

Mr Allan Hudson

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Australian Energy Market Commission  
Level 15  
60 Castlereagh Street  
Sydney NSW 2000

**Submission to Australian Energy Market Commission (AEMC):  
Directions Paper Gas Networks in Transition 19 March 2026**

Please find attached a submission containing responses to the AEMC's questions in its Directions Paper Gas Networks in Transition 19 March 2026. Also attached is a simple excel model showing outcomes under a post tax revenue model framework (indexed) and a nominal historical cost framework. This model was used to conceptually view the outcomes under the two frameworks.

The AEMC's asset stranding risk initiative is a welcome development in gas network regulation. The Directions Paper contains worthwhile amendments to the National Gas Rules (NGR). However, the submission contains two areas of disagreement with the AEMC's proposals.

**Areas of disagreement**

Firstly, use of an indexed model like the post tax revenue model (PTRM) should not be continued until a decision point is reached but rather transition should be mandatory at the next access arrangement review to avoid further exacerbating stranded asset risk by capitalising the inflation part of returns in the regulated asset base (RAB).

Secondly, there is a mismatch between the assignment of asset stranding risk to service providers and the level of control allowed to service providers to mitigate the risk under the AEMC's recommended options. There is also no consideration given to the fact that the RAB includes deferred service provider returns which have been capitalised. If these amounts are not returned to service providers, they will be short paid for past services provided and consumers will have received services for which they have not paid the full cost. Additionally inadequate consideration has been given to the breach of the revenue and pricing principles contained in the National Gas Law implied by assigning the cost of asset stranding to service providers. It must be borne in mind that service providers have invested believing they had a reasonable opportunity to recover their costs.

**About the author**

I was employed by a gas distribution company for 17 years until approximately 9 months ago. That employment was focussed on calculation of tariffs and led to a detailed understanding of the relevant National Gas Rules and Laws as well as the different methods of calculating tariffs. I also have a masters in economics from the London School of Economics and have studied finance theory

at the University of Chicago. This experience and study have informed the submission I make as a consumer.

Thank you for the opportunity to contribute to this National Gas Rule change process.

Yours faithfully

A handwritten signature in black ink, appearing to read 'AH' or 'Allan Hudson', written in a cursive style.

Allan Hudson

## **Response to Australian Energy Market Commission (AEMC): Directions Paper Gas Networks in Transition 19 March 2026**

### **Question 1: AEMC proposed package of reforms**

The AEMC approach is preferable to the status quo and the ECA and JEC rule change proposals primarily because:

- The current regulatory framework implemented by Regulators using the post tax revenue model (PTRM) tariff calculation method exacerbates asset stranding risk by deferring recovery of the inflation portion of financing costs which are capitalised in the asset base. Therefore, the proposal to allow a nominal (unindexed) approach is preferable. The AEMC approach could be improved by a firm commitment to move to a nominal historical cost based tariff calculation method rather than creating a “decision point”.
- Any proposal to obviate recovery by service providers of capitalised costs in an arbitrary way as suggested by JEC is a breach of the Revenue and Pricing Principles (RPP).<sup>1</sup> Therefore the AEMC approach to allow service providers to manage asset stranding risk, subject to regulatory oversight, is preferable to the ECA and JEC approach even though residual asset stranding risk is still assigned to service providers. However, as stated in response to question 5.2b the preferred approach is for service providers not be assigned asset stranding risk.

### **Question 2: Implementation considerations**

There will need to be rules or guidelines about:

- What happens to the asset base at the time of transition from a PTRM framework to a nominal historical cost based framework.
- Creating a new tariff class for new connections where the cost of connection has been covered by capital contributions to ensure an equitable distribution of Total Revenue.

### **Question 3: Application to transmission and distribution**

No response.

### **Question 4: AEMC proposed direction on a longer-term outlook**

No response.

### **Question 5: AEMC proposed direction on capital cost recovery**

#### **Question 5.1:**

No response

#### **Question 5.2 a: Depreciation and treatment of inflation – Agree subject to amendment**

**Bring forward depreciation -Agree:** There should be provision to bring forward depreciation to manage the path of future prices consistent with maximising the economic utility of the network. However, it should be up to the service provider not the regulator or other parties to determine the path of depreciation. Who bears the risk should have unfettered control to manage the risk. To do otherwise is inequitable.

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<sup>1</sup> National Gas Law, Version: 10.4.25, Section 24(2)

Given the AER has in recent decisions limited the bringing forward of capital recovery by using a “price path constraint”,<sup>2</sup> there is concern about the degree of discretion regulators have relative to service providers with regard to managing asset stranding risk.

Should the outcome be that regulation is determined by the AEMC to be required then AEMC option C(i) is the best option because it is least likely to harm plans to mitigate risk by the party best able to manage the risk.

Refer also to the Question 5.2b response.

**Cease deferral of compensation for inflation – Agree but needs to happen at the next access arrangement review; not be a decision point.**

Use of the PTRM, which defers compensation for inflation, should be transitioned out at the next access arrangement review and replaced by a nominal historical cost based model. The PTRM:

- Increases asset stranding risk by capitalising the inflation portion of funding costs. *Why make the situation worse?*
- Makes future customers pay for services provided to past customers; particularly inequitable where there is a declining customer base.
- Is more complex and difficult to understand than a nominal historical cost based tariff setting method.
- In absolute dollars results in higher costs to consumers than a nominal historical cost based method.

Therefore, a change to a nominal (unindexed) framework should be made as soon as practical – not left to a future decision point.

The AEMC in its Directions Paper states:

*“All else being equal, this approach [nominal(unindexed)] results in comparatively higher revenues in early years and lower revenues in later years, which can lead to greater price volatility and consumers being exposed to more inflation risk.”<sup>3</sup>*

These stated risks relating to using a nominal (unindexed) approach are unfounded and should not be used to delay implementation of a nominal (unindexed) framework. It is correct that a nominal approach results in higher revenues in earlier years and lower revenues in later years. However, to say this can lead to greater price volatility is not correct. The path of prices over time may be different to using an indexed approach but not necessarily more volatile from year to year. In fact, recent experience shows how prices are made volatile from one access arrangement (AA) period to the next due to the indexation of the asset base. This effect can lead to, and has done in the past, to a “saw tooth” effect on prices rising in one period and then falling in the next or vice versa. Consumers are still exposed to inflation variations under an indexed framework due to annual tariff variations to take account of inflation.

**Question 5.2 b: Redundant capital provisions – Disagree**

**RPP breached**

Service providers bearing the cost of asset stranding is a breach of the revenue and pricing principles (RPP) which require:

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<sup>2</sup> Australian Energy Market Commission, Directions Paper Gas Networks in Transition 19 March 2026, page 12

<sup>3</sup> Australian Energy Market Commission, Directions Paper Gas Networks in Transition 19 March 2026, page 51

*"A scheme pipeline service provider should be provided with a reasonable opportunity to recover at least the efficient costs the service provider incurs..."<sup>4</sup>*

Service providers have invested based on the RPP. Literally changing the rules now is inequitable.

#### **Costs for past services transferred to service providers**

Insufficient attention has been given to the effect of the PTRM framework which:

- Defers recovery by service providers of the inflation portion of funding costs to future periods by including it in the RAB.
- Has allowed consumers to receive services at less than full cost deferring the cost so that it is borne by future customers.

The capitalising of the past inflation portion of funding costs that has occurred under the PTRM framework means shifting asset stranding cost to service providers results in:

- Consumers never paying the full cost of past services provided.
- Services providers do not recover the full cost of past services provided

These results are inequitable. It would assist the discussion for service providers to quantify how much of their RAB is capitalised inflation. The amount is significant and made worse by recent high inflation.

#### **Mismatch between who bears risk and who controls risk**

The AEMC states:

*"In our view, the capital redundancy provisions should continue to allow service providers to be exposed to the risks of competition from alternative fuels, changing consumer preferences, market and technological change and the risk that they do not recover all of their efficient costs as a result."<sup>5</sup>*

It appears from the Discussion Paper this view apart from being based on trying to replicate a competitive market is also based on a recent ACCC decision which stated service providers and regulators were expected to:

- use accelerated depreciation once the risk of potential stranding (physical or economic) is identified, to try and mitigate the risk of stranding
- only use redundant capital provisions if the risk of stranding cannot be averted.<sup>6</sup>

Additionally, the AEMC indicates its belief service providers are best placed to manage asset stranding risk.<sup>7</sup>

Taking these principles together any rule change must place decisions regarding the use of accelerated depreciation or other means to manage asset stranding risk solely in the hands of the service provider. To do otherwise invalidates any proposition that the service provider should bear asset stranding risk.

The AEMC's options for regulation of asset stranding risk mitigation tools (Option C(i) or C(ii)) and also full control over capital redundancy provision activation (Option D) are logically inconsistent

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<sup>4</sup> National Gas Law, Version: 10.4.25, Section 24(2)

<sup>5</sup> Australian Energy Market Commission, Directions Paper Gas Networks in Transition 19 March 2026, page 55

<sup>6</sup> Ibid., page 54

<sup>7</sup> Ibid., page 25

with the AEMC's basis for arguing the service provider should bear any asset stranding risk. The party taking the risk must have the unfettered ability to manage the risk; AEMC Option B.<sup>8</sup>

However, should the outcome be that regulation is determined by the AEMC to be required then AEMC option C(i) is the best option because it is least likely to harm plans to mitigate risk by the party best able to manage the risk.

**Question 5.3:**

No response

**Question 6: AEMC proposed direction on expenditure**

**Question 6.1 a: Quantitative assessment of all credible capex options**

No response

**Question 6.1 b: Amending justification for safety related capex.**

No response

**Question 6.1 c: Amending justification for capex to meet existing demand. - Disagree**

NGR 79(2)(c)(iv) should not be restricted to forecast demand. It is not necessary to include either term "forecast demand" or "existing demand". Regardless of whether expenditure is necessary for existing or forecast demand it is necessary to provide services to end users. Therefore, simply amend the term to "demand".

**Question 6.2: NPV test in rule 79(2)(b).**

No response

**Question 6.3: Amend the NGR opex definition**

No response

**Question 7: AEMC propose direction on tariff arrangements**

No response

**Question 8: Incentive mechanisms**

No response

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<sup>8</sup> *Ibid.*, page 72