: Application to transmission and distribution 1. What are your views on our proposed direction that reforms should apply to distribution and transmission pipelines (where relevant)?	6.3 - Application to transmission and distribution	21
Question 4: Our proposed direction on a longer-term outlook (detailed in appendix A) 1. What are your views on our proposed direction to require service providers and the regulator to consider a longer-term outlook and longer-term consequences? 2. Do you have any views on the information or analysis that should be included in a service provider's 20-year outlook?	4 - Long-term outlook	16-17
Question 5: Our proposed direction on capital cost recovery (detailed in appendix B) 1. What are your views on our proposed direction for capital cost recovery tools in the NGR? 2. Do you have any views on the decision-making model options explored for: a. depreciation and treatment of inflation? b. redundant capital provisions? 3. In relation to our proposed direction for redundant capital, do you have any views on: a. the materiality threshold that should apply to partial redundancy? b. the constraints that could apply to the regulator's use of partial redundancy?	2 - Capital cost recovery	3-12
Question 6: Our proposed direction on expenditure (detailed in appendix C) 1. What are your views on our proposed direction to amend the NGR capex provisions? For example: a. Clarifying that service providers must justify all capex through a quantitative assessment of all credible options that support the provision of regulated pipeline services.	5 - Expenditure assessments	18-20

b. Amending the justification for safety-related capex to be necessary for the safe operation of pipelines and use of services in NGR rule 79(2)(c)(i). c. Amending the justification for capex to maintain capacity to meet forecast (instead of existing) demand for services under NGR 79(2)(c)(iv). 2. What are your views on the need for the NPV test in rule 79(2)(b)? 3. What are your views on our proposed direction to amend the NGR opex definition?		
Question 7: Our proposed direction on tariff arrangements (detailed in appendix D) 1. What are your views on our proposed direction for amending the reference tariff arrangements? 2. What are your views on our proposal to provide guidance on applying the concepts of long run marginal cost, standalone and avoidable costs? 3. What are your views on our proposal to require service provider and the regulator to give greater consideration to customer impacts in setting tariffs and tariff variation mechanisms?	3 - Reference tariffs	13-14
Question 8: Incentive mechanisms (detailed in appendix F) 1. Having regard to our proposed direction, do you consider there is a need for additional or modified incentive mechanisms for service providers?	6.1 - Incentives	21