Australian Energy Market Commission

AEMC
Australian Energy Market Commission

RULE

Draft rule determination

National Gas Amendment (Gas networks in transition) Rule

Proponents

Energy Consumers Australia
The Justice and Equity Centre

27 August 2026

Enquiries

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Reference: GRC0082

About the AEMC

The AEMC reports to the energy ministers. We have two functions. We make and amend the national electricity, gas and energy retail rules and conduct independent reviews for the energy ministers.

Acknowledgement of Country

The AEMC acknowledges and shows respect for the Traditional Custodians of the many different lands across Australia on which we live and work. The AEMC office is located on the land of the Gadigal people of the Eora nation. We pay respect to all Elders past and present, and to the enduring connection of Aboriginal and Torres Strait Islander peoples to Country.

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Summary

1 Australia's energy transition is changing the outlook for gas networks. While natural gas will continue to play an important role for many households, businesses and industrial users for years to come, future demand for gas is becoming increasingly uncertain and, in parts of Australia, is expected to decline over time.

2 This changing outlook creates significant uncertainty for governments, the regulator, gas transmission and distribution pipeline service providers (service providers) and consumers as Australia progresses its net-zero objectives. The central challenge is ensuring that the long-term interests of consumers continue to be promoted when changing consumer preferences and varying jurisdictional policies are contributing to uncertainty about future gas demand and pipeline utilisation.

3 The gas economic regulatory framework in the National Gas Rules (NGR) has an important role to play in supporting an orderly energy transition and achieving a consumer-focused net-zero energy system. The framework has operated effectively to support efficient investment in, operation and use of pipelines to provide safe and reliable gas services at stable prices. However, changing expectations about the future role of gas pipelines mean some aspects of the framework may no longer consistently promote the long-term interests of gas consumers.

4 The Commission's draft determination forms part of the broader response designed to support an orderly energy transition. It proposes a package of reforms to ensure that the NGR remains fit for the future and continues to promote the long-term interests of consumers in a changing energy system.

5 We are seeking feedback on our draft determination and rule by **8 October 2026**.

Uncertain and declining demand creates shared risks

6 The energy transition is creating shared risks between consumers and service providers.

7 As gas demand and customer numbers decline, the costs of providing pipeline services would need to be recovered from fewer consumers. This would place upward pressure on prices for consumers that remain connected to gas pipelines. At the same time, service providers face increasing uncertainty about future pipeline utilisation and the recovery of efficient costs from long-lived pipeline assets. As demand falls, the risk increases that some assets may become stranded, with service providers unable to recover their efficient costs.

8 Left unmanaged, these shared risks could contribute to a disorderly transition, where consumers are exposed to inefficiently high and escalating prices. For service providers, uncertainty of cost recovery and an inability to respond appropriately to changing demand conditions may be a disincentive to continue investing in the services consumers need, meaning services may become less reliable or cease prematurely. This would not be in gas consumers' long-term interests and could undermine confidence in the regulatory framework's ability to manage consumers' long-term interests.

9 It is important to address these challenges now. Delaying action increases the likelihood that transition risks become larger, more difficult to manage, and more costly for gas consumers over time.

The regulatory framework must evolve to remain fit for the future

10 The Commission does not consider that these challenges require a fundamental redesign of gas pipeline economic regulation.

11 But they highlight the need for change to ensure that the existing framework remains fit for the future under a broader range of future circumstances.

12 In particular, the Commission has identified two key issues:

- The existing framework does not provide for sufficient transparency, consistency and accountability regarding how transition risks over the long-term are identified, assessed and managed.
- Regulatory provisions relating to capital cost recovery, reference tariffs, and expenditure were developed in a context of demand stability or growth. Existing provisions may not always support efficient outcomes when demand is uncertain or declining.

13 The Commission therefore considers that the framework must evolve to support more forward looking and consumer-centric regulatory decision-making, while preserving the core economic principles that have historically underpinned efficient outcomes.

The Commission's reform package represents a balanced approach to address the challenges of the energy transition

14 The draft rule introduces an integrated package of reforms designed to support an orderly energy transition and to continue promoting the long-term interests of consumers.

15 The package is built around a new long-term outlook framework requiring service providers and the regulator to explicitly identify, assess and explain the long-term consequences of their proposals and decisions. The Commission considers that greater transparency regarding future risks, assumptions and trade-offs, and how they have been considered and incorporated into an access arrangement (AA), is critical in circumstances where current decisions may have significant long-term consequences for consumers.

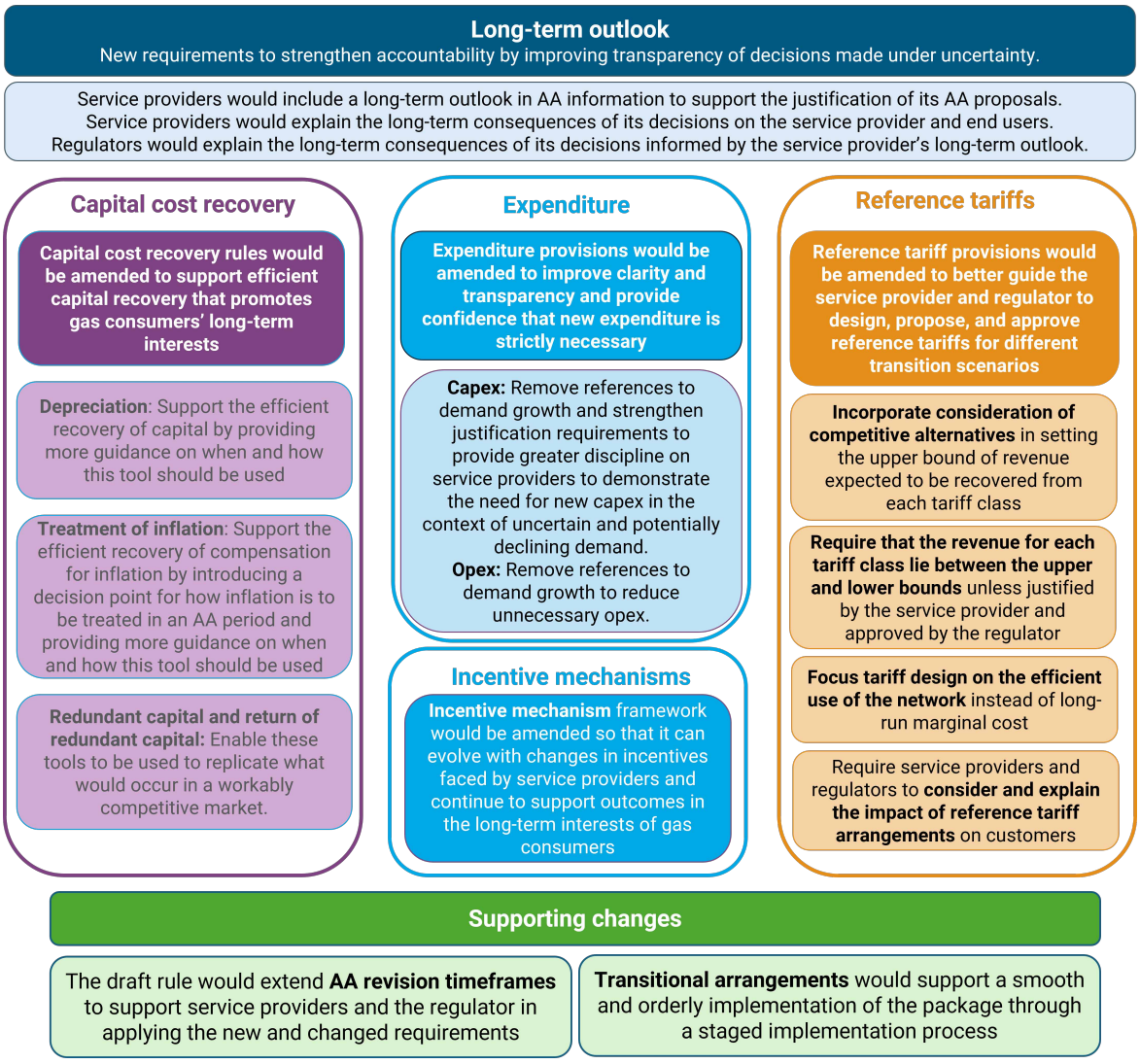
16 The draft rule also clarifies the operation of capital cost recovery tools, updates reference tariff arrangements, strengthens expenditure assessment requirements, expands the flexibility of the incentive mechanism framework and introduces supporting changes to access arrangement processes.

17 Transitional arrangements provide a smooth and orderly implementation of the package through a staged implementation process, preserving regulatory certainty and avoiding unnecessary costs for service providers, the regulator and consumers.

18 The reforms are intended to work together. Improved transparency alone would not address limitations within capital cost recovery, tariff or expenditure provisions in the context of a transitioning energy system. Equally, amendments to individual regulatory tools would not, by themselves, ensure that long-term risks are consistently identified and managed. The draft rule therefore represents a coordinated package of reforms, ensuring that the right decisions can be made at the right time over the course of the transition.

19 The reforms proposed in this draft determination sit alongside the recent gas connections and customer abolishment rule changes that were proposed by ECA and JEC, respectively, which also support efficient consumer outcomes as the energy transition progresses. Together, these reforms achieve the NGO by applying principles of economic efficiency to decisions made by service providers and the regulator and that impact consumers.

Figure 1: The Commission's reform package represents a balanced approach to address the challenges of the energy transition



The draft rule would support efficient outcomes for consumers through the transition and promotes the NGO

20 The Commission considers that its more preferable draft rule would better promote the NGO than both the current arrangements and the ECA and JEC rule change proposals. The proponents identified important risks associated with declining demand, rising tariffs and stranding. The Commission agrees that these risks require action. However, rather than focusing primarily on individual regulatory tools, the draft rule adopts a broader and more integrated approach aimed at improving how these risks are identified, assessed and managed across the regulatory framework and over time.

21 A key objective of the reforms is to support efficient outcomes for consumers regardless of how they engage in the energy transition.

22 The Commission recognises that consumers will experience the transition in different ways. While

demand and gas connections are projected to fall on a number of gas distribution networks over the next 20 plus years, a relatively large number of residential, small commercial and industrial customers are still expected to remain connected and use gas for some time. This includes those customers that:

- choose to continue using gas for certain purposes and are not currently considering switching to alternative energy sources
- are considering switching to alternative energy sources, but want to align this with the end of the life of their appliances which for some may be many years into the future (e.g., up to 15 years)
- face financial, technical and other barriers to switching to alternative energy sources, such as low-income customers, vulnerable customers, renters and hard-to-abate residential, commercial and industrial customers.

23 The draft rule would strengthen transparency and accountability by requiring service providers and the regulator to identify and consider long-term consequences for consumers and service providers and explain how those risks have informed their proposals and decisions and the implications for consumers over time. Importantly, the reforms are intended to bring emerging transition risks to light earlier, while a broader range of regulatory options remains available to manage these risks efficiently. This would support more informed decision-making by service providers, the regulator, consumers and governments before risks to consumers and service providers become larger, more costly and more difficult to address.

24 The package would also improve the operation of the capital cost recovery, reference tariff and expenditure frameworks to support more efficient outcomes for all consumers in the context of an uncertain demand outlook. Together, these reforms would strengthen the quality of decision-making, better reflect the increasing influence of competition from alternative energy sources, and minimise the risks associated with inefficient expenditure, inefficient and escalating reference tariffs and unrecovered capital.

25 The Commission has taken the Revenue and Pricing Principles (RPPs) into account when developing the draft rule. The Commission considers that the package, as a whole, strikes an appropriate balance between protecting consumers from inefficiently high and escalating reference tariffs over time, and preserving service providers' reasonable opportunity to recover at least their efficient costs while remaining exposed to the commercial risks associated with changing demand conditions, as they would in a competitive market. In doing so, the package supports efficient decision-making and provides incentives for service providers to continue providing safe and reliable services for as long as consumers require them.

26 The Commission recognises that the draft rule cannot, on its own, fully address all the risks associated with uncertain and declining gas demand - for consumers and service providers alike. While the reforms are intended to improve transparency, support more efficient decision-making and reduce the likelihood that transition risks become more acute and costly over time, the economic regulatory framework should not determine the future role of gas networks and cannot address all transition challenges facing consumers.

27 Governments will continue to play an important role in supporting consumers through the transition, including through broader decisions regarding energy policy, consumer assistance, decommissioning arrangements, and support for consumers facing barriers to switching to alternative energy sources. By identifying emerging risks earlier and providing greater visibility of their implications, the draft rule would help governments, the regulator and stakeholders respond to these challenges in a more coordinated and orderly way.

28 The Commission's draft rule would support a more orderly transition by improving transparency, accountability and economic efficiency. Collectively, the reforms would reduce the risk that consumers face inefficiently high and escalating prices or experience a sudden and avoidable reduction in the availability of safe and reliable gas services. While governments will need to play a key role in supporting consumers through the transition, the Commission considers that this draft rule package lays the foundation for managing these risks in a way that best promotes the long-term interests of consumers.

Next steps

29 The Commission seeks stakeholder feedback on our draft determination and draft rule amendments by **8 October 2026**. We are particularly interested in whether our draft rule amendments achieve our policy intent.

How to make a submission

We encourage you to make a submission

Stakeholders can help shape the solution by participating in the rule change process. Engaging with stakeholders helps us understand the potential impacts of our decisions and contributes to well-informed, high quality rule changes.

How to make a written submission

Due date: Written submissions responding to this draft determination and rule must be lodged with Commission by 8 October 2026.

How to make a submission: Go to the Commission's website, www.aemc.gov.au, find the "lodge a submission" function under the "Contact Us" tab, and select the project reference code GRC0082.[1]

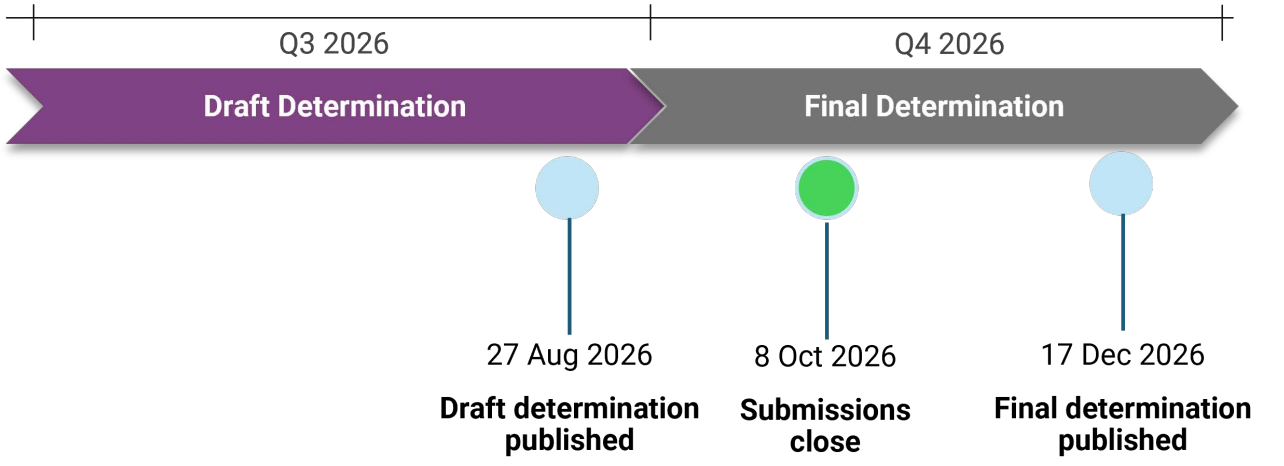
Tips for making submissions on rule change requests are available on our website.[2]

Publication: The Commission publishes submissions on its website. However, we will not publish parts of a submission that we agree are confidential, or that we consider inappropriate (for example offensive, defamatory, vexatious or irrelevant content, or content that is likely to infringe intellectual property rights).[3]

Next steps and opportunities for engagement

There are other opportunities for you to engage with us, such as one-on-one discussions or industry briefing sessions.

Figure 1: *Gas networks in transition* timeline



You can also request the Commission to hold a public hearing in relation to this draft rule determination.[4]

Due date: Requests for a hearing must be lodged with the Commission by 3 September 2026.

How to request a hearing: Go to the Commission's website, www.aemc.gov.au, find the "lodge a submission" function under the "Contact Us" tab, and select the project reference code GRC0082. Specify in

1 If you are not able to lodge a submission online, please contact us and we will provide instructions for alternative methods to lodge the submission

2 See: https://www.aemc.gov.au/our-work/changing-energy-rules-unique-process/making-rule-change-request/our-work-3

3 Further information about publication of submissions and our privacy policy can be found here: https://www.aemc.gov.au/contact-us/lodge-submission

4 Section 310(2) of the NGL.

the comment field that you are requesting a hearing rather than making a submission.[5]

For more information, you can contact us

Please contact us with questions or feedback at any stage, noting the project code.

Email: aemc@aemc.gov.au
Telephone: (02) 8296 7800

5 If you are not able to lodge a request online, please contact us and we will provide instructions for alternative methods to lodge the request.

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1.1 Introduction

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The gas pipeline economic regulatory framework in the National Gas Rules (NGR, or the rules) was developed in a context where demand was generally expected to remain stable or grow over time. This regulatory framework has served consumers well by supporting efficient investment in scheme pipelines, the provision of safe and reliable pipeline services, and relatively stable reference tariffs. However, changing market conditions are testing whether the existing framework remains fit for the future in an environment characterised by uncertainty, declining utilisation and differing jurisdictional pathways for the future of gas.

The Commission commenced this rule change process in response to four rule change requests from Energy Consumers Australia (ECA) and the Justice and Equity Centre (JEC) regarding the current regulatory framework's ability to continue promoting the long-term interests of consumers through the energy transition. The Commission has considered the concerns raised in the rule change requests from ECA and JEC, as well as those of a broad range of stakeholders, through our consultation processes to date. This has informed our analysis of the challenges facing gas consumers.

The Commission has made a draft determination to amend the gas pipeline economic regulatory framework. Our more preferable draft rule would provide a balanced approach to managing transition risks and promote the long-term interests of gas consumers under the National Gas Objective (NGO). We have also considered the Revenue and Pricing Principles (RPPs) in making this draft determination.

- **Chapter 1 – Introduction**. This chapter outlines the challenges arising from the energy transition and how the draft rule would operate as an integrated package to provide a balanced approach to managing transition risk, promote the NGO and take into account the RPPs.
- **Chapter 2 – Long-term outlook**. This chapter describes how our draft rule would require service providers and the regulator to employ a long-term outlook in access arrangement (AA) processes.
- **Chapter 3 – Capital cost recovery**. This chapter describes how our draft rule would support efficient capital cost recovery in the long-term interests of consumers.
- **Chapter 4 – Expenditure assessment**. This chapter describes how our draft rule would strengthen transparency and accountability for efficient expenditure decisions.
- **Chapter 5 – Incentive mechanisms**. This chapter describes how our draft rule would support a broader range of incentive mechanisms.
- **Chapter 6 – Reference tariffs**. This chapter describes how our draft rule would guide the design of efficient tariff arrangements for different transition scenarios.
- **Chapter 7 – AA timeframes**. This chapter describes how our draft rule would extend AA timeframes.

- **Chapter 8 - Transitional arrangements**. This chapter describes the transitional provisions to support a smooth and orderly implementation of reforms.

1.1.1 The *Gas networks in transition* rule change process to date

The Commission initiated the *Gas networks in transition* rule change process in response to four rule change requests submitted by ECA (on 14 February 2025) and JEC (on 4 June 2025). The rule change requests propose changes to the following provisions of the economic regulatory framework for gas pipelines.

- **Depreciation**. ECA propose stronger conditions on when service providers and the regulator can accelerate the recovery of capital costs through changes to the depreciation criteria.
- **Capital and operating expenditure**. ECA propose changes to the capital expenditure (capex) provisions and operating expenditure (opex) definition to ensure that only efficient expenditure is incurred and paid for by gas consumers in the context of uncertain and/or declining demand.
- **Planning requirements**. ECA propose new planning reporting obligations on all service providers (that own and operates scheme and non-scheme gas pipelines) to provide the regulator, governments, electricity networks, and other stakeholders with information required to understand the opportunities to minimise expenditure and energy system costs.
- **Accelerated depreciation and redundancy**. JEC propose changes to the depreciation and redundant asset provisions. Their proposed changes would prohibit the use of accelerated depreciation to manage stranding risks unless in combination with the use of the capital redundancy provisions. JEC further propose to cap the customer contribution to 50 per cent, in the case of a cost sharing arrangement.

On 18 September 2025, the Commission published a consultation paper jointly consulting and seeking stakeholder feedback on the issues raised by the rule change proponents. We also sought stakeholder feedback on whether there was a need to consider several interrelated aspects of the gas pipeline economic regulatory framework. We received 26 responses to our consultation paper, with some stakeholder submissions also identifying a range of additional issues.[6]

On 18 December 2025, the Commission consolidated the four rule change requests.[7] We decided that the breadth and interrelated nature of the issues covered in the consultation paper and raised by stakeholders required a holistic approach when considering changes to the NGR.

On 19 March 2026, the Commission published a directions paper setting out the Commission's proposed policy direction for strengthening the gas pipeline economic regulatory framework. We received 22 responses to the directions paper.[8]

The Commission has continued to engage with stakeholders throughout our process. We held roundtable discussions with stakeholder groups in January and July 2026, including with consumer and user groups, pipeline service providers and industry groups, retailers and jurisdictions. We have also held bilateral discussions with the Australian Energy Regulator (AER) and the Western Australian Economic Regulation Authority (ERA).[9]

We have also continued to engage with stakeholders bilaterally throughout our process.

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6 AEMC, *Gas networks in transition*, Consultation paper

7 The Commission published a statutory notice under section 300(1)(a) and under section 317 on 18 December 2025 consolidating the rule change requests and extending the time to make a draft determination to 27 August 2026 and extending the time to make a final determination to 17 December 2026.

8 AEMC, *Gas networks in transition*, Directions paper

9 Schedules 3 and 4 of the draft rule, which would amend the NGR as in force in Western Australia (WA NGR), refer to the AER in various provisions. However, as noted in Appendix C.5, these references to the AER would be read as references to the ERA.

Stakeholder engagement and feedback throughout this rule change process has helped inform our draft determination. The Commission thanks stakeholders for taking the time to provide their views and relevant evidence through their submissions, and for participating in our processes to date.

1.1.2 Related work and reform

The Commission's draft rule sits alongside the Commission's recent gas connections and customer abolishment rule changes. These reforms, together with the reforms contemplated by the Commission's draft rule, would comprise a joint package of reforms to the NGR so that it remains fit-for-purpose to manage the challenges of the energy transition. Together, the changes to the NGR would help to ensure that investment, utilisation and network transition decisions are made in the long-term interests of consumers.

- The Commission made a final determination and final rule for *Updating the regulatory framework for gas connections* in response to a rule change request submitted by ECA.[10] The final rule requires gas distribution service providers to charge newly connecting retail gas customers cost-reflective connection charges up front, limiting the growth of distributors' capital bases. The final rule will commence on 1 October 2026 and applies to scheme and nominated non-scheme pipelines in jurisdictions subject to the National Energy Customer Framework for gas.[11]
- The Commission made a final determination and final rule for *Establishing a regulatory framework for retail customer initiated gas abolishment* in response to a rule change request submitted by JEC.[12] The final rule requires retail gas customers that request an abolishment of their gas connection to pay the prudent and efficient cost reflective charge of their abolishment, limiting the costs to be recovered from other network users. The final rule does not apply to safety or other regulatory mandated abolishments, which can be undertaken by the distributor with costs recovered from all gas customers.

The Commission is also continuing to engage with jurisdictions on the approach for establishing a decommissioning framework. In the directions paper, we set out our reasoning for why this work is out of scope of this rule change process.[13] However, we note the importance of ensuring that regulatory frameworks (nationally and at the jurisdictional level) support decommissioning where this is efficient.

Finally, the Commission has recently made a final determination and final rule for *Enhancing distribution network planning and reporting* in response to a rule change request from ECA.[14] The final rule requires electricity distribution network service providers (DNSPs) to prepare distribution network development plans with a 20-year horizon using inputs and assumptions that we expect will have been the subject of consultation with relevant stakeholders. This would include service providers where appropriate. This reform complements the *Gas networks in transition* draft rule and would support more coordinated planning across gas and electricity networks and provide governments, the regulator, consumers and market participants with greater visibility of the implications of electrification and declining gas demand over time, where this is a relevant future scenario.

10 AEMC, Updating the regulatory framework for gas connections, Rule determination, 11 December 2025.

11 These jurisdictions are the ACT, NSW, South Australia, and Queensland. The Commission's final rule is consistent with the approach adopted by the Victorian Essential Services Commission following their review of the Victorian Gas Distribution Code of Practice.

12 AEMC, Establishing a regulatory framework for retail customer initiaed gas abolishment, Rule determination, 2 April 2026

13 AEMC, Gas networks in transition – Directions paper, 19 March 2026, p. 20.

14 AEMC, Enhancing Distribution Network Planning and Reporting, Rule determination, 16 July 2026.

1.2 An uncertain future presents challenges to an orderly energy transition

1.2.1 The energy transition is changing the outlook for gas and creating uncertainty

The natural gas demand outlook is changing as the transition to net-zero progresses and the energy system transforms. The changing outlook is creating uncertainty about the future demand for gas, particularly in the residential and small commercial customer segment.

The Australian Energy Market Operator's (AEMO)'s latest Gas Statement of Opportunities (GSOO) provides some insight into the projected outlook for gas demand for residential and small commercial customers over the next 10-20 years. AEMO's forecasts reflect broad expectations for a long-term decline in residential and small commercial customer gas use:

- The East Coast GSOO projects distribution connected residential and small commercial demand will fall by around 75 per cent over the next 20 years.[15]
- The West Coast GSOO projects that distribution connected demand fill will fall by around 55 per cent over the next 20 years.[16]

While AEMO's projections indicate a declining trend in gas use over time, it is important to note that the pace and breadth of decline remains uncertain[17] and that there are many consumers who are expected to continue to rely on gas to meet some or all of their energy needs throughout the energy transition over at least the next 20 plus years.

1.2.2 The uncertain outlook creates shared risks between consumers and service providers

The energy transition is creating shared risks between consumers and service providers.

As demand and customer numbers decline, the costs of providing network services would need to be recovered from fewer consumers. This would place upward pressure on prices for consumers that remain connected to gas networks.[18] At the same time, service providers face increasing uncertainty about future network utilisation and the recovery of efficient costs from long-lived pipeline assets. As demand falls, the risk increases that some assets may become stranded, with service providers unable to recover their efficient costs.[19]

Left unmanaged, these risks could contribute to a disorderly transition in which inefficiently high and escalating tariffs prompt consumers who can readily do so to switch to alternative energy sources. This would leave consumers who cannot switch, or who need more time to switch, to bear a disproportionate and inefficient share of pipeline costs. At the same time, if capital recovery is inefficiently constrained, service providers may decide to cease operations prematurely (as has already occurred on a number of smaller non-scheme pipelines), potentially leaving consumers who continue to rely on gas without access to safe and reliable services.[20] This could require government intervention to manage early or unexpected pipeline closures, support

15 AEMO, Gas Statement of Opportunities, March 2026, pp. 5-6. These projections are based on AEMO's Step Change Scenario, which forecasts that residential and small commercial demand will fall from 130 PJ in 2026 to 35 PJ in 2045.

16 AEMO, Western Australia Gas Statement of Opportunities,December 2025. These projections are based on AEMO's Step Change Scenario, Figure 8, which forecasts that distribution connected demand will fall from around 56TJ/day in 2026 to 25 TJ/day in 2045.

17 As recognised by AEMO's Gas Statement of Opportunities, March 2026, p. 5.

18 We note that gas reference tariffs are charged by gas pipeline service providers to pipeline users, typically retailers and large gas users that contract directly with service providers. Gas retailers may use reference tariffs as an input to the setting of their gas retail charges, which also includes the costs a retailer incurs in procuring gas and other services required to supply the retail customer. Retailers have some discretion as to how they recover distribution charges from their customers (e.g. they can employ a different tariff structure and/or level of charges to that used in a service provider's reference tariff).

19 The term 'stranded' or 'stranding' is used in this context to refer to assets that remain capable of providing services, but for which a service provider is unable to recover a full return of and on the capital prudently invested in those assets.

20 There are now a number of examples of this occurring, including the Esperance gas distribution system, which was shut down in 2025, and the Solstice compressed natural gas distribution system in Victoria, which is expected to shut down in 2026. ATCO also announced earlier this year it intends to shut down the Albany LPG reticulated gas distribution system (see here).

affected consumers, and allocate costs that someone must ultimately bear. These outcomes are likely to be more expensive and less efficient than a planned orderly transition, where consumers have time to make efficient switching decisions, including replacing gas appliances with alternatives when those appliances reach the end of their useful life.

While projections indicate that demand may decline, many residential, commercial and industrial consumers are likely to continue relying on gas to help meet their energy needs for many years. These consumers have a strong interest in maintaining access to safe, reliable and affordable gas services throughout the transition. Some consumers may choose to continue using gas for certain purposes (e.g. cooking). Others may choose to transition to alternative energy sources over time (e.g. aligning their decisions with the end of the life of their gas appliances, which could take a number of years). Some consumers may face financial, technical or practical barriers to switching and may continue relying on gas services for many years (e.g. low income customers, vulnerable customers, renters and hard to abate residential, commercial and industrial customers).

The energy transition is exposing consumers and service providers to different consequences of the same underlying challenge: uncertain and potentially declining demand. If consumers are exposed to inefficiently high prices, some may leave the network earlier than is efficient. Conversely, if service providers do not have a reasonable opportunity to recover at least their efficient costs, their incentives and/or ability to continue to operate and efficiently invest, where necessary, may be weakened. Either outcome could contribute to a disorderly transition and adverse long-term outcomes for consumers.

The shared risks described above presents the key challenge to an orderly energy transition. Many of the key elements of the regulatory framework were developed in a context of demand stability or growth. Supporting an orderly energy transition as future demand becomes increasingly uncertain requires consumers to be able to make informed decisions about their future energy use, service providers to retain incentives to continue operating and investing efficiently where services continue to be required, and governments and the regulator to have sufficient information to manage emerging risks before they become more difficult and costly to address. Without an appropriate response, the transition may become more costly and disruptive to consumers than necessary.

1.2.3 The regulatory framework should evolve to continue promoting the long-term interests of consumers

The NGO seeks to promote efficient investment in, and efficient operation and use of, covered gas services for the long-term interests of consumers with respect to price, quality, safety, reliability, security of supply and the achievement of targets set by participating jurisdictions for reducing or that are likely to contribute to emissions reduction.[21] The energy transition does not change this objective. What has changed are the circumstances in which the regulatory framework must operate. The challenge is to ensure that the framework remains capable of promoting the long-term interests of consumers under a broader range of future scenarios.

The Commission acknowledges the issues identified by stakeholders throughout this rule change process. Consumer representatives have highlighted concerns regarding rising prices, inefficient expenditure, and the allocation of costs across a shrinking customer base.[22] Service providers have highlighted increasing uncertainty regarding future demand, growing stranding risks and the need to preserve a reasonable opportunity to recover efficient costs.[23] The AER has likewise

21 NGL section 23. We note that Western Australia has not yet adopted the *National Gas Amendment (Other Gases) Rule 2024* or associated changes to the NGL to introduce the definition of "covered gas" into the NGL. The NGO that applies in Western Australia refers to "natural gas services".

22 Submissions to the directions paper: ECA, p. 2; JEC/SACOSS, p. 15; BSL, p. 3; COTA, p. 1; Environment Victoria, p. 6.

identified challenges associated with balancing affordability concerns today against the longer-term consequences of regulatory decisions, advocating for regulatory flexibility and discretion to allow them to respond to uncertainty.[24]

The current framework was largely developed in an environment where gas demand was expected to remain stable or grow over time. However, increasing uncertainty regarding future gas demand, network utilisation, consumer preferences and government policy means that some aspects of the framework may no longer consistently promote efficient outcomes across the full range of scenarios that could emerge through the energy transition. The challenge is to ensure that the regulatory framework remains capable of promoting the long-term interests of consumers as conditions evolve.

The Commission also considers that consumers, service providers, the AER, ERA and governments would benefit from greater clarity regarding how the transition may affect tariffs, the safety and reliability of services and future network utilisation. Jurisdictional policies, consumer preferences and demand projections continue to evolve, creating uncertainty regarding future outcomes. In these circumstances, transparency and accountability become increasingly important. Stakeholders, particularly consumers, should be able to understand how regulatory decisions made today may affect future tariffs and service outcomes, while service providers and the regulator should be accountable for clearly explaining the assumptions, risks and trade-offs that underpin their proposals and decisions.

In particular, the Commission considers that the current framework exhibits two important shortcomings:

- **There is insufficient transparency, consistency, or accountability regarding how long-term risks are identified, assessed and managed.** While service providers and the regulator are increasingly considering longer-term issues in AA processes, the framework does not currently provide a structured basis for explaining how future demand uncertainty, asset utilisation, expenditure requirements, pricing outcomes and capital cost recovery risks have informed proposals and decisions. This can make it difficult for stakeholders to understand the long-term consequences of regulatory decisions, the trade-offs that have been made, and whether different elements of a proposal are working together to address transition risks in a coherent way.
- **Key regulatory provisions may not be sufficiently adaptable to the wider range of scenarios that could emerge through the transition**. The capital cost recovery, reference tariff and expenditure provisions were developed in a context where demand was expected to remain stable or increase over time. Consequently, the framework does not always provide clear guidance regarding how efficient outcomes should be achieved when demand is uncertain or declining. This increases the risk that decisions which appear efficient within a single AA period may increase long-term costs and risks for consumers.

The Commission does not consider that these issues require a fundamental redesign of the economic regulatory framework. Rather, they reveal the need to update and clarify how the framework operates so that it remains capable of delivering efficient risk allocation and consumer outcomes under a broader range of future scenarios.

Importantly, the Commission considers that the framework should support an orderly transition that promotes the long-term interests of consumers regardless of how individual consumers

23 Submissions to the directions paper: ATCO, p. 11; Evoenergy, p. 1; APA, p. 7; AusNet, p. 1; AGIG, p. 2.

24 AER, submission to the directions paper, p. 5.

engage with the transition. This includes consumers who continue to rely on gas to help meet their energy needs, consumers who may transition to alternative energy sources over time, and consumers who face financial, technical or practical barriers to switching. The Commission is concerned that, without reform, all consumers may face greater risks of inefficiently high tariffs, reduced service outcomes or increased uncertainty regarding the future availability and affordability of gas services.

We also note that jurisdictional policy approaches are likely to play an important role in shaping the pace, scale and form of the transition. Some jurisdictions may pursue policies that accelerate electrification or reduce the role of gas more quickly. Other jurisdictions may adopt different pathways reflecting local circumstances, consumer needs and policy objectives. The regulatory framework should therefore be sufficiently flexible to accommodate these potentially different policy approaches, while continuing to support efficient outcomes for consumers.

The Commission considers that the long-term interests of consumers are best served where consumers have access to safe, reliable and affordable gas services for as long as they require them, while also being able to make decisions about whether and when to transition to alternative energy sources. The purpose of the draft rule is not to determine the future role of gas or to favour a particular transition pathway. Rather, it is to ensure that the regulatory framework remains capable of promoting efficient outcomes for consumers regardless of how the transition unfolds.

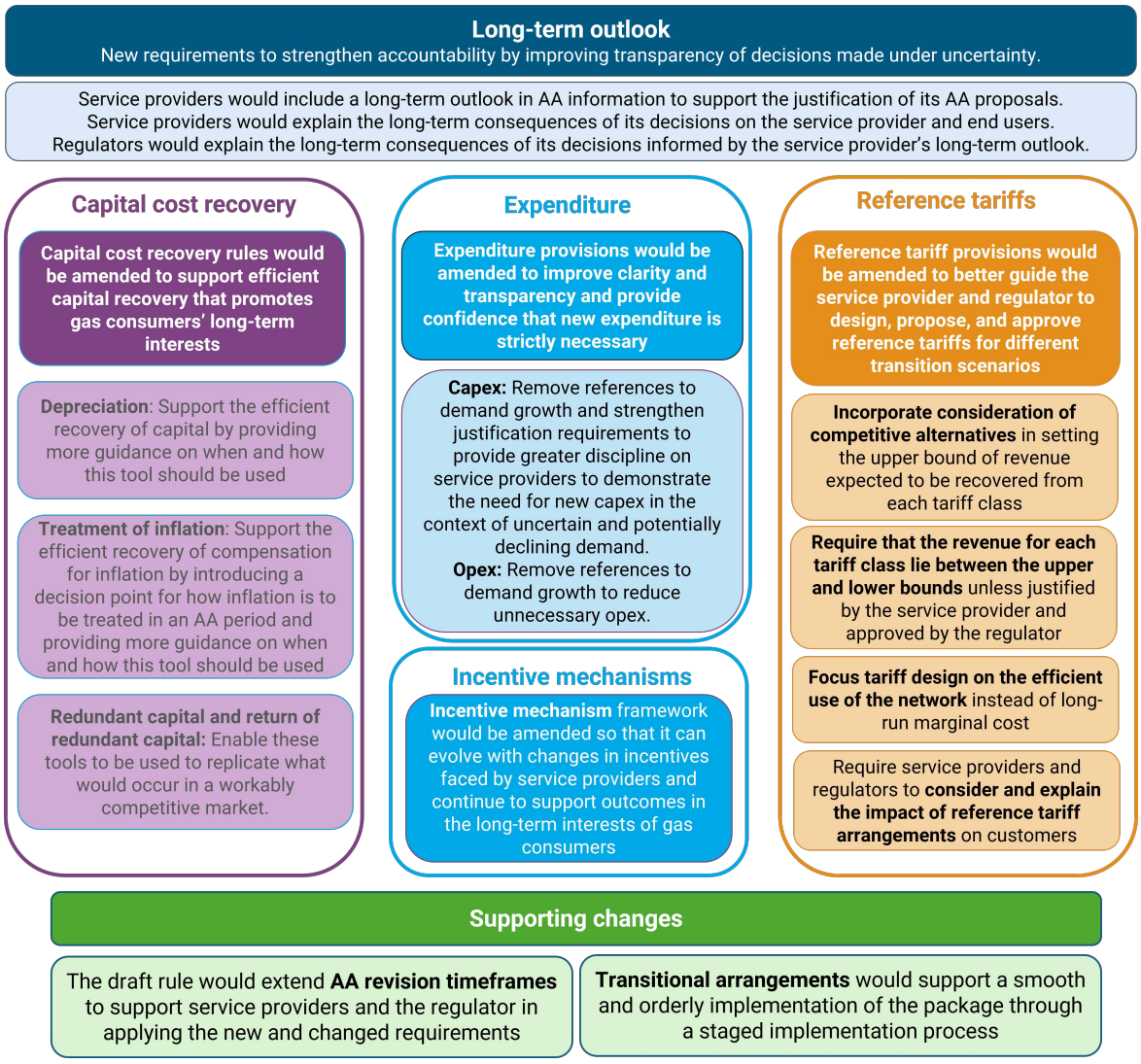
1.3 Our draft rule would provide a balanced approach to supporting an orderly energy transition

The Commission's draft rule represents a balanced approach, comprising a package of reforms that work together to support an orderly energy transition. It does so by improving transparency and accountability on service providers and the regulator for identifying and assessing long-term risks and explaining how their proposals and decisions manage these risks. It would ensure that key regulatory provisions remain relevant, flexible and adaptable to the wider range of scenarios that could emerge during the transition. And importantly, the draft rule would better recognise and reflect the increasing role of competition in shaping efficient outcomes.[25]

Together, these reforms are intended to provide confidence that future risks are being consistently identified and managed by service providers and the regulator.

25 The gas pipeline regulatory framework has always contemplated the potential for competition from alternative energy sources. Changing technology and opportunities that exist for gas consumers to reduce and offset their bills by their own electricity generation and storage assets will result in a reduction in the competitiveness of gas as a fuel source compared to electricity, potentially more rapidly than may have been contemplated.

Figure 1.1: Our draft rule would provide a balanced approach to supporting an orderly energy transition



1.3.1 Improving transparency and accountability in decision-making under uncertainty by employing a longer-term outlook

A central feature of the package is the introduction of long-term outlook requirements. The Commission considers that it is necessary to improve transparency and accountability where the future is uncertain and where decisions today may have significant long-term consequences for consumers. The draft rule would support forward-looking, consumer centric decision-making in AA processes, by introducing obligations on service providers and the regulator to employ a longer-term outlook, including by requiring:

- The service provider to develop a 20-year outlook, containing the service provider's identification of risks and uncertainties related to demand for reference service facing its network
- The service provider to provide its assessment of how its AA proposal might affect outcomes for consumers and its business over the same outlook period.

- The regulator to consider the 20-year outlook when making its decision on the service provider's proposal and assess how its decision might affect outcomes for consumers and service providers over the same period.

Taken together, the long-term outlook obligations on service providers and the regulator will provide a more structured basis for considering the impact of long-term transition risks on consumers and service providers in an AA and beyond. The draft rule would provide a transparent and consistent framework for presenting the service provider's expectations regarding future demand, network utilisation, expenditure, tariffs and capital recovery, together with the risks, uncertainties and assumptions underpinning those expectations. This should provide a common reference point to demonstrate how long-term risks and uncertainties have informed present-day proposals and regulatory decisions.

The Commission emphasises that the purpose of the long-term outlook is not prediction, but transparency. The Commission's intention is not to require a prediction of the future nor to bind future regulatory decisions. Our intent is to improve the quality of present-day decision-making by ensuring that long-term risks and consequences are transparently considered and communicated. This would improve stakeholder understanding of the trade-offs inherent in AA proposals and decisions, strengthen accountability for explaining how long-term risks are managed and thereby support more informed and efficient decision-making in the long-term interests of consumers.

Chapter 2 describes this reform in more detail.

1.3.2 Supporting efficient capital recovery that promotes the long-term interests of consumers

The draft rule clarifies how the capital cost recovery tools in the regulatory framework are intended to operate in the circumstances of uncertain and declining demand. The draft rule would promote efficient tariff outcomes for consumers while preserving the incentives on service providers to continue to provide safe and reliable services, for as long as consumers continue to rely on gas to help meet their energy needs.

The draft rule amends the depreciation, inflation, redundant capital and the return of redundant capital provisions to:

- allow service providers that are facing declining demand to align the recovery of depreciation with the expected use of the pipeline, where consistent with the NGO
- enable service providers that are facing declining demand to cease deferring inflation compensation where that is consistent with the NGO and also allow an inter-period smoothing mechanism to be used to manage the price impacts over a 10 year period
- allow redundant capital to be removed from a service provider's capital base where it reflects what would occur in a workably competitive market (e.g., in response to competition from alternative energy sources in the upcoming AA period)
- allow capital that has previously been removed from the capital base to be returned where there is an opportunity to do so
- establish clearer regulatory guidance regarding when and how these tools may be used.

The Commission considers that these reforms are necessary to support efficient capital recovery and promote the long-term interests of consumers through the transition.

Allowing depreciation to be aligned with the expected use of the pipeline and inflation compensation to cease being deferred, where justified, facilitates the recovery of efficient costs while there remains a relatively large customer base across which those costs can be recovered. This helps reduce the risk that a declining number of future consumers bear a disproportionate

share of capital costs and inflation compensation. It also provides service providers with a reasonable opportunity to recover at least their efficient costs, preserving incentives to continue operating and investing efficiently and to provide safe and reliable services to consumers that continue to rely on gas, today and into the future.

The draft rule would better reflect the competitive pressures that arise in a workably competitive market. Service providers facing the prospect of customer exit already have incentives to price services efficiently and retain customers where it is efficient to do so.[26] However, those incentives may weaken over time as customers that can readily switch to alternative energy services may leave the network and those remaining are likely to face financial, technical or other barriers to switching. The redundant capital provisions recognise the constraints that competition from alternative energy sources would place on recoverable capital in a competitive market. In doing so, the draft rule helps protect consumers who remain connected to the network from inefficiently high tariffs while supporting a more orderly, efficient and equitable transition.

Chapter 3 describes this reform in more detail.

1.3.3 Strengthening transparency and accountability for expenditure decisions

The draft rule would amend the expenditure assessment framework to ensure it is future focussed in an environment of uncertain and potentially declining gas demand. The Commission considers that greater discipline, transparency and accountability are required to provide confidence that new expenditure is prudent, efficient and strictly necessary to provide safe and reliable pipeline services.

The draft rule amends the expenditure provisions to:

- require service providers to consider all credible options for meeting an identified need and, where practicable, undertake a quantitative assessment of the costs and benefits of those options
- introduce a more outcomes-focused approach to assessing safety-related capex while preserving service providers' ability to comply with applicable safety obligations and standards
- require capex to maintain capacity to be justified with reference to forecast demand rather than existing demand
- remove provisions that may encourage expenditure to increase demand for pipeline services, ensuring the framework remains neutral with respect to future demand trends
- require service providers to clearly identify the basis on which proposed capex is justified under the rules.

These changes are intended to minimise costs to consumers by requiring greater justification and scrutiny of proposed capex, minimising further growth of the capital base and reducing future risk of stranding.

As uncertainty regarding future demand increases, decisions regarding network expenditure have greater potential to affect future tariffs, stranding risks, and the safe and reliable provision of pipeline services. The draft rule therefore seeks to strengthen the quality of expenditure assessment by ensuring that investment proposals are subject to robust analysis and that the reasons supporting those proposals are transparent to consumers and other stakeholders.

26 Modelling carried out by CEPA for the Commission shows that timely use of the capital cost recovery tools can help reduce the impacts of declining demand on both gas consumers and service providers and support a more orderly transition. AEMC, Gas networks in transition, Directions paper, 19 March 2026, Appendix B, pp. 45-47.

Chapter 4 describes this reform in more detail.

1.3.4 Supporting a broader range of incentive mechanisms

The draft rule would amend the incentive mechanism framework to ensure it remains fit-for-purpose as the energy transition changes the incentives faced by service providers. The Commission considers that future circumstances may require new or modified incentive mechanisms to encourage outcomes such as efficient operation of ageing assets, efficient use of pipeline services, or other behaviours that promote consumers' long-term interests.

To address this, the draft rule would retain the existing principles-based approach while broadening the scope of incentive mechanisms that may be proposed by service providers or required by the regulator. Rather than limiting incentive mechanisms to those that encourage efficiency in the provision of services, the draft rule would allow mechanisms that contribute more broadly to the achievement of the NGO.

The draft rule would also require service providers and the regulator to explain how the RPPs have been applied when proposing, requiring or approving an incentive mechanism. This approach provides flexibility for the framework to evolve alongside the transition without prescribing specific incentive schemes before a clear need for them has emerged.

Chapter 5 describes this reform in more detail.

1.3.5 Guiding the design of efficient tariff arrangements for different transition scenarios

The draft rule would amend the reference tariff framework to better support efficient outcomes across a broader range of transition scenarios, including circumstances involving uncertain or potentially declining demand. The draft rule would retain established economic concepts that seek to promote efficient pricing and minimise cross-subsidies, while guiding service providers and the regulator to apply those concepts in a way that reflects the circumstances of individual networks and the evolving competitive environment.

The draft rule amends the reference tariff provisions to:

- (for distribution pipelines) broaden the upper bound on the revenue expected to be recovered from each tariff class to incorporate competition from alternative energy sources (assessed by reference to consumers that can readily switch), in addition to standalone costs
- (for distribution pipelines) require the revenue expected to be recovered from each tariff class to remain within the upper and lower bounds unless otherwise justified by the service provider and approved by the regulator
- (for distribution pipelines) replace the existing requirement to take long-run marginal cost into account when designing tariffs with a broader requirement to have regard to the efficient use of the network
- (for distribution and transmission pipelines) require service providers and the regulator to consider and explain the impacts of reference tariff arrangements and tariff variation mechanisms on consumers over the AA period.

The Commission considers that these reforms would maintain the existing flexibility for service providers and the regulator to design and assess tariff arrangements while ensuring that they continue to promote efficient outcomes for consumers as the energy transition progresses.

By recognising competition from alternative energy sources and focusing tariff design on the efficient use of networks, the draft rule seeks to better emulate the outcomes that would be expected in a workably competitive market, where customers that can readily switch respond to

prices. In particular, in broadening the upper boundary to incorporate competition from alternative energy sources, the draft rule would strengthen the existing safeguards available to consumers against inefficiently high prices and inefficient cost allocation between tariff classes as the energy transition progresses. The requirement to consider competitive alternatives when setting the upper bound should not be interpreted as constraining the recovery of total allowed revenue as determined through the AA process.

The draft rule would also strengthen transparency and accountability on service providers and the regulator to consider and explain the impacts of tariff arrangements on consumers. These requirements complement the Commission's proposed long-term outlook framework and are intended to improve stakeholder understanding of the trade-offs embedded in tariff decisions, support informed consumer engagement, and promote confidence that tariff settings are being developed in the long-term interests of consumers.

Chapter 6 describes this reform in more detail.

1.3.6 Extending AA revision timeframes

The draft rule would extend AA revision timeframes to allow service providers and the regulator additional time given the new and changed requirements under the *Gas networks in transition* rule change.

The Commission considers that existing timeframes are already challenging to meet in practice, with recent AA reviews typically taking between 10 and 14 months from proposal to final decision despite the rules specifying an eight-month decision period. The introduction of new requirements relating to long-term outlooks, expenditure assessment, tariffs, incentives and capital cost recovery will increase the complexity of future review processes and place additional demands on both service providers and the regulator – in order to support consumers' long-term interests throughout the transition.

To address this issue, the draft rule would:

- extend the period from submission of an AA proposal to the regulator's final decision from eight to 12 months
- increase the time available for service providers to submit a revised proposal following a draft decision from 30 to 45 business days
- extend the minimum period between submission of an AA proposal and commencement of the next AA period from 12 to 14 months
- simplify how the AA revision timeframe can be extended so that it can only be extended using the 'stop the clock' provisions.

Chapter 7 describes this reform in more detail.

1.3.7 Transitional arrangements

The draft rule includes transitional provisions to provide clarity on how and when the *Gas networks in transition* rule change package would apply to individual service providers. The Commission considers that implementation should occur as soon as practicable, while avoiding unnecessary disruption to ongoing AA processes and regulatory decisions that have already been made or are underway under the existing framework. The transition arrangements are therefore designed to support a smooth and orderly implementation of the package through a staged implementation process, preserving regulatory certainty and avoiding unnecessary costs for service providers, the regulator and consumers.

Under the draft rule:

- Victorian gas distribution service providers would apply the new framework to their 2028-33 AA reviews, while retaining the existing AA review timeframes
- certain service providers with current AAs in effect when the rule commences would begin applying the new framework from their next AA period, commencing between 2030 and 2031
- service providers that have already submitted AA proposals before the rule commences would be subject to the existing rules, with the new framework applying from their next AA review commencing in 2032 or 2033.

Chapter 8 describes the transitional arrangements in more detail.

1.4 Our draft rule would better promote the NGO

1.4.1 We considered ECA and JEC's rule change requests

The proponents identified important risks associated with declining demand, rising prices and stranding and expressed concerns that the use of existing capital cost recovery provisions could disproportionately shift the cost and risk of stranding to consumers. ECA also proposed reforms to improve long-term planning, transparency, and scrutiny of capex so that investment decisions better reflect likely future reductions in gas network utilisation.

The Commission agrees with a number of the underlying concerns raised by ECA and JEC in their rule change requests. In particular, we agree that the current framework does not:

- support consideration of the longer-term consequences of service providers' proposals and regulatory decisions, and provide for internally consistent proposals and decisions that respond to the changing circumstances facing consumers and service providers throughout the transition
- provide sufficient transparency regarding how stranding risks are identified and assessed, and guidance on the use of the available capital cost recovery tools is not effectively dealt with under the current rules
- provide sufficient confidence that expenditure is strictly necessary to ensure safe and reliable provision of services, particularly in the context of declining demand.

The Commission's draft rule adopts a broader and integrated approach aimed at improving how risks to consumers through the energy transition are identified, assessed, and managed across the regulatory framework. The draft rule is a balanced approach that would achieve many of the proponents' reform objectives in a way that better promotes the NGO and supports an orderly energy transition.

A central feature of the draft rule is the introduction of new obligations on the service provider and regulator to employ a longer-term outlook in AA processes. This aspect of the draft rule is intended to address a more immediate regulatory challenge: the lack of transparency regarding how long-term risks and uncertainties influence capital recovery, tariff and expenditure decisions. The draft rule therefore embeds long-term analysis directly within the AA process, requiring service providers and the regulator to explain how long-term risks have informed proposals and decisions, and the consequences of those decisions for consumers and service providers over time.

The introduction of the long-term outlook would provide earlier visibility of long-term demand risks, network utilisation, expenditure requirements, tariffs, capital recovery, stranding risks and potential future repurposing or decommissioning activities. It would address much of the information asymmetry identified by ECA, albeit at a less granular level than sought by the

proponent. However, the Commission considers that integrating long-term considerations directly into regulatory processes would provide a clearer basis for stakeholder engagement and regulatory scrutiny of AA proposals and decisions and support more efficient responses by service providers, the regulator and governments. Further, the Commission notes that the introduction of more granular planning requirements on service providers would be beneficial in the context of strategic decommissioning considerations. We acknowledge the need to develop a decommissioning framework, spanning national and jurisdictional arrangements, in the near future and continue working on this issue with relevant stakeholders.

The Commission also considers that its capital cost recovery reforms would better promote the NGO than the approaches proposed by ECA and JEC. The solutions proposed by the proponents would have the effect of inefficiently constraining access to regulatory tools that could help to mitigate the price and other impacts of declining demand on consumers. Limiting access to these tools may reduce the ability of service providers and the regulator to manage stranding risks before they become acute and undermine service providers' incentives to continue operating and efficiently investing in the provision of safe and reliable services. Our draft rule would instead clarify when and how the capital cost recovery tools may be used as complementary measures for managing the different impacts of declining demand on consumers and service providers over time.

- Under the draft rule, if a service provider's AA information and long-term outlook show that it is facing declining demand and stranding risk, the depreciation and treatment of inflation tools could be used to better align the recovery of capital and the compensation for inflation with the expected use of a pipeline, while there remains a reasonable opportunity to recover at least efficient costs. This would minimise the risk of escalating and volatile tariffs over time, while preserving the incentives on service providers to continue to provide safe and reliable services, for consumers that continue to rely on gas.
- Once it becomes clear that stranding can no longer be averted (due to competition or to reflect what would occur in a workably competitive market), the draft rule would enable the service provider and regulator to remove partially redundant capital from a service provider's capital base. Together with the requirement to consider the prices that would be payable by hypothetical end-users who could readily switch to alternative energy sources, this element of the draft rule would ensure consumers that face barriers to switching are not subject to inefficiently high tariffs. For example, where recovering the full capital base would result in reference tariffs exceeding the price that consumers that can readily switch would pay for alternative energy sources in the AA period, the regulator may require a portion of the capital base to be removed. This allows the remaining capital base and associated reference tariffs to better reflect the outcomes that would occur in a workably competitive market and better promote the NGO.

The Commission considers that this approach better balances the interests of consumers and service providers in a way that is more likely to promote efficient prices, efficient investment, and the ongoing provision of safe and reliable services. We do not consider that an approach where redundancy is a pre-requisite for accelerating depreciation (as recommended by JEC) or an ex-post redundancy approach (as suggested by service providers) would best promote the long-term interests of consumers.

While the JEC's approach may provide earlier price relief, it could also reduce service providers' opportunity to recover efficient costs and potentially weakening their incentives to continue operating and investing efficiently in the provision of safe and reliable services. This could have implications for a much broader group of residential, small commercial and industrial consumers

if uncertainty over future cost recovery affects the ability of service providers to provide safe and reliable services, or otherwise prompts them to prematurely cease providing services. Conversely, limiting the tool to circumstances where redundancy has already occurred may delay action until prices have already increased materially, exposing consumers to inefficiently high tariffs and other adverse effects.

The Commission's draft rule would also amend the assessment of expenditure to improve the discipline on service providers to demonstrate that proposed expenditure is necessary by requiring consideration of all credible options. This would ensure that future expenditure is strictly necessary to provide safe and reliable services. While we have not adopted all of the ECA's expenditure proposals, we consider that other aspects of our draft rule would complement existing incentives on services providers to invest efficiently. Importantly, our draft rule would sit alongside our decision in late 2025 to amend the NGR to implement the ECA initiated gas connections rule change. Our final rule will mean that connection costs, which have accounted for a significant share of service providers' capex programs in the past, will no longer be added to the capital base that service providers then seek to recover from all consumers, supporting reduced new capex going forward.

While not raised directly by ECA and JEC, our draft rule would amend distribution tariff arrangements to recognise competition from alternative energy sources and focusing tariff design on the efficient use of networks. This would better emulate the outcomes that would be expected in a workably competitive market, where there are customers that can readily switch and thereby respond to prices. In particular, the draft rule amendments to broaden the upper boundary to incorporate competition from alternative energy sources strengthens the existing safeguards available to consumers against inefficiently high prices and inefficient cost allocation between tariff classes as the energy transition progresses.

1.4.2 Our draft rule would promote the NGO

Our objective is to ensure that, as a whole, the regulatory framework remains fit-for-purpose through the energy transition and continues to support the long-term interests of gas consumers. The NGO has guided our decision-making process by identifying the outcomes that the regulatory framework should promote for consumers.

We have assessed the draft rule against the assessment criteria identified in the consultation paper.[27] Having regard to these criteria, the Commission considers that the draft rule would better promote the long-term interests of consumers compared to both the current arrangements and the solutions proposed by the rule change proponents.

The draft rule would strengthen transparency and accountability requirements on service providers and the regulator to identify and consider long-term risks and explain how those risks have informed their proposals and decisions and the implications for consumers over time. This would bring emerging risks to light earlier while a broader range of options remains available to manage those risks efficiently. This would support more informed decision-making by service providers, the regulator, consumers and governments before risks become larger, more costly, or more difficult to address. In this way, the long-term outlook is better aligned with the immediate regulatory challenge facing gas networks in transition while achieving many of the information and transparency benefits identified by ECA.

27 AEMC Gas networks in transition, Consultation paper, 18 September 2025, p. 41.

The draft rule would also improve the operation of expenditure, reference tariff and capital cost recovery provisions, and better recognise the influence of competition from alternative energy services. Together, these reforms are intended to support more efficient investment in networks, more efficient operation of regulated services and more efficient use of gas infrastructure over time.

The Commission considers that the draft rule would improve outcomes for consumers with respect to price. The reforms seek to reduce the risk of inefficient expenditure, inefficient tariffs and inappropriate deferral of costs that could otherwise result in consumers facing inefficiently high tariffs over time. The package strengthens transparency regarding the long-term consequences of regulatory decisions, provides a clearer framework for managing risks and uncertainties related to demand for reference services and seeks to ensure that tariffs more closely reflect efficient market outcomes.

The Commission further considers that the draft rule would support the long-term interests of consumers with respect to quality, safety, reliability and security of supply. Many residential, commercial and industrial consumers are expected to continue relying on gas services for years to come. Preserving incentives for service providers to continue operating, maintaining and investing in networks where required and efficient remains an important component of promoting consumer interests during the transition. The expenditure reforms preserve the ability of service providers to undertake prudent and efficient expenditure necessary to comply with safety, reliability and regulatory obligations, while the capital cost recovery reforms help ensure that service providers continue to have a reasonable opportunity to recover at least their efficient costs.[28] Collectively, these reforms support the continued provision of safe, secure and reliable services for as long as consumers continue to require them.

Importantly, the Commission considers that the package appropriately recognises the shared risk between consumers and service providers. Consumers face the risk of inefficiently high prices and reduced service outcomes if transition risks are not managed effectively. At the same time, service providers face increasing uncertainty regarding future utilisation of their pipelines and the recovery of efficient costs. The draft rule seeks to balance these risks by promoting efficient outcomes for consumers while preserving incentives for service providers to continue operating, maintaining and investing in pipelines where it is efficient and prudent to do so. This balance is important to supporting an orderly transition and promoting the long-term interests of consumers.

The Commission also considers that the draft rule would better support emissions reduction objectives under the NGO. The package is not intended to determine the future role of gas or to favour a particular technology pathway. Rather, it seeks to ensure that expenditure, pricing and capital recovery decisions appropriately reflect changing market conditions, consumer preferences and competition from alternative energy services. By promoting more efficient price signals, strengthening consideration of long-term demand trends and improving transparency regarding future outcomes, the reforms support informed decision-making by consumers, governments and market participants as the transition progresses. The Commission considers that this is consistent with supporting an orderly transition to a lower-emissions energy system.

Finally, the Commission considers that the draft rule promotes good regulatory practice. The package is a targeted evolution of the existing framework, which is based on economic efficiency, rather than a fundamental redesign. It improves transparency, consistency and accountability in decision-making while preserving sufficient flexibility for service providers and the regulator to respond to differing transition pathways and future demand scenarios.

28 NGL, sections 24(2) and 24(3).

1.5 We have taken the RPPs into account

In making this draft rule, the Commission has taken the RPPs into account. The RPPs provide guidance regarding how economic regulation should support the promotion of economic efficiency for the long-term interests of consumers.

The Commission recognises that service providers should be provided with a reasonable opportunity to recover at least their efficient costs and be able to earn returns commensurate with the regulatory and commercial risks they face.[29] The capital cost recovery reforms provide service providers with clearer and more flexible mechanisms to manage stranding risk, where justified and approved by the regulator. At the same time, the draft rule preserves service providers' exposure to demand risk, competition from alternative energy services, and the possibility of stranding where this reflects outcomes that would occur in a workably competitive market.

The Commission has also had regard to the RPPs requiring consideration of the economic costs and risks associated with under investment and over investment, and under utilisation and over utilisation of regulated assets.[30] These issues are central to the challenges created by uncertain and declining demand. The draft rule addresses these risks by strengthening expenditure assessment requirements, improving transparency regarding future utilisation, supporting more efficient pricing outcomes and providing a framework that allows capital cost recovery tools to be used more effectively.

Finally, the Commission notes that the draft rule does not alter the fundamental building block framework or the established approach to the capital base.[31] Rather, it clarifies and strengthens the operation of existing regulatory tools so that they remain fit for the future as circumstances change during the transition.

1.6 There will be a role for government to support gas consumers and service providers through the energy transition

The draft rule would strengthen the economic regulatory framework for gas pipelines so that the NGR continues to promote the NGO throughout the energy transition. The draft rule provides a stronger platform for managing transition risks in an orderly way to the extent possible within the economic regulatory framework by identifying emerging risks earlier, while those risks can still be managed and reduced. Earlier action would help to reduce the scale of the problem before it grows and becomes more difficult, costly and disruptive to manage for consumers, service providers, the regulator and governments.

Nevertheless, the economic regulatory framework cannot fully resolve the impacts on gas consumers and service providers of uncertain and declining demand. Some choices and management of risk will need to be guided by government policy and action. There will therefore be a role for governments in helping to support an orderly transition. In the directions paper, the Commission outlined the following areas for consideration:

- reducing the scale of the capital cost recovery problem by removing obligations to connect customers and to continue to service customers (which would support commercial decisions to strategically decommission parts of gas distribution networks)
- addressing affordability concerns by providing more financial support to vulnerable customers

29 NGL, sections 24(2) and 24(5).
30 NGL, sections 24(5) and 24(6).
31 NGL, section 24(4).

- supporting harder to abate and vulnerable customers to transition to alternative energy sources, where that is consistent with jurisdictional policy
- helping to plan for any gas distribution network decommissioning (supported by cost-benefit analysis), where that is consistent with jurisdictional policy
- in the case of South Australia and Victoria, their respective governments considering the appropriateness of retaining the designation classification for the AGN SA, AGN Victoria, Multinet and Ausnet networks (which prevents changes to the form of regulation applied to these networks).

In addition, the Energy and Climate Change Ministerial Council (ECMC) may consider changes to the National Gas Law (NGL) to allow service providers to charge a reference tariff for services not provided by means of a pipeline (e.g. LGP tanks) or consider electrification options.

If governments want service providers to continue to operate if stranding starts to occur, they may also need to consider providing financial support to ensure they can continue to provide safe and reliable service.

2 How our draft long-term outlook requirements would operate

Our draft rule would introduce new requirements on:

- service providers to prepare a 20-year long-term outlook to inform their AA proposals
- the regulator to consider the long-term outlook when assessing the long-term consequences of its decisions.

This would improve transparency over forward-looking decision-making under uncertainty. The draft rule is broadly consistent with the policy direction set out in the directions paper.

Figure 2.1 provides an overview of the draft rule comprising obligations on the service provider and the regulator.

Figure 2.1: Overview of the draft rule for the long-term outlook

Service providers and regulators would be required to be transparent about how AA proposals and decisions consider long-term risks and be transparent about the long-term consequences of its AA proposals and decisions on service providers and end users

Service providers would include a long-term outlook in AA information to support the justification of its AA proposals	**The long-term outlook would include:** • forecasts including the projected capital base, operating expenditure, pipeline capacity and utilisation, demand for each reference service, the allowed and expected rate of return, the estimated cost of corporate income tax, total revenue from pipeline services, reference tariffs for each reference service and class, and how the price of gas to be paid by end users is expected to compare with the forecast costs of alternative energy sources, including the costs of switching to those alternative energy sources. • an explanation of inputs and assumptions used to determine these forecasts and any material changes to forecasts, inputs, assumptions and expected risks from the previous long-term outlook. • an explanation of risks and uncertainties related to demand for reference services, the source of those risks, and service provider's proposed approach to managing those risks • a sensitivity analysis explaining how the service provider considered different demand forecast scenarios • an explanation of expected material future investment and expected material repurposing or decommissioning

Service providers would explain the long-term consequences of its proposals	**Service providers would be required to explain**:
	• the consequences of the service providers AA proposal on:
	  • the service provider, including its ability to efficiently provide safe and reliable pipeline services and to recover efficient costs the service provider incurs in providing reference services
	  • end users, including on prices paid, and the availability of safe and reliable reference services.

Regulators would explain the long-term consequences of its decisions considering the service provider's long-term outlook	**Regulators would be required to explain**:
	• the consequences of the regulator's decision on:
	  • the service provider, including its ability to efficiently provide safe and reliable pipeline services and to recover efficient costs the service provider incurs in providing reference services
	  • end users, including on prices paid, and the availability of safe and reliable reference services.
	• how the service provider's long-term outlook has informed the service provider's assessment of the consequences on the service provider and end users, and inputs and assumptions that materially differ from the assumptions in the long-term outlook.

Source: AEMC

The long term outlook is intended to help service providers and the regulator identify transition risks earlier while more options to manage these risks are available, and to enable more efficient, deliberate and transparent responses. Our draft rule is not intended to create an expectation that service providers can accurately predict future conditions and future AA proposals. The long-term outlook would, however, serve as a reference point for the service provider, the regulator, and stakeholders to engage with risks and uncertainties related to demand for reference services affecting the service provider's network over the long-term, and the implications for the consumers connected to the service provider's pipeline (end users) in developing its AA proposal.

Our draft rule is more preferable to ECA's rule change request to introduce a gas annual planning report (GAPR). The Commission's draft rule would address the current lack of information about risks and uncertainties related to demand for reference services over the long-term and improve AA proposals and decisions by embedding long-term analysis into the AA process. In this way, the long-term outlook is better aligned with the immediate regulatory challenge facing gas networks in transition while achieving many of the information and transparency benefits identified by ECA in its rule change request.[32]

The Commission considers that the benefits of more granular planning information would largely arise only if broader decommissioning frameworks and jurisdictional transition arrangements exist. While these broader reforms are not being considered as part of this rule change process, the Commission is actively engaging with jurisdictions and other stakeholders to support ongoing consideration of these broader issues and potential pathways forward.

This chapter outlines:

- why it is important for service providers and the regulator to take a longer-term view when making AA proposals and decisions (section 2.1)
- why a rule change is needed to improve transparency over how AA proposals and decisions are expected to impact end users and service providers over the longer term (section 2.2)
- how the draft rule would operate and how we have considered stakeholder views in making the draft rule (section 2.2, section 2.3, section 2.4 and section 2.5)
- why the draft rule would better promote the NGO than ECA's proposed rule change while also achieving some of ECA's intent (section 2.7).

2.1 Greater transparency is needed for how long-term transition risks are considered in AA processes

Uncertainty about the future, including in declining demand contexts, creates shared risks for consumers and service providers. If these risks are not actively managed through AA processes, they may have significant consequences for both groups.

As the energy transition progresses, service providers and the regulator will face increasing challenges to manage these shared risks in a way that promotes the long-term interests of consumers.

The Commission considers that a forward-looking approach to decision-making is needed, one that actively considers the potential impacts of future demand uncertainty on both consumers and service providers.

Where longer-term risks and opportunities are not considered holistically and consistently across AA proposals and decisions, there is an increased risk that decisions made today could impose avoidable future costs on consumers or service providers. For example, insufficient consideration of longer-term demand uncertainties may result in investment that exceeds what is required to provide safe, reliable and secure services over the remaining life of the pipeline. This could increase prices for consumers and expose a greater proportion of capital to stranding risk. Similarly, failing to consider longer-term demand risks when determining capital cost recovery approaches may limit the opportunity to manage future price impacts and stranding risks in an efficient and orderly way.

32 ECA Rule change request - New gas planning requirements.

While long-term considerations are already informing some AA proposals and regulatory decisions, it is not always clear how these considerations have influenced outcomes or whether a consistent longer-term approach has been applied across all aspects of AA decisions.

The Commission considers that consumers and stakeholders should have greater confidence that long-term risks are being actively identified, assessed and managed. This requires service providers and the regulator to:

- be transparent about the long-term demand related risks and uncertainties that are expected to impact the service provider and end users
- be transparent about the long-term consequences of their proposals and decisions, including the trade-offs involved
- apply long-term analysis consistently across all aspects of AA proposals and decisions and explain changes to the long-term outlook between AA proposals
- be accountable, through increased transparency, for identifying, managing and responding to long-term risks affecting the service provider and end users.

Taken together, these measures would support more informed decision-making and improve confidence that regulatory outcomes are being developed in the long-term interests of consumers while maintaining the ability of service providers to provide safe and reliable services.

2.2 Our draft rule would introduce long-term outlook requirements to support future-focused decision-making in AA processes

The Commission considers that service providers and the regulator must adopt a long-term perspective when developing and assessing AA proposals.

Currently, service providers and the regulator are generally required to develop forecasts and assess risks and uncertainties over the forthcoming five-year AA period. While the existing framework enables service providers and the regulator to consider long-term issues where relevant, and service providers and the regulator have increasingly drawn on longer-term analysis to support their proposals and decisions, the rules do not provide a consistent framework for identifying, assessing and explaining how longer-term considerations have informed AA proposals and decisions.

In particular, the current framework does not require service providers and the regulator to apply a consistent long-term perspective across all aspects of AA proposals and decisions. The framework also does not require service providers and the regulator to clearly explain how long-term considerations have influenced proposed or approved expenditure, tariff, capital recovery and other regulatory allowances and approaches.

Despite consideration of long-term issues in some recent AA proposals and decisions, the Commission considers that there remains:

- insufficient transparency regarding the long-term demand related risks and uncertainties that may affect the service provider and end users and how these risks are expected to be managed over time
- insufficient transparency regarding how long-term considerations have influenced the development of AA proposals and the regulator's decisions
- insufficient transparency regarding the expected long-term consequences of AA proposals and the regulator's decisions for the service provider and end users

- inconsistency in how long-term analysis is applied across different aspects of an AA proposal and the regulator's decision
- inconsistency across service providers and regulatory decisions in how long-term analysis has been used to support proposals and decisions.

As a result, stakeholders may find it difficult to understand what long-term risks and uncertainties have been considered, how these may affect consumers and service providers over time, and how those considerations have influenced the development of the AA proposal and the regulator's decision. The extent to which service providers and the regulator currently undertake and rely upon long-term analysis may also differ between service providers, between successive AA proposals, and between regulatory decisions. Long-term considerations may also be applied differently across individual issues, reducing transparency, and consistency regarding how transition risks are being identified, assessed, and managed over time. This can make it more difficult for stakeholders to compare approaches across different service providers, understand the trade-offs embedded in regulatory outcomes, and assess whether those outcomes are being developed in the long-term interests of consumers.

The Commission considers that a structured framework is required to support a more transparent and consistent approach for considering long-term risks and uncertainties related to demand for reference services as part of AA processes.

Our draft rule would support accountability of long-term decision-making, through improved transparency, by requiring:[33]

- service providers to prepare a long-term outlook that includes forecasts, inputs and assumptions, risk assessments and supporting analysis over a 20-year period (section 2.3 and section 2.4)
- service providers to explain the consequences of their AA proposals on the service provider and end users over the long-term outlook period (section 2.5)
- the regulator to consider the long-term outlook when explaining the consequences of its decisions on the service provider and end users over the long-term outlook period (section 2.6).

Taken together, these requirements would create an integrated framework for considering long-term transition risks in AA processes. It would establish clearer expectations on the service provider and the regulator to provide greater transparency on how their proposals and decisions about expenditure, tariffs and capital recovery impact its end users over time, including the prices these consumers pay and the service provider's incentives to continue to provide safe and reliable services. It would also ensure that proposals and decisions are internally consistent and work together as a package to address future risks and uncertainties.

The Commission considers that the long-term outlook would provide stakeholders with more accessible information on service providers' longer term views, by bringing together information that may otherwise be dispersed across multiple supporting documents and focussed on supporting individual aspects of AA proposals.

In the context of gas networks in transition, these requirements would provide stakeholders with greater visibility of the assumptions, risks, and trade-offs informing AA proposals and regulatory decisions. They would help identify circumstances where decisions that appear efficient over a single AA period may give rise to longer-term risks or costs. They would also improve stakeholders' understanding of how current expenditure, pricing and capital recovery decisions

33 Draft rule, NGR rules 45, 59(4), 62(4) and 67(b) and WA NGR rules 44A, 59(4), 62(4) and 67(b).

made today may affect consumers and service providers, not just in the next AA period but over the longer term.

This would support more informed and robust regulatory decision-making in an environment where future gas demand is increasingly uncertain, and where present day decisions may have significant implications for both consumers and service providers over time.

2.3 Service providers would be required to prepare a long-term outlook

Our draft rule would introduce a requirement on service providers to prepare a long-term outlook as part of the AA information supporting its AA proposal.[34]

At a high-level, the long-term outlook would include:[35]

1. an annual forecast of expected building block and reference tariff allowances and supporting inputs and assumptions over the long-term outlook period including the demand scenario that forecasts are informed by
2. supporting explanations and sensitivity analyses about long-term risks and considerations that are relevant to those forecasts over the long-term outlook period including the implications on forecasts of higher or lower demand outcomes and how changes in price impact forecast demand.

Taken together, the contents of the long-term outlook would provide the regulator, consumers and other stakeholders with a comprehensive assessment of:

- the service provider's expectations including in relation to future network use, expenditure, prices, capital recovery and demand
- the risks and uncertainties relating to demand for reference services over the long-term outlook period that may affect future outcomes for consumers and service providers
- the inputs and assumptions informing those expectations
- how the service provider expects to respond to risks and uncertainties relating to demand for reference services over the long-term outlook period
- how the price of gas to be paid by end users is expected to compare with the forecast costs of alternative energy sources.

The long-term outlook period is a 20-year period beginning from the commencement of the next AA period.[36] Service providers would be required to ensure the forecasts, inputs and assumptions in respect of the first years of the long-term outlook would be the same as those used for their AA proposal for the next AA period.[37] In effect, this means that the proposed allowances and approaches in an AA proposal should be consistent with the first years of the long-term outlook.

The long term outlook would help service providers and the regulator to identify transition risks earlier while more options to manage these risks are available, enabling more efficient, deliberate and transparent responses. The Commission recognises that the future is inherently uncertain and forecasts may not accurately predict how the future will unfold (particularly over the 20-year outlook period). The purpose of the forecasts in the long-term outlook is not to predict the future, but to improve transparency about how future uncertainty has factored into decision-making. It

34 Draft rule, NGR and WA NGR rule 72(1)(p).

35 Draft rule, NGR rule 45(2) and WA NGR rule 44A(2).

36 Draft rule, NGR and WA NGR rule 3(1), definition of "long-term outlook". We consider a 20-year outlook period is appropriate to use in this context and note that it is consistent with the outlook period used for AEMO's Gas Statement of Opportunities, which we understand is typically relied upon by service providers when developing their demand forecasts.

37 Draft rule, NGR rule 45(3) and WA NGR rule 44A(3).

provides a consistent analytical basis for demonstrating how the different elements of the regulatory proposal work together over time, and for identifying the longer-term costs and risks created by decisions made today. That is, the key value of the long-term outlook lies not in whether its forecasts prove correct, but in the insight it provides about how future uncertainty has been considered in AA proposals and how this can be efficiently managed.

Service providers may be subject to other regulatory obligations including in relation to forecasts or the provision of information, such as under the *Corporations Act 2001* (Cth). The long-term outlook requirements in the draft rule are not intended to affect a service provider's ability to comply with such other obligations.

In submissions to the directions paper, stakeholders broadly supported the introduction and intention of a long-term outlook and considered that it would improve transparency over long-term considerations that inform AA proposals.[38]

The rest of this section explains what service providers would be required to include in the long-term outlook under the draft rule. The draft rule does not represent an exhaustive list of information that service providers could include in its long-term outlook. Service providers may include additional information they consider appropriate to include in its long-term outlook.

2.3.1 The long-term outlook would include building block and reference tariff forecasts

Our draft rule would require service providers to include, in its long-term outlook, annual forecasts of the key variables that reflect how the pipeline is expected to operate, be funded, and recover costs over the long-term outlook period. Some of these mirror what a service provider is required to provide as part of its AA proposal. The long-term outlook would include a single forecast, for each year of the outlook period of:[39]

- the projected capital base including:
  - conforming capex
  - depreciation including a demonstration of how the forecast is derived on the basis of the proposed depreciation method
  - full redundancy and partial redundancy that may occur
  - the extent to which amounts previously removed from the capital base for full redundancy or partial redundancy (or which may be removed during the long-term outlook period) may become capable of being returned to the capital base.
- pipeline capacity and utilisation of pipeline capacity
- operating expenditure
- the demand for each reference service
- the allowed rate of return (for the years of the long-term outlook period that overlap with the coinciding AA period) or the expected rate of return (for the remaining years of the long-term outlook period)
- the estimated cost of corporate income tax calculated in accordance with rule 87A, including the allowed imputation credits referred to in that rule
- the total revenue to be derived from pipeline services
- reference tariffs for each reference service and tariff class

38 Submissions to the directions paper: Origin, p. 3; Alinta, p. 4; EUAA, p. 3; Evoenergy, p. 5; AGIG, p. 5; ENA, pp. 3-4; APGA; pp. 7-8; AER, p. 3.

39 Draft rule, NGR rule 45(2)(a) and WA NGR rule 44A(2)(a).

- how the price of gas to be paid by end users is expected to compare with the forecast costs of alternative energy sources, including the costs of switching to those alternative energy sources.

These forecasts would improve transparency regarding how service providers expect future expenditure, tariffs and capital recovery approaches to affect long-term outcomes, including potential stranding risks and future price impacts on end users over time.

The draft rule would require service providers to develop no more than one long-term outlook with a single set of forecasts.[40] This provides a clear and transparent basis to assess AA proposals. Without a single reference point, stakeholders may find it difficult to identify the future assumptions that underpin a service provider's proposal or assess the consequences of those assumptions proving incorrect. The draft rule would enable stakeholders to understand, assess and challenge the service provider's proposal while recognising that alternative outcomes remain possible.

Service providers would have flexibility over how they develop the long-term outlook and determine forecasts. Importantly, the forecasts would not bind future AA proposals. Rather, they would provide a transparent basis for understanding the service provider's current expectations regarding future outcomes.

The rest of this section expands on some of the forecasts that would be included in the long-term outlook and the stakeholder feedback on the directions paper.

The projected capital base

The projected capital base is an important indicator of future capital recovery outcomes and potential exposure to stranding risk.

The Commission considers that requiring service providers to forecast all key components of the capital base, including expected expenditure, depreciation, and redundancy adjustments would provide a comprehensive picture of how capital recovery outcomes may evolve over time.

Forecasts of full and partial redundancy would improve transparency regarding the service provider's expectations for when the network (including specific assets or parts of the pipeline) may become underutilised or cease to contribute to the provision of pipeline services over time. The Commission considers that this information would be relevant to understanding future capital recovery outcomes and the potential exposure of consumers and service providers to stranding risks. This information would also assist the regulator and the service provider determine when they may need to use each of the tools.

Pipeline capacity and utilisation of pipeline capacity

Forecasts of pipeline capacity and utilisation would provide transparency regarding how intensively the pipeline is expected to be used over time. Together with demand forecasts, this information should help the regulator and other stakeholders understand future utilisation trends and potential redundancy risks. It would also help identify any safety and reliability risks service providers expect over the outlook period and inform future expenditure needs.

The demand for each reference service

Service providers would be required to include a single central forecast of demand for each reference service over the long-term outlook period that represents its best view of the future after

40 Draft rule, NGR rule 45(5) and WA NGR rule 44A(5).

considering other plausible demand scenarios. The draft rule would not specify how a service provider determines its central demand forecast for each reference service. Service providers may take a range of approaches or methodologies to achieving this. This demand forecast would be a critical input into developing forecasts for expenditure, reference tariffs, capital recovery and other components of the long-term outlook. This is because the building block and reference tariff forecasts would seek to manage risks arising from the central demand forecast.

The Commission recognises that a single, central forecast for demand over a 20-year period is inherently uncertain. Actual demand outcomes may differ materially from the central forecast due to a range of factors, including changes in customer preferences, technology adoption, government policy, electrification trends, and broader economic conditions. The purpose of a central demand forecast for each reference service is therefore not to predict precisely how future demand will evolve, but to provide a transparent reference point for understanding how future expectations have informed the service provider's proposed allowances and approaches and to assess future risks, uncertainties and trade-offs.

A central demand forecast also provides a consistent analytical basis for demonstrating how the different elements of an AA proposal work together over time and for assessing the longer-term consequences of decisions made today. The value of the forecast is in the transparency it provides regarding the assumptions and expectations underpinning the proposal. To recognise the uncertainty inherent in any long-term forecast, the draft rule would also require the service provider to undertake sensitivity analysis using alternative demand scenarios.[41] This would provide transparency as to how uncertainty has been considered in developing the AA proposal and help stakeholders to understand how the proposal may perform under different future demand scenarios.

The expected rate of return for the remaining years of the long-term outlook after the next AA period

Changes in the rate of return may impact the level of stranding risks and prices charged to consumers.

While service providers must adopt the allowed rate of return in respect of the next AA period, the draft rule would provide service providers with the flexibility to use an expected rate of return that is the rate of return they expect the regulator would apply in the following years of the outlook after the next AA period.

Where they expect a different rate in the future, they would need to explain the inputs and assumptions used to determine the change. In practice, we expect service providers to only vary the risk-free rate when adopting an expected rate of return that is different to the allowed rate of return.

How the price of gas to be paid by end users is expected to compare with the costs of alternative energy sources, including the costs of switching to those alternative energy sources

The purpose of this comparison is to provide a proxy for when alternative energy sources may become more competitive with pipeline gas, and for how changing tariffs may affect end users' decisions to remain connected or switch to alternative fuel sources.

ENA and ATCO opposed requiring service providers to forecast prices of alternative energy sources.[42] ENA suggests that the content of the long-term outlook should be "limited to information reasonably available from public or government sources" and thus exclude modelling

41 See section 2.3.5.

42 Submissions to the directions paper: ENA, p. 3; ATCO, pp. 8-9.

of external sectors. ATCO suggested that forecasting prices of alternative energy sources is an inappropriate and impractical obligation for service providers.

The Commission acknowledges stakeholder concerns over challenges in accurately forecasting this information over the outlook period. The forecast is not expected to predict precisely when alternative energy sources become competitive with gas prices paid by end users. However, the forecast is expected to provide, at a high level, sufficient transparency in how the price impacts of expected allowances and approaches over the long-term outlook period may affect customers' decisions to remain connected or switch to alternative fuel sources.

The point at which end users may switch to an alternative energy source may involve significant upfront capital and labour costs, and will also depend on end users' circumstances and preferences. In comparing the relative forecast costs of gas and alternative energy sources at a high level, a service provider may incorporate customer preferences. For example, where end users derive greater utility from using gas for a particular service than from an electricity-based alternative, the comparison could adjust the effective cost of the alternative to reflect the additional consumption and expenditure required to provide an equivalent level of utility. This would result in a higher effective comparative cost than a simple unit-for-unit price comparison.

Much of this information and analysis has previously been provided by service providers in accordance with the AER's expectations articulated in its *Regulating gas pipelines under uncertainty* information paper. Service providers are not expected to include more granular and detailed information in the long-term outlook than what is already being provided by some service providers based on those expectations.[43]

Through our draft changes to the tariff provisions, a service provider would be required to carry out similar, but more detailed analysis to incorporate competition from alternative energy services into the upper bound of revenue that is expected to be recovered by a service provider from a tariff class. See for more detail section 6.2.

2.3.2 Existing forecasting requirements would apply to forecasts in the long-term outlook

The rules currently require any forecast or estimate provided by a service provider to: [44]

- be arrived at on a reasonable basis
- represent the best forecast or estimate possible in the circumstances.

In practice, service provider's AA information typically includes detailed analysis to support the approach they have taken to demonstrate that its forecasts or estimates are arrived at on a reasonable basis and represent the best forecast or estimate possible in the circumstances.

The regulator can take a different view on the appropriateness of a service provider's forecasts and can ultimately adopt a different set of forecasts in its AA decision.

The Commission considers that the existing rule requirements for forecasts and estimates for the AA remain appropriate for forecasts contained in the long-term outlook. Consistent with existing arrangements, forecasts and estimates included in the long-term outlook would be required to be arrived at on a reasonable basis and represent the best forecast or estimate possible in the circumstances.

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43 For example: AGN WA, AA 2021-2026 - Dampier to Bunbury Natural Gas Pipeline, Attachment 9.3 (ACIL Allen Report, January 2020), p. 27; ATCO WA, ATCO Plan 2025-29, Attachment 03.002, Future of Gas Report, pp. 24-26; Jemena Gas Networks (NSW), AA 2025-30 Revised proposal, Attachment 31, HoustenKemp Economics – Smoothing cost recovery when decline is falling, p. 9; AER, *Regulating gas pipelines under uncertainty* information paper, p. 45.

44 NGR and WA NGR rule 74.

The Commission considers that this existing framework provides an appropriate level of flexibility for the long-term outlook while ensuring forecasts remain subject to appropriate scrutiny.

2.3.3 The long-term outlook would include inputs and assumptions used to determine forecasts

Our draft rule would require service providers to include the inputs and assumptions used to determine the forecasts contained in the long-term outlook.[45] This would improve transparency regarding how service providers have assessed future demand, utilisation, expenditure requirements, tariffs and capital recovery outcomes. It would also assist the regulator and stakeholders in understanding and testing the assumptions underpinning the service provider's view of future risks and opportunities over the outlook period.

The draft rule would also make minor amendments to rule 74 of the NGR and WA NGR, and other related provisions in rule 72, to clarify that forecasts must be supported by a statement of the inputs and assumptions used for that forecast. The Commission considers that a "statement of the inputs and assumptions" would impose a clearer obligation on service providers than a "statement of the basis" for a forecast under the existing rules.

Some stakeholders considered that the rules should prescribe the inputs and assumptions used to develop the long-term outlook or provide guidance on how those inputs and assumptions should be determined:

- service providers suggested further guidance on the assumptions and modelling approaches they should adopt.[46]
- consumer groups and retailers considered robust guidance should be provided on assumptions to avoid the risk of bias and inaccuracies.[47]

The Commission acknowledges stakeholder concerns that inputs and assumptions might materially differ between service providers but does not consider it appropriate to require service providers to adopt a standard set of inputs and assumptions. We consider it is important to retain service providers' flexibility to make assumptions that best reflect their individual circumstances.

2.3.4 The long-term outlook would include an explanation of risks and uncertainties relating to demand for reference services

Our draft rule would require service providers to include in its long-term outlook an explanation of:[48]

- the risks and uncertainties related to demand for reference services that the service provider and end users are likely to face over the long-term outlook period;
- the source of those risks and uncertainties; and
- the service provider's proposed approach to managing those risks and uncertainties

This purpose of this requirement is to improve transparency regarding a service provider's assessment of long-term demand risks and uncertainties, the sources of these risks and how they expect to manage these risks. Service providers responsible for long-lived pipeline assets would ordinarily consider such issues and the draft rule therefore seeks primarily to make these considerations more transparent to stakeholders, allowing them to better understand how uncertainty has been taken into account in developing the AA proposal.

45 Draft rule, NGR rule 45(2)(b) and WA NGR rule 44A(2)(b).
46 Submissions to the directions paper: AusNet, p. 3; IEEFA, p. 7; EUAA, p. 2; Evoenergy, p. 7; AGIG, p. 3; APGA, p. 7.
47 Submissions to the directions paper: VEFN, pp. 10-11; Origin Energy, p. 4; ECA, p. 12.
48 Draft rule, NGR rule 45(2)(c) and WA NGR rule 44A(2)(c).

Our draft rule is not prescriptive about how service providers undertake and explain this risk assessment. We consider this approach would provide service providers appropriate discretion to describe risks relevant to their scheme pipeline and the source of those risks, which may differ between networks and between AA periods (e.g. demand uncertainty may arise from a range of factors including government policy and the pace of electrification).

Our draft rule would require service providers to explain how they propose to manage the risks they identify through the outlook period. A service provider may explain these matters by reference to tools and approaches such as:

- any of the capital cost recovery tools (i.e. depreciation, indexation, redundant capital and/or re-use of redundant capital)
- other regulatory tools (e.g. reference tariff variation mechanisms, AA variation proposals, shorter AA periods)
- other approaches (e.g. minimising expenditure, repurposing, decommissioning).

2.3.5 The long-term outlook would include a sensitivity analysis of different demand scenarios and prices

While the forecasts in the long-term outlook would be based on a single demand forecast for each reference service, given the inherent uncertainty in gas demand over the long term, we do not consider it appropriate for service providers to rely solely on a single deterministic demand forecast without considering alternative outcomes when developing AA proposals.

Our draft rule would require service providers to include in its long-term outlook a sensitivity analysis explaining how the service provider considered alternative demand scenarios and the impact on the long-term outlook forecasts if demand is lower or higher than forecast.[49] This analysis would provide stakeholders with greater visibility of the uncertainty surrounding forecasts and the implications of different demand outcomes over time. This would help stakeholders understand the factors that may cause future access arrangement proposals to differ from the forecasts set out in the long term outlook.

In developing and explaining its AA proposal, we expect service providers to have regard to both the forecasts and sensitivity analysis in the long-term outlook. We expect service providers to explain how they have considered uncertainty and incorporated different demand outcomes into their AA proposal.

For example, a service provider's long-term outlook would include capital base and reference tariff forecasts over the outlook period based on a central demand scenario. The accompanying sensitivity analysis would then explain how those forecasts would change under higher and lower demand scenarios. This would help service providers determine the building blocks and reference tariff proposals that best manage risks over multiple demand scenarios.

Our draft rule would also require service providers to explain how they have considered how changes in the price of gas expected to be paid by end users impacts the demand for each reference service over the outlook period.[50] Changes in prices paid by end users may affect the level of demand for network services over time, particularly where consumers have opportunities to reduce consumption and/or switch to alternative energy sources. Understanding this relationship is important when developing an AA proposal because decisions about capital recovery, expenditure and reference tariff design can themselves influence future demand

49 Draft rule, NGR rule 45(2)(d)(i) and WA NGR rule 44A(2)(d)(i).
50 Draft rule, NGR rule 45(2)(d)(ii) and WA NGR rule 44A(2)(d)(ii).

outcomes. Requiring service providers to consider both alternative demand scenarios and the impact of different prices on demand would therefore provide for a more robust analytical basis to inform AA proposals and decisions.

Stakeholders considered that it is important for service providers to undertake scenario analysis to ensure the long-term outlook is robust in the context of uncertainty.[51]

- AGIG and Jemena considered that deploying a single best-estimate approach in the long-term outlook would risk conveying false precision and would undermine decision-making under uncertainty.
- ATCO similarly supports the use of multiple scenarios, but notes that creating multi-scenario models materially increases regulatory complexity and cost, with those costs ultimately borne by consumers.

Requiring long-term outlook forecasts to be developed using multi-scenario models is complex and costly. Instead, a separate sensitivity analysis would appropriately help AA proposals factor demand uncertainty.

We consider that this approach achieves an appropriate balance between:

- delivering a sufficient level of detail such that service providers' long-term outlooks are meaningful and robust to future uncertainty, and
- avoiding excessive regulatory burden for both service providers and the regulator in compiling and evaluating the long-term outlook based on multiple demand scenarios.

2.3.6 The long-term outlook would explain how the pipeline is expected to change over time

Our draft rule would require service providers to include in its long-term outlook an explanation of expected material future investment and expected material repurposing or decommissioning of parts of the relevant pipeline (in each case, to the extent applicable) over the long-term outlook period and the expected timing of such investment or repurposing or decommissioning of parts of the relevant pipeline.[52] This information would provide greater transparency over what is expected to drive material changes to the capital base.

2.3.7 Service providers would be required to explain material differences between long-term outlooks

The draft rule would require a service provider to submit a new long-term outlook as AA information supporting each AA proposal. It is likely that long-term outlooks may differ as:

- AA proposals are revised or varied
- new information impacting future considerations becomes available and circumstances change given there may be significant time between long-term outlooks in the context of a rapidly transitioning energy sector.

Where forecasts, inputs, assumptions and risks and the service provider's approach to managing risk materially differ from previous long-term outlooks, service providers would be required to explain those differences and the reasons for them in the long-term outlook.[53] This would improve transparency regarding how service providers' expectations and assessment of risks evolve over time. This increased transparency should support greater scrutiny and understanding of changes in the assumptions underpinning AA proposals.

51 Submissions to the directions paper: AGL, p. 2; JGN, pp. 16-17, ENA, pp. 2-4, 13; AGIG pp. 4-7; APGA, pp. 6-7; AusNet, p. 3; ATCO, pp. 7-9.
52 Draft rule, NGR rule 45(2)(e) and WA NGR rule 44A(2)(e).
53 Draft rule, NGR rule 45(2)(f) and WA NGR rule 44A(2)(f).

The table below explains the draft rule requirements on service providers to explain differences between long-term outlooks.

Table 2.1: Draft rule requirements to improve transparency over changes between long-term outlooks

Circumstance when a new long-term outlook may be provided to the AER	Draft rule requirement
The service provider submits an AA proposal for an AA period	For each new long-term outlook that is prepared by the service provider after its first long-term outlook, the draft rule would require service providers to include details of any forecasts, inputs, assumptions and risks that materially differ from its previous long-term outlook and the reasons for each difference.[1] For example, assumptions in relation to government policy or electrification may change between AA proposals which would materially impact forecasts in the long-term outlook such as demand forecasts which may impact building block forecasts.
The service provider submits a revised AA proposal	If a service provider submits a revised AA proposal in response to the regulator's draft decision on its initial proposal, the service provider would include a long-term outlook that is consistent with the revised AA proposal. For example the forecasts for the first five years of the long-term outlook would be consistent with any revised allowance or approach included in the revised proposal. This would likely have consequential changes for the rest of the outlook.
The service provider submits a variation proposal	Our draft rule does not require a service provider to submit a long-term outlook in respect of a proposal to vary a service provider's AA. This is because a long-term outlook may not be required to justify a variation. However, if a service provider chooses to update its long-term outlook as part of a variation proposal, it would be required to similarly explain any material changes in assumptions.[2]

Source: [1]Draft rule, NGR rule 45(2)(f) and WA NGR rule 44A(2)(f); [2]Draft rule, NGR rule 45(4) and WA NGR rule 44A(4).

2.3.8 The regulator may provide additional guidance where needed

Our draft rule would not require the regulator to provide additional guidance to service providers on the contents or form of the long-term outlook. This is consistent with existing arrangements in respect of forecasts provided by service providers for an AA proposal. The Commission considers that it would not be appropriate for the rules to require the regulator to provide guidance on development of forecasts for the long-term outlook period where this is not currently required for forecasts in respect of its AA proposal.

However, if the regulator considers that additional guidance would be beneficial in the development of long-term outlooks by service providers, our draft rule would not prevent the regulator from providing guidance on its expectations regarding the content or form of the long-term outlook, including the development of forecasts and assumptions. We expect the regulator would consider providing guidance if different approaches taken by service providers to preparing

the long-term outlook was limiting the benefits of the outlook, for example by making it difficult for stakeholders to engage with AA proposals.

2.4 The long-term outlook and AA proposal would be developed simultaneously through an iterative process

The draft rule would require the forecasts, inputs and assumptions included in the long-term outlook to be consistent with those supporting the AA proposal for the overlapping years of the next AA period.[54] This would ensure the long-term outlook remains relevant to the proposal it supports and that, together, the long-term outlook and AA proposal present a coherent view of the service provider's expectations of the future including forecast expenditure, tariffs and its capital recovery approach.

However, our draft rule would not affect how service providers currently use different analytical approaches to develop their AA proposals, including discrete scenarios, stochastic modelling and least-regrets assessments across multiple possible outcomes. The approach used to determine the AA proposal may be different to the approach used to determine the long-term outlook.

In practice, the Commission expects service providers would generally develop the long-term outlook and AA proposal together through an iterative process to ensure that the AA proposal and long-term outlook are consistent. Both documents would be developed drawing from the service providers' view of the future, and the building blocks and reference tariffs it considers best manages the future risks outlined in the long-term outlook over the outlook period.

The long-term outlook will cover 20 years, including periods that will be subject to future access arrangement decisions. When service providers later submit proposals for those periods, they will do so using the information and circumstances available at that time. Those proposals may therefore differ materially from the earlier outlook.

The Commission considers this appropriate. The long-term outlook is not intended to constrain or predetermine future AA proposals. Rather, it provides a transparent and consistent framework for service providers to explain how their AA proposals work cohesively as a package to manage long-term risks and the potential consequences of not doing so. It provides a single reference point for understanding the service provider's expectations regarding future demand, utilisation, expenditure, tariffs and capital recovery outcomes with a sensitivity analysis to explain how forecasts may change if demand is higher or lower than forecast.

2.5 The draft rule would require the service provider to explain the consequences of its AA proposal on consumers and the service provider

The Commission considers that service providers should be required to explain the overall implications of their proposals for future prices, services and cost recovery outcomes. This would improve transparency and accountability regarding the trade-offs embedded within the AA proposal and help stakeholders better understand how long-term risks are expected to be managed.

In addition to preparing a long-term outlook, the draft rule would therefore place a requirement to provide in its AA information a separate explanation of:[55]

54 Draft rule, NGR rule 45(3) and WA NGR rule 44A(3).

55 Draft rule, NGR and WA NGR rule 72(1)(q).

- the consequences of the service providers AA proposal on:
  - the service provider, including its ability to efficiently provide safe and reliable pipeline services and to recover at least the efficient costs the service provider incurs in providing reference services
  - end users, including on prices paid and the availability of safe and reliable reference services.

This would require service providers to explain how they expect the elements of the AA proposal, taken together, to impact service providers and end users over the long-term outlook period. This would require the service provider to describe any trade-offs implicit in the AA proposal (e.g. between prices and capital cost recovery) and how these trade-offs impact outcomes for end users and service providers over the long-term outlook period. For example:

- **Increases in opex in the short term may consequently manage long-term price impacts on consumers** - service providers would be required to explain the consequences of increasing opex for the next AA period. For example, a decision to undertake significant maintenance works may increase prices in the next AA period but reduce the need for capex over the longer term, better managing price impacts on consumers as demand declines.
- **Recovering more capital now may consequently manage long-term price impacts on consumers** - a service providers would be required to explain how its proposed cost recovery approach for the next AA period is expected to impact end users and the service provider over the next 20 years. For example whether the proposed combination of capital cost recovery tools appropriately manages the impacts of long-term stranding risks and consumer price impacts.

EUAA proposed that service providers' long-term outlooks should include a forecast of unrecovered capital at the end of the outlook period.[56] Our draft rule does not explicitly require this information to be included in the long-term outlook though it may be inferred from the information in the outlook. However, we expect service providers to explain the consequences of its AA proposal on unrecovered capital as part of it explanation of its AA proposal.

The types of consequences we expect service providers to explain include:

- how its AA proposal manages the risk of stranding and what it expects to be unrecovered capital over the outlook period.
- how the AA proposal would enable service providers to efficiently operate and invest in the pipeline over the outlook period
- what its AA proposal would mean for the prices consumers are likely to have to pay over the outlook period and the availability and the safety, security and reliability of services over this period.

Service providers would draw on the analysis in the long-term outlook to inform this explanation including the sensitivity analysis, risk assessment and relevant building block forecasts.

The purpose of these explanations is to:

- provide stakeholders clearer insight into how a service provider has considered the consequences of long-term risks on end users and the service provider in developing its AA proposal, including any trade-offs implicit in the AA proposal (e.g. between prices and capital cost recovery)

56 EUAA, Submission to the directions paper, p. 3.

- help the regulator determine how changing the AA proposal would alter the consequences of the AA proposal on service providers and end users over time.

The Commission expects this requirement would improve the quality of stakeholder engagement by enabling stakeholders (including consumers, the regulator and governments) to better assess whether proposed approaches appropriately manage long-term transition risks.

2.6 The draft rule would require the regulator to explain the consequences of their AA decisions, having regard to the long-term outlook

The Commission considers that greater transparency is required not only in relation to AA proposals, but also in relation to regulatory decisions.

While the regulator are increasingly considering long-term issues as part of their AA decisions, it is not always clear how long term considerations have influenced final outcomes or how those outcomes are expected to affect consumers and service providers over time.

The draft rule would therefore explicitly require the regulator to consider the service provider's long-term outlook and explain how it has informed its decision. Under the draft rule, the regulator would be required to explain:[57]

- the consequences of the regulator's decision, over the long-term outlook period, on:
  - the service provider, including its ability to efficiently provide safe and reliable pipeline services and to recover at least the efficient costs the service provider incurs in providing reference services
  - end users, including on prices paid and the availability of safe and reliable reference services
- how the long-term outlook has informed the regulator's assessment of the consequences of the regulator's decision on the service provider and end users
- if the regulator has used inputs and assumptions that materially differ from the inputs and assumptions in the long-term outlook and that impact the consequences of the AER's decision on the service provider and end users, why it has done so and what the alternative inputs and assumptions it has used are.

The draft rule would require the regulator to explain the consequences of its decisions for consumers and service providers over the long-term outlook period. This mirrors the obligation on service providers outlined in section 2.5 above, and recognises that regulatory decisions can materially influence future prices, cost recovery outcomes, and a service provider's incentive and/or ability to provide safe and reliable services and/or continue to operate. Stakeholders should therefore be able to understand not only what decision has been made, but also the consequences the regulator expects that decision to have over time.

Our draft rule would not require the regulator to produce its own long-term outlook to support its analysis. Instead, the service provider's long-term outlook would provide a common reference point for the regulator to assess the consequences of its decision. While the regulator would have flexibility to determine how the long-term outlook would inform its decision, our draft rule would require the regulator to explain how it has taken the long-term outlook into account when assessing the consequences of its decision. In practice, we expect the regulator to engage with service providers prior to the regulator making its decision, should the regulator require any additional information from service providers.

57 Draft rule, NGR and WA NGR rules 59(4), 62(4) and 67(b).

Where the regulator uses inputs and assumptions that materially differ from those used in the long-term outlook when assessing the consequences of its decision, our draft rule would require the regulator to explain, as part of its decisions, those differences and the reasoning supporting its alternative assumptions.

This reflects the Commission's view that the primary purpose of the long-term outlook is transparency. The long-term outlook represents a comprehensive analysis of the service provider's expectations, inputs and assumptions. By requiring the regulator to engage directly with that analysis, the draft rule would enable stakeholders to understand where the regulator agrees with the service provider, where it disagrees, and why.

This would support our intent to improve transparency over the assessment of long-term risks and provide stakeholders with greater visibility of the judgement exercised in regulatory decision-making. For example, the regulator may have materially different demand assumptions which would inform its assessment of stranded asset risk and therefore its decisions on accelerated depreciation.

Importantly, under our draft rule, the long-term outlook would not bind future decisions by the regulator. Rather, the Commission's intent is to improve transparency regarding how the regulator considers long-term risks and uncertainties and how its decisions are expected to affect the service provider and end users over time. The Commission considers that these requirements would provide greater transparency regarding how long-term considerations have informed regulatory decisions, while preserving the regulator's discretion to respond to the circumstances of each AA review.

2.7 We consider our more preferable rule would better contribute to the achievement of the NGO than the rule change request

2.7.1 We considered ECA's rule change request

Service providers, retailers and the AER generally support the long-term outlook as a transparency and decision-making tool that informs AA proposals and decisions.[58]

Consumer and interest groups supported the long-term outlook requirements but considered the role of the long-term outlook should extend beyond supporting regulatory decision-making.[59] In their submissions to the directions paper, these stakeholders suggested the long-term outlook should function as a network planning tool. Stakeholders suggested expanding the contents of the long-term outlook to require the publication of a granular, locational network data. ECA suggests that more granular data could inform locationally-specific electricity network augmentation expenditure requirements arising from electrification and reveal the most prospective areas for strategic network decommissioning.[60] This is consistent with ECA's rule change to require service providers to publish a GAPR.

ECA's planning rule change request seeks to address an information and planning gap arising from the expected long-term decline in gas network utilisation. ECA argues that governments, electricity networks, consumers and other stakeholders lack sufficient visibility of where demand is declining, where future expenditure may be required, and where opportunities may emerge for demand management, electrification and strategic decommissioning.[61] In particular, ECA notes

58 Submissions to the directions paper: ATCO, p. 6; AGIG, pp. 3-4; Jemena, p. 16; AusNet, p. 2; ENA, pp. 3, 13; AGL, pp. 2-3; Origin, pp. 3-4; APGA, p. 6; Alinta, p. 3; AER, pp. 1, 3; Evoenergy, p. 5; IEEFA, p. 7.

59 Submissions to the directions paper: ECA, p. 10; JEC/SACOSS, pp. 8-9; VEFN, pp. 10-11; IEEFA, p. 7.

60 ECA, Submission to the directions paper, pp. 10-11.

61 ECA Rule change request - New gas planning requirements, p. 5.

that gas distribution networks are not currently subject to planning obligations comparable to those that apply to electricity networks and that stakeholders are therefore "largely guessing" about when, where and at what rate consumers will leave the gas network.[62] ECA considers that greater transparency and more granular planning information are required to support coordinated decision-making and reduce the risk of inefficient future investment and higher consumer costs.[63] Appendix A.6 outlines this rule change request in more detail.

The Commission agrees that there is a need for greater transparency regarding future demand decline and long-term transition risks. We also agree that information asymmetries make it difficult for stakeholders to understand how declining demand may affect expenditure, tariffs, capital recovery and stranding risks.

The Commission considers that the central and more immediate challenge requiring reform is greater transparency over how long-term demand risks and uncertainties are considered in AA proposals and decisions to ensure transition risks are surfaced and managed earlier while more options to manage these risks are available. The long term outlook under the draft rule would provide a transparent and accountable framework for identifying risks and uncertainties relating to demand for reference services over the long-term and for assessing how AAs are expected to affect consumers and service providers over time. The draft rule would improve visibility of long-term demand risks, network utilisation, expenditure requirements, tariffs, capital recovery, stranding risks and potential future repurposing or decommissioning activities.

In doing so, the draft rule would address much of the information asymmetry identified by ECA. Stakeholders would gain greater visibility of the service provider's expectations regarding future network utilisation, investment requirements and exposure to transition risks, together with the assumptions and analysis supporting those expectations. This would provide a clearer basis for stakeholder engagement and regulatory scrutiny of AA proposals and decisions.

The long-term outlook would be less granular and provided less frequently than ECA's proposed GAPR. The Commission acknowledges ECA's view that more granular network information may assist governments, electricity networks and other stakeholders to identify opportunities for strategic decommissioning and coordinate local electrification initiatives. However, some stakeholders stated that providing more granular information may be costly.[64] The Commission considers that the benefits of more granular planning information would be most realised within a broader policy and regulatory framework for gas network decommissioning. As gas demand declines and increasing numbers of consumers switch to alternative energy sources, situations may arise where it is no longer efficient to continue supplying a particular part of the network and where strategic decommissioning may better promote the long-term interests of consumers. A decommissioning framework would provide greater clarity regarding when and how such decisions should be made and support a more orderly energy transition.

The Commission acknowledges that there is currently a gap in the regulatory framework in this regard. While we are not considering decommissioning arrangements as part of this rule change process, the Commission recognises the importance and urgency of this issue, particularly given the uncertainty surrounding the pace and distribution of demand decline across jurisdictions. Some service providers may reach these decisions points earlier than others, increasing the need for clear and coordinated arrangements to support future decommissioning decisions. The Commission is working with jurisdictions to consider the best approach forward.

62 ECA Rule change request - New gas planning requirements, p. 15.

63 ECA Rule change request - New gas planning requirements, p. 15.

64 Submissions to consultation paper: AGIG, p. 20; Jemena, pp. 21-22; ENA, pp. 19-20; APGA; p. 36; AER, submission to the directions paper, p. 3.

In the meantime, jurisdictions that identify a need for more granular network information to support their planning and policy objectives could consider introducing licensing obligations requiring gas distribution businesses to provide more detailed network and pipeline planning information.[65]

2.7.2 Our draft rule promotes the NGO and takes into account the RPPs

Our draft rule would promote the NGO by improving transparency of long-term considerations in the AA process. This would support more informed and efficient decision-making by service providers and the regulator.

Specifically our draft would:

- **improve outcomes for consumers** - greater transparency about how long-term risks are managed would:
  - provide confidence to stakeholders that decisions are made in the long-term interest of consumers
  - support consumers and other stakeholders to effectively engage in the AA process.
- **promote principles of market efficiency** - greater transparency about how long-term risks are managed should promote efficient investment in, operation and use of pipeline services over the longer-term.
- **support safety, security and reliability of services and broader gas market reform over the longer term -** requiring service providers and the regulator to explain the consequences of its proposals and decisions on the provision of reference services over the long-term outlook period would include long-term consequences on safety, security and reliability of services. Greater transparency over the consideration of these consequences could help jurisdictional governments, safety the regulator and other relevant bodies make more informed decisions about the future operation of the network or pipeline. This would also improve accountability over long-term safety, security and reliability outcomes.
- **align with good regulatory practices -** by promoting internal consistency across the elements of a service provider's AA proposal and regulatory decision-making within an AA period and over time.
- **not impose a material implementation burden on the service provider and the regulator** - by aligning new obligations with current informal approaches for incorporating long-term analysis into AA proposals and decisions, and building on these approaches to provide a broad range of stakeholders with more valuable and transparent insight into critical decision-making.

We have taken the RPPs into account in making our draft rule. The draft rule would improve transparency over how service providers are expected to recover at least their efficient costs over the long-term. For example, requiring the regulator to explain the consequences of its AA decision on service providers would improve transparency over how the the regulator decision on the service provider's proposed approach to capital cost recovery would impact the service provider's ability to recover at least their efficient costs.

65 For example, the Victorian Government recently introduced new licensing obligations requiring Victorian gas distribution businesses to provide more granular demand and usage information. See Victorian Government Gazette, *Gas Distribution Network Data Ministerial Licence Condition 2026*, No. S 407, 15 July 2026.

3 How our draft rule to amend the capital cost recovery rules would operate

Our draft rule would amend the capital cost recovery provisions to help support efficient capital recovery that promotes the long-term interests of gas consumers through the energy transition. That is, by helping to minimise the risk that uncertain and/or declining demand pose for both gas consumers and service providers of gas distribution networks and transmission pipelines (pipelines).

The draft rule is broadly consistent with the policy direction set out in the directions paper, although we have made some refinements in response to stakeholder feedback and our own further analysis. Figure 3.1 provides an overview of the draft rule, which would involve changes to the depreciation, treatment of inflation, redundant capital and return of redundant capital tools.[66]

Figure 3.1: Overview of the draft rule changes in the capital cost recovery provisions

Capital cost recovery rules would be amended to support efficient capital recovery that promotes gas consumers' long-term interests

Depreciation

Our draft rule would support the efficient recovery of capital by providing more guidance on when and how this tool should be used, including by:
- Amending the depreciation criteria to:
  - Require consideration to be given to the depreciation profile that promotes economic efficiency rather than reference tariffs that promote growth.
  - Remove qualifications to using the best forecast or estimate of an asset's economic life.
  - Require separate consideration to be given to a service provider's reasonable needs for cash flow.
- Setting out when different depreciation profiles may be appropriate and requiring regulatory models to allow for accelerated, straight-line and deferred depreciation profiles.

Treatment of inflation

Our draft rule would support the efficient recovery of compensation for inflation by:
- **Introducing a decision point for how inflation is to be treated in an AA period.**
- **Providing more guidance on when and how this tool should be used by:**
  - Setting out when a real (indexed) or nominal (unindexed) approach may be appropriate and requiring regulatory models to allow for both approaches.
  - Allowing for an inter-period smoothing mechanism to be used to smooth the impacts of any change in treatment of inflation over a 10-year period (two AA periods).

Redundant capital and return of redundant capital

Our draft rule would enable the redundant capital and return of redundant capital tools to be used to replicate what would occur in a workably competitive market, by:
- **Amending the redundant capital provisions to:**
  - Separately recognise full redundancy and partial redundancy.
  - Provide more guidance on when and how this tool should be used.
  - Allow the regulator to remove partially redundant capital, subject to rules that would set out:
    - when the regulator could use this tool
    - how the regulator is to determine the value of the capital to be removed.
- **Amending the return of redundant capital provisions to:**
  - Enable partially redundant capital to be returned to the capital base and recovered from consumers if there is a reasonable opportunity to do so.
  - Provide guidance on how to determine the value of redundant capital returned to the capital base.

Our draft rule would also support regulatory decisions that are in the long-term interests of consumers by:
- **Clarifying the role of the regulator** when determining when and how to use the depreciation, treatment of inflation, redundant capital and return of redundant capital tools.
- **Providing for greater transparency and accountability** of:*
  - service providers' capital cost recovery proposals
  - the regulator's capital cost recovery decisions,

  Including by requiring service providers and the regulator to explicitly consider the NGO and RPPs.

***Long-term outlook**
Our draft rule on the long-term outlook would also support greater transparency and accountability of these decisions, by requiring service providers and the regulator to report on the longer-term impacts of their capital cost recovery proposals and decisions on reference tariffs and cost recovery.

At a high level, the draft rule would enable service providers and the regulator to use each tool, as appropriate, to respond to uncertain and potentially declining demand. It would also provide greater guidance on when and how the tools should be applied. Our draft rule would clarify the regulator's role in relation to each tool and strengthen accountability by requiring service providers

66 Rule 86 of the NGR and WA NGR currently refer to the re-use of redundant assets. Our draft rule would replace the heading with 'Return of redundant capital'.

and the regulator to transparently explain how the use of the tools have been informed by long-term risks, uncertainties and trade-offs.

Together, the Commission expects these elements of the draft rule to promote the NGO by improving outcomes for consumers over the longer term, promoting principles of market efficiency, supporting the safety, security and reliability of services and promoting principles of good regulatory practice, including by emulating what would occur in a workably competitive market.[67]

Our draft rule, which is a more preferable draft rule, differs from that proposed by both ECA and JEC. This is because, while the Commission agrees with a number of the underlying concerns raised by ECA and JEC (many of which are being addressed through other aspects of the draft rule), it does not consider that inefficiently constraining the recovery of capital in the manner they have proposed would be in gas consumers' long-term interests and so would not promote the NGO.

This chapter provides further detail on:

- the limitations that we have identified with the current capital cost recovery rules and how our draft rule would address those problems (section 3.1)
- how our draft rule on depreciation, the treatment of inflation, redundant capital and return of redundant capital would operate and how we considered stakeholder views when developing the draft rule (section 3.2 - section 3.4)
- our consideration of the ECA and JEC rule change requests (section 3.5)
- how our more preferable draft rule is expected to better contribute to the achievement of the NGO and how we have taken into account the RPPs (section 3.6).

3.1 Improvements to the current framework could help support efficient capital cost recovery that promotes consumers' long-term interests

3.1.1 Our draft rule would address a number of limitations we have identified in the current capital cost recovery rules

The NGR currently provides for a number of complementary capital cost recovery tools, including the depreciation, treatment of inflation, redundant capital and return of redundant capital tools.

As the energy transition progresses, we expect these tools to play an increasingly important role in helping to avoid a disorderly transition and mitigate the risks that uncertain and/or declining demand pose for both gas consumers and service providers. As discussed in more detail in chapter 1, these risks include:

- **For consumers,** the risk of escalating and volatile reference tariffs, the risk that the reliability and/or safety of services deteriorates and/or the risk that a service provider decides to cease operations prematurely, all of which could have a range of adverse impacts on those consumers that remain connected to a pipeline.
- **For services providers,** the risk of stranding, which may affect the service provider's incentive and/or ability to continue to operate, invest where it is necessary and efficient to do so, and provide safe and reliable services to those consumers that remain connected to a pipeline.

67 At a high level, the term 'workably competitive market' is used to refer to a market where suppliers are constrained by their rivals from exercising market power over time and consumers can readily switch between alternative suppliers. In such a market, if gas prices started to exceed the price of electricity or other energy sources, then gas consumers would switch to suppliers of the alternative energy sources. Gas distribution service providers would therefore need to respond by reducing their prices to ensure that, on a delivered basis, gas can continue to compete with these other energy sources.

These risks, which are interdependent, highlight the exposure that service providers have to gas consumers' decisions about when to switch to an alternative energy source and the exposure that gas consumers have to service providers' decisions about how to manage their exposure to stranding risk.

It is therefore important that these tools are fit for the future and that service providers and the regulator can use these tools, as and when required, to help manage these risks collectively and support efficient capital recovery that promotes the long-term interests of gas consumers.

We have identified several limitations with the current capital cost recovery provisions, based on our review of the rules, how these rules have been applied and stakeholder feedback.[68] These limitations are described in further detail in the sections below, but at a high level the limitations stem from the fact that the capital cost recovery provisions do not currently:

- Enable some of the tools to be efficiently and effectively used by service providers and the regulator to help mitigate the impacts of uncertain or declining demand on consumers and service providers.
- Provide sufficient guidance to service providers or the regulator on when and how each tool should be used.
- Employ an appropriate regulatory decision-making model for the depreciation, treatment of inflation and redundant capital tools.
- Provide for an appropriate level of transparency or accountability for service providers' capital cost recovery proposals and the regulator's decisions on the use of these tools.

Our draft rule seek to address these limitations in the current rules so that the capital cost recovery tools can be used to help support efficient capital recovery that promotes the long-term interests of consumers through the energy transition. It also recognises the need to maintain flexibility in the rules to accommodate the different circumstances that service providers may be facing.

3.1.2 Our draft rule would allow for timely use of the capital cost recovery tools to help mitigate the adverse impacts of declining demand

Service providers and the regulator would be able to use the depreciation and treatment of inflation tools to align capital and inflation recovery with the expected use of the pipeline

Under our draft rule, if a service provider's long-term outlook shows that it is facing declining demand and stranding risk, the service provider could propose the use of the following:

- **Depreciation tool:** The service provider could propose that this tool be used to better align the recovery of capital with the expected use of the pipeline over its remaining economic life through a reduction in the economic lives and/or the use of an accelerated depreciation profile, where that is consistent with the rules and NGO. In this regard, it is worth noting that a straight line depreciation profile is a simple proxy of pipeline utilisation that may work relatively well when demand is relatively stable, but does not produce economically efficient outcomes when demand is declining. That is why the regulator in other jurisdictions and sectors allow service providers that are facing declining demand to use accelerated depreciation profiles.[69]

68 These limitations are set out in more detail in sections B.3-B.5 of the directions paper. AEMC, Directions paper: National Gas Amendment (Gas Networks in Transition) Rule, 19 March 2026, pp. 47-69.

69 We set this out in the case studies included in our consultation paper. AEMC, Consultation paper National Gas Rule Amendments 2026 (Gas networks in transition), 18 September 2025, Appendix A.

- **Treatment of inflation tool:** The service provider could propose that this tool be used to cease deferring the recovery of inflation compensation by moving to a nominal (unindexed) approach, where that is consistent with the rules and NGO. Given the potential for this change to result in a material increase in prices, the regulator may require an inter-period smoothing mechanism be used to smooth the impacts over a 10-year period.

The service provider would have to explain how these proposals are consistent with the NGO and how it has applied the RPPs. The service provider would also have to explain the longer-term consequences of its proposal on its customers (including on reference tariffs and reference services), as well as its ability to continue to provide safe and reliable services and to recover at least the efficient costs of providing reference services.

The regulator would be required to consider the service provider's proposal having regard to the additional guidance in the rules on the circumstances in which the alternative approaches to depreciation and treatment of inflation may be appropriate. The draft rule would also require the regulator to approve the service provider's proposal unless it identifies an approach that better contributes to the achievement of the NGO.

If the regulator requires an alternative depreciation or treatment of inflation approach to be used (e.g. if it requires a straight line depreciation profile to be used instead of an accelerated depreciation profile or a real approach to be used instead of a nominal approach), the regulator would need to set out the reasons for that decision and explain how its approach better contributes to the NGO and how it has taken into account the RPPs. Like service providers, the regulator would also need to explain the longer term consequences of its decisions on consumers and the service provider.

Early use of the depreciation and treatment of inflation tools can help to mitigate the risk of inefficiently high and escalating prices for consumers over time. However, using these tools earlier may result in higher prices for consumers in the near term than would otherwise occur. While such price increases may be efficient and better align cost recovery with the use of the pipeline, there is a risk that they could influence some customers' decisions about whether and when to cease using gas and disconnecting from the pipeline.

At the same time, bringing forward the recovery of capital and ceasing to defer the recovery of inflation compensation may assist in maintaining service providers' incentives to continue operating and investing in the safe and reliable provision of services to consumers that remain connected. Service providers and the regulator would therefore need to carefully consider the timing and application of these tools, having regard to the potential impacts on both current and future consumers, as well as service providers' incentives and obligations.

Importantly, the use of these two tools would not immunise service providers from the risk of stranding (i.e. the risk that they cannot recover a full return of and on capital). Rather, in line with the current arrangements, that risk continues to sit with the service provider. This is because if demand falls faster than expected, or there are other technological or market developments that constrain what a service provider can charge, then service providers may be unable to recover all the capital they have invested.

Service providers and the regulator would also be able to use the redundant capital tool to remove full and partially redundant capital from the capital base

We consider the depreciation, treatment of inflation and redundant capital tools to form a balanced package of tools that service providers and the regulator would be able to use over time. That is, during the early stages of any decline in demand when there are a relatively large number

of customers still connected to the pipeline, the depreciation and treatment of inflation tools could be used to bring forward the recovery of capital and compensation for inflation. However, once it becomes clear that stranding can no longer be averted (i.e. when competition from alternative energy sources becomes evident), the service provider or regulator would be able to use the **redundant capital tool** to remove the following from the capital base:

- *Fully redundant capital* could be removed where an asset ceases to contribute in any way to the delivery of pipeline services, as per the current rules.
- *Partially redundant capital* could be removed where an asset contributes to the delivery of pipeline services but is underutilised, at the election of the service provider at any time, or by the regulator subject to the following conditions:
  - The regulator could only require partially redundant capital to be removed where it considers it necessary to respond to competition from competing energy sources or pipeline services to which a hypothetical end user could switch in the AA period, or to replicate what would otherwise occur in a workably competitive market in that period. As this assessment is focused on competitive conditions arising during the AA period, the regulator could not use this tool to address the risk of stranding that may emerge beyond that period.
  - If the regulator requires partially redundant capital to be removed, it would be required to determine the amount having regard to:
    i. the service provider's reasonable needs for cash flow to meet debt financing costs and non-capital costs relating to the provision of reference services
    ii. the price of any competing energy sources or pipeline services to a hypothetical end user who can readily switch to these energy source or pipeline service, including the costs of switching[70]
    iii. the NGO and RPPs.

The emphasis placed on the price of competing energy sources or pipeline services that a **hypothetical end-user who can readily switch would pay** in (ii) is intended to reflect the competitive constraint that a service provider operating in a **workably competitive market** would face. In such a market, gas users would not face any barriers to switching. We have adopted the term 'hypothetical end-user' because there may come a point where there are no remaining end-users able to readily switch to alternative energy sources or pipeline services. In these circumstances, the relevant competitive constraint is best understood by reference to the price that a hypothetical end-user who could readily switch would pay for the competing energy source, or pipeline service (see section 3.4.2 for detail). Importantly, this isn't the only factor the regulator would need to consider. It would also need to consider the matters in (i) and (iii).

If the regulator requires redundant capital to be removed from the capital base, it would need to set out the reasons for its decision and explain how its decision contributes to the NGO and takes into account the RPPs.

Service providers and the regulator would be able to use the return of redundant capital tool to add redundant capital back to the capital base

If it subsequently becomes possible for any redundant capital to be recovered through reference tariffs, then the service provider and regulator would be able to consider using the **return of redundant capital tool** to add the following back to the capital base:

70 The costs of switching are expected to be amortised over time, not just be added to the price of competing energy sources.

- *Fully redundant capital* if the asset starts to contribute to the delivery of pipeline services and satisfies the new capex criteria, as per the current rules.
- *Partially redundant capital* if there is a reasonable opportunity to recover some or all of the capital, having regard to the same matters as those used to determine the value of partially redundant capital to remove in (i)-(iii) above.

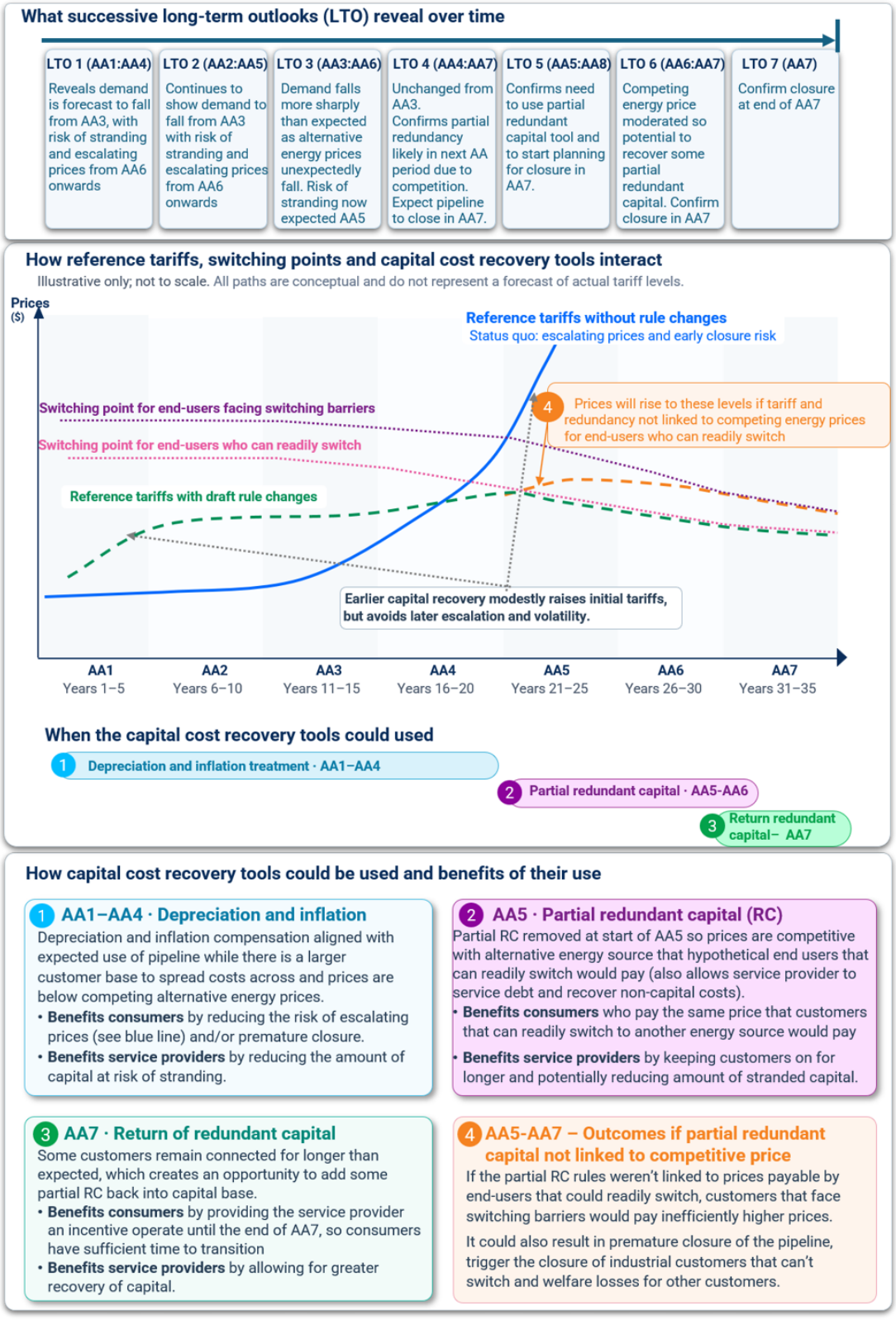
The long-term outlook would help guide the use of the capital cost recovery tools and support more efficient decision-making by service providers, the regulator and consumers

Our draft rule on capital cost recovery is intended to work together with the long-term outlook transparency and accountability measures (see chapter 2) to enable:

- service providers and the regulator to make more informed and efficient decisions about the use of the capital cost recovery tools by requiring a more holistic and longer-term assessment of when and how they should be used to help manage the impacts of declining demand
- consumers to make more informed and efficient choices about their use of a pipeline over time by requiring service providers and the regulator to report on the longer-term consequences of their proposals and decisions on reference tariffs and services.

Figure 3.2 shows how we expect the long-term outlook to inform the use of the capital cost recovery tools over time, where a pipeline is facing declining demand and competition from alternative energy sources. Note that this figure is highly stylised and had been prepared for illustrative purposes only.

Figure 3.2: Illustrative example of a pipeline experiencing significant declining demand and how the capital cost recovery tools could be used over time in response to changing conditions



Source: AEMC; *In this illustrative example, the switching point declines over time to reflect: (i) technological improvements reducing the cost of switching to alternative energy sources; and (ii) more consumers reaching the point at which their gas appliances need replacing. Assuming a constant switching point would not change the implications of the analysis.*

3.1.3 On their own, the capital cost recovery tools may be unable to address all the risks for consumers and service providers, but can help mitigate impacts

Modelling carried out by CEPA shows that timely use of the capital cost recovery tools can help reduce the impacts of declining demand on both gas consumers and service providers and support a more orderly transition. Specifically, the modelling shows that:[71]

- Aligning the recovery of depreciation and compensation for inflation with the expected use of the pipeline while there are still a relatively large number of customers and the delivered price of gas is below the price of competing energy sources, can help to:
  - smooth the impact on consumer prices over the longer term and avoid some of the other adverse impacts on consumers outlined above
  - support the recovery of efficient capital costs.
- Using the redundant capital tool when it becomes clear stranding cannot be averted can help to:
  - mitigate the impact of escalating consumer bills for those customers that remain connected
  - reduce the amount of capital at risk of stranding if the lower bills result in customers staying connected to the pipeline for longer, which could, in turn, benefit:
    - customers by providing them a longer period of time to transition
    - service providers because it may provide an opportunity to recover additional capital through prolonged operations and potentially return of redundant capital.

The modelling also shows that even if the tools are used in this way, there are limits to what the regulatory framework can achieve in addressing consumer prices impacts and the risk of stranding. The challenge of supporting an orderly transition is therefore likely to require a broader response than regulatory reform alone. Governments may have a role to play by taking additional actions outside the regulatory framework. The types of actions that could be considered are set out in chapter 1.

While the Commission encourages governments to consider these actions, it does consider that the changes to the capital cost recovery tools, together with the other elements of the draft rule, would enable more to be done within the scope of the existing regulatory framework to:

- reduce the size of the problem governments and ultimately taxpayers may need to deal with
- provide governments time to plan for an orderly transition, where that is their policy intent.

3.2 Our draft rule would amend the depreciation provisions to support the efficient recovery of capital costs

This section explains how our draft rule would amend the depreciation provisions in the NGR to support the efficient recovery of capital costs that promotes the long-term interests of gas consumers.

Figure 3.3 provides a summary of the key elements of the draft rule. As explained further in section 3.6 the Commission expects these elements of the draft rule to promote the NGO by improving outcomes for consumers over the longer term, promoting principles of market efficiency, supporting safety and reliability of services and promoting principles of good regulatory practice.

71 CEPA, Gas networks in transition: Modelling results, 6 March 2026.

Figure 3.3: Overview of draft rule depreciation provisions

Draft rule objective: Support efficient recovery of capital that promotes gas consumers' long-term interests.	

Provide rules guidance on when and how this tool should be used	• Amend the depreciation criteria to:
	  • Require consideration to be given to the depreciation profile that promotes economic efficiency.
	  • Remove qualifications to using the best forecast or estimate of an asset's economic life.
	  • Require separate consideration to be given to a service provider's reasonable needs for cash flow.
	• Set out when the accelerated, straight-line and deferred depreciation profiles may be appropriate and require any regulatory models developed by the regulator to allow for these profiles.

Clarify the regulator's role	• Require the regulator to approve the service provider's proposal unless it determines an alternative approach would better contribute to the achievement of the NGO.
Provide for greater transparency and accountability	• Require service providers and the regulator to consider and report on how the NGO and RPPs have been considered in their depreciation proposals and decisions. • Through the long-term outlook, require service providers and regulator to report on impacts of their proposals and decisions on reference tariffs and capital cost recovery over 20-year outlook period.

Our draft rule is broadly consistent with the policy direction set out in the directions paper. However, as explained in further detail below, we have made some refinements in response to stakeholder feedback and our own analysis.

Stakeholders expressed mixed views on our proposed direction on depreciation. Service providers, pipeline associations, most retailers and one independent organisation broadly supported the proposed direction, noting that it would help to mitigate the risk of escalating prices over time,[72] while the AER, consumer groups and some other stakeholders were opposed to the changes because they were concerned it would tilt the balance of cost recovery in favour of service providers.[73] Alinta expressed more of a mixed view, noting that accelerated depreciation should be applied where risk is clearly demonstrated, and the cost is "equitably shared between customers and the service provider".[74]

Those stakeholders that were opposed to the changes noted their concerns that the changes would enable accelerated depreciation to be used more readily and that this would:

- result in a transfer of cost and risk from network investors to consumers[75]

72 Submissions to directions paper: ENA, pp. 4-5; Evoenergy pp. 1-3; Jemena pp. 1, 9-10; AusNet pp. 1, 4; AGIG, p. 8; APA, pp. 7-8; ATCO p. 10; APGA, p. 2; EUAA p.3; Origin, p.4; AGL p.3; A. Hudson, pp.3- 4; VEFN, p. 9.

73 Submissions to directions paper: IEEFA, pp. 1, 7; AER, p.5; ECA, p. 12; JEC/SACOSS, p. 11; BSL, p. 3; Environment Victoria, p. 6.

74 Alinta, Submissions to directions paper, p. 4.

75 Submissions to directions paper: ECA, p. 13; BSL, p. 3; Environment Victoria, p. 6; IEEFA, p. 3; JEC-SACOSS, p. 11.

- increase customer bills without meaningfully reducing stranding risk,[76] and potentially trigger disconnections and a reduction in use of the pipelines.[77]

The ECA, for instance, stated that the proposed direction on accelerated depreciation is "heavily weighted towards guaranteeing network cost recovery", but the RPPs do not guarantee full cost recovery.[78] JEC/SACOSS also submitted that a "reasonable opportunity to recover efficient costs does not constitute a guarantee".[79]

The Commission acknowledges this feedback and agrees that current judicial commentary on the RPPs suggests that a reasonable opportunity does not guarantee recovery of costs, efficient or otherwise.[80] The draft rule supports the provision of a reasonable opportunity to recover efficient cost, but importantly does not guarantee that service providers will recover their efficient costs. For the reasons set out in section 3.1, the Commission considers that early use of accelerated depreciation can help to manage price risks for consumers over the longer term, while preserving service providers' incentives to continue to provide those customers that remain connected to the network safe and reliable services, both of which are in gas consumers' long-term interests. We also note that the draft rule would provide flexibility to change the economic lives of assets and/or depreciation profile over time as new information comes to light. For example, if demand doesn't fall as quickly as expected the level of acceleration could be reduced, Similarly, if there was a policy change that extended the economic lives of the assets, then this could also be changed. In the Commission's view this provides for a balanced way to manage the risks posed by declining demand.

Further detail on the feedback provided by stakeholders and how the draft rule would operate in relation to providing more rules guidance and removing potential constraints on the efficient use of the depreciation tool (section 3.2.1), the decision-making model for depreciation (section 3.2.2), and the transparency and accountability measures applying to depreciation proposals and decisions (section 3.2.3) is provided in the following sections.

3.2.1 The draft rule would provide more rules guidance on when and how the depreciation tool should be used and remove potential constraints on its efficient use

Our draft rule would amend the current rules to provide more guidance on when and how the depreciation tool should be used and remove potential constraints on its efficient use, by:

- Replacing the current requirement for the depreciation schedule to be designed so reference tariffs vary over time in a way that promotes efficient growth, with a requirement for the schedule to be designed so that the depreciation profile promotes economic efficiency.[81]
- Require the regulator to consider when different depreciation profiles (i.e. straight-line, accelerated and deferred profiles) may be appropriate and requiring any financial models developed by the regulator to allow depreciation to be calculated using a straight-line, deferred and accelerated profile.[82]
- Removing the 'as far as reasonably practicable' qualification to adjusting economic lives, to allow economic lives to be set using the best forecast or estimate.[83]

76 Submissions to directions paper: ECA, p. 3; JEC/SACOSS, p. 15.
77 AER, Submission to directions paper, p. 5.
78 ECA, Submission to directions paper, p. 6.
79 JEC/SACOSS, Submission to directions paper, p. 12.
80 See for example, *Application by EnergyAustralia and Others* [2009] ACompT 8.
81 Draft rule, NGR and WA NGR rule 89(1)(a).
82 Draft rule, NGR and WA NGR rule 89(4) and draft rule, NGR and WA NGR rule 75A(2).
83 Draft rule, NGR and WA NGR rule 89(1)(c).

- Changing the depreciation criteria so that when designing the depreciation schedule, regard must be had to the service provider's reasonable needs for cash flow to meet financing, non-capital and other cost.[84]

The section below describes these aspects of our draft rule in more detail.

The draft rule would amend the depreciation criteria to require consideration to be given to the depreciation profile that promotes efficiency

Our draft rule would amend current rule 89(1)(a) to require the depreciation schedule to be designed so that the depreciation profile promotes economic efficiency with respect to reference services the service provider provides, including:[85]

- efficient investment in, or in connection with, a pipeline with which reference services are provided
- the efficient provision of pipeline services
- the efficient use of the pipeline.

As explained further in the next section, the draft rule would also require the regulator to have regard to the guidance on when each of the following types of depreciation profiles may be appropriate to use:

- straight-line depreciation profile
- accelerated depreciation profile, which results in capital recovery being accelerated relative to the straight-line depreciation profile
- deferred depreciation profile, which results in capital recovery being deferred relative to the straight-line depreciation profile.

Rule 89(1)(a) currently requires the depreciation schedule to be designed so that reference tariffs will vary, over time, in a way that promotes efficient growth in the market for reference services.[86] In the directions paper, we proposed removing the reference to demand growth to better reflect a future where demand for gas networks may be uncertain or decline over time.

All stakeholders who provided feedback on this aspect of the directions paper supported, or were not opposed to, this proposal.[87] APA recommended that rule 89(1)(a) be reframed "to equally promote longer-term stability in reference tariffs over time in circumstances of declining demand".[88]

Our draft rule is broadly consistent with the directions paper. However, rather than focusing on the impact of depreciation on reference tariffs or price stability, as suggested by APA, the draft rule requires consideration to be given to the depreciation profile that would promote economic efficiency with respect to reference services. In our view, this requirement would allow issues such as price stability to be considered when determining what depreciation profile to use, because it will have consequences for the efficient use of, investment in, and provision of pipeline services. We do not therefore consider it necessary to include a stand-alone tariff based criterion.

In practice, this change to the depreciation criteria would mean that a service provider would have to explain how its proposed depreciation profile would promote efficient investment in the pipeline, the efficient provision of pipeline services and efficient use of the pipeline. This

84 Draft rule, NGR and WA NGR rule 89(1)(e).
85 Draft rule, NGR and WA NGR rule 89(1)(a).
86 NGR and WA NGR rule 89(1)(a).
87 Submissions to directions paper: Origin, p. 4; ATCO, p. 10; AGIG, p. 9; APA, p. 7; Victorian Energy Future Network, p. 9; AER, p. 1; APGA p. 2.
88 APA, Submission to directions paper, p. 8.

explanation would be of particular importance where a service provider is considering changing the profile and would need to be justified, having regard to the longer term outlook for demand and the risks facing the pipeline. If the regulator requires a different depreciation profile to be used, it would also need to explain why that alternative profile better reflects the depreciation criteria and would better contribute to the achievement of the NGO.

The draft rule would require the regulator to have regard to the guidance on when different depreciation profiles may be appropriate and require regulatory models to allow for different depreciation profiles

Our draft rule would require the regulator to have regard to the following guidance on when each type of depreciation profile may be most appropriate.[89]

- Deferred depreciation may be appropriate where:
  - the market for pipeline services is relatively immature
  - reference tariffs have been calculated on the assumption of significant market growth
  - the pipeline has been designed and constructed to accommodate that future growth.
- Accelerated depreciation may be appropriate where use of the asset is expected to decline over the remaining economic life.[90]
- Straight-line depreciation may be appropriate where use of the asset is expected to remain relatively constant over the remaining economic life of that asset or group of assets.

In each of these cases, deferring, accelerating or using straight line depreciation should seek to support an outcome where capital recovery is aligned to the expected use of the assets.

The draft rule would also require any financial models developed by the regulator under rule 75A to allow depreciation to be calculated using these different profiles. If the regulator has published a financial model, the service provider's AA proposal must be provided using the financial models, unless the regulator approves an alternative financial model.[91]

The draft rule is broadly consistent with the directions paper, but has been refined to:

- provide rules-based guidance on each type of depreciation profile that may be used
- require any regulatory financial models developed by the regulator to allow for each profile.

Service providers broadly supported providing more guidance in the rules on when the depreciation tool should be used.

- Evoenergy suggested the rules make clear that service providers should have an opportunity to bring forward depreciation where this best achieves the NGO and RPPs.[92]
- ENA, Jemena and AusNet also suggested the rules include objectives for depreciation, consistent with the NGO and RPPs and with clear relevance to an uncertain or declining market.[93]
- APA submitted that the current rules do not adequately contemplate declining customer numbers and load and recommended that this be considered in developing depreciation

89 Draft rule, NGR and WA NGR rule 89(4); The current rules set out when deferral of depreciation may be appropriate and the draft rule expands on this by requiring the regulator to consider guidance on the use of accelerated and straight-line depreciation as well. NGR and WA NGR rule 89(2).

90 The focus on 'use of the asset' is intended to capture a range of circumstances in which accelerated depreciation may be appropriate. This includes where demand is falling, the supply of gas is falling, assets are subject technological obsolescence or other circumstances where the use of an asset may not be constant over time.

91 Draft rule, NGR and WA NGR rule 72(3).

92 Evoenergy, submission to directions paper, p. 3.

93 Submissions to directions paper: AusNet, p. 4; Jemena p. 3; ENA p. 5.

schedules. APA also noted that there may be merit in the rules more explicitly recognising the potential use of a non-linear (e.g. accelerated) depreciation schedule.[94]

The Commission has considered these suggestions but considers that the guidance outlined above, together with the requirement for service providers and the regulator to consider the NGO and RPPs, is sufficient. It is also important to note that the guidance on the circumstances in which each profile may be appropriate, is not intended to be exhaustive. However, it is intended to capture most of the cases in which it may be appropriate to use each of the depreciation profiles.

Victorian Energy Future Network also noted the guidance should be anchored in independent demand scenarios rather than service provider forecasts.[95] The Commission considers that the draft rule would allow for this to be considered by the regulator when determining the appropriate depreciation profile.

Separately, ENA stated that there should be a low evidentiary threshold for stranding risk in requesting accelerated depreciation and suggested the rules explicitly allow for front loading depreciation where the service provider expects a material risk to future cost recovery, or that the threshold be based on a 'real possibility rather than being definitively proven or quantified'.[96]

The Commission has considered this suggestion, but considers that the draft rule provides an appropriate framework for assessing whether accelerated depreciation should be used. The draft rule provides guidance on when accelerated depreciation may be appropriate. This guidance would operate together with the decision-making model (see section 3.2.2) and the requirement for both service providers and the regulator to explain how their proposals are consistent with the NGO. On that basis, the Commission does not consider it necessary for the rules to refer to an evidentiary threshold.

The draft rule would allow economic lives to be set using the best forecast or estimate

Our draft rule would remove the qualification "as far as reasonably practicable" from current rule 89(1)(c) so that any changes to the expected economic life over time reflect the best estimate or forecast of economic lives being used.[97]

We did not identify this change in the directions paper. However, we consider it necessary to remove this qualification to ensure that the NGR does not unnecessarily constrain changes in the economic lives of assets. The Commission considers that economic lives should be updated if new information indicates the existing lives no longer reflect the best forecast or estimate possible in the circumstances. This is consistent with the requirements in rule 74 of the NGR.

Separately, Evoenergy and Jemena suggested we consider defining the term 'expected economic life' in rule 89(1)(c).[98] Elaborating on this further, Jemena stated that there would be:[99]

> "…benefit from removing potential for contention on establishing economic lives… [a]pproaches 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

94 APA, Submission to directions paper, pp. 7-8.
95 Victorian Energy Future Network, Submission to directions paper, p. 9.
96 ENA, submission to directions paper, p. 5.
97 Draft rule, NGR and WA NGR rule 89(1)(c).
98 Submissions to directions paper: Evoenergy, p. 3, Jemena, p. 10.
99 Jemena, submission to directions paper, p. 10.

acknowledges that asset lives can later be adjusted upwards as needed."

The Commission has considered this suggestion, but does not consider it necessary to make this change. This is because rule 89(1)(c) would already appear to allow service providers to propose what Jemena has suggested, as long as they can demonstrate that their estimate of the expected economic life has been arrived at on a reasonable basis and represents the best forecast or estimate possible, consistent with rule 74. Whether or not the regulator approves that approach is a matter for the regulator, although it is worth noting that under our draft rule if the regulator takes an alternative view on the expected economic life, it would need to explain why its alternative estimate better contributes to achievement of the NGO.

The draft rule would require consideration of the service provider's reasonable needs for cash flow

Our draft rule would require the depreciation schedule to be designed having regard to the service provider's reasonable needs for cash flow to meet financing, non-capital and other costs.[100]

This differs from the current rule 89(1)(e), which may have been interpreted as stating the service provider's reasonable needs for cash flow as a criterion that must be jointly met along with the other depreciation criteria.

We did not identify this change in the directions paper. However, we consider it necessary because there is a risk that if depreciation is accelerated early, then towards the end of the life of an asset it may not be possible to ensure that the service provider's reasonable needs for cash flow are met. The draft rule treats the service provider's reasonable needs for cash flow as a matter that must be considered when designing the depreciation schedule, although it would not guarantee that those needs will be met in all circumstances.[101]

3.2.2 The draft rule would require the regulator to approve a service provider's proposal unless there is an alternative that better contributes to the NGO

Under our draft rule, a service provider would be required to state its proposed approach to recovering depreciation. The regulator would then be required to approve the proposed approach unless it determines that an alternative approach that reflects the depreciation criteria would better contribute to the NGO.[102]

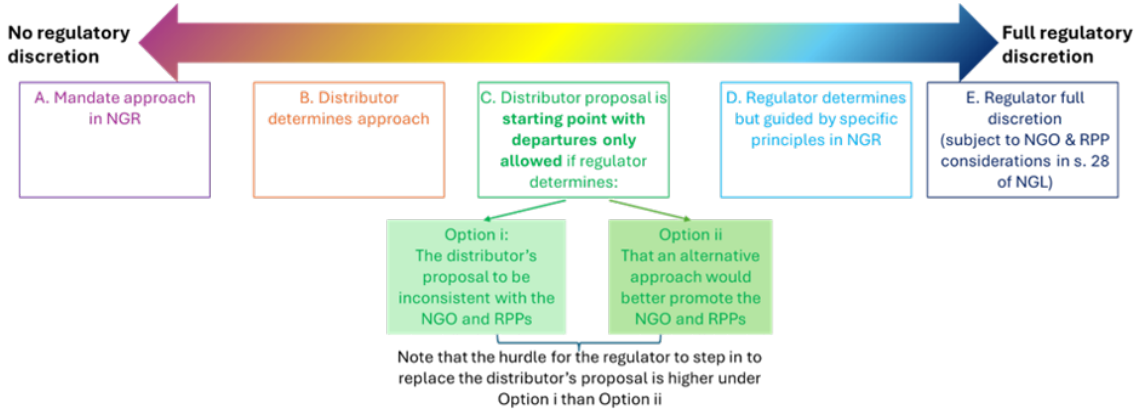
This is a refinement from the directions paper. In the directions paper we noted that there were five potential decision-making options (see Figure 3.4) that could be used and that Option C was likely to be more appropriate than the other options because where service providers face stranding, they are likely to be well-placed and have a strong incentive to appropriately balance the risks associated with accelerating depreciation and triggering early exit. We also noted that we were yet to form a view on whether sub-option C(i) or C(ii) should be used and sought stakeholder feedback on the options.

100 Draft rule, NGR and WA NGR rule 89(1)(e).

101 Requiring the cash flow to be separately considered is similar to what occurs for the financeability adjustment for transmission network service providers in respect of ISP projects. NER clause 6A.6.3A.

102 Draft rule, NGR and WA NGR rule 89(2)-(3).

Figure 3.4: Potential decision-making models



Source: AEMC

In the draft rule we have adopted sub-option c(ii) and framed the approval threshold as requiring the regulator to approve a service provider's proposal unless it determines that an alternative approach that reflects the depreciation criteria would better contribute to the achievement of the NGO. This differs from the current rules, which provide the regulator with broader discretion regarding depreciation.

Stakeholders expressed mixed views on the appropriate level of regulatory discretion for depreciation. Service providers and pipeline associations supported reducing the regulator's discretion to either no regulatory discretion (i.e. Option B)[103] or limited regulatory discretion (i.e. sub-option C(i)).[104] ENA, for example, supported sub-option C(i), on the basis that service providers are best placed to manage the risks associated with their decisions.[105] Jemena, on the other hand, stated that there should be no regulatory discretion to enable service providers the best opportunity to recover efficient costs and preserve investment confidence.[106] Evoenergy, also stated that its preference was for Option B and that, in its view, sub-option C(i) was the "limit of acceptable regulator discretion".[107]

The EUAA supported Option C and noted that this provides a "balanced approach to allowing service providers to identify when assets may be at risk while ensuring the regulator retains discretion to assess proposals".[108]

By contrast, the AER, consumer groups, other interest groups and one retailer supported retaining the existing regulatory discretion.[109] The AER stated that regulatory discretion should be preserved at this stage of the energy transition, adding that there is a need for effective regulatory oversight given the potential for service provider proposals to significantly increase reference tariffs in the short term.[110] The AER also noted that some service providers' recent depreciation proposals

103 Submissions to directions paper: ATCO, p. 10; AusNet, p. 4; Evoenergy, pp. 2-3; Jemena, pp. 10-12. Note that Evoenergy stated that sub-option C(i) is the limit of what it considers acceptable. Jemena also stated that sub-option C(i) is better than C(ii). AusNet also suggested we consider Option B, but if that is not our preferred option, then it would support sub-option C(i).

104 Submissions to directions paper: AGIG, p. 9; APGA pp. 8-9; ENA p. 6. ENA and AGIG also noted that Option B may be a viable option.

105 ENA, Submission to directions paper, p. 2.

106 Jemena, Submission to directions paper, p. 12.

107 Evoenergy, Submission to directions paper, p. 2.

108 EUAA, Submission to directions paper, p. 3.

109 Submissions to directions paper: AER, p. 2; IEEFA, p. 7; JEC & SACCOS, p. 19; ECA pp. 16-17; Origin, p. 4.

110 AER, Submission to directions paper, p. 5.

would have led to significant increases in tariffs.[111] ECA supported Option D or E, adding that depreciation decisions should sit "firmly in the hands of the regulator".[112]

Some stakeholders also questioned whether service providers' incentives would align with the NGO where they face stranding risk.[113] For example, IEEFA submitted that networks may be encouraged to submit larger accelerated depreciation proposals if the regulator have less scope to reduce them and "disagreed that service providers are well-placed to determine appropriate levels of accelerated depreciation".[114]

COTA did not comment on the decision-making model, it did observe that regulatory discretion can create uncertainty and noted the need for "firm rules".[115]

The Commission considers the draft rule strikes an appropriate balance between the role of the service provider and the role of the regulator. The Commission acknowledges stakeholder concerns that service providers' incentives may not always align with the NGO. However, the Commission considers that where a service provider faces stranding risk, its incentives regarding the timing of capital recovery are likely, in most cases, to align with the NGO and the RPPs. This is because if they increase prices too much, this could trigger customer exit, which could lead to a greater amount of capital being stranded, which is not in service providers' interests. Service providers should therefore have an incentive to appropriately balance the risks associated with accelerating depreciation and triggering early exit, which would be further reinforced by the draft rule transparency and accountability requirements outlined below.

At the same time, the Commission recognises that service providers will not all face the same level of stranding risk, and that significant uncertainty remains regarding the pace and nature of the transition. For this reason, the draft rule would preserve a degree of regulatory oversight by requiring the regulator to approve the service provider's proposal unless it determines that an alternative approach better contributes to the NGO. The exercise of that discretion would also be supported by the rules guidance on when accelerated, straight-line or deferred depreciation may be appropriate.

A separate issue was raised by AGL, that consideration could be given to a bond-like mechanism to help align incentives for gas networks to operate towards an orderly decline. AGL suggested that a substantial bond or equivalent financial mechanism, such as a sinking fund, may be necessary to reduce incentives for owners to exit early and socialise costs after profits have already been recovered.[116] The Commission's view is that such a mechanism would be more appropriately considered in the context of a decommissioning framework.

3.2.3 The draft rule would provide for greater transparency and accountability of service provider proposals and regulatory decisions on depreciation

Our draft rule would require greater transparency and accountability by requiring:

- Service providers to explain, in their AA information, how their proposed approach to recovering depreciation reflects the depreciation criteria, is consistent with the NGO and applies the RPPs.

111 AER, Submission to directions paper, p. 5.
112 ECA, Submission to directions paper, pp. 16-17.
113 Submissions to directions paper: AER, p. 2; IEEFA, p. 6; JEC & SACCOS, p. 16; ECA p. 14.
114 IEEFA, Submission to directions paper, p. 6.
115 COTA, Submission to directions paper, p. 2.
116 AGL, Submission to directions paper, p. 3.

- The regulator to set out its reasons if it uses an alternative approach and to explain how the alternative approach reflects the depreciation criteria, better contributes to the NGO and takes the RPPs into account.

Our draft rule is consistent with the approach proposed in the directions paper. Stakeholder feedback did not focus specifically on this proposal in relation to depreciation, although some stakeholders did support the need for greater transparency and accountability across the capital cost recovery tools. For example, AGL supported enabling earlier and more transparent use of capital cost recovery tools where demand is declining.[117]

The Commission considers that these provisions of the draft rule, together with the provisions on the long-term outlook (see Chapter 2), would make service providers and the regulator more accountable for transparently considering and explaining the longer-term impacts of capital cost recovery proposals and decisions for reference tariffs and capital recovery and the service provider's ability to continue providing safe and reliable services.

3.3 Our draft rule would amend the treatment of inflation provisions to support the efficient recovery of compensation for inflation

This section explains how our draft rule would amend the treatment of inflation provisions in the NGR to support the efficient recovery of compensation for inflation.

Figure 3.5 provides a summary of the key elements of the draft rule. As explained further in section 3.6 the Commission expects these elements of the draft rule to promote the NGO by improving outcomes for consumers over the longer term, promoting principles of market efficiency, supporting safety and reliability of services and promoting principles of good regulatory practice.

117 AGL, Submission to directions paper, p. 3.

Figure 3.5: Overview of draft rule treatment of inflation provisions

Draft rule objective: Support efficient recovery of compensation for inflation that promotes gas consumers' long-term interests.	
Enable tool to be used in AA period	• Introduce a decision point for how inflation compensation is to be treated in an AA period.
Provide rules guidance on when and how this tool should be used	• Provide guidance on when a real (indexed) or nominal (unindexed) approach should be used and require any regulatory models developed by the regulator to allow for both approaches. • Allow an inter-period mechanism to be used to smooth the impacts of any change in inflation treatment over 10 years (two AA periods).
Clarify the regulator's role	• Require the regulator to approve the service provider's proposal unless it determines an alternative approach would better contribute to the achievement of the NGO.
Provide for greater transparency and accountability	• Require service providers and the regulator to consider and report on how the NGO and RPPs have been considered in their treatment of inflation proposals and decisions. • Through the long-term outlook, require service providers and regulator to report on impacts of their proposals and decisions on reference tariffs and capital cost recovery over 20-year outlook period.

Our draft rule is broadly consistent with the policy direction set out in the directions paper. However, as explained in further detail below, we have made some refinements in response to stakeholder feedback and our own analysis.

Stakeholders expressed mixed views on our proposed policy direction for the treatment of inflation. Service providers, pipeline associations and a number of retailers generally supported the direction.[118] AER and ECA, on the other hand, were concerned that it could further bring forward capital recovery.[119]

The Commission acknowledges the concerns that the AER and ECA have raised about the potential for the draft rule to further bring forward the recovery of capital if it results in a nominal (unindexed) approach being used. However, for the reasons set out in section 3.1, the Commission considers that early use of this tool, together with the inter-period smoothing mechanism, can help to manage the impacts of declining demand on consumers, by better aligning the recovery of compensation for inflation with the expected use of the pipeline.

Further detail is provided below on the feedback stakeholders provided and how we took it into account when developing the draft rule on the decision point for the treatment of inflation (section 3.3.1), the rules guidance (section 3.3.2), the decision-making model (section 3.3.3), and the transparency and accountability measures (section 3.4.4) for the treatment of inflation.

118 Submissions to directions paper: ENA, p. 6; APGA, p. 8; AGIG, pp. 9-10; APA, p. 8; ATCO p. 10; AusNet, p. 5; Evoenergy pp. 4-5, Jemena pp. 10-11, AGL, p. 1; Origin, p. 4.

119 Submissions to directions paper: ECA, p. 18; AER, p. 6.

3.3.1 The draft rule would enable this tool to be used where it is efficient to do so, by introducing a decision point for the treatment of inflation

Our draft rule would introduce a decision point for the treatment of inflation in each AA, which would allow the service provider to propose, and the regulator to determine, whether a real (indexed) or nominal (unindexed) approach to the treatment of inflation should be used. This would allow application of this tool depending on the individual circumstances of a service provider, given the varying demand outlook across networks.

This draft rule is intended to overcome a deficiency that we have identified in the current rules, which do not currently require the regulator to decide how inflation is to be treated in each AA period. This differs from the approach taken with depreciation, where the rules expressly provide for the regulator to make a decision on how a service provider is to recover depreciation on a case-by-case basis, having regard to the conditions facing the service provider.[120]

The draft rule is consistent with the directions paper. We received limited feedback on this proposal, although those that did comment generally supported the need for a decision point. ATCO, Jemena, AGIG and Evoenergy, for example, broadly supported the proposal.[121] APA, ATCO and the ENA also stated the rules should not mandate the use of a real or nominal approach.[122] Mr A Hudson, on the other hand, stated that the rules should mandate the use of a nominal approach for all service providers at the next AA review, because, amongst other things, maintenance of a real approach increases stranding risk and inequitable for future customers.[123]

The problem with mandating an approach, as suggested by Mr Hudson, is that a single approach may not be appropriate in all circumstances. As the AER has previously observed:[124]

- A real approach is generally more appropriate if demand is stable or growing. This is because it maintains the value of the capital base in real terms over time and, when demand is stable or growing, results in current customers paying the same amount in real terms as future users. Maintaining the real value can also reduce the potential for price shocks when assets are replaced at the end of their life.
- A nominal approach may be more appropriate if demand is declining. This is because it avoids deferring compensation for inflation to future periods when there may be fewer customers to recover this from and higher risks of stranding. It can therefore help to avoid triggering an escalation of prices in later years and reduce the risk that service providers do not recover this compensation.

As outlined in Chapter 1, service providers are not all necessarily facing declining demand at this point in time. For example, APGA observed that some networks continue to grow.[125] The Commission does not therefore consider it appropriate to mandate a single approach that would apply in all circumstances. This is consistent with the broader flexibility in the draft rule, which allows the capital cost recovery tools to be applied having regard to the circumstances facing each service provider and the expected use of the pipeline over time. The draft rule instead allows the treatment of inflation to be determined by the service provider and regulator on a case-by-case basis.

120 NGR, WA NGR rule 89.

121 Submissions to directions paper: ATCO p. 11; Jemena p. 10; AGIG p. 9; Evoenergy p. 3. Note that some of these stakeholders' support was linked to their view on the appropriate decision-making model to use.

122 Submission to directions paper: APA, p. 8; ATCO, p. 11; ENA, pp. 5-6.

123 Mr. A Hudson, Submission to directions paper, p. 4.

124 AER, Fact Sheet: Why do we index the regulatory asset base?, undated and AER, Regulating gas pipelines under uncertainty paper, November 2021, p. 34.

125 APGA, Submission to directions paper, p. 2.

3.3.2 The draft rule would provide more rules guidance on when and how this tool should be used

The draft rule would provide guidance on when it may be appropriate to use the different inflation approaches and require regulatory models to allow for different inflation approaches

Our draft rule would require the regulator to have regard to the following guidance when deciding whether to approve a service provider's treatment of inflation proposal, or to employ a different approach:

- A nominal approach may be appropriate where use of the pipeline is expected to decline over the remaining economic life of that pipeline
- A real approach may be appropriate where use of the pipeline is expected to remain stable, or grow, over the remaining economic life.

The draft rule would also require any financial models that the regulator decides to publish under rule 75A to allow for both a real and nominal approach to the treatment of inflation.[126] Where a regulator has published financial models, the draft rule would also require a service provider's AA information to be provided using the financial models, unless the regulator approves the service provider using an alternative financial model.[127]

The Commission considers that this draft rule, together with the requirement for service providers to explain how their proposed treatment of inflation is consistent with the NGO, would help the regulator to make a more informed decision on when to use the nominal or real approaches. The changes to the financial model requirements would also help to facilitate changes between these two approaches over time where a regulator has developed these models and where the change is appropriate.

The draft rule is largely consistent with our directions paper, with the main difference being the requirement for any financial models developed by the regulator to accommodate both real and nominal approaches.

Service providers were the only group of stakeholders to comment on this aspect of our directions paper. ENA and Evoenergy supported more rules-guidance on when a real or nominal approach may be appropriate.[128] Jemena also suggested the regulator's financial models permit the use of both real and nominal approaches,[129] which is provided for in our draft rule.

ENA and Jemena also suggested the rules set out clear objectives for the treatment of inflation, consistent with the NGO and RPPs.[130] The Commission does not consider it necessary to include any specific objectives in the rules, because the draft rule expressly require service providers and the regulator to consider the NGO and RPPs.

ATCO also noted the potential need for transitional arrangements where a service provider moves from a real approach to a nominal approach, including to ensure the correct value of the capital base is carried forward.[131] The Commission considers this can be managed on a case-by-case basis by the regulator and service provider, rather than requiring any changes to the rules.

126 NGR and WA NGR rule 75A currently leave it up to the regulator to decide whether they want to prepare and publish financial models. We understand that the AER has chosen to do so, but the ERA has not. Our draft rule would not change the current choice that the regulator has to publish financial models.

127 Draft rule, NGR and WA NGR rule 72(3).

128 Submissions to directions paper: ENA pp. 5-6; Evoenergy p. 3. Evoenergy's support was conditioned on the decision-making model.

129 Jemena, Submission to directions paper, p. 10.

130 Submissions to directions paper: Jemena p. 10; ENA p. 6.

131 ATCO, Submission to directions paper, p. 11.

The draft rule would enable impacts of a change in treatment of inflation to be smoothed over 10 years

Our draft rule provides for an inter-period smoothing mechanism that the regulator could use to mitigate the price impacts of a change in the treatment of inflation over a 10-year period (or two AA periods).[132] Specifically, the draft rule:

- Allows service providers to propose, and the regulator to require, a portion of the revenue that would otherwise be recovered in that period be recovered in the subsequent AA period if the approach to treatment of inflation changes.
- The regulator to be satisfied that approving or requiring the inter-period smoothing mechanism would help manage the impacts of the change in a way that promotes economic efficiency with respect to reference services, including efficient investment, efficient provision of pipeline services and efficient use of the pipeline.

While this change was not identified in the directions paper, it has been included in the draft rule in response to stakeholder feedback regarding the potential for a substantial increase in reference tariffs if a move from a real to a nominal approach were required.

The ECA, for instance, noted that moving from a real to a nominal approach is a relatively "blunt instrument" because it involves a "binary choice between indexation or no indexation" and there is no ability to calibrate the effects.[133] ENA and Jemena also noted the importance of this tool providing for stability in prices over time.[134]

The Commission understands the concerns raised by the ECA about the potential for a change to a nominal approach to result in a significant step change in reference tariffs. This is why the Commission has decided to include the inter-period revenue smoothing mechanism in the draft rule. A decision to use this smoothing mechanism would ultimately be a matter for the regulator, who as noted above would need to be satisfied that its use would promote economic efficiency.

Our draft rule requires the regulator to consider economic efficiency, because it is possible that in some circumstances, switching to the nominal approach may result in:

- reference tariffs in the AA period that while higher, still promote efficient investment, efficient provision of pipeline services and efficient use of the pipeline
- a significant step change in reference tariffs that could inefficiently bring forward customer exit decisions, or result in inefficient provision of pipeline services or investment.

The inter-period smoothing mechanism in the draft rule provides for the impacts of any change in inflation treatment to be smoothed over 10 years, which is equivalent to two AA periods. While a longer smoothing period could help to further smooth the impacts of the change, it could also reduce the effectiveness of changing the inflation approach because it would mean some of the costs are having to be recovered in future periods where there may be fewer customers. The Commission therefore considers that a 10-year smoothing period strikes an appropriate balance between enabling this tool to be used while there are still a relatively large number of customers, with mitigating the risk that higher reference tariffs lead to inefficient outcomes.

The Commission is seeking stakeholder feedback on:

- the appropriateness of a 10-year smoothing period, where the inter-period smoothing mechanism is approved or required

132 Draft rule NGR and WA NGR rule 73(5)-(7).

133 ECA, Submission to directions paper, p. 18.

134 Jemena and ENA submitted that the NGR should set out clear objectives for establishing changes to the treatment of inflation, consistent with the NGO and RPPs, including encouraging stability in prices over time. See Submissions to directions paper: Jemena, p. 10; ENA, p. 6.

- whether any financial models developed by the regulator under rule 75A should also provide for the application of an inter-period smoothing mechanism.

3.3.3 The draft rule would require the regulator to approve the service provider's proposal unless there is an alternative that better contributes to the NGO

The draft rule would adopt the same decision-making model for treatment of inflation as for depreciation (see section 3.2.2). Under this decision-making model:

- the service provider's proposal to use a real or nominal approach would act as the starting point for the regulator's assessment
- the regulator would be required to approve the service provider's proposal unless it determines an alternative approach would better contribute to the achievement of the NGO.

As with depreciation, this is a refinement on the directions paper (see section 3.2.2) and differs from the current rules, where, in practice, the approach is determined by the regulator through any published financial models.

In a similar manner to depreciation, stakeholders expressed mixed views on the appropriate level of regulatory discretion. Service providers and pipeline associations supported reducing the regulator's discretion to either no regulatory discretion (i.e. Option B)[135] or limited regulatory discretion (i.e. sub-option C(i)).[136] By contrast, the AER and several consumer groups and other interest groups supported retaining the existing regulatory discretion.[137]

The AER also noted the potential for service providers to have an incentive to switch between real and nominal approaches depending on inflation outcomes, which it noted could have implications for price stability.[138] The Commission considers that the guidance in the rules, together with the requirement for service providers to consider the NGO and apply the RPPs and the ability of the regulator to require an alternative approach if it considers it more consistent with the NGO, would mitigate the risk of this type of behaviour.

More generally, the Commission considers that the decision-making model provided for in the draft rule strikes an appropriate balance between the role of the service provider and the role of the regulator. It recognises that service providers facing stranding risk are likely to have a strong incentive to balance the risks of inflation compensation recovery and potentially triggering customer exit in a manner aligned with the NGO. It also preserves the regulator's ability to require an alternative approach where it would better contribute to the achievement of the NGO. Section 3.2.2 provides further detail on our rationale for using this decision-making model.

3.3.4 The draft rule would provide for greater transparency and accountability of service provider proposals and regulatory decisions on treatment of inflation

For similar reasons to those set out in section 3.2.3, our draft rule would require greater transparency and accountability by requiring:

- Service providers to explain, in their AA information, how their proposed approach to the treatment of inflation is consistent with the NGO and how they have applied the RPPs.

135 Submissions to directions paper: ATCO, p. 10; AusNet, p. 4; Evoenergy, pp. 2-3; Jemena, pp. 10-12. Note that Evoenergy stated that sub-option C(i) is the limit of what it considers acceptable. Jemena also stated that sub-option C(i) is better than C(ii). AusNet also suggested we consider Option B, but if that is not our preferred option, then it would support sub-option C(i).

136 Submissions to directions paper: AGIG, p. 9; APGA pp. 8-9; ENA p. 6. ENA and AGIG also noted that Option B may be a viable option.

137 Submissions to directions paper: ECA, pp. 14-15, Origin, p. 5; AER, pp. 2-6.

138 AER, Submission to directions paper, p. 6.

- The regulator to provide reasons if it determines that an alternative approach should be used and an explanation of how the alternative approach would better contribute to the NGO and how the RPPs have been taken into account.

We did not receive any feedback on this aspect of our policy direction.

However, ECA and AGIG did note the need for the depreciation and treatment of inflation decisions to be considered holistically. ECA, for instance noted that use of both tools could result in a significant acceleration of capital recovery.[139] AGIG noted that "the best response to future stranding risk may involve the use of both changes in inflation and other changes in the depreciation schedule, so the NGR should not preclude this, but should rather focus on making sure that the total response is appropriate".[140]

The Commission acknowledges the issues raised by ECA and AGIG and while the draft rule does not prescribe a single combined assessment of the use of these two tools, in practice we would expect their use to be considered holistically by both service providers and the regulator.

For instance, when developing their AA proposals, we would expect service providers to jointly consider the impacts of their depreciation and inflation proposals on consumers, given the potential for a material increase in prices to trigger customer exit and stranding. The regulator would also be able to consider the joint impacts when evaluating whether service providers' depreciation and inflation proposals would promote the NGO, or if there may be another approach that better contributes to the NGO.

3.4 Our draft rule would enable the redundant and return of redundant capital tools to be used to replicate competitive market outcomes

This section explains how our draft rule would amend the redundant capital and return of redundant capital provisions in the NGR so that they can be used to replicate what would occur in a workably competitive market and promote gas consumers long-term interests.

Figure 3.6 provides an overview of the key elements of the draft rule. As explained further in section 3.6 the Commission expects these elements of the draft rule to promote the NGO by improving outcomes for consumers over the longer term, promoting principles of market efficiency and promoting principles of good regulatory practice, including by reflecting what would occur in a workably competitive market.

139 ECA, Submission to directions paper, p. 18.
140 AGIG, Submission to directions paper, p. 9.

Figure 3.6: Overview of draft rule redundant capital and return of redundant capital provisions

Objective: Enable the redundant capital & return of redundant capital tools to be used to replicate what would occur in a workably competitive market and promote gas consumers' long-term interests.

Fully redundant capital

Provide more rules guidance

- Maintain the full redundancy provisions.
- Provide more guidance on how the value of fully redundant capital to be removed from the capital base is to be determined.
- Replace the AA redundant capital mechanism with a rules-based mechanism.

Partially redundant capital

Clarify the redundant capital tool can be used for partial redundancy and who can use it

Separately recognise partial redundancy through the inclusion of new provisions that allow the removal of partially redundant capital from the capital base and clarify that:

- a service provider can voluntarily propose to use this tool to remove partially redundant capital
- the regulator can require this tool to be used, subject to rules-based conditions below.

Provide rules guidance on when and how the regulator can use the partial redundancy tool

Conditions on the regulator's use of partial redundancy tool

Trigger for use of the tool

The regulator can **only** require an amount to be removed from the capital base if it considers it:

- is necessary to respond to competition from alternative energy sources, or another pipeline, to which a hypothetical end user could readily switch in the AA period
- otherwise replicates what would occur in a workably competitive market in the AA period.

Before requiring the removal of an amount the regulator must also take into account:

- the uncertainty it would cause and the effect the uncertainty would have on the service provider, users and prospective users.
- the potential transitory nature of the partial redundancy.

Value of capital that could be removed

The regulator must, in requiring an amount to be removed from the capital base, determine the amount having regard to the following:

a. the service provider's reasonable needs for cash flow to meet debt financing costs (including in relation to any capital to be removed) and non-capital costs relating to the provision of reference services
b. the price of any competing energy sources or pipeline services to a hypothetical end user who can readily switch to such competing energy sources or pipeline services, including the costs of switching to these energy sources or pipeline services
c. the NGO and RPPs.

Return of redundant capital

Provide rules guidance on when and how redundant capital can be added back to the capital base

- Include a separate test for partial redundant capital that allows capital to be added back to the capital base if there is a reasonable opportunity to recover some (or all) of the capital.
- Require the regulator to have regard to the same matters in a-c in the box above when determining the value of partial redundant capital that can be added back to the capital base.
- Clarify how the rate of return is to be accounted for when determining the value of any fully or partial redundant capital that is to be added back to the capital base.

Providing for greater transparency & accountability

Require:

- Service providers' AA Information to include information on redundant capital and the return of redundant capital.
- The regulator to explain how any decision to remove redundant capital is consistent with the NGO and how it has taken into account the RPPs.

Through the long-term outlook, require service providers and regulator to report on impacts of their proposals and decisions on reference tariffs and capital cost recovery over 20-year outlook period.

Figure 3.7 provides more detail on how the draft rule is intended to operate in relation to both fully and partially redundant capital.

Figure 3.7: How the draft rule would apply to fully and partially redundant capital

	Fully redundant capital	Partially redundant capital
How do we distinguish between the two forms of redundant capital?*	Asset that ceases to contribute in any way to delivery of pipeline services.	Asset that still contributes to the delivery of pipeline services but is under-utilised.
Who can trigger tool?	Service provider OR Regulator	Service provider OR Regulator
When can the tool be triggered and what are the mandatory considerations and constraints on the use of this tool?	As soon as asset ceases to contribute in any way to the delivery of services.	Service provider can propose to remove at any time.
		The regulator can **only** require removal of an amount from the capital base if it considers it: • is necessary to respond to competition from alternative energy sources, or another pipeline, to which a hypothetical end user could readily switch in the AA period • otherwise replicates what would occur in a workably competitive market in the AA period.
	Before requiring the removal of an amount the regulator must take into account the uncertainty it would cause and the effect the uncertainty would have on the service provider, users and prospective users.	Before requiring the removal of an amount the regulator must take into account: • the uncertainty it would cause and the effect the uncertainty would have on the service provider, users and prospective users. • the potential transitory nature of the partial redundancy.
What value can be removed?	The value of capital to be removed from the capital base is to be based on the depreciated value of asset at the time it is removed. If an asset has become redundant due to a decline in demand for services, the regulator may allow costs to be shared between service provider and users.	The regulator must have regard to the following when determining the value to be removed from the capital base: a. the service provider's reasonable needs for cash flow to meet debt financing costs (including in relation to any capital to be removed) and non-capital costs relating to the provision of reference services b. the price of any competing energy sources or pipeline services to a hypothetical end user who can readily switch to such competing energy sources or pipeline services, including the costs of switching c. the NGO and RPPs.
When can capital be added back?	If an asset later contributes to the delivery of services, then to the extent the new capex criteria allow, it can be added back to the capital base (with adjustment for the allowed rate of return in the period it was excluded).	If there is a reasonable opportunity to recover some (or all) of the partially redundant capital, an amount can be added back. The amount must be determined having regard to the same matters in (a)-(c) in the box above and must not exceed the amount that was removed (adjusted for the allowed rate of return in the period it was excluded).

Note: * This is used for definitional purposes only, with the rules providing further constraints on when fully or partially redundant capital can be removed.

Our draft rule is broadly consistent with the policy direction set out in the directions paper, although as explained in further detail below we have made some refinements in response to stakeholder feedback and our own analysis.

Most stakeholders that responded to the directions paper supported, or were not opposed to, our proposal to enable better use to be made of the redundant and return of redundant capital tools.[141] This included the AER, consumer groups, other interest groups, retailers, service providers and pipeline associations.[142] However, as discussed in further detail below, stakeholders expressed diverse views on when and how the partially redundant capital tool should be used and who should be able to trigger its use. For instance:

- The AER, consumer groups, other interest groups and retailers supported the regulator being able to use this tool,[143] with some consumer and other interest groups also suggesting the tool should be capable of being used well in advance of redundancy actually occurring (anticipatory redundancy).[144]

141 The only stakeholder who didn't agree was Mr. A. Hudson. See Mr. A. Hudson, submission to directions paper, p. 4.

142 Submissions to directions paper: EUAA, p. 4; ECA, p. 17; JEC/SACOSS, p. 19; IEEFA, p. 1; VEFN, p. 9; Alinta, p. 4; AGL, p. 3; Origin, p. 4; AER, p. 6; APGA, p. 8; ENA, pp. 6-8; AGIG, pp. 10-13; APA, p. 9; ATCO, pp. 11-12; AusNet, p. 5; Evoenergy, pp. 3-4; Jemena, pp. 3-9.

143 Submissions to directions paper: AER, p. 6; EUAA, p. 3; ECA, p. 17; JEC/SACOSS, p. 7; VEFN, p. 9; IEEFA, p. 1; AGL, p. 3; Alinta, p. 4; Origin, p. 4.

144 Submissions to directions paper: ECA, p. 17JEC/SACOSSJEC/SACOSS, p. 19; IEEFA, p. 4.

- Service providers and pipeline associations believe that this tool should only be used as a last resort and should only be capable of being triggered by a service provider on an ex post basis.[145]

A number of these stakeholders also identified areas where further guidance could be included in the rules,[146] while some service providers and pipeline associations suggested we consider an alternative approach to capital redundancy.[147]

The specific feedback that these stakeholders provided on the redundant capital and return of redundant capital provisions is discussed further below.

The only stakeholder that did not agree with our policy direction on redundant capital was Mr A Hudson, who was concerned that our direction would mean service providers would not have a reasonable opportunity to recover their efficient costs.[148]

As we explained in section 3.2, the RPPs do not provide a guarantee that service providers will recover their costs, efficient or otherwise.[149] However, they do require service providers to be given a reasonable opportunity to recover their efficient costs, which the draft rule provides for. In this regard, it is worth noting early use of the depreciation and inflation tools may help to minimise the amount of service provider capital that is stranded, but there may still come a point where stranding cannot be averted and the reasonable opportunity to recover at least efficient costs may have passed. It is at this point that our draft rule would allow the regulator to use the redundant capital provisions. This is consistent with what would occur in a workably competitive market, where firms also face the risk of stranding. Our draft rule also provides service providers an opportunity to later recover redundant capital if there is a reasonable opportunity to do so.

Further detail is provided below on how we considered the stakeholder feedback when developing the draft rule on full redundancy (section 3.4.1), partial redundancy (section 3.4.2), the return of redundant capital (section 3.4.3), and the transparency and accountability measures applying to these tools (section 3.4.4).

3.4.1 The draft rule would maintain the full redundancy provisions and provide more guidance and remove potential constraints on its efficient use

Our draft rule would allow the service provider to propose, or the regulator to require, the value of any assets that cease to contribute in any way to the delivery of pipeline services (full redundancy) to be removed from the capital base.[150]

The draft rule would also:[151]

1. Require the value that is to be removed to be based on the depreciated value of the asset at the time of the removal.
2. Require the regulator to take into account the uncertainty that the removal of redundant capital would cause and the effect this could have on the service provider, users and prospective users, before requiring the removal of any fully redundant capital.

145 Submissions to directions paper: ENA, pp. 6-8; AGIG, pp. 10-13; APA, p. 9; ATCO, pp. 11-12; AusNet, p. 5; Evoenergy, pp. 3-4; Jemena, pp. 3-9.

146 Submissions to directions paper: EUAA, p. 4; JEC and SACOSS, p. 19; IEEFA, p. 1; VEFN, p. 9; Origin, p. 4; AER, p. 6; APGA, p. 8 ENA, pp. 6-8; AGIG, pp. 10-13; APA, p. 9; ATCO, pp. 11-12; AusNet, p. 5; Evoenergy, pp. 3-4; Jemena, pp. 3-9.

147 Submissions to directions paper: ENA, p. 8; Jemena, p. 3.

148 Mr. A. Hudson, submission to directions paper, p. 4.

149 See for example, *Application by EnergyAustralia and Others* [2009] ACompT 8.

150 Draft rule, NGR and WA NGR rule 85(1)-(3) and (7).

151 Draft rule, NGR and WA NGR rule 85(1)-(3) and (7).

This largely retains current rule 85, although we have made some changes to clarify how the value of any fully redundant capital is to be calculated and remove the current requirement for a redundant capital mechanism to be specified in an AA in the period prior to its use.

The Commission considers that these changes are required to support the timely and efficient use of this tool and provide for a more consistent approach to full redundancy across service providers. That is, by:

- providing service providers, the regulator and other stakeholders greater guidance on how to determine the value of fully redundant capital
- allowing capital to be removed in the AA period in which it ceases to contribute to service delivery, rather than having to wait for up to 5 years to do so.

The draft rule is broadly consistent with the policy direction set out in the directions paper. We did not receive any specific feedback on this aspect of the policy direction.

3.4.2 The draft rule would allow the redundant capital tool to be used for partial redundancy and provide more guidance on when and how it should be used

Our draft rule would separately recognise the potential for an amount to be removed from the capital base to reflect partial redundancy in the following circumstances:[152]

- the **service provider proposes to use this tool**, which the service provider could do at any time
- the **regulator requires the use of this tool**, which the regulator could **only** do if it considers a reduction of the capital base:
  - is necessary to respond to competition in the AA period from alternative energy sources or another pipeline to which a hypothetical end user could readily switch, or
  - otherwise replicates what would occur in a workably competitive market in the AA period.

Partial redundancy is defined in the draft rule as an asset that contributes to the delivery of pipeline services but is under-utilised. This definition is required to distinguish between full and partial redundancy, but it is important to note that under-utilisation would not be the sole determinant of when the regulator could require the removal of partially redundant capital from the capital base. Rather, as set out above, the regulator could only require partially redundant capital to be removed where it is necessary to respond to competition in the AA period, or otherwise replicates what would occur in a workably competitive market in the AA period.

Our draft rule would also require the regulator, in requiring an amount to be removed from the capital base for partial redundancy, to have regard to the following matters when determining the **value of any partially redundant capital to remove**:

1. the service provider's reasonable needs for cash flow to meet debt financing costs (including for any capital to be removed) and non-capital costs relating to the provision of reference services
2. the price of any competing energy sources or pipeline services to a hypothetical end user who can readily switch to such a competing energy source or pipeline service
3. the NGO and RPPs.

The regulator would also continue to be required to take into account:

152 Draft rule, NGR and WA NGR rule 85(4)-(6) and (8).

- the uncertainty that the removal would cause and the effect this could have on the service provider, users and prospective users before requiring the removal of partially redundant capital
- the potential transitory nature of the partial redundancy.

Our draft rule on partial redundancy is expected to promote the long-term interests of gas consumers by emulating what would occur in a workably competitive market. In such a market, firms also face the risk of stranding due to competition, technological and policy changes and are not guaranteed that they will recover a full return of and on the capital they have invested.

The draft rule is broadly consistent with the policy direction set out in the directions paper. Further detail is provided below on our rationale for the following elements of the draft rule and the feedback we received on partial redundancy in response to the directions paper:

- distinguishing between full and partial redundancy
- when the partial redundancy tool could be used
- the matters the regulator would be required to consider when determining value of any partially redundant capital that is to be removed.

The draft rule would distinguish between full and partial redundancy

Our draft rule includes separate provisions for full and partial redundancy.[153]

ENA, AusNet, Evoenergy and Jemena suggested that rather than distinguishing between full and partial redundancy, the rules should either distinguish between physical and economic redundancy, or just focus on economic redundancy.[154] They described 'economic redundancy' as occurring where capital is unable to be recovered because declining demand and/or increasing competition prevents service providers charging prices sufficient to recover the capital.[155]

We considered these suggestions, but found that:

- If this tool was only used to deal with economic redundancy, it would result in customers having to pay for physically redundant assets that are no longer contributing to pipeline service delivery. This is contrary to how the redundant capital rules currently work and would not in the Commission's view promote gas consumers' long-term interests.
- One of the main benefits that the full and partial redundancy terms have over the physical and economic redundancy terminology is that they can, if required, be applied at an individual asset level rather than at a network-wide level. The use of the full and partial redundancy terms would therefore allow for a more granular assessment of redundancy, as JEC/SACOSS and Environment Victoria noted may be required.[156]

Our draft rule therefore uses the terms full and partial redundancy.

The draft rule would allow the regulator to use the partial redundancy tool where it is necessary in an AA period to respond to competition, or otherwise replicates a competitive market

Under our draft rule, service providers would be able to propose to remove partially redundant capital from their capital base at any time.

153 Draft rule, NGR and WA NGR rule 85.

154 Submissions to directions paper: ENA, p. 27; AusNet, p. 5; Evoenergy, p. 4; Jemena, p. 3.

155 For example, in a report prepared by Incenta for ENA, Incenta stated that "…the distinction between full and partial redundancy (or physical and economic redundancy) distracts attention from the core issue of whether capital value can be recovered. Abandoning this distinction and dealing solely with the concept of economic redundancy would clarify the debate and avoid confusion of whether redundancy is considered in physical or financial terms and align consideration of redundancy with the terms of the NGO and the Revenue and Pricing Principles". Incenta, Gas Networks in Transition, April 2026, p. 27.

156 Submissions to directions paper: JEC/SACOSS, p. 7; Environment Victoria, p. 6.

The draft rule would also allow the regulator to require partially redundant capital to be removed, but only if it considers it:

- is necessary to respond to competition in the AA period from alternative energy sources or pipeline services to which a hypothetical end user could readily switch, or
- otherwise replicates what would occur in a workably competitive market in the AA period.

This will require the regulator to consider what is likely to occur with competition from alternative energy sources, or other pipeline services, over the next AA period, which may also be informed by the actions consumers have already taken.

Before requiring the removal of an amount, the regulator would also need to take into account:

1. the uncertainty the use of this tool would cause and its effects on the service provider, users and prospective users.
2. the potential transitory nature of partial redundancy.

The matters in 1 and 2 would, in effect, allow the regulator to decide not to remove partially redundant capital if it is concerned about the effect that the uncertainty would cause, or if it considers that partial redundancy is only transitory.

This aspect of the draft rule is broadly consistent with the policy direction set out in the directions paper. Stakeholders expressed diverse views on this policy direction, particularly in relation to **who should be able to use the partial redundancy tool** and **when it should be able to be used**. For instance:

- **The EUAA, AGL, Alinta and Origin supported the policy direction.**[157] The EUAA, for example, noted it "sees merit in enabling the regulator to initiate partial redundancy assessments, given that service providers have limited incentive to voluntarily write down their own capital base", subject to there being "clear and robust decision-making principles" to guide the regulator's use of the tool.[158] Origin noted the importance of "clear criteria and guidance" on the use of this tool to ensure decisions are transparent and aligned with the NGO and RPPs.
- The **AER** also **supported the policy direction** but cautioned against "overly prescribing the conditions under which capital redundancy could be applied" because it may limit the regulator's ability to adapt to changing circumstances.[159]
- **JEC/SACOSS, ECA** and **IEEFA** believe this tool should **not just be used as a last resort** and that the **regulator should have greater discretion to use it**.[160] IEEFA, for example, stated that this should be a "primary tool for managing risks, as opposed to a "last resort" tool to be used after accelerated depreciation".[161] JEC/SACOSS and ECA also expressed concerns about this tool being used as a 'last resort' and think it should be capable of being used in an anticipatory manner,[162] with ECA noting that using the tool in this way may mean it cannot be used to help avoid a disorderly transition.[163]
- **Service providers and pipeline associations** consider that this **tool should only be used as a last resort,**[164] with some also stating the rules should only allow either:[165]

157 Submissions to directions paper: EUAA, p. 4; Alinta, p. 4; AGL, p. 1; Origin, p. 5.
158 EUAA, Submission to directions paper, p. 4.
159 AER, Submission to directions paper, p. 6
160 Submissions to directions paper: ECA, p. 17; JEC/SACOSS, p. 19; IEEFA, p. 4.
161 IEEFA, Submission to directions paper, p. 4.
162 JEC/SACOSS, Submission to directions paper, p. 19.
163 ECA, Submission to directions paper, p. 17.
164 Submissions to directions paper: ENA, p. 7; APGA, p. 3; AGIG, p. 12; APA, p. 9; ATCO, p. 12; AusNet, p. 5; Evoenergy, p. 4; Jemena, p. 3.
165 Submissions to directions paper: ENA, pp. 6-8; AGIG, pp. 10-13; APA, p. 9; ATCO, pp. 11-12; AusNet, p. 5; Evoenergy, pp. 3-4; Jemena, pp. 3-9.

- the tool to be used by the service provider, because they are concerned that the regulator may activate the tool too early, or
- the regulator to use the tool where a service provider has already reduced its prices below the reference tariff, which they referred to as 'revealed redundancy' and described as follows:[166]

> "Capital redundancy should only be considered in ex post terms as 'revealed redundancy', ie when it is observed that service prices during the last Access Arrangement Period were being set by the service provider at levels below the regulated prices and therefore insufficient to recover all capital costs, and that this practice is reasonably expected to continue…To the extent that the regulator is given the power to impose partial capital redundancy, then this should only be permitted on 'revealed' redundancy."

ENA and Jemena also suggested that we consider using an alternative approach - the loss capitalisation approach - to deal with partial redundancy.[167]

Who should be able to use the partial redundancy tool?

The Commission has considered the feedback provided on **who** should be able to trigger the use of the partial redundancy tool, including the suggestion by service providers and pipeline associations that the rules should only allow this tool to be triggered by service providers.

In contrast to the depreciation and treatment of inflation tools, the Commission does not consider that service providers would generally have a strong incentive to use the partial redundancy tool, where doing so would reduce the value of their capital base. As a result, limiting initiation of the tool to service providers could reduce the likelihood that it is used in circumstances where its application would be consistent with the NGO.

Even if service providers were incentivised to use the partial redundancy tool as some service providers have suggested,[168] the Commission is not persuaded that relying solely on service providers to determine when the tool should be used would necessarily produce outcomes comparable to those expected in a workably competitive market. This is particularly relevant where customers that can readily switch have largely exited the network, leaving a greater proportion of the customers who remain facing financial, technical or other barriers to switching and being more dependent on pipeline services. In these circumstances, a service provider may have an incentive to set prices having regard to the higher switching threshold for customers that face barriers to switching, rather than the prices that would be faced by consumers in a workably competitive market. This could result in remaining customers paying materially higher prices than would be expected in such a market.

This can be seen in Figure 3.2 Rather than using the partial redundancy tool to align reference tariffs with the prices that would prevail in a workably competitive market, a service provider may have an incentive to use the tool only to the extent necessary to keep reference tariffs below the switching threshold of customers who face barriers to switching (represented by the purple line). This contrasts with the prices that would be constrained by customers who can readily switch to alternative energy sources or pipeline services (represented by the pink line). This could result in those consumers that remain connected to the pipeline paying inefficiently higher prices relative to those that would emerge in a workably competitive market. Requiring the regulator to consider

166 ENA, submission to directions paper, pp. 7-8.

167 Submissions to directions paper: Jemena, p. 5; ENA, p. 8.

168 Submissions to directions paper: AGIG, pp. 7-8; ATCO, p. 13; AusNet, p. 5; Evoenergy, p. 4; Jemena, p. 4.

the prices that would be payable by a hypothetical end user who can readily switch helps replicate the competitive constraint that would otherwise exist and better promote gas consumers' long-term interests.[169]

The Commission does not, therefore, consider it sufficient to rely on service providers to trigger the use of this tool. Rather, the Commission considers that the regulator should be able to require this tool to be used, subject to the conditions set out above. This is consistent with the Option D decision-making model in Figure 3.4, which as we noted in the directions paper is appropriate to use where service providers' incentives may not be aligned with the NGO and where regulatory oversight is required to ensure tools are used efficiently and in a manner that promotes gas consumers long-term interests.

In developing the conditions that would apply to the regulator's use of this tool, the Commission has had regard to stakeholder feedback, including from the AER, EUAA and Origin. Stakeholders generally emphasised the importance of providing clear guidance that is not overly prescriptive, but still provides customers, service providers and other stakeholders sufficient certainty as to when this tool should be used. The Commission considers the conditions provided for in the draft rule strike the right balance between certainty and flexibility.

When should the regulator be able to use the partial redundancy tool?

As noted above:

- ECA, JEC/SACOSS and IEEFA have suggested that the partial redundancy tool should be capable of being used in an anticipatory manner well in advance of redundancy occurring[170]
- service providers and pipeline associations have suggested the partial redundancy tool should only be able to be used as a last resort and in an ex post manner (i.e. after redundancy has started to occur).[171]

While the Commission understands the desire of consumer and advocacy groups for the regulator to use this tool in an **anticipatory manner** well in advance of redundancy occurring, it is also important to recognise the risk this could pose for gas consumers. In particular, if service providers do not have a reasonable opportunity to recover their efficient costs, this could affect their incentive and capacity to continue operating the pipeline and making efficient investments where required. This may in turn affect the safe and reliable delivery of services to consumers who remain connected, including residential, commercial and industrial customers that continue to use the pipeline. The Commission therefore considers it important that the conditions governing use of the tool strike an appropriate balance between providing earlier price relief where justified and maintaining incentives for the ongoing provision of safe and reliable services.

Importantly, the adverse effects outlined in the preceding paragraph are unlikely to be limited to a relatively small group of customers that remain connected at the end. Rather, the uncertainty that a more pre-emptive approach could introduce into the regulatory framework may impact investment and operational decisions much earlier, with consequences for a broader group of gas consumers. For example, if it contributed to a service provider deciding to cease operations earlier than would otherwise be efficient, the impacts could be felt by a wider cohort of residential, commercial and industrial customers. In the Commission's view, such outcomes would not be in the long-term interests of gas consumers.

169 We explain this rationale further below under "The price of any competing energy sources, or pipeline services."

170 Submissions to the directions paper: ECA, p. 17; JEC/SACOSS, p. 19; IEEFA, p. 4.

171 Submissions to the directions paper: ENA, pp. 6-8; AGIG, pp. 10-13; APA, p. 9; ATCO, pp. 11-12; AusNet, p. 5; Evoenergy, pp. 3-4; Jemena, pp. 3-9.

Equally, the Commission does not consider it appropriate to limit use of the tool to an **ex post** tool (i.e. after redundancy has started to occur), as suggested by some service providers and pipeline associations. Restricting the tool's use until after redundancy has begun to occur could result in those gas consumers that remain connected having to pay inefficiently high prices for services until the tool is triggered, which could have a range of adverse effects on those gas consumers and on efficiency, more generally.

As the preceding discussion highlights, consumers would face significant risks under both the anticipatory and ex post options, which is why we have not opted for either of these proposals. The draft rule instead seeks to promote gas consumers long-term interests by emulating what would occur in a workably competitive market. That is, by allowing the regulator to use this tool to remove partially redundant capital in the next AA period where it considers it necessary to respond to competition in that period, or it otherwise reflects what would occur in a workably competitive market in that AA period. In the Commission's view this approach will better promote the long-term interests of gas consumers than the anticipatory and ex-post options.

Should an alternative approach be used?

Jemena and ENA suggested that we consider using a 'loss capitalisation' approach to deal with partial redundancy, rather than the redundant capital mechanism.[172] Jemena described the loss capitalisation approach as being like a revenue cap 'unders and overs' mechanism that could work as follows:[173]

- The service provider would determine the extent of any discount on its reference tariffs in response to competitive pressures, with any foregone revenue capitalised in a loss reserve.
- At the next AA review, an assessment would be made as to whether the capitalised losses are recoverable over time. If they are recoverable, they could remain in the capital base, but if they are not then consideration could be given to writing down the assets.

Jemena acknowledged that this approach is "economically equivalent in present value terms to the use of the capital redundancy provisions", but noted that it could avoid "large, premature, and potentially speculative [capital base] write-downs driven by uncertain long-term forecasts."[174] Jemena also noted the potential for the price of competing energy sources to become cheaper temporarily and for the situation to reverse in later years, which it suggested could be better dealt with under the loss capitalisation approach.[175]

The Commission has examined the alternative loss capitalisation approach proposed by ENA and Jemena, but considers it would be less transparent and provide for less regulatory oversight than the redundant capital provisions. When coupled with the fact that the loss capitalisation approach is, as Jemena observed, 'economically equivalent' to the redundant capital tool, the Commission considers that using the redundant capital provisions to deal with partial redundancy would better promote the long-term interests of consumers.

The Commission also notes that the conditions provided for in our draft rule on when the regulator could use the partial redundancy capital mean that the risks of 'premature' and 'speculative' write downs referred to by Jemena are unlikely to eventuate. It is also worth noting that it would be open to service providers to use the existing intra-period risk management tools (e.g. the AA

172 Submission to directions paper: Jemena, p. 5; ENA, p. 8.
173 Jemena, Submission to directions paper, pp. 4-8.
174 Jemena, Submission to directions paper, p. 5.
175 Jemena, Submission to directions paper, p. 5.

revision and trigger event mechanisms)[176] to manage the risk that competition with competing energy sources within an AA period reverses or does not eventuate in the way it was expected when partially redundant capital was removed.[177] In the Commission's view, these mechanisms would be more transparent and provide for greater regulatory oversight than the loss capitalisation approach.

The draft rule would require the regulator, in requiring partially redundant capital to be removed from the capital base, to consider a number of matters when determining the value be removed

When determining the value of partially redundant capital to remove from the capital base, where the regulator requires it to be removed, the draft rule would require the regulator to have regard to the NGO and RPPs, as well as:[178]

1. *the service provider's reasonable needs for cash flow* to meet debt financing costs (including for partially redundant capital) and non-capital costs relating to provision of reference services
2. *the price of any competing energy sources, or pipeline services* to a hypothetical end user who can readily switch to these competing energy sources or services, including the costs of switching to such a competing energy source or pipeline service.

The service provider's reasonable needs for cash flow

The first of the matters that the regulator would be requried to consider is intended to ensure that if the regulator requires partially redundant capital to be removed from the capital base, the service provider can continue to earn sufficient revenue to operate and service any debt it may have. This includes any debt that may still be owing on partially redundant capital.

The focus on debt financing in this draft rule reflects the well accepted financial principle that debt ranks ahead of equity and that equity holders bear the residual risks of a company.[179] This means that where the risk of redundancy impacts a service provider, their equity holders bear losses first in the first instance. This results in a reduction to the return on equity. The consequences of redundancy become materially more impactful on consumers once a service provider can no longer meet its debt obligations or fund its operations. This can trigger administration, default and potentially the cessation of operations. These outcomes would not serve the long-term interests of consumers. The draft rule therefore requires the regulator to have specific regard to debt and non-capital costs.

The price of any competing energy sources, or pipeline services

The second matter that the regulator would be required to consider reflects the competitive constraint on prices that a service provider operating in a workably competitive market would face. In such a market, gas users would not face any barriers to switching, so if the price of gas delivered to customers' locations started to exceed the delivered price of other energy sources, they would be able to switch to suppliers of these energy sources. Service providers would then need to respond by reducing their prices. This is reflected in the draft rule, which focuses on the price of competing energy sources (or pipeline services) that would be payable by a hypothetical

176 NGR, rules 51 and 65.

177 For instance, a service provider could use rule 65 to seek a variation of its applicable AA to allow for some partially redundant capital to be returned to the capital base within the AA period if actual demand turned out to be higher than forecast in that period. Rule 51 could be used for a similar purpose, by advancing the review submission date to an earlier date, if the potential for materially higher demand was identified as a trigger event.

178 Draft rule, NGR and WA NGR rule 85(6).

179 Bodie, Kane & Marcus, Investments, 5th edition, 2002, p. 44.

end user that can readily switch, taking into account the costs of switching to the competing energy source (or pipeline service).[180]

We have used the 'hypothetical end-user' wording because we recognise that there may come a point where there are no remaining end-users that can readily switch. The price constraint is therefore expressed in terms of the price that a hypothetical end-user who can switch would pay for the competing energy source, or pipeline services. We have employed a similar approach in the draft rule relating to reference tariffs (see Chapter 6).

The Commission has decided to employ this approach because customers that have connected to gas pipelines have made long-run investment decisions in reliance on the continued provision of reference services at prices regulated to emulate workably competitive market conditions. However, where customers face material technical, financial or other barriers to switching (such as consumers in apartment blocks who have no feasible switching options), the competitive discipline posed by alternative energy sources or pipeline services may be weak and would not result in prices that would emerge in a workably competitive market. There is a risk therefore that customers that face these barriers may be required to pay inefficiently high prices based on their 'willingness to pay', particularly once consumers that can readily switch have done so.

The draft rule would address this risk by requiring the regulator to consider the prices that would be payable by a hypothetical end-user that could readily switch to competing energy sources or pipeline services, when determining the amount of redundant capital to remove from the capital base. The Commission expects this to promote the NGO by ensuring that customers that remain connected to a pipeline do not pay more than they would otherwise pay in a workably competitive market.

Service providers and pipeline associations were the only stakeholders that directly commented on this aspect of the policy direction. ENA, ATCO, Evoenergy and Jemena stated that the partial redundancy tool should not be used to try and protect 'vulnerable customers', because this is the role of government.[181]

The Commission agrees governments are best placed to assist vulnerable customers. However, the Commission's objective in requiring the regulator to consider the prices payable by hypothetical end-users that can readily switch is **not** focused on protecting vulnerable customers. Rather, the objective is to emulate what would occur in a workably competitive market by requiring the regulator to consider the prices that would be payable by end-users who do not face barriers to switching.

In the Commission's view, focusing on what would occur in a workably competitive market is consistent with the overarching objective of economic regulation and would promote the long-term interests of gas consumers. The Commission remains therefore of the view that this is the appropriate price threshold for the regulator to consider when determining the value of any partially redundant capital to remove from the capital base.

In this regard, it is worth noting that price paid for gas by end users reflects several components, including wholesale gas costs, pipeline tariffs, and retail costs and margins. The effect of this constraint is therefore that pipeline tariffs could not cause the total delivered price of gas to exceed the point at which those consumers that can switch to alternative energy sources would choose to disconnect. There are several reasons why this package focuses primarily on pipeline tariffs:

180 Draft rule, NGR and WA NGR rule 85(5)(a)

181 Submissions to the directions paper: ENA, p. 26; ATCO, p. 12; Evoenergy, p. 4; Jemena, p. 7.

- The service providers that would be subject to this draft rule are regulated monopolies. Wholesale suppliers and retailers are exposed to declining demand through lower sales and cannot rely on a regulatory reset to recover unchanged fixed costs from remaining consumers. Wholesale suppliers and retailers are also subject to competition. Competitive pressures constrain their ability to raise prices in response. The proposed provisions seek to replicate that discipline for network tariffs.
- The mechanics of the regulatory framework can intensify demand decline. Unless recoverable network costs fall in proportion to demand, those costs must be spread across fewer consumers or units of gas. The resulting tariff increases may prompt further disconnections, leaving an even smaller customer base to meet the remaining costs. Our partial redundancy proposal would interrupt this feedback loop once prices reach the switching point.
- Partial redundancy may also benefit service providers. By slowing customer exit and prolonging network operation, it may increase the amount of capital they ultimately recover.
- The proposal forms part of a balanced package. Greater scope to accelerate depreciation would help service providers recover capital from a broader customer base during the earlier stages of decline. Partial redundancy would protect consumers during the later stages, once delivered prices approach the switching point.
- The provisions should respond to enduring changes in the competitiveness of delivered gas, rather than short-term price movements. A temporary increase in wholesale gas prices should not, by itself, result in network capital being made partially redundant. See discussion of this inChapter 6.

In its submission, APA noted that transmission charges may represent a relatively small share of a consumer's total bill and that applying the partial redundancy provisions to transmission pipelines in the same way as distribution networks may be inappropriate. [182]We consider that the proposed draft rule, which also requires the regulator to consider the NGO and RPPs, when determining the value to remove provides the regulator additional flexibility in this area if it is required. However, we welcome stakeholder views on whether the partial redundancy rules should expressly differentiate between transmission and distribution pipelines.

Separately, the Commission understands that some service providers have concerns about using the 'switching price' concept in the partial redundancy provisions, because of the challenges estimating this value.[183] While the Commission recognises that there are likely to be some complexities associated with estimating the prices of competing energy sources that would be payable by a hypothetical end user that can readily switch (including switching costs), it is aware that a number of service providers have been providing such estimates to the AER and ERA as part of their proposals to accelerate depreciation.[184] This suggests that it is feasible for service providers to come up with these estimates, although there could be value in the regulator voluntarily developing guidance on how these prices should be estimated (see also Chapter 6).

3.4.3 The draft rule would provide more guidance on when and how the return of redundant capital tool should be used

The draft rule would specify a separate test for the return of partially redundant capital

Our draft rule would allow service providers to propose, and the regulator to require, partially redundant capital to be added back to the capital base if there is a reasonable opportunity to

182 APA, Submission to the directions paper, pp. 10-11.
183 Submissions to the directions paper: APA, p. 10; ATCO, p. 13; Evoenergy, p. 2; Jemena, p. 3.
184 See for example, JGN, 2025-30 AA Proposal Attachment 7.4, June 2024.

recover some (or all) of the capital. The draft rule would also require the amount to be added back to be determined having regard to:[185]

1. the service provider's reasonable needs for cash flow to meet debt financing costs (including for any capital to be removed) and non-capital costs relating to the provision of reference services
2. the price of any competing energy sources or pipeline services to a hypothetical end user who can readily switch to such a competing energy source or pipeline service
3. the NGO and RPPs.

This differs from the current test in rule 86, which only allows assets that have previously been identified under rule 85 as redundant to be added back to the capital base if they "later contribute to the delivery of pipeline services" and satisfy the new capex criteria.[186]

While the Commission considers this test appropriate for fully redundant capital, we consider a different test is required for partial redundancy. This is because, in contrast to full redundancy where assets have ceased to contribute in any way to the delivery of pipeline service, partially redundant assets are still in use and contribute to the provision of pipeline services. The draft rule therefore provides for separate tests for the return of fully redundant capital and partially redundant capital to the capital base.

This is broadly consistent with the policy direction set out in the directions paper, which was that the test for the return of partially redundant capital should allow capital to be added back to the capital base if utilisation has increased or been extended, and there is an opportunity to recover some (or all) the capital from consumers.

Stakeholders that commented on the return of redundant capital were generally supportive of this proposal,[187] although we did receive some feedback on the test to be used for partially redundant capital and the role of the regulator:

- **Test:** ENA and several service providers suggested the test be simplified by allowing partially redundant capital to be added back to the capital base if it becomes 'recoverable'.[188] The EUAA also questioned the use of a utilisation test.[189]
- **Role of regulator:** AGIG stated that the price of alternative energy source should pose a 'natural restriction' on what can be added back and did not consider there was a need for the regulator to be involved in this process.[190] The EUAA, on the other hand, stated that allowing capital to be reintroduced without strict tests would pose a risk for consumers.[191]

The Commission agrees that the test for the return of partially redundant capital could be simplified by removing the requirement to demonstrate that the utilisation has increased, or extended. This would mean the test just focuses on whether there is a reasonable opportunity to recover some (or all) of the capital.

Whether there is a reasonable opportunity to do so will require the service provider and regulator to consider the same matters as those used to determine how much partially redundant capital can be removed, which includes the price of competing energy sources or pipeline services, as

185 Draft rule, NGR and WA NGR rule 86(4)-(5)
186 NGR and WA NGR rule 86(1)-(2).
187 Submissions to the directions paper: AER, p. 6; EUAA, p. 4; ENA, p. 8; ATCO, p. 14; Evoenergy, p. 4; Jemena; p. 9; AGIG, p. 12.
188 Submissions to the directions paper: ENA, p. 8; ATCO, p. 14; Jemena; p. 9.
189 EUAA, Submission to the directions paper, p. 6.
190 AGIG, Submission to the directions paper, p. 13.
191 EUAA, Submission to the directions paper, p. 6.

AGIG noted. While AGIG did not consider it necessary for the regulator to be involved in determining how much capital can be added back to the capital base, for the reasons set out in section 3.3.2 the Commission considers the regulator should have the same level of oversight as it has for capital redundancy.

The Commission expects the draft rule, which includes the refinements outlined above, to support the efficient use of the return of redundant capital tool. The draft rule would provide service providers and the regulator with clearer guidance on when and how partially redundant capital could be added back to the capital base, while also ensuring there is sufficient regulatory oversight and flexibility in the rules to manage a range of potential future outcomes.

The draft rule would clarify how the value of any return of redundant capital is to be calculated

Our draft rule would require the service provider and regulator to calculate the value of any fully or partially redundant capital to be added back to the capital base by:[192]

- taking the value at the time of the removal from the capital base
- increasing that value annually by the allowed rate of return between the date the capital was removed from the capital base and when it is added back to the capital base.

The amount that could be added back would also depend on the following:

- *Fully redundant capital:* The extent to which the regulator determines the new capex criteria would allow the calculated amount to be returned to the capital base.[193]
- *Partially redundant capital:* The service provider and regulator's consideration of the same matters that must be considered when determining the value of partial redundant capital to be removed (i.e. the service provider's reasonable needs for cash flow, the price of competing energy sources or pipeline services, the NGO and RPPs).[194]

The draft rule seeks to address a limitation we have identified in rule 86, but was not identified in the directions paper. This rule currently states that the value is to be determined by taking the value at the time of removal and increasing it annually at the "rate of return implicit in the reference tariff". However, the rule does not make clear whether the rate of return is to be based on the reference tariff at the time the capital is added back to the capital base, or the reference tariff prevailing over the period that it was removed from the capital base.

The Commission notes that the latter interpretation is more consistent with the intent of the rule, which is that the service provider should, to the extent possible,[195] be put back in the position it would have been in if the capital had not been removed. That is, by properly accounting for the time value of money during the period in which it is removed. The Commission considers it appropriate therefore to make this clearer in the rules, so that service providers, the regulator and other stakeholders have greater clarity on how the value of any redundant capital to be returned to the capital base is to be calculated.

While this change was not identified in the directions paper, ENA and a number of service providers noted the need to properly account for the rate of return before adding any redundant capital back into the capital base.[196]

192 Draft rule, NGR and WA NGR rule 86(2) and (5)(b).
193 Draft rule, NGR and WA NGR rule 86(3).
194 Draft rule, NGR and WA NGR rule 86(5).
195 Determined with regard to the factors proposed in draft NGR and WA NGR rule 86(4)-(5).
196 Submissions to the directions paper: ENA, p. 8; AGIG, p. 12; ATCO, p. 14; Jemena, p. 3.

3.4.4 The draft rule would provide for greater transparency and accountability of service provider proposals and regulatory decisions

Our draft rule would require:

- Service providers to include the following information in their AA Information:
  - full and partial redundancy in the last AA period and amounts added back to the capital base in the last AA period[197]
  - the forecast full and partial redundancy and amounts that may become capable of being added back to the capital base in the next AA period.[198]
- The regulator, when requiring the removal of full or partially redundant capital from the capital base, to set out the reasons for its decision and to explain how its decision is consistent with the NGO and takes into account the RPPs.[199]

The draft rule is consistent with the proposed policy direction set out in the directions paper. We did not receive any stakeholder feedback on this proposed direction.

Our draft rule seeks to address the limited transparency and accountability under the current rules relating to the use of the redundant capital and return of redundant capital provisions. The Commission considers that this aspect of the draft rule, together with the long-term outlook requirements (see Chapter 2), should help support more informed and efficient decision-making in relation to the use of the redundant and return of redundant capital tools.

3.5 We considered ECA and JEC's rule change requests

3.5.1 ECA and JEC raised a number of concerns about the depreciation and redundant capital rules

In their respective rule change requests, ECA and JEC expressed concerns about the use of the existing capital cost recovery rules in the context of declining demand and increasing stranding risk. While the proponents proposed different amendments to the rules, both proponents were concerned that allowing for earlier recovery of capital could shift the costs and risks of stranding to consumers.[200]

ECA's principal concern with how accelerated depreciation is currently being used is that it implies that consumers must pay the full costs of stranded assets, in circumstances where service providers "are not demonstrating full, good faith efforts to reduce stranding risk in the future".[201] ECA has therefore proposed making accelerated depreciation contingent on a range of conditions that would show service providers are actively taking steps to reduce risks and costs for consumers as a 'quid pro quo' for consumers "paying to help protect" service providers from stranding risks.[202] ECA noted that while accelerated depreciation may have a role to play, greater scrutiny should be placed on its use to ensure consumers are protected from the costs of future stranded assets before requiring them to pay for stranded asset costs now.[203]

JEC raised related but distinct concerns. JEC's view is that the rules currently lack a transparent mechanism for identifying potential redundancy, assessing stranding risks, and determining how associated costs and risks should be allocated between consumers and investors. JEC consider

197 Draft rule, NGR and WA NGR rule 72(1)(a)(iv) and (v).
198 Draft rule, NGR and WA NGR rule 72(1)(c)(iii) and (iv).
199 Draft rule, NGR and WA NGR rule 85(9).
200 ECA, Rule change request - Depreciation, p. 15 and JEC, Rule change request - Accelerated depreciation and redundancy, p. 4.
201 ECA, Rule change request – Depreciation, p. 15
202 ECA, Rule change request – Depreciation, p. 18.
203 ECA, Rule change request – Depreciation, p. 19.

that accelerated depreciation has increasingly been used as the primary response to stranding risk, despite not being specifically designed for that purpose.[204] To address these concerns, JEC proposed changes to:

- prohibit the use of accelerated depreciation for the purposes of managing stranding risk unless used in conjunction with the redundant capital provisions.
- the redundancy provisions to broaden the definition of redundancy to include anticipated redundant assets, provide for a principles-based decision-making framework, cap the amount of redundancy that can be shared with customers at 50 per cent, and require service providers to identify redundant assets in advance.[205]

3.5.2 We agree with some of ECA and JEC's underlying concerns, but do not consider they should be addressed by inefficiently constraining capital recovery

The Commission agrees with a number of the underlying concerns raised by ECA and JEC. In particular, we agree that the current framework does not:

- Provide sufficient transparency regarding how stranding risks are identified and assessed, and guidance on the use of the available capital cost recovery tools, including partial redundancy which is not effectively dealt with under the current rules.
- Support consideration of the longer-term consequences of service providers' proposals and regulatory decisions, and provide for internally consistent proposals and decisions that respond to the changing circumstances facing consumers and service providers throughout the transition.

However, the Commission does not consider that the changes to the depreciation provisions proposed by ECA and JEC to address their legitimate concerns about transparency and accountability would promote the NGO. This is because they involve constraining the efficient use of a tool that could help to mitigate the price and other impacts of declining demand on consumers.

As explained above, inefficiently constraining capital recovery could have a range of adverse effects on gas consumers. It could, for instance:

- Result in reference tariffs escalating over time, because the capital costs need to be spread over a diminishing number of customers, which could trigger a disorderly exits and lead to higher and more volatile tariffs for those customers that remain connected to the pipeline. Constraining the recovery of capital by maintaining a straight-line approach to depreciation would also result in future customers bearing a disproportionate share of the capital costs, which is inefficient.
- Adversely affect service providers' incentives and/or ability to continue to provide safe and reliable services to those consumers that continue to rely on gas to meet some or all of their energy needs.[206] This creates a material risk for consumers that the reliability and/or safety of services decline and/or that service providers decide to prematurely and abruptly cease to provide services, which could have a range of adverse financial and other effects on gas consumers.[207] It could, for instance, result in:

204 JEC, Rule change request – Accelerated depreciation and redundancy, p. 7.

205 JEC, Rule change request – Accelerated depreciation and redundancy, pp. 9-15.

206 While long-term demand projections show a downward trend, the Commission notes that there will be many consumers that continue to rely on gas for the next 20 years.

207 There are now a number of examples of this occurring, including the Esperance gas distribution system, which was shut down in 2025 and the Solstice compressed natural gas distribution system in Victoria, which is expected to shut down in 2026. ATCO also announced earlier this year it intends to shut down the Albany LPG reticulated gas distribution system (see here).

- a far more expensive transition for those consumers that can switch (e.g. because appliances have to be switched out before the end of their life), the costs of which may be borne by both consumers and/or governments (and ultimately taxpayers).[208]
- the potential closure of industrial consumers that are unable to switch.

In the Commission's view, ECA and JEC's underlying concerns would be better addressed by employing the targeted reforms provided for by long-term outlook, expenditure assessment and tariff reform elements of our draft rule. Together, these reforms would require service providers to provide more information regarding future demand, network utilisation, redundancy and future investment requirements, while also strengthening regulatory scrutiny of expenditure proposals and improving incentives for efficient decision-making. This approach, which we consider better promotes the long-term interests of consumers and the NGO than ECA's and JEC's proposals to make the use of accelerated depreciation conditional on other matters, would preserve flexibility for service providers and the regulator to respond to differing circumstances across pipelines, while still strengthening transparency, accountability and expenditure discipline.

As to JEC's proposals regarding the redundant capital provisions, the Commission agrees that these require reform. However, we do not agree that depreciation and redundancy should be viewed as mutually exclusive alternatives. Rather, they are complementary tools that should be available to manage the different impacts of declining demand on consumers and service providers over time.

The Commission notes that depreciation is the means by which service providers are repaid the efficient capital that they have invested in an asset. Permitting depreciation to be accelerated should not be perceived as a transfer of stranding costs and risks to consumers, but rather a change in the timing of the recovery of those costs. Importantly, the Commission's draft rule would not guarantee the recovery of capital costs or immunise service providers from their assets becoming stranded.[209] Rather, under the draft rule, service providers would remain exposed to this risk, including where demand declines more rapidly than forecast, or competition places increasing pressure on prices, which is consistent with what would occur in a workably competitive market.

The Commission considers that the draft rule would better align capital recovery with the expected use of a pipeline while there remains a reasonable opportunity to recover at least efficient costs. It would also more explicitly recognise the circumstances where competition from alternative energy sources constrains the amount of capital that can be recovered. We consider that as a package, our draft rule on the capital cost recovery tools, would better promote the long-term interests of consumers and the NGO than JEC's proposal. It would also provide a broader and more flexible framework to respond to the challenges of the energy transition.

The Commission also considered JEC's proposal for a principles-based sharing mechanism for redundancy costs. However, we consider that a framework based on competitive market outcomes would better promote economic efficiency. Under the draft rule, the extent to which capital can continue to be recovered would be informed by the competitive constraints faced by a hypothetical end-user who can readily switch to competing energy sources or pipeline services. This approach better reflects the intent of the gas pipeline regulatory framework, which has always contemplated the potential for competition from alternative energy sources. The

208 It could also result in welfare losses from reduced use of appliances and equipment that customers have invested in.

209 As noted in section section 3.2, the Commission recognises that current judicial commentary on the RPPs suggests that a reasonable opportunity does not guarantee recovery of costs, efficient or otherwise. See for example, *Application by EnergyAustralia and Others* [2009] ACompT 8.

Commission's approach would replicate the outcomes that would occur in a workably competitive market.

3.6 We consider our more preferable draft rule would better contribute to the achievement of the NGO than the rule change requests

When deciding whether or not to make a rule, the Commission is required to act in the long-term interests of gas consumers by considering whether the rule will, or is likely to, contribute to the achievement of the NGO. The Commission may also make a rule that is different, including materially different, to a proposed rule if it is satisfied the more preferable rule is likely to better contribute to the achievement of the NGO.[210]

The Commission has decided in this case to make a more preferable draft rule, because it considers it will better contribute to the achievement of the NGO than ECA and JEC's proposed rule changes and the status quo. That is, by improving consumer outcomes over the longer term, promoting economic efficiency, supporting the safety, security and reliability of services and promoting good regulatory practice (section 3.6.1). We have also considered the RPPs in making our draft rule (section 3.6.2).

3.6.1 Our draft rule would better contribute to the achievement of the NGO

Improving consumer outcomes over the longer term

Our draft rule would **improve outcomes for consumers** by helping to protect them from the consequences of a disorderly transition and supporting the continued provision of safe, secure and reliable services for as long as gas consumers remain connected**.**

In this regard, it is worth noting that while demand and gas connections are projected to fall on a number of gas distribution networks in the future, a relatively large number of existing and potentially new residential, commercial and industrial customers are still expected to remain connected and use gas for some time. This includes those customers that:

- choose to continue using gas for certain purposes and are not currently considering switching to alternative energy sources
- are considering switching to alternative energy sources, but want to align this with the end of the life of their appliances whom for some may be many years into the future (e.g. up to 15 years)
- face financial, technical and/or other barriers to switching to alternative energy sources, such as low income customers, vulnerable customers, renters and hard to abate residential,[211] commercial and industrial customers.

The draft rule seeks to help improve the outcomes for all of these consumers and support an orderly energy transition, where customers can make informed and efficient decisions about their future use of the pipeline, including if and when they will switch to an alternative energy source. It is intended to do so by ensuring these consumers continue to have access to safe and reliable gas services and do not face inefficiently high network tariffs through the transition.

The draft rule would achieve this by:

- Enabling the recovery of depreciation to be aligned with the expected use of the pipeline and compensation for inflation to cease to be deferred on pipelines facing declining or uncertain

210 Section 296 of the NGL.

211 This includes residential customers in apartment blocks that may face technical challenges replacing centralised gas hot water systems.

demand. Importantly, this would not result in service providers recovering more costs than they would have under a straight-line depreciation and real (indexed) approach. Rather, the amounts would be the same in net present value terms. Together with the inter-period smoothing mechanism, use of these tools while there are still a relatively large number of customers should minimise price impacts for current customers. It should also:

  - Provide for a more economically efficient time profile of reference tariffs and more equitable outcomes for gas consumers, with current and future customers making equivalent contributions to the recovery of efficient capital costs.[212]
  - Help to mitigate the risk of other adverse effects that customers could face, including the risk that the reliability and/or safety of services declines and/or that a service provider decides to prematurely cease operations (as has already occurred on a number of smaller non-scheme pipelines,[213] which could have a range of adverse effects on consumers.[214]
- Enabling redundant capital to be removed from a service provider's capital base where it reflects what would occur in workably competitive market. Together with the requirement to consider the prices that would be payable by hypothetical end-users who could readily switch to alternative energy sources, this element of the draft rule would ensure consumers that face barriers to switching are not subject to inefficiently high tariffs.

The Commission acknowledges that aligning the recovery of depreciation and compensation for inflation with the expected use of the pipeline would result in capital recovery being brought forward and today's gas consumers facing higher prices. However, the Commission must have regard to the long-term interests of gas consumers when considering changes to the NGR. The Commission does not consider that gas consumers' long-term interests would be promoted if there was a disorderly transition that resulted in consumers facing escalating prices, a deterioration in the reliability and/or safety of services, and/or the service provider deciding to prematurely cease operations, which is what could occur if the capital cost recovery tools can't be used to help manage the impacts of declining demand.

Promoting principles of market efficiency and safety, security and reliability of services

Our draft rule would promote principles of market efficiency and support the safety, security and reliability of pipeline services by:

- Providing service providers with the confidence they will have a reasonable opportunity to recover at least their efficient costs over the remaining economic life of the pipeline. This should, in turn, preserve service providers' incentives to:
  - prudently and efficiently operate their networks and invest where necessary, including in compliance with applicable safety standards and regulations
  - continue to efficiently provide safe and reliable pipeline services.

212 This is because maintenance of the straight-line depreciation and real (indexed) approach when demand is falling results in cost recovery being deferred to the future when there are fewer customers. This creates a growing mismatch between who benefits from use of the asset, and who is required to pay for it, with customers that remain connected bearing a disproportionate share of capital and inflation costs.

213 There are now a number of examples of this occurring, including the Esperance gas distribution system, which was shut down in 2025 and the Solstice compressed natural gas distribution system in Victoria, which is expected to shut down in 2026. ATCO also announced earlier this year it intends to shut down the Albany LPG reticulated gas distribution system (see here).

214 As outlined above, this could result in a more expensive transition for those consumers that can switch to other energy sources and the potential closure of industrial consumers that are unable to switch. It could also result in welfare losses from reduced use of appliances and equipment that customers have invested in.

- Providing for a more efficient profile of reference tariffs, which would support efficient use of pipelines over time and enable consumers to make more informed and efficient decisions about their future use of the network.[215]

Promoting good regulatory practice

Our draft rule promotes good regulatory practice. The changes to the capital cost recovery provisions would ensure these tools are fit for the future, can be used as and when required through the transition, and are sufficiently flexible to deal with the different positions each service provider may be in through the transition.

Consistent with principles of good regulatory practice, the draft rule would also provide for:

- Appropriate decision-making models for each of the capital cost recovery tools, which take into account the extent to which service providers' incentives are likely to be aligned with the NGO, while also providing for an appropriate level of regulatory oversight.
- Service providers and the regulator to be more transparent and accountable for their capital cost recovery proposals and decisions and to consider and report on the longer term consequences of their proposals and decisions on consumers and the service provider.
- Any regulatory financial models developed by the regulator to better accommodate the use of the depreciation and/or treatment of inflation tools.

3.6.2 We have also considered the RPPs in making our draft rule

Service providers would be provided a reasonable opportunity to recover at least efficient costs

The proponents and a number of stakeholders (including service providers) have observed[216] that the RPPs do not guarantee that service providers will recover their efficient costs. The Commission acknowledges this feedback and agrees that current judicial commentary on the RPPs suggests that a reasonable opportunity does not guarantee recovery of costs, efficient or otherwise.[217] However, they do require service providers to be provided with a reasonable opportunity to recover at least their efficient costs.

The Commission considers the draft rule is necessary to provide service providers' confidence that they will be provided with such an opportunity. This is because a loss of confidence in the reasonable opportunity to recover efficient costs could, as outlined insection 3.6.1, have a range of adverse effects on gas consumers, many of whom are likely to continue to use pipelines for some time.

The draft rule seeks to provide service providers a reasonable opportunity to recover at least their efficient costs, by allowing:

- the depreciation and treatment of inflation tools to be used to align the recovery of capital with the expected use of the pipeline and cease the deferral of compensation for inflation while there remains a reasonable opportunity to recover at least efficient costs
- any redundant capital that is used to provide services to potentially be added back to the capital base if there is a reasonable opportunity to do so.

215 This includes decisions by prospective customers to connect to the network and decisions by existing customers to either remain connected to the network (and potentially invest in new appliances or equipment), or to switch to alternative energy sources.

216 See for example, JEC, Rule Change Request, p. 4 and Stakeholder submissions to the consultation paper: ECA, p. 15; ENA, p. 10; Evoenergy, p. 1; Jemena, p. 6; AGIG, p. 5; AusNet, p. 6; EnergyAustralia, p. 5; Alinta Energy, p. 1; IEEFA, p. 4 .

217 See for example, *Application by EnergyAustralia and Others* [2009] ACompT 8.

While this may help to minimise the amount of capital that is stranded, there may still come a point where stranding cannot be averted and the reasonable opportunity to recover at least efficient costs may have passed. This is when we would expect the redundant capital provisions to be used to remove any full or partially redundant capital. This is consistent with what would occur in a workably competitive market, where firms also face the risk of stranding due to competition, technological and policy changes.

Service providers would be provided effective incentives to promote economic efficiency

The Commission considers that the draft rule would also provide **service providers effective incentives to promote economic efficiency.**[218]

For similar reasons to those set out in section 3.6.1, we expect it to do so by providing service providers confidence they will have a reasonable opportunity to recover at least their efficient costs and providing for a more efficient profile of reference tariffs.

Together, we expect these aspects of the draft rule to provide service providers with effective incentives to efficiently provide pipeline services, efficiently invest in the pipeline (where that is necessary) and to promote the efficient use of the pipeline.

We have had regard to the potential for inefficient investment and utilisation of pipelines

Our changes to the capital cost recovery provisions in the draft rule would help avoid the potential for inefficient investment and utilisation of pipelines, by helping to avoid the costs and risks of:[219]

- **Under and over-investment in the pipeline.** Specifically, the draft rule would help to avoid the costs and risks of:
  - **Under-investment** that could arise if service providers did not have confidence that they would have a reasonable opportunity to recover at least their efficient capital costs. As explained above, our draft rule on depreciation, the treatment of inflation and return of redundant capital seek to provide service providers this opportunity.
  - **Over-investment** that may arise if the redundant capital tool could not be used, where it is appropriate to do so. We note that under our draft rule, service providers would still face a risk of stranding (e.g. if demand declines faster than expected). Together with the provisions in our draft rule on expenditure, this should mean that service providers have neither the incentive nor the ability to overinvest in the network.
- **Under and over-utilisation of the pipeline** by providing for a more economically efficient time profile of reference tariffs that aligns capital recovery with the forecast use of the pipeline and allows for the impacts of any change in inflation to be smoothed across a 10-year period.

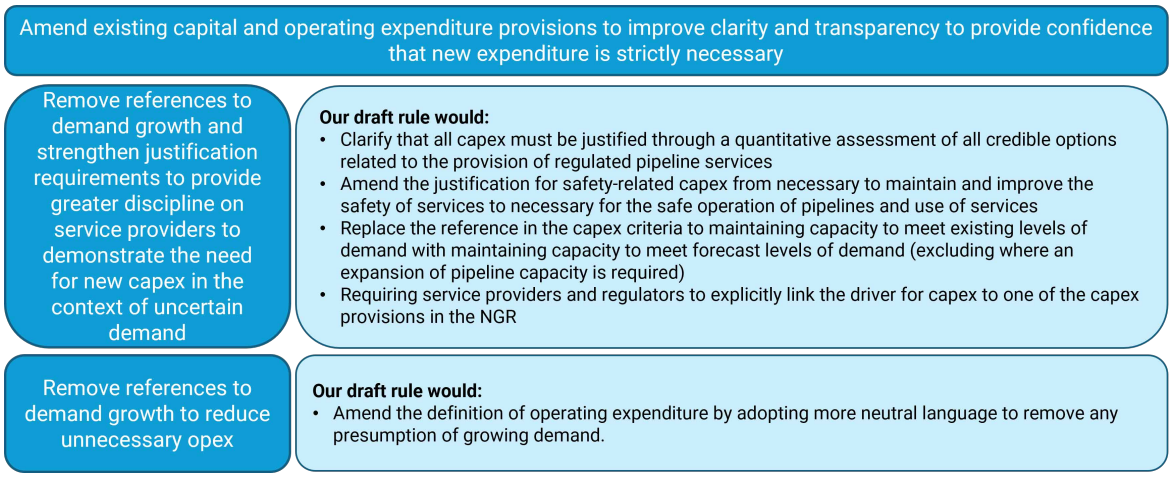
218 Consistent with NGL section 24(3).
219 Consistent with NGL section 24(6)-(7).

4 How our draft rule to amend expenditure assessments would operate

Our draft rule would amend the capex and opex provisions to improve clarity and transparency, providing confidence that new expenditure is strictly necessary and supports the long-term interests of consumers under uncertain or potentially declining demand. The draft rule amends several of the capex criteria to provide greater discipline on service providers to demonstrate that proposed capex is in the long term interests of consumers. It also amends the capex criteria and definition of opex to remove references to demand growth so that the rules are neutral in respect of future demand trends.

The key changes to the framework that would result from our draft rule are summarised in Figure 4.1

Figure 4.1: Overview of the draft changes to expenditure provisions



Together, these amendments seek to minimise expenditure while continuing to support safety and reliability. They would improve transparency in how service providers justify expenditure and how expenditure is assessed by the regulator. In turn, this would support consumers' and other stakeholders' confidence that the regulatory framework is promoting efficient outcomes.

This chapter outlines:

- the limitations that we have identified with the current expenditure rules (section 4.1)
- how our draft rule would operate (section 4.2 to section 4.7)
- how we have considered other elements of the ECA's rule change request (section 4.8)
- how our draft rule would promote the NGO (section 4.9).

4.1 Improvements to the current framework could help minimise expenditure and enhance transparency in the context of uncertain demand

As discussed in Chapter 1, forecasts from AEMO and service providers indicate that gas demand in the residential and small commercial customer segment is expected to decline over the medium to long term, although the pace and extent of decline varies significantly across

jurisdictions. The capex and opex provisions in the NGR were established based on expectations of stable or growing demand and encouraging demand growth.

With the growing uncertainty in the outlook for demand, the rules need to be flexible and fit for the future to cater for the operating environments, including future trends, of all service providers to drive efficient expenditure outcomes that are in the long term interests of consumers. In an environment of uncertain demand, stranding risk increases relative to a demand growth environment, making it increasingly important to avoid unnecessary additions to a service provider's capital base that may contribute to future stranding. In this context, capex decisions must be appropriately justified and scrutinised to minimise the impacts of future stranding risks on customers, including greater consideration of the impact of future demand trends on investment decisions.

4.1.1 Our draft rule would support greater justification, scrutiny and transparency of service providers' capex proposals to minimise stranding risk and remove any presumption of demand growth

Against this background, the Commission considers there is an opportunity to improve the current framework for proposing and assessing gas pipeline expenditure to better meet the challenges of uncertain and potentially declining demand. We have identified several issues and gaps in the current regulatory framework for capex and opex that we consider should be addressed to support prudent and efficient investment:

- **There are several areas where the capex criteria could be tightened to provide greater discipline on service providers to demonstrate that proposed capex is in the long term interests of consumers.** For example, while good business practice, the NGR do not currently require service providers to undertake a quantitative assessment of all credible options for meeting an investment need.
- **The capex criteria and opex definition could be amended to be neutral in respect of future demand trends**. Some elements of the NGR may be interpreted as having an implicit presumption that gas demand will stay the same or increase, which may be inconsistent with some service providers' operating environments.
- **There is limited transparency in some aspects of service providers' AA proposals.** For example, expenditure proposals do not always clearly demonstrate how proposed capex satisfies the requirements of rule 79(2). This could make it difficult for stakeholders to consider and provide feedback on proposed expenditure, and can reduce confidence that proposed expenditure is prudent and efficient.
- **There is no explicit requirement to consider long-term demand trends beyond the five-year AA period and the potential implications of changing long-term demand trends on expenditure proposals within the five-year AA period under review.** Greater explicit consideration of longer-term demand trends or scenarios may influence expenditure decisions and help minimise stranding risks. For more information on our proposed approach to require service providers and the regulator to consider a long-term outlook, refer to chapter 2.

The Commission acknowledges that the AER has sought to address some of these issues through its *Better Resets Handbook* and *Information Paper on regulating gas pipelines under uncertainty*. These publications set out the AER's expectations regarding how forecast capex should be justified, including consideration of alternative options for meeting an investment need and the

assessment of longer-term demand scenarios beyond the AA period.[220] [221] However, they are not binding and we consider there are benefits in addressing these issues directly through the NGR.

To address these issues, we propose to amend the capex provisions and opex definition in the NGR to ensure the regulatory framework continues to support the long-term interests of gas consumers by:

- requiring service providers to conduct a quantitative assessment of all credible options (see section 4.2)
- introducing an outcomes-focused approach to justifying safety-related capex while ensuring services are provided safely and in compliance with jurisdictional safety regulations (see section 4.3)
- requiring capex to maintain capacity to be justified using forecast, instead of existing, demand for services (see section 4.4)
- amending the definition of opex to remove expenditure to increase long-term demand for pipeline services and otherwise develop the market for pipeline services (see section 4.5)
- requiring service providers to explicitly link the driver for capex to one of the capex provisions in the NGR (see section 4.6).

The draft rule retains the net present value test as a means to justify capex (see section 4.7) and does not include other proposals put forward by the ECA in its rule change request (see section 4.8).

The draft rule intends to ensure that any new investment is strictly necessary to continue supplying services to customers in a safe and reliable way. It would also increase transparency and scrutiny, supporting stakeholder engagement in the regulatory process and providing greater confidence that investment decisions are in consumers' interests.

4.1.2 Other elements of our draft rule would further support existing incentives on service providers to invest efficiently to minimise stranding risk

The current regulatory framework provides service providers with incentives to invest efficiently in their networks to minimise the risk of stranding. This is because if assets become stranded, there is no guarantee of cost recovery under the regulatory framework, only a reasonable opportunity to recover at least their efficient costs.[222] Incentives for service providers to invest efficiently would be further strengthened under the draft rule for the redundant capital provisions. The draft rule would impose further discipline on service providers to invest only in capex necessary to reduce the potential need to apply the redundant asset provisions and so bear the cost of stranding. While the draft rule would allow for accelerated depreciation to help limit the stranding risk and so could arguably moderate this incentive, there is a limit to how much revenue recovery can be brought forward without triggering customers to leave the network earlier than they otherwise would.[223] As such, we consider stranding risk will continue to incentivise service providers - particularly those facing declining demand - to minimise capex while maintaining safety and reliability.[224]

220 AER, Better Resets Handbook – Towards consumer centric network proposals, July 2024, p. 20.

221 AER, Regulating gas pipelines under uncertainty, Information paper, November 2021, p. 53.

222 NGL section 24(2).

223 BSL submitted that while stranding risk does give service providers some incentive to minimise expenditure, the proposal to allow accelerated depreciation would reduce this incentive. See BSL submission to directions paper, p. 5.

224 This is consistent with a view expressed by the AER that "The more exposed a network business is to stranding risks, the more incentives it may have to minimise capex". See AER, Regulating gas pipelines under uncertainty, Information paper, November 2021, p. 53.

4.1.3 Our related final rule to introduce cost reflective connection charges supports reduced new capex going forward

In addition, the quantum of capex proposed by distribution network service providers will decrease in future following our rule change to require newly connecting retail gas customers to pay cost-reflective connection charges upfront from 1 October 2026.[225] The Victorian Essential Services Commission implemented a similar requirement on 1 January 2025, which applies to retail customers using Victorian distribution networks.[226] Together these changes will eliminate connections capex for scheme pipelines in Victoria, New South Wales, South Australia and the ACT.[227] Net connections capex accounted for 34 per cent of total capex, based on the aggregate of all capex for scheme pipelines in their current AA period.[228]

4.2 The draft rule would require service providers to conduct a quantitative assessment of all credible options

There is currently no requirement in the NGR for service providers to consider a range of credible options or apply a quantitative assessment of different options for all forms of capex, when justifying new or replacement capex.

The AER's *Better Resets Handbook* sets out the AER's expectation that service providers conduct a quantitative cost benefit analysis of all feasible options to support their expenditure proposals.[229] However, the Handbook is not binding and we consider there are transparency benefits in elevating this requirement into the NGR.

The draft rule would introduce a new approach to assessing proposed expenditure, which would require service providers to:[230]

- consider all credible options that can be provided by way of a pipeline service to address an identified need, and
- conduct a quantitative assessment of the costs and benefits associated with all credible options.

Service providers would be required to submit their analysis and the outcomes of that analysis as part of their AA information for the purposes of meeting this requirement.[231]

These requirements would apply to all proposed capex, irrespective of the limb under which a service provider justifies new capex.

The draft rule is consistent with the approach proposed in the directions paper and reflects ECA's proposal that service providers be required to consider alternatives to investments in replacement or new network equipment.[232] Most stakeholders, including the AER, consumer and interest groups, Environment Victoria and some service providers expressed support for this approach.[233] They considered that this requirement would help to minimise capex, minimise stranding risk and improve transparency. While some service providers raised concerns about how the approach

225 AEMC, Updating the regulatory framework for gas connections, Rule determination, 11 December 2025.

226 Essential Services Commission, Gas Distribution System Code of Practice review, Final decision, 9 May 2024.

227 The new rule in respect of gas connections applies to operators of scheme or nominated non-scheme pipelines in the National Energy Customer Framework (NECF) jurisdictions subject to Part 12A of the NGR.

228 ECA, Rule change request, Updating the regulatory framework for gas connections, 14 February 2025, p. 16.

229 AER, Better Resets Handbook – Towards consumer centric network proposals, July 2024, p. 20.

230 Draft rule, NGR and WA NGR rule 79(1)(a1).

231 Draft rule, NGR and WA NGR rule 79(2A).

232 ECA, Rule change request - Capital expenditure, p. 19.

233 Submissions to the directions paper: AER, p. 6; Alinta, p. 1&5; APGA, pp. 3-4; AusNet, p. 6; ECA, p. 18; ENA, p. 8; EUAA, p. 4; Evoenergy, p. 6; Jemena, p. 18; Origin, p. 5; VEFN, p. 10.

would be applied in practice, none explicitly opposed the introduction of this requirement on the basis that it is consistent with current practice.

Jemena and ENA submitted that there may not always be multiple credible options for meeting an identified need.[234] We acknowledge that in some instances there may not be multiple solutions to meet an identified need and note that the draft rule only requires quantitative assessment of credible options. Nonetheless, we would expect service providers to set out in their businesses cases where alternative options had been considered and determined not to be credible, and the reasons why they are not credible. While service providers are best placed to know whether all credible options have been identified, we expect that greater stakeholder engagement enabled through increased transparency combined with regulatory oversight will help reinforce this requirement.

In assessing all credible options, we note that this could include service providers working with the relevant regulatory authority (e.g. the state technical and/or safety regulator) to identify whether there are alternative ways to meet an identified regulatory requirement at lower cost.[235] ECA proposed that the rules introduce a requirement for a service provider to demonstrate that it has explored lower cost options with the relevant regulatory authorities, where regulatory requirements are cited as the justification for investment.[236] The Commission considers that the draft rule would support this outcome by requiring service providers to consider all credible options, without the need to prescribe a mandatory requirement for engagement with relevant regulatory authorities. In addition, we also note that these outcomes are already occurring under the existing framework. For example, Evoenergy and the AER are working with the technical regulator in the ACT to address a requirement that unreliable meters be replaced even where they are not in use, and the technical regulator is considering amending these regulatory obligations as a result.[237]

We note stakeholder feedback that in some instances it may not be practicable to justify a particular type of capex using quantitative cost-benefit analysis.[238] In addition, the costs of detailed analysis may outweigh the benefits in some instances.[239] We consider the draft rule is sufficiently flexible to cater for both these scenarios. The draft rule allows a service provider to propose an alternative assessment approach where it considers a quantitative assessment is not practicable for a particular option. This could be because it is not possible to quantify the costs and/or benefits, or because the costs of detailed analysis would outweigh the benefits. However, the service provider must explain why a quantitative assessment is not practicable and the alternative basis upon which it proposes to assess costs and benefits.[240] The Commission considers the regulator is best placed to determine whether service providers have conducted sufficient analysis and provided sufficient evidence to demonstrate that proposed capex meets the new capex criteria, rather than setting overly prescriptive thresholds in the NGR.

The Commission considers that the draft rule would provide greater discipline on service providers to ensure that new capex is efficient and prudent. We consider that service providers operating prudently and in accordance with the regulator's expectations would already be conducting quantitative assessments where possible for all proposed capex and considering

234 Submissions to the directions paper: ENA, p, 8; Jemena, p. 18.

235 This could include, for example, engaging with the relevant regulatory authority (e.g. the state technical and/or safety regulator) to understand whether a lower-cost approach such as an exemption, variation, amendment or other form of regulatory flexibility may be available.

236 ECA, Rule change request - Capital expenditure, p. 19.

237 See AER, Final Decision, Evoenergy (ACT) access arrangement 2026 to 2031 (1 July 2026 to 30 June 2031), Overview, May 2026, p. 24.

238 Submissions to the directions paper: AGIG, p. 14; ATCO, p. 15.

239 Submissions to the directions paper: ATCO, p. 15; Evoenergy, p. 6.

240 Draft rule, NGR and WA NGR rule 79(1)(a1)(ii).

alternative options, and this view was confirmed in feedback from service providers and the AER.[241] Nonetheless, we consider there would be benefits to consumers and other stakeholders through improved transparency and greater confidence that only necessary and efficient capex is proposed and approved.

4.2.1 Service providers are only required to consider credible options that relate to the provision of regulated pipeline services

Consistent with our view set out in the directions paper, the draft rule would require service providers to consider credible options that can be provided via pipeline services. Service providers are not required to consider alternative options that cannot be provided via pipeline services such as electrification or LPG tanks. The directions paper sets out the legislative barriers to service providers considering non-pipeline alternatives, and notes that changes to the NGL would be necessary to allow service providers to charge a reference tariff for services that are not provided by means of a pipeline (e.g. LPG tanks) or consider electrification options. This would be a matter for the Energy and Climate Change Ministerial Council (ECMC) and would occur outside of the AEMC rule change process.[242]

There was some support for a law change where it would deliver more efficient long term outcomes for consumers.[243] For example BSL and JEC/SACOSS are concerned that without amendments to the NGL, uneconomic investment decisions could arise and suggested the AEMC make recommendations to address these issues.[244]

Broader changes to the national energy frameworks would be required to facilitate switching from gas to alternative fuels where this would be a more efficient outcome than continuing to invest in the pipeline. These issues need to be considered holistically as part of a broader decommissioning framework and need to address important issues, including (but not limited to):

- Who is best placed to determine that switching all households and businesses in an area to alternative fuels is a more efficient outcome than continuing to invest in the gas network and that pipeline services will no longer be provided to customers in that area?
- What changes to the national energy frameworks, including the NGL, NGR, National Energy Retail Law and National Energy Retail Rules, are required to enable this to occur, including necessary consumer protections?
- Who should be responsible for providing financial support to customers to assist them in switching appliances and, for those that electrify, the cost to rewire their premises if required?
- How to ensure the relevant electricity distribution network has sufficient capacity to maintain a safe, secure and reliable network if a large cohort of gas customers electrify?

As noted in the directions paper, establishment of a decommissioning framework is not being considered as part of this rule change process as it requires consideration of issues that extend beyond the NGR. The AEMC is actively engaging with jurisdictions and other stakeholders to support ongoing consideration of these broader issues and potential pathways forward.

241 Submissions to the directions paper: AER, p. 6; AGIG, p. 14; APGA, p. 10; ATCO, p. 15; AusNet, p. 6.
242 See the directions paper, pp. 98-99 for further discussion.
243 Submissions to the directions paper: AusNet, p. 6; BSL, pp. 5-6; ECA, p. 19; JEC/SACOSS, pp. 16-17.
244 Submissions to the directions paper: BSL, pp. 5-6; JEC/SACOSS, pp. 16-17.

4.3 The draft rule would introduce an outcomes-focused approach to justifying safety-related capex while ensuring services are provided safely and in compliance with jurisdictional safety regulations

The NGR currently allows service providers to justify capex where it is "necessary to maintain and improve the safety of services".[245] While safety capex must also be demonstrated to be prudent and efficient to meet the test for conforming capex to be added to the capital base,[246] the ability for service providers to justify capex for improving safety provides limited constraints on service providers in proposing safety-related capex. In the context of uncertain demand, the Commission considers this limb should be tightened to ensure that safety-related capex is strictly necessary to allow for the safe operation of pipelines and provision of services.

The draft rule would amend the justification for safety-related capex to be outcomes focussed while allowing jurisdictional safety standards and regulations to be met. Specifically, the draft rule amends the provision such that service providers may justify safety-related capex where it is "necessary for the safe operation of pipelines and provision of services".[247] This is consistent with the position set out in the directions paper and the intent of ECA's rule change request.

Most stakeholders that commented on this issue, including consumer groups, retailers and some service providers, supported the proposed approach.[248] The AER and AGL provided general support for the proposed direction on capex while not commenting specifically on safety-related capex.[249] While BSL supported the amendment, they noted that enforcement may be challenging due to information asymmetry between the service provider and the regulator.[250]

APGA and AusNet considered the amendment provides limited practical value as service providers already adopt an "as low as reasonably practicable" approach to safety-related capex, in compliance with jurisdictional safety regulations.[251] The Commission considers that, in combination with the requirement to consider all credible options and conduct a quantitative assessment where practicable, amending the safety provision will provide additional discipline on service providers to demonstrate that proposed safety-related capex will benefit consumers. While this may not significantly change practical investment outcomes where service providers are already applying a best practice approach to safety expenditure, it will nonetheless deliver benefits to consumers and other stakeholders through improved transparency.

Some service providers and pipeline associations raised concerns about their ability to undertake prudent safety investments or meet jurisdictional regulatory requirements:

- ENA, while supporting the proposed direction, raised concerns about the potential for the provision to be interpreted in a narrow way that would preclude prudent preventative or resilience-building capex to reduce safety risks.[252]
- ATCO did not support the proposed change on the basis that it would set a minimum threshold for safety, in contrast with jurisdictional regulations which require service providers to continuously reduce risk so far as is reasonably practical.[253]

245 NGR and WA NGR rule 79(2)(c)(i).
246 NGR and WA NGR rule 79(1)(a).
247 Draft rule, NGR and WA NGR rule 79(2)(c)(i).
248 Submissions to the directions paper: BSL, p. 6; VEFN, p. 10; Origin Energy, p. 5; Alinta, pp. 1, 5; Jemena, p. 18; ECA, p. 19; EUAA, p. 4; ENA, p. 9.
249 Submissions to the directions paper: AER, p. 6; AGL, p. 3.
250 Submission to the directions paper: BSL, p. 6.
251 Submissions to the directions paper: APGA, p. 10; AusNet, p. 6.
252 ENA, Submission to the directions paper, p. 9.
253 ATCO, Submission to the directions paper, p. 15.

The Commission confirms that the policy intent of the draft rule is to continue to allow service providers to meet industry standards and jurisdictional regulatory obligations in respect of safety. The draft rule is also intended to be interpreted sufficiently broadly to allow safety improvements where these are demonstrably in consumers' interests. The draft rule is not intended to set a minimum or threshold-based interpretation of safety, and we are satisfied that this is not the case. Consistent with this view, Jemena noted that the proposed approach would allow service providers both to meet evolving industry standards and jurisdictional legislative requirements, as well as accommodating incidental safety improvements e.g. due to technological advances.[254] Further, we note that if there was any doubt about service providers' ability to meet legislative obligations, that capex could also be justified on the basis that capex is necessary to comply with a regulatory obligation or requirement.[255]

4.4 The draft rule would require capex to maintain capacity to be justified using forecast, instead of existing, demand for services

The NGR currently allows capex to be justified where necessary to maintain a service provider's capacity to meet levels of demand for services existing at the time the capex is incurred. In an environment of uncertain demand, the Commission considers that a short term focus on demand forecasts within the regulatory period is no longer appropriate. The ability to justify expenditure based on current levels of demand risks locking in capex that may no longer be required if service providers experience declining demand in parts of their network.

We note that the AER's *Information paper on regulating gas pipelines under uncertainty* provides additional guidance to service providers about the AER's expectations of how capex should be justified. This includes that in their AA proposals service providers should (among other things) consider demand and supply conditions well beyond the next regulatory period, and potentially several regulatory periods into the future.[256] Despite the AER's guidance, we consider there would be benefit in amending the NGR to clearly require service providers to consider likely demand beyond the relevant AA period in justifying capex.

To address this issue, the draft rule would amend the justification for capex to maintain capacity to meet forecast, instead of existing, demand for services.[257] This is consistent with the position set out in the directions paper and with ECA's rule change request.[258] It would allow service providers to justify capex to maintain capacity to meet forecast demand for services such as the like-for-like replacement of meters and pipelines. Consistent with the operation of the existing provisions, capex to maintain capacity to meet demand that is dependent on an expansion of pipeline capacity could not be justified under this provision.[259]

The Commission considers the draft rule will help prevent locking in investment that ultimately may not be required. We do not consider that service providers would face difficulties complying with the amended provision on the basis that it is consistent with existing practices.

254 Jemena, Submission to the directions paper, p. 18.

255 NGR and WA NGR rule 79(2)(c)(iii).

256 AER, *Information paper on regulating gas pipelines under uncertainty*, November 2021, p. 53.

257 Draft rule, NGR and WA NGR rule 79(2)(c)(iv).

258 See the directions paper, p. 100.

259 The current NGR and WA NGR rule 79(2)(c)(iv) excludes maintaining capacity to meet projected demand that is dependent on an expansion of pipeline capacity. The draft rule maintains this position, with minor clarifications to the rule.

Consumer groups, retailers and some service providers including the ENA supported the proposed amendment.[260] For example, Origin considered the amendment would reduce the risk of over-investment in network capacity.[261] APGA and Jemena submitted that the approach is consistent with good business practice and that the amended provision would codify existing practices.[262]

ATCO opposed the proposed amendment on the basis that it may restrict capex for expansion or consumer choice.[263] ATCO was concerned that their ability to invest to meet expected demand growth would be restricted and that consumers may not be able to access gas where growth is expected but not yet realised. The Commission does not consider that the draft rule would restrict service providers' abilities to make necessary investments to meet demand where future growth is forecast, which could be justified under the economic value or net present value tests.[264] In addition, we note that the existing operation of this limb specifically excludes capex that is required to meet future growth that is dependent on an expansion of pipeline capacity and that such capex would need to be justified using either the economic value or net present value tests.

ENA supported a forward-looking approach to demand but considered there is a risk of the regulator using hindsight or applying their own preferred forecasts in ex post reviews.[265] ENA proposed making explicit that the assessment of conforming capex (or ex post reviews in WA) are based on the service provider's original forecast and not one reconstructed in hindsight.

The Commission agrees that any ex post reviews should be based on information that was available to the service provider at the time it undertook the relevant expenditure, and that this approach reflects good regulatory practice. We understand that both the AER and ERA already adopt this approach, only using information that is available before the AA period (not with the benefit of hindsight) in conducting ex post capex reviews. Further, the NGR do not currently provide any prescription in respect of how the regulator should conduct ex post capex reviews more generally. We do not consider it necessary to introduce prescription for how the regulator should conduct any ex post review in this draft rule.

4.5 The draft rule would amend the definition of opex to remove expenditure to increase long-term demand for pipeline services and otherwise develop the market for pipeline services

The opex definition in the NGR currently includes specific reference to "expenditure incurred in increasing long-term demand for pipeline services and otherwise developing the market for pipeline services".[266] We consider this definition is no longer appropriate in the context of uncertain and potentially declining demand and where some governments have banned new connections and are planning to decommission gas networks. Rather, we consider that the definition of opex should be neutral in relation to demand and so should not expressly refer to expenditure being incurred to increase long-term demand.

260 Submissions to the directions paper: Alinta, p. 5; AER, p. 6; APGA, pp. 3-4; ECA, p. 19; ENA, p. 9; EUAA, p. 4; IEEFA, p. 2; Jemena, pp. 18-19; Origin, p. 5; VEFN, p. 10.

261 Submission to the directions paper: Origin, p. 5.

262 Submissions to the directions paper: APGA, pp. 3-4; Jemena, pp. 18-19.

263 ATCO, Submission to the directions paper, p. 16.

264 NGR and WA NGR rule 79(2)(a) or (b).

265 Submission to the directions paper: ENA, p. 9.

266 NGR and WA NGR rule 69, definition of "operating expenditure".

The draft rule would address this issue by removing the reference to expenditure incurred in increasing long-term demand for pipeline services from the definition of opex.[267] This is consistent with the position set out in the directions paper and with ECA's rule change request.[268] We consider this approach would ensure opex is strictly necessary to provide safe and reliable pipeline services, which would improve outcomes for consumers and is consistent with the principles of market efficiency.

Most stakeholders, including some service providers, considered it was sensible to remove the focus on network growthfrom the opex definition.[269]

ATCO and APGA opposed changing the opex definition due to concern that it would reduce flexibility and limit the integration of new technologies, including renewables.[270] Similarly, while Jemena supported the change in principle, they noted it should not preclude prudent and efficient opex to support demand growth, or to facilitate emissions reduction.[271] As discussed in the directions paper, the Commission considers that amending the opex definition removes a bias without impacting on a service provider's ability to propose prudent and efficient expenditure that supports increasing demand for pipeline services where it is otherwise consistent with the opex criteria.

The draft rule would still allow service providers to propose opex to engage in marketing or other activities to try and increase demand for pipeline services, and for the regulator to assess whether such opex meets the opex criteria, on a case-by-case basis. For example:[272]

- if a gas distribution network is being repurposed to supply biomethane, then it may be prudent and efficient to incur some opex to try and increase demand for pipeline services
- if a gas transmission business can be used to supply more gas to gas-fired electricity generators that could help support the energy transition, then it may be prudent and efficient to attract this additional demand.

EUAA raised a concern that tighter capex criteria could lead to service providers seeking a greater opex allowance, which may not lead to efficient outcomes, and suggested we consider whether the opex provisions require amendment.[273] Assessment of forecast opex requirements follows a well-established base-step-trend approach. Any proposed step change in opex to compensate for reduced capex would need to be clearly justified by the service provider and approved by the regulator. We consider this approach is sufficiently robust to ensure that any substitution from capex to opex is efficient and do not consider the operating expenditure criteria require amending.

4.6 The draft rule would require service providers to explicitly link the driver for capex to one of the capex provisions in the NGR

Currently, there is no specific requirement for service providers to link the driver for capex to one of the provisions under which capex may be justified under the NGR. This can make it difficult for customers and stakeholders to understand the basis on which service providers propose capex.

267 Draft rule, NGR and WA NGR rule 69, definition of "operating expenditure".

268 See the directions paper, pp. 100-102.

269 Submissions to the directions paper: AER, p. 6; Alinta, pp. 1 & 5; AusNet, p. 6; BSL, p. 7; ECA, p. 19; ENA, p. 9; EUAA, p. 5; IEEFA, p. 8; Jemena, p. 20; Environment Victoria, p. 6; Origin, p.6; VEFN, p. 10.

270 Submissions to the directions paper: ATCO, pp. 17-18; APGA, p. 10.

271 Jemena, Submission to the directions paper, p. 20.

272 A service provider may propose, and the regulator may assess, that such opex related to current limb (b) of the opex definition in NGR and WA NGR rule 69 is expenditure incurred in providing pipeline services that contributes to meeting emissions reduction targets.

273 EUAA, Submission to the directions paper, p. 5.

The draft rule would require both service providers and the regulator to explicitly identify the basis on which proposed capex is being justified.[274] For example, if capex is being proposed for safety purposes, the service provider and the regulator should explicitly link this capex to rule 79(2)(c)(i). This approach is consistent with the proposed direction in the directions paper. ECA did not raise this issue in its rule change request. The stakeholders that commented on this issue, primarily service providers, all supported the approach on the basis that it improves transparency and provides regulatory clarity.[275]

The draft rule would improve good regulatory practice by promoting transparency in how service providers justify expenditure. This would benefit consumers and stakeholders by allowing them to more readily understand why a service provider proposes an investment. It could also reduce ambiguity where a service provider provides multiple justifications without clarity on the primary driver. Greater transparency could allow for more meaningful engagement and challenge during AA reviews.

4.7 The draft rule retains the NPV test as a means to justify capex

In the directions paper, the Commission sought feedback from stakeholders on whether to retain the NPV test as a justification for capex.[276] This test allows a service provider to justify capex where the present value of the expected incremental revenue to be generated as a result of the expenditure exceeds the present value of the capex (NPV test).

The Commission recently determined that all newly connecting retail gas customers in NSW, ACT and South Australia should pay upfront cost-reflective charges for their gas connection. To give effect to this, the Commission made a final rule to remove the equivalent NPV test in Part 12A of the NGR.[277] Given these changes, we sought feedback on whether rule 79(2)(b) is still required, or if it could be removed.

In response, no stakeholder supported the complete removal of the NPV test. The EUAA considered the test could potentially be removed for gas distribution but retained in Western Australia and for transmission to avoid unintended constraints on investment.[278] The AER and ECA considered there was no harm in retaining it and considered it could have some merit.[279] No service providers supported its removal, although ENA and AusNet were neutral.[280] Others noted that the NPV test is relevant where demand and connections are growing, in Western Australia where cost reflective connection charges will not apply and to assess capex to support renewable and other gases.[281]

Based on this feedback, the Commission's draft determination is to retain the NPV test as a means to justify capex.

274 Draft rule, NGR and WA NGR rule 79(2A).

275 Submissions to the directions paper: AusNet, p. 6; ENA, p. 9; Jemena, p. 18.

276 NGR and WA rule 79(2)(b).

277 See National Gas Amendment (Updating the regulatory framework for gas connections) Rule 2025 No. 4, item [22] which amends NGR rule 119M. This change commences on 1 October 2026.

278 EUAA, Submission to the directions paper, p. 5.

279 Submissions to the directions paper: AER, p. 7; ECA, p. 19.

280 Submissions to the directions paper: AustNet, p. 6; ENA, p. 8.

281 Submissions to the directions paper: AGIG, p. 15; APGA, p. 10; ATCO, p. 2 and pp. 16-17; Jemena, p. 19.

4.8 We considered the other proposals put forward by the ECA in its rule change request

ECA proposed several other amendments to the regulatory framework for expenditure assessments. We have analysed these proposals and consider that they are addressed through other elements of our draft rule, which would better promote the NGO, for reasons set out below. This is consistent with our position in the directions paper.

In response to the directions paper, ECA reiterated its view that we should make the other changes that it proposed in its rule change request.[282] BSL supported ECA's rule change request and noted that while it supports the approach in the directions paper, the rules need to go further to constrain spending.[283]

The remainder of this section explains how we have considered the following proposals:

- require service providers to explicitly consider the impact of declining demand in capex programs (see section 4.8.1)
- require a regulator to review whether the service provider acted prudently in its past decisions before allowing new replacement capex (repex) to be approved (see section 4.8.2)
- require service providers to consider the value that gas consumers place on reliability when proposing capex to maintain network integrity (see section 4.8.3)
- require service providers to account for future abolishment costs in their cost-benefit analysis (see section 4.8.4)
- exclude capex relating to renewable gases from reference tariffs (see section 4.8.5), and
- remove advance determinations for future capex or require public consultation on all applications for advance determinations (see section 4.8.6).

4.8.1 Requiring service providers to explicitly consider the impact of declining demand in capex programs

The Commission considers that our draft rule achieves the objective of requiring service providers to more explicitly consider the impacts of declining demand in their capex proposals, but limits this to where declining demand is a plausible scenario. ECA considered that requiring service providers to account for declining demand would result in a more robust quantitative cost analysis that includes a realistic assessment of asset lives and utilisation levels.[284] We consider that ECA's concerns are addressed by our draft rule, which would require service providers to:

- develop a long term outlook and explain how its AA proposal reflects the long term outlook, which must consider plausible demand scenarios (see Chapter 2)
- require capex to maintain capacity to be justified using forecast, instead of existing, demand for services (see section 4.4).

In response to the consultation paper, Rewiring Australia, DCAN and SACOSS supported the proposal to require service providers to consider declining demand scenarios in their capex proposals, highlighting the need to minimise expenditure as gas demand declines and the need to reflect climate change policies to reduce greenhouse gas emissions.[285] Service providers and industry groups opposed the proposal on the basis that:

282 ECA, Submission to the directions paper, pp. 19-20.
283 BSL, Submission to the directions paper, p. 5.
284 ECA, Rule change request - Capital expenditure, p. 20.
285 Submissions on consultation paper: Rewiring Australia, p. 3; DCAN, p. 3; and SACOSS, pp. 4-5.

- a requirement to consider declining demand is not appropriate if demand is increasing or where government policy is to increase renewable gases in a jurisdiction[286]
- given stranding risk, service providers' demand forecasts are conservative, so this is not necessary[287]
- service providers can and have recently included declining demand scenarios in their capex proposals[288]

No stakeholders commented specifically on this issue in response to the directions paper.

We support service providers considering declining demand scenarios in their capex proposals where this is a plausible demand scenario and we consider that the draft rule would achieve this. Our draft rule supports identifying realistic demand scenarios by requiring service providers to develop a long term outlook and submit it as part of their AA Information.[289] The draft rule would also require service providers to explain how the long term outlook has impacted their AA proposals, providing greater transparency about how future expected demand influences proposed capex. Therefore, where it is reasonably expected that demand will decline, the draft rule would require service providers to consider declining demand in their capex proposal.

In addition, our draft rule, which would require service providers to justify maintaining capacity based on forecast, instead of existing, demand for services, would also support improved consideration of declining demand where this is relevant to an individual service provider. Requiring service providers to consider demand trends in justifying capex to maintain capacity will help promote efficient outcomes, particularly in the context of declining demand.

As declining demand may not be plausible for all service providers, we do not support a prescriptive approach which would require service providers to always consider declining demand. This would add regulatory costs, would not be consistent with good regulatory practice and would not promote the NGO.

4.8.2 Requiring a regulator to review whether the service provider acted prudently in its past decisions before allowing new repex to be approved

The Commission does not consider that changes are required to reflect ECA's proposal that the regulator be required to assure itself that the service provider has acted prudently in its previous investment decisions before allowing capex to replace assets due to obsolescence, or where the current asset is no longer fit for purpose.[290] We consider that ECA's concerns are addressed by our draft rules that will impose greater discipline on service providers to justify forecast capex. In addition, ECA's proposed approach would increase costs for service providers and the regulator and shift away from established features of the regulatory framework, without a commensurate increase in benefit.

ECA was concerned that service providers are seeking capex for the purpose of replacing assets where replacement is either not justified or is in response to a previous decision that is no longer considered the best approach. They cite examples including:[291]

286 ATCO, submission on consultation paper, p. 3.
287 APGA, submission on consultation paper, p. 23.
288 AGIG, submission on consultation paper, p. 7.
289 Draft rule, NGR and WA NGR rules 45(2) and 72(p).
290 ECA, Rule change request - Capital expenditure, p. 19.
291 ECA Rule change request - Capital expenditure, pp. 16-17.

- obsolescence as a justification for capex, where the asset has not necessarily failed or is about to fail but the original equipment manufacturer no longer supports the model or it is difficult to obtain spare parts
- capex being sought because alternative approaches are considered safer than existing pole mounted cathodic protection units, despite the pole mounted approach presumably being considered safe (or that risks could be appropriately managed) at the time the decision was made.

In response to the consultation paper, consumer and user groups and other interest groups supported the proposal to increase scrutiny on repex, including proposals to replace assets before the end of their life.[292] For example, BSL noted that AER approved $567m of mains repex, in total for three VIC distributors in 2023-28, for assets that may be redundant in 20 years.[293]

Service providers and industry groups as well as EUAA noted that the regulator and stakeholders already scrutinise repex proposals, including extensive requests for information from service providers.[294] APGA, ENA and Jemena noted that retrospective powers to assess whether past investment was prudent would increase investment risk, be impractical or add administrative cost.[295] In response to the directions paper, APGA added that reviewing whether past repex was prudent would re-prosecute assessment of expenditure.[296]

We consider the draft rule would introduce greater clarity and transparency of capex proposals and provide greater discipline on service providers to justify their proposals. This additional rigour and transparency will improve confidence that, going forward, new capex is strictly necessary to support safe and reliable services. The long term outlook will also provide more visibility and justification for the need for expenditure.

We also consider that requiring the regulator to assess prudency of past investment would materially increase the regulatory burden on service providers and the regulator, be impractical to implement, and increase investment uncertainty and risk. This is for three reasons:

- The approach creates a risk that a service provider will not be given a reasonable opportunity to recover at least its efficient costs of providing safe, secure and reliable services, assessed at the time of the investment. This is because future necessary repex could be disallowed due to historical investment decisions that had previously met the conforming capex criteria but, based on a retrospective assessment, are subsequently seen as imprudent.
- Service providers would need to justify historical investment decisions when proposing repex, which in some cases would have been made under different regulatory or jurisdictional settings in place at the time. This would be impractical and would create a significant burden on both the service provider and the regulator.
- The approach would represent a shift away from an important aspect of the regulatory framework, whereby the regulator approves efficient and prudent expenditure for the next AA period, but the service provider retains discretion about the investment decisions it makes during that AA period subject to meeting its regulatory obligations.

292 Submissions to the consultation paper: DCAN, p. 3; JEC, p. 16; IEEFA, p. 3; SACOSS, p. 9; and BSL, p. 3.
293 BSL, Submission to the consultation paper, p. 3.
294 Submissions to the consultation paper: AGIG, p. 8; ATCO, p. 3 of 18; ENA, p. 18; and EUAA, p. 3.
295 Submissions to the consultation paper: APGA, p. 22; ENA, pp. 18-19; and Jemena, pp. 13-15.
296 APGA, submission to the directions paper, p. 3.

4.8.3 Requiring service providers to consider the value that gas consumers place on reliability when proposing capex to maintain network integrity

The Commission does not consider that changes are required to adopt ECA's proposal that would require service providers and the regulator to weigh the costs of capex to maintain reliability against the value that customers place on avoiding loss of supply.[297] ECA suggested that capex incurred to maintain the reliability of the network should not exceed the value that customers place on reliability.[298] We consider that developing a customer value of reliability in gas would have significant practical complexities because reliability and safety are interwoven in gas (e.g., a reliability issue can give rise to a safety issue). The conforming capex criteria, as amended by this draft rule, provide sufficient discipline to deliver efficient and prudent expenditure that is in consumers' long term interests.

The Commission's consideration of this issue is in line with the majority of stakeholder feedback in response to the consultation paper. DCAN was the only stakeholder to explicitly support a requirement for reliability investments to consider the value to consumers.[299] Service providers and the AER did not support the proposal on the basis that reliability is inherently linked to safety and gas outages are rare, making it difficult to estimate the value of customer reliability.[300] No stakeholders commented specifically on this issue in response to the directions paper.

The Commission agrees that safety and reliability are more inter-related in gas than in electricity, meaning it is likely to be more difficult to calculate a value of customer reliability for gas consumers than electricity consumers. Integrity investments are usually to manage issues such as gas leaks, which can be both a reliability and safety issue. Further, existing AER regulatory information notice (RIN) reporting requirements for service providers support transparency, with reporting on outcomes including supply quality, network reliability and integrity.[301]

We consider that the conforming capex criteria as amended by our draft rule would help support efficient and prudent expenditure decisions without the need for introducing consideration of the value of customer reliability through:

- a requirement to conduct a quantitative assessment of all credible options to address an identified need
- an outcomes-based approach to safety-related expenditure, and
- stronger focus on the impact of longer-term demand forecasts on capex proposals.

4.8.4 Requiring service providers to account for future abolishment costs in their cost-benefit analysis

The Commission does not consider that changes are required to adopt ECA's proposal that seeks to clarify that distributors should account for future abolishment costs in any cost benefit analysis they undertake in relation to capex.[302] The intent of this proposal is to improve the assessment of the relative costs and benefits of proposed investments against a range of alternatives including decommissioning, which would provide an opportunity to reduce the cost of abolishment. Identifying abolishment costs would require an understanding of the remediation obligations associated with decommissioning, which we understand are not currently specified in national or

297 ECA, Rule change request - Capital expenditure, p. 19.

298 On 25 June 2026, the AEMC published a final determination in response to a rule change request from the Chair of the Energy Senior Officials and the Victorian Minister for Energy and Resources seeking the implementation of a reliability standard and related reliability tools for the East Coast Gas System (ECGS). The Commission made a more preferable rule that enhances the reliability and supply adequacy arrangements The rule did not introduce a reliability standard in the ECGS.

299 DCAN, submission to the consultation paper, p. 3.

300 Submissions to the consultation paper: AER, p. 5; AGIG, p. 7; APGA, p. 22; Jemena, pp. 16-17.

301 See the AER's website for further information on reporting requirements for regulated businesses.

302 ECA, Rule change request - Capital expenditure, p. 19.

jurisdictional legislative or regulatory requirements. Further, we consider this issue is best considered as part of a wider analysis of a decommissioning framework, which is not being considered as part of this rule change request process.

Most consumer and interest groups did not comment specifically on this issue in response to the consultation or directions papers, although JEC considered a detailed definition of abolishment costs is required to ensure costs are necessary and efficient.[303]

AGIG submitted that abolishment costs are "highly dependent on future government policies and long-term assumptions about the scale, timing and method of any decommissioning activity".[304] They consider that while abolishment costs could be considered in cost benefits analyses, estimates would be very uncertain and introduce complexity.

The Commission considers that a clearer approach to decommissioning is a necessary precursor to quantifying abolishment costs, which is not being considered in this rule change. For example, gas infrastructure could be decommissioned by removing it or making it safe. These two options would have significantly different implications for the costs associated with decommissioning the network. Until there are clearer requirements on service providers in respect of decommissioning, we do not consider it practical to require service providers to include abolishment costs in their quantitative analysis. In addition, without a clear approach to decommissioning, it is difficult for the AER to make an assessment of whether a service provider's estimated costs are prudent and efficient.

4.8.5 Excluding capex relating to renewable gases from reference tariffs

The Commission does not consider that changes are required to adopt ECA's proposal to prevent capex on renewable fuel projects from being included in reference tariffs.[305] ECA considers that service providers should only be able to recover such expenditure (to the extent that it is conforming capex) from customers who wish to be supplied with renewable fuels in the future. We do not consider this proposal would be consistent with the NGL and NGO, which apply generally to covered gases.[306]

Alinta, IEEFA, EUAA, GCCN, JEC and SACOSS consider that the capex criteria should prevent speculative investments in renewable gases and exclude these costs from reference tariffs. GCCN suggest defining a renewable gas investment test in the NGR.[307]

Service providers noted that the regulatory framework applies to covered gases, which include renewable gases, and that the conforming capex criteria related to the type of service being provided, not the type of gas.[308] APGA, ENA and Jemena considered that the regulator should retain discretion to approve renewable gas costs and set tariffs.[309]

We note that the basis of the capex criteria in rule 79 is tied to the provision of services and not the nature of the gas used in providing services. Renewable gases may be used to provide a service, so excluding the costs associated with facilitating renewable gases would be inconsistent

303 JEC, Submission to the consultation paper, p. 16.

304 AGIG, Submission to the consultation paper, p. 10.

305 ECA, Rule change request - Capital expenditure, p. 20.

306 Covered gases is defined in section 2 of the NGL and includes primary gases such as natural gas, hydrogen, biomethane, synthetic methane and other prescribed substances, and blends of primary gases. We note that Western Australia has not yet adopted the *National Gas Amendment (Other Gases) Rule 2024*, or associated changes to the NGL to introduce the definition of "covered gas" into the NGL.

307 Submissions to the consultation paper: Alinta, p. 3; IEEFA, p. 3; EUAA, p. 3; GCCN, pp. 4 and 11; JEC, p. 16; SACOSS, p. 4. Submission on the directions paper: IEEFA, p. 8.

308 Submissions to the consultation paper: AGIG, p. 9; APGA, p. 22; ATCO, p. 3; ENA, p. 18; Jemena, p. 17.

309 Submissions to the consultation paper: APGA, p. 22; ENA, p. 18; Jemena, p. 17.

with the NGO, which requires consideration of the long term interests of consumers of covered gas. It is up to the regulator to determine whether capex is prudent and efficient based on the conforming capex criteria and, if so, that expenditure should be captured in reference tariffs.

4.8.6 Removing advance determinations for future capex or require public consultation on all applications for advance determinations

The Commission does not consider that changes are required to adopt ECA's proposal to remove the AER's ability to make advance determinations for future capex or to require public consultation on all applications for advance determinations.[310] ECA questioned whether it is appropriate to allow the AER to make advance determinations under rule 80 of the NGR that capex conforms with the new capex criteria. At the very least, ECA consider that the AER must be required to consult on expenditure proposals before determining that the capex is conforming. We do not consider that these amendments would contribute to the achievement of the NGO and, conversely, could risk imposing additional costs on the service provider and regulator.

DCAN and Origin consider that the AER should be required to consult on advanced proposals before determining that it is conforming capex.[311] In contrast, APGA considered that mandating public consultation would add administrative cost and delay outcomes.[312] The AER did not support removing advance determinations or mandating consultation if proposed costs are non-material.[313]

We do not consider that the advance determination provisions in the NGR need to be amended.[314] The rule provides flexibility for service providers to invest additional capex when circumstances change during a regulatory period and have certainty that the regulator would allow the capex to be rolled into the capital base in the next AA period. This allows projects to proceed when the need is identified rather than waiting until the next regulatory period to have the capex approved. We consider this flexibility should be maintained to reduce the risk of investment being inefficiently deferred.

This provision has rarely been used, and we understand that the AER has consulted publicly on the small number of applications that they have received to date.[315] Our draft determination is to retain the regulator's flexibility to decide whether or not to consult on advance determinations, rather than mandating consultation on all advance determinations. While the regulator currently has discretion on whether it publicly consults, the regulator's ability to approve capex without consultation is limited to cases where the service provider applies, within an AA period, for a determination that capex not captured in the ex ante forecast will meet the new capex criteria. The AER's practice has been to consult on all advance determinations.

We note that, if consultation were mandated this would mean that the regulator would need to consult on an application for an immaterial amount of expenditure, for which the additional regulatory costs would outweigh the benefits.

We also note that in making a decision under rule 80, the AER must consider whether the new capex criteria set out in rule 79 are met. The draft rule would place greater discipline on service providers to justify proposed capex, including for applications for an advance determination. The

310 ECA, Rule change request - Capital expenditure, pp. 20-21.
311 Submissions to the consultation paper: DCAN, p. 3 and Origin, p. 3.
312 APGA, Submission to the consultation paper, pp. 24-25.
313 Submissions to the consultation paper: APGA, p. 24-25 and AER, p. 5.
314 NGR and WA NGR rule 80.
315 We have identified two instances where the AER has approved an application under rule 80: a 2018 decision on AGN's Mount Barker gas network extension and a July 2026 decision on APA's South West Pipeline expansion.

additional rigour and transparency will improve confidence that, going forward, new any applications under rule 80 are strictly necessary to support safe and reliable services.

4.9 We consider our more preferable draft rule will better promote the NGO than the rule change request

The Commission considers that its more preferable draft rule will better promote the NGO than the rule change request and the existing arrangements. While the draft rule adopts several elements proposed by the ECA, it also includes modifications and alternative approaches that the Commission considers will more effectively address the identified challenges associated with uncertain gas demand. Taken together with other elements of the draft rule, the reforms provide a balanced framework that supports efficient expenditure where it is strictly necessary, minimising the capital at risk of stranding, while continuing to support the safe and reliable provision of gas services. It will also improve clarity and transparency, enabling stakeholders to engage with the AA process and providing greater confidence that investment decisions are being made in the long term interests of consumers.

Our proposed amendments to the NGR would contribute to the achievement of the NGO by:

- **Improving outcomes for consumers** by increasing the discipline on service providers to identify the most suitable option to meet an investment need, with a longer-term focus (that is also supported through our proposed long-term outlook requirements on service providers and the regulator), minimising expenditure and therefore costs on current and future customers.
- **Supporting the safety, security and reliability of gas services** by requiring service providers to continue to invest efficiently to maintain and operate their networks in compliance with applicable safety standards and regulations.
- **Promoting principles of market efficiency** by requiring service providers to have a longer-term focus, helping to minimise the risk of stranding.
- **Supporting emissions reduction** by increasing scrutiny of capex in new long-lived gas assets and removing references to demand growth in the expenditure provisions, supporting the energy transition towards net zero.
- **Considering implementation issues** by making changes to the gas economic regulatory framework that are appropriate for the current and future stages of the energy transition.
- **Promoting good regulatory practice** by improving transparency and predictability in how businesses justify expenditure and how expenditure is assessed by the regulator, improving confidence for consumers and other stakeholders that the regulatory framework is promoting efficient outcomes under uncertain demand. Greater transparency will also improve stakeholders' understanding and ability to engage with and provide feedback on AA proposals.

We consider that service providers operating prudently and in accordance with the regulator's expectations would already be undertaking many of the activities underlying the proposed changes. For this reason, there are unlikely to be significant additional costs imposed on either service providers or the regulator. However, making these proposed amendments would drive greater transparency for consumers and other stakeholders and provide confidence that the challenges of uncertain and potentially declining demand are being suitably considered in AA proposals and regulatory decisions.

We have also considered the RPPs in making our draft rule. The draft rule strengthens the discipline applied to expenditure proposals and decisions and improves transparency, rather than changing the fundamentals of the expenditure framework. Service providers would continue to

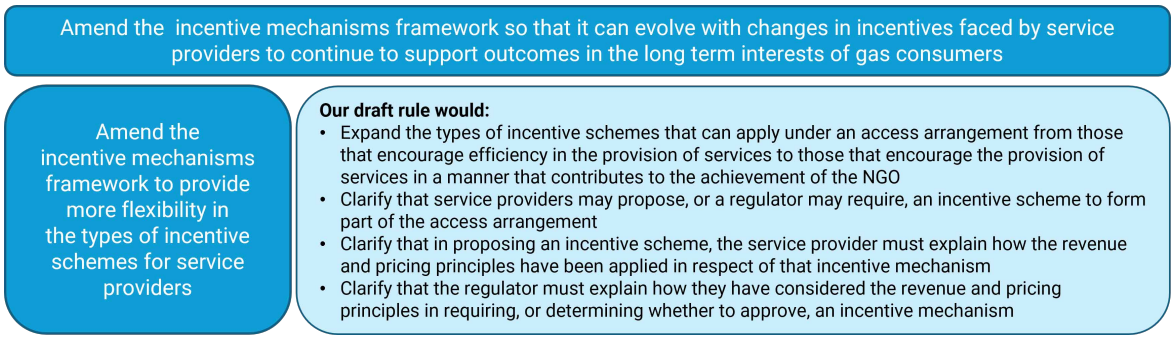
have a reasonable opportunity to recover at least the efficient costs that they incur, including to comply with regulatory obligations, and would retain incentives to efficiently invest in pipelines and efficiently provide services.

5 How our draft rule to amend the incentive mechanism framework would operate

Our draft rule would amend the incentive mechanisms framework to provide more flexibility in the types of incentive mechanisms for service providers. The draft rule retains the current principles-based approach while improving clarity and flexibility for service providers to propose, or the regulator to require, a broader range of incentive mechanisms to be included in AAs. The draft rule would allow these mechanisms to be included in a service provider's AA if they would contribute to the achievement of the NGO.

The key changes to the framework that would result from our draft rule are summarised in Figure 5.1.

Figure 5.1: Overview of the draft rule changes to incentive mechanisms



This amendment would support a more flexible and future-focused incentive framework. Incentive mechanisms would be able to evolve as the energy transition changes the incentives faced by service providers, while maintaining regulatory flexibility and supporting outcomes that are in the long-term interests of gas consumers.

This chapter outlines:

- the limitations that we have identified with the current incentive mechanism framework (section 5.1)
- how our draft rule would operate (section 5.2)
- how our draft rule would promote the NGO (section 5.3).

5.1 The current framework could be improved to support a broader range of incentive mechanisms as service providers' incentives change through the energy transition

The rules currently allow a service provider to propose, and a regulator to require, that an AA include one or more incentive mechanisms to encourage efficiency in the provision of services by the service provider.[316] The NGR does not prescribe particular types of incentive mechanisms that must or may be developed, or how they are to be developed.

The AER currently allows a capital expenditure sharing scheme (CESS), which includes a service performance element, to be applied to all service providers and an operating expenditure sharing

316 NGR and WA NGR rule 98.

scheme (efficiency benefits sharing scheme (EBSS)) to all service providers. The ERA has allowed an operating expenditure sharing scheme to be applied to one transmission service provider,[317] but has not required incentive mechanisms to apply to other service providers.

The Commission considers that the current framework has operated effectively to date. However, the energy transition may change the incentives faced by service providers and may require new or modified incentive mechanisms in the future. For example, service providers' incentives to continue operating assets that have been fully depreciated is likely to change, and incentives to promote efficient use of pipeline services if demand declines may become increasingly important.

We have identified two main limitations in the current framework:

1. **The current rules do not clearly allow incentive mechanisms to be developed for all dimensions of the NGO**. The current wording refers to incentive mechanisms that "encourage efficiency in the provision of services".[318] It is not clear whether this covers all efficiency dimensions in the NGO, which refers to efficient investment in, efficient operation of and efficient use of covered gas services. The current focus of the NGR on the efficient provision of services has not been an issue to date, because to date service providers and the regulator have only implemented expenditure efficiency schemes, such as the CESS and the EBSS. However, as the transition progresses, service provider incentives are likely to change, and other types of incentive mechanisms may be required to promote the long-term interests of consumers. The rules should not constrain the development of schemes that could be suitable as the transition progresses.
2. **The requirement for incentive mechanisms to be considered through an AA process may not provide sufficient time for the regulator to develop, consult on and assess new or modified incentive mechanisms.** This may be particularly important where a mechanism raises novel issues or is intended to respond to changing incentives during the energy transition. This issue is discussed in chapter 7.

Neither ECA nor JEC proposed changes to the incentive mechanism provisions in their rule change requests. In our consultation paper, we asked stakeholders whether modified or additional incentive mechanisms should apply to service providers in the energy transition.

Stakeholders expressed mixed views on whether new or modified incentive mechanisms are required. EUAA supported further consideration of whether new or modified incentive mechanisms may be needed, while the AER was open to amendments.[319] Other stakeholders did not consider that new or modified incentive mechanisms are required, either because:

- existing mechanisms, combined with the risk of stranding and competition from alternative energy sources, are sufficient[320] or
- some stakeholders consider existing incentive mechanisms have "contributed to supernormal profits".[321]

317 ERA, Final decision on revisions to the access arrangement for the Dampier to Bunbury Natural Gas Pipeline (2026 to 2030), Attachment 7: Return on capital, taxation, incentives, 18 December 2025.

318 NGR and WA NGR rule 98(1).

319 Submissions to the directions paper: AER, p. 7; EUAA, p.6.

320 Submissions to the directions paper: ATCO, p. 22; AusNet, p. 8; ENA, p. 16; Jemena, p. 21.

321 Submissions to the directions paper: IEEFA, p. 6; JEC/SACOSS, p. 20.

5.2 The draft rule would improve clarity and flexibility for service providers to propose, or the regulator to require, a broader range of incentive mechanisms

The draft rule would provide greater flexibility for a broader range of incentive mechanisms to apply to service providers. It would do this by expanding the types of incentive mechanisms that can apply under an AA from those that encourage efficiency in the provision of services to those that encourage the provision of services in a manner that contributes to the achievement of the NGO.[322] This would broaden the scope of incentive mechanisms that may be proposed by a service provider or required by the regulator, while maintaining the current principles-based approach.

The draft rule would not prescribe the types of incentive mechanisms that may or must be developed. This maintains flexibility for the regulator to consider whether an incentive mechanism is appropriate for a specific service provider in a specific AA period. It also avoids locking in particular mechanisms or design features before there is a clear need for them.

The draft rule would also clarify that service providers may propose, or a regulator may require, an incentive mechanism to form part of the AA. In proposing an incentive mechanism, the service provider must explain how the RPPs have been applied in respect of that incentive mechanism.[323] The regulator must likewise explain how they have considered the RPPs in requiring, or determining whether to approve, an incentive mechanism.[324]

The Commission considers this approach is important because the energy transition is likely to change the incentives faced by service providers over time. For example, a new or modified incentive mechanism may be required in the future to support efficient ongoing operation of assets that have been fully depreciated, or to encourage efficient use of pipeline services where demand is declining. The draft rule would provide regulatory flexibility to develop such mechanisms if they are needed.

The Commission agrees that there is not currently a demonstrated need to prescribe new incentive mechanisms in the NGR. However, we consider it is prudent to clarify the scope of the framework now so that new or modified mechanisms can be developed if they are required in the future. This approach responds to the uncertainty of the transition while preserving the regulator's discretion to determine whether a mechanism is appropriate in the circumstances.

5.3 We consider our more preferable draft rule would promote the NGO

The Commission considers that the more preferable draft rule would promote the NGO. The draft rule would improve outcomes for consumers and promote principles of market efficiency by allowing incentive mechanisms to be developed across all efficiency dimensions of the NGO, including efficient investment in, and efficient operation and use of, covered gas services.

The draft rule would support the safety, security and reliability of gas services by enabling incentive mechanisms to be developed where they would contribute to these outcomes. It would also support good regulatory practice by improving clarity about the scope of the incentive mechanisms framework and allowing sufficient flexibility for the regulator to respond to changing circumstances.

322 Draft rule, NGR and WA NGR rule 98(1).
323 Draft rule, NGR and WA NGR rule 98(3).
324 Draft rule, NGR and WA NGR rule 98(4).

We have also taken the RPPs into account with the incentive mechanism amendments in the draft rule. Under the draft rule, service providers would retain incentives to efficiently invest in pipelines providing reference services and to efficiently provide pipeline services. By allowing any incentive mechanism to be developed where it contributes to the NGO, the draft rule is consistent with the efficiency dimensions in the RPPs.

Overall, the Commission considers that the draft rule provides a proportionate response to the potential limitations in the current framework. It does not require new incentive mechanisms to be developed before a need has been established, but ensures that the regulatory framework is sufficiently flexible to support efficient outcomes for consumers as the energy transition progresses.

6 How our draft rule to amend reference tariff arrangements would operate

Our draft rule would amend reference tariff arrangements in the NGR, with various amendments applying to distribution or transmission service providers, over the next AA period or the long-term outlook period.

Figure 6.1 below provides an overview of our draft rule to amend reference tariff provisions in the NGR.

Figure 6.1: Summary of our draft rule to amend reference tariff provisions in the NGR

Reference tariff provisions would be amended to better guide service providers and the regulator on how to design, propose and approve reference tariffs for different transition scenarios

The upper bound of revenue for each tariff class incorporates competition from other energy services so that it caters for different transition scenarios	**The draft rule would amend the upper bound of revenue expected to be recovered by a distribution service provider, from each tariff class, so that it is based on the lower of:** • the standalone cost of providing the reference service to customers who belong to that class, and • the equivalent price of the reference service necessary to keep the retail price of gas competitive with alternative sources of energy for a hypothetical end user who can readily switch to such alternatives, taking into account the cost of switching to those alternative sources.
Revenue for each tariff class must lie on or between the upper and lower bounds unless justified by the service provider and approved by the regulator	**Our draft rule would amend the existing rules related to the revenue a distribution service provider expects to recover from each tariff class by:** • amending from 'should' to 'must' lie on or between the upper and lower bound • adding that the revenue a service provider expects to recover from each tariff class may be in excess of the upper bound or less than the lower bound, if justified by the service provider and approved by the regulator, having regard to the National Gas Objective (NGO).
In designing reference tariffs a broader definition of efficiency would apply that caters for different transition scenarios	**Our draft rule would require reference tariffs for distribution service providers to be designed having regard to the efficient use of the network.** • Our draft rule would replace the existing requirement to take into account the long run marginal cost (LRMC) for the reference service or charging parameter with a new requirement to have regard to the efficient use of the reference service or efficient use of the element of the service to which the charging parameter relates.
Embedding consumer impacts in tariff decisions	**Our draft rule would include a package of changes that would require transmission and distribution service providers and the regulator to consider and explain the impact of reference tariff arrangements on customers:** • new requirements for service providers and the regulator to have regard to reference tariff arrangements and tariff variation mechanisms would impact customers within the next AA period • amend existing concepts related to efficiency within the next AA period (upper bound and LRMC) • new requirements for service providers and the regulator to consider and explain the impact of reference tariff arrangements on customers over the long-term outlook period.

Our draft rule would amend various reference tariff arrangements in the NGR, either for distribution or transmission service providers, over either the next AA period or the long-term outlook period.

Our draft rule would amend the NGR for **distribution service providers (only)** by:

- supporting efficient outcomes for consumers by better recognising the effects of competition from alternative energy services as a constraint on the upper bound of revenue a distribution service provider expects to recover from each tariff class, and to ensure that reference tariffs promote the efficient use of the network
- clarifying that the revenue expected to be recovered by a distribution service provider from each tariff class must lie on or between the upper bound and lower bound, unless justified by the service provider and approved by the regulator.

Our draft rule would amend the NGR for **distribution and transmission service providers** by:

- improving transparency and accountability through greater discipline on transmission and distribution service providers and the regulator to consider and explain the impacts of reference tariff arrangements on consumers
- providing consistent terminology in the NGR related to the revenue and pricing principles in determining the allocation of costs between reference and other services

Our draft rule would amend the NGR for **transmission service providers (only)** by providing consistent terminology in the NGR related to the revenue and pricing principles in determining reference tariffs for transmission service providers.

Our draft rule would amend the existing rules related to the next AA period and include explicit new requirements in relation to the long-term outlook period. Our draft rule would:

- **for the next AA period**:
  - amend existing concepts related to reference tariff arrangements
  - include explicit new requirements for service providers and the regulator to have regard to how reference tariff arrangements and tariff variation mechanisms would impact customers
- **for the long-term outlook period require**:
  - service providers and the regulator to explain the consequences of their AA proposals and AA decisions on customers, including on reference tariffs and the provision of reference services
  - service providers to include a forecast of reference tariffs for each reference service and tariff class
  - service providers to state how the price of gas to be paid by customers is expected to compare with the costs of alternative energy sources, taking into account the cost of switching to those alternative sources.

Our draft rule would support efficient prices for consumers and efficient use of the network through distribution network tariff arrangements. This would seek to reflect what would otherwise happen in a workably competitive market, where competitive discipline provides the incentive for businesses to provide services that reflect efficient costs. We note, however, that retailers are not required to reflect distribution network tariff arrangements through their retail price structures.

Our draft rule is generally consistent with the direction of reform outlined in the directions paper to support efficient reference tariff arrangements for different demand scenarios. Our draft rule adopts some, but not all, of the elements of the proposed changes outlined in the directions paper.

6.1 Reference tariff provisions lack guidance on how to design reference tariffs for a broad range of demand scenarios

This section summarises the general issues with the current provisions that govern reference tariffs for distribution pipelines,[325] while section 6.2 provides a detailed explanation of issues with specific reference tariff provisions and amendments to address these issues in our draft rule.

Gas reference tariffs are the regulated prices that a gas distribution service provider (service provider) charges users for reference services. Reference tariffs relate to distribution network costs, which represent one of many components that make up the retail gas price. [326] A 'user' of gas reference services is usually a gas shipper or retailer and reference tariffs are designed to

325 NGR and WA NGR rule 94.

326 The retail gas price is the total delivered price of gas which includes other costs such as wholesale and retail costs.

reflect the efficient cost of providing each reference service. Gas retailers may use reference tariffs to inform the prices they then charge to end-use gas consumers, but reference tariffs are not charged directly to end use consumers.[327]

Under the existing rules, the revenue expected to be recovered from each tariff class should lie on or between the upper and lower bound costs of providing the reference service to customers who belong to that tariff class.[328] Tariff classes must be constituted with regard to the need to group customers for reference services together on an economically efficient basis and to avoid unnecessary transaction costs.[329] In practice, service providers group together consumers (end users) into tariff classes, rather than grouping together their customers (shippers or retailers). For example, service providers group consumers into tariff classes based on their location and whether they are residential or non-residential consumers.[330] For information on the use of 'customers' and 'consumers' in our draft rule, see Table 6.1.

Reference tariffs are the mechanism through which the service provider recovers its allowed revenue requirement from different tariff classes. Reference tariffs are proposed by the service provider and approved by the regulator as part of an AA and may vary within the AA period consistent with an approved tariff variation mechanism.[331] This mechanism determines how demand forecasting risks are allocated between the service provider and customers during the AA period.

As the energy transition progresses, reference tariffs and tariff variation mechanisms can play a role in supporting efficient customer decisions and managing the risks associated with uncertain and/or declining gas demand. It is therefore important that the reference tariff provisions in the NGR can support service providers and customers in managing these challenges.

Rule change proponents ECA and JEC did not explicitly raise any concerns or propose amendments to reference tariff provisions. In the directions paper we proposed to amend reference tariff arrangements so that they would be fit for the future for the broader range of demand scenarios that may occur in the transition. Stakeholders had mixed views in response to our directions paper, as explained in section 6.2 and section 6.3 below. In general, retailers and customer groups considered that the reference tariff provisions should be updated to better reflect the changing external landscape for the transition, while most service providers thought that the current rules provide sufficient flexibility going forward without the need for change (see section 6.2 and section 6.3 for more detail).

The Commission considers the current reference tariff arrangements to be largely appropriate, however given the range of demand scenarios, there are opportunities to improve the current framework. We consider that the key issues with the existing rules are that:

- some existing concepts that are related to efficiency are not fit for the future for all demand scenarios so may not support efficient outcomes for consumers, as explained in section 6.1.1 below
- they do not expressly require service providers and the regulator to consider and explain the impact of reference tariff arrangements on consumers, as explained in section 6.1.2 below.

To address these issues, we propose to:

327 We note that some large commercial and industrial users can be 'self-contracting users' who engage the service provider directly for haulage services.
328 NGR and WA NGR rule 94(3).
329 NGR and WA NGR rule 94(2).
330 For example, see: Multinet, Attachment 14.1 - Network Pricing - Formulae and Efficiency - Final Plan 2023/24 – 2027/28, p. 3.
331 NGR and WA NGR rule 97.

- amend some existing concepts in the rules that are related to efficiency around how reference tariff arrangements are bounded and designed, as explained in section 6.2 below, and
- supplement the regulator to consider and explain the impacts of reference tariff arrangements on consumers, as explained in section 6.2 below.

6.1.1 Some existing concepts in the rules are not fit for the future for all demand scenarios

The existing rules include concepts that are related to efficiency that service providers and the regulator use when designing, proposing and approving reference tariff arrangements. This includes existing concepts such as:

- the revenue expected to be recovered from each tariff class should lie on or between (to avoid cross-subsidies between customers):
  - an upper bound representing the standalone cost of providing the reference service to customers who belong to that class;[332]and
  - a lower bound representing the avoidable cost of not providing the reference service to those customers.[333]
- the design of reference tariffs must take into account the long run marginal cost (LRMC) for the reference service or charging parameter.[334] LRMC measures the future costs that would be caused by an incremental change in demand, including any need to expand the capacity of the network to serve the incremental change in demand.

The Commission considers that the existing concepts above should remain key considerations for service providers and the regulator when designing tariff classes, structures and variation mechanisms. We consider that the current concept for the lower bound of revenue expected to be recovered from a tariff class, based on avoidable costs, remains appropriate in proposing and approving reference tariff arrangements that are efficient and promote the long-term interests of consumers, as explained in section 6.3.1.[335]

However, due to a wide range of potential demand scenarios facing service providers, other concepts in the existing rules may not be fit for the future to support efficient outcomes for consumers. The issues with the other existing concepts are that:

- the upper bound of revenue expected to be recovered from each tariff class does not take into account competition from alternative energy services, which may lead to inefficient prices and outcomes for consumers (see section 6.2.1)
- there is an insufficiently firm requirement to prevent cross-subsidies between tariff classes because the revenue expected to be recovered from each tariff class may lie outside the upper bound or lower bound, without a requirement for this to be justified by the service provider or approved by the regulator (see section 6.2.2)
- reference tariff design must take into account the LRMC for the reference service or charging parameter, which may not be relevant and could deliver inefficient outcomes in a declining demand scenario (see section 6.2.3).

Given these issues, we consider that the NGR should be amended to support service providers and the regulator apply these existing concepts in context-specific ways, acknowledging the broader range of demand and jurisdictional policy scenarios that may emerge during the energy

332 NGR and WA NGR rule 94(3)(a).
333 NGR and WA NGR rule 94(3)(b).
334 NGR and WA NGR rule 94(4)(a).
335 NGR and WA NGR rule 94(3)(b).

transition. If these concepts are not applied in a context-specific way, we may see reference tariff arrangements that:

- are not internally consistent with the intent of decisions made in other components of an AA, such as the long-term outlook
- may not promote the long-term interests of consumers.[336]

6.1.2 The existing rules do not expressly require service providers and the regulator to consider and explain the impact of reference tariff arrangements on consumers

The Commission acknowledges the existing work that service providers and the regulator do to understand customer needs and behaviours when designing, proposing and approving reference tariff arrangements. While these activities occur in practice, the existing rules do not explicitly require service providers (when proposing) and the regulator (when approving) to consider and explain how reference tariff arrangements impact customers within and beyond the AA period. This limits transparency and weakens accountability for consumer outcomes.

Our draft rule would strengthen transparency and accountability by requiring service providers and the regulator to demonstrate how the interests of consumers have been considered when developing and approving reference tariff arrangements under a range of plausible future demand scenarios, including those that may emerge during the transition as explained in section 6.2.4.

6.2 Our draft rule would place new and amended requirements on service providers and the regulator on how to design, propose and approve reference tariff arrangements

This section explains how our draft rule would amend various reference tariff arrangements in the NGR, either for distribution or transmission service providers, over either the next AA period or the long-term outlook period.

Our draft rule would amend the NGR for **distribution service providers (only)** so that:

- the upper bound of revenue a distribution service provider expects to recover for each tariff class would be the lower of standalone costs and the equivalent price of competitive energy services (section 6.2.1)
- the revenue expected to be recovered by a distribution service provider from each tariff class must lie on or between the upper bound and lower bound, unless justified by the distribution service provider and approved by the regulator having regard to the NGO (section 6.2.2)
- in designing reference tariffs, distribution service providers and the regulator would need to have regard to the efficient use of the network (section 6.2.3)

Our draft rule would amend the NGR for **distribution and transmission service providers**:

- by improving transparency and accountability through explicit requirements on distribution and transmission service providers to consider and explain the impact of reference tariff arrangements and tariff variations mechanisms on customers (section 6.2.4)
- through a minor change to provide consistent terminology in the NGR related to the revenue and pricing principles in determining the allocation of costs between reference and other services (section 6.2.5)

336 Consistent with the NGO.

Our draft rule would amend the NGR for **transmission service providers (only)** through a minor change to provide consistent terminology in the NGR related to the revenue and pricing principles in determining reference tariffs for transmission pipelines (section 6.2.5).

Our draft rule would amend the existing rules related to the **next AA period** and include explicit new requirements in relation to the **long-term outlook period**, as explained below.

- Amendments related to the next AA period are set out in section 6.2.1, section 6.2.2 and section 6.2.3 below.
- Amendments related to the long-term outlook period are part of the changes set out in section 6.2.4 below.

6.2.1 The upper bound of revenue a service provider expects to recover for each tariff class would be the lower of standalone costs and the equivalent price of competitive energy services

The draft rule would amend the upper bound of revenue expected to be recovered from each tariff class so that it is based on the lower of:

- the standalone cost of providing the reference service to customers who belong to that class, and
- the equivalent price of the reference service necessary to keep the retail price of gas competitive with alternative sources of energy, taking into account the cost of switching to those alternative sources, for a hypothetical consumer who can readily switch to such alternatives.[337]

Our draft rule is consistent with the general direction proposed in our directions paper to amend upper bound provisions in the NGR so the upper bound operates effectively across a broader range of demand scenarios. In particular, the Commission seeks to better recognise the effects of competition from alternative energy services as a constraint on the revenue that a service provider could recover from each tariff class. Our draft rule has further developed our proposed direction, as explained below in this section.

Under the existing rules, the revenue a service provider expects to recover from each tariff class through reference tariffs should not be higher than their standalone costs. Standalone costs are the costs the service provider would incur, were the network only to supply those customers.[338] Standalone costs used in AAs today tend to focus on the costs of building a hypothetical gas network that only supplies customers within that tariff class. The concept of standalone costs is intended to support efficient outcomes by avoiding cross-subsidies between tariff classes. That is, if revenue expected to be recovered from a tariff class is in excess of standalone costs then that tariff class would be the source of a subsidy to other tariff classes.[339]

In the directions paper we proposed to broaden the upper bound, that is currently based on standalone costs, to also incorporate competition from alternative energy services. This would support efficient prices, that better reflect those that would prevail in a workable competitive market.[340]

337 Draft rule, NGR and WA NGR rule 94(3)(a).
338 NGR and WA NGR rule 94(3)(a).
339 For more information on the use of standalone costs in relation to cross-subsidy see: ACCC, Test for assessing cross-subsidy, June 2014.
340 AEMC, *National Gas Amendment (Gas Networks in Transition) - directions paper*, 19 March 2026, pp. 122-123.

Under our draft rule, the revenue expected to be recovered from each tariff class must not be in excess of the upper bound, unless justified by the service provider and approved by the regulator, as explained in section 6.2.2 above.[341]

Our draft rule would retain the concept of standalone costs in the upper bound provisions

We consider that the concept of standalone costs remains relevant and should be retained in the upper bound provisions. The concept of standalone cost is well understood in economic regulation[342] as a measure of what would be required to replicate or bypass the network, such that if prices were above standalone costs then customers may bypass using the network. The idea of using it as a price ceiling remains sound under the broad range of scenarios that could arise through the energy transition.[343]

Our draft rule would broaden the upper bound provisions by incorporating competition from alternative sources of energy so that tariffs reflect what would occur in a workably competitive market

Customers who remain on the gas network should not face prices consistently above those that would prevail in a workable competitive market.[344] The Commission recognises that some households and businesses have made long-run investment decisions based on the continued provision of regulated gas services at prices that emulate workably competitive market conditions. Prices cannot be described as workably competitive if they remain elevated longer than the period within which a competitive response might reasonably be expected. Where material financial, technical or other barriers to switching exist this competitive discipline may be weak or delayed. Barriers to switching will likely be experienced by large apartment blocks or business users.

Broadening the upper bound to include competition between reference services and alternative energy services, for consumers that face no impediment to switching, would protect consumers from paying prices in excess of what would prevail in a workably competitive market. That ceiling reflects the credible exit option of consumers who can leave and, in doing so, constrains prices for others within the same tariff class that may find it more difficult to do so. These provisions are intended to reflect competitive outcomes, and are not intended to provide protections for consumers experiencing vulnerability, who are protected through retailer-based provisions.[345]

The concept of standalone costs is unlikely to support efficient prices and efficient use of the network in all demand scenarios. In uncertain or declining demand scenarios, if reference service prices are set below standalone costs but above the equivalent price of competitive sources of energy, customers would pay more to meet their energy demand than is possible from competitive sources of energy. In a workably competitive market, this may result in some customers deciding to switch to competitive sources of energy (if they can readily switch as they do not face unreasonably high barriers), a disorderly exit and low utilisation of the gas network and higher and more volatile charges for remaining customers.

To address this issue, we propose to broaden the upper bound to incorporate competition from other sources of energy, so that the upper bound supports efficient prices and use of the network in all scenarios.

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341 Draft rule, NGR and WA NGR rule 94(3A).

342 For example, ACCC, *Tests for assessing cross subsidy*, June 2014, defined a standalone test as whether a service is a source of cross-subsidy if the revenue generated by that service is greater than the standalone cost of the service.

343 Standalone costs are used in NER clause 6.18.5(e) for similar reasons to NGR rule 94(3).

344 Australian Government, National Competition Policy Review Report (the Hilmer Report), August 1993.

345 For example, Part 3 of the National Energy Retail Rules (NERR) has customer hardship provisions on energy retailers.

How the draft rule would operate

Table 6.1 below sets out how we propose to incorporate competition from other sources of energy into the upper bound provisions and our reasons.

Table 6.1: Rule 94(3)(a)(ii) of our draft rule would incorporate competition into the upper bound of revenue expected to be recovered from each tariff class

Element of our draft rule	Rationale
The equivalent price of the reference service necessary to keep the retail price of gas competitive with alternative sources of energy, taking into account the cost of switching to those alternative sources	• Reference services tariffs only relate to the distribution network portion of the retail gas price and do not include wholesale, retail and any other costs that form part of a total retail gas price. Given this, there is a need to calculate the equivalent reference tariffs to keep the total retail price of gas competitive with alternative sources of energy. • Alternative sources of energy are energy services that are not provided via a pipeline (e.g. electricity or LPG tanks). • Competition between reference services and alternative sources of energy would take into account costs to supply and use energy (i.e. supply and consumption charges) and any costs required to switch to those alternative sources (e.g. replace gas appliances with electric alternatives or install LGP tanks). • Given the potential year-on-year variability in the competitiveness of reference services versus alternative energy of sources, and the need to take into account longer-term customer investment decisions to switch to alternative sources of energy, we expect that service providers and the regulator would carry out analyses estimating and comparing competitive services over a number of years. A single year comparison may result in rapid changes so may be impractical to implement by service providers and the regulator. Our draft rule provides discretion for service providers and the regulator to determine a methodology for the time period over which the competitive analysis of reference services vs alternative sources of energy is carried out, as explained below.
For a hypothetical consumer who can readily switch to such alternatives	• The competitive analysis between reference services and alternative sources of energy would be undertaken for a hypothetical consumer who can readily switch to alternative sources of energy as they do not face high technical or financial barriers to switching (e.g. residential consumers living in a house or small business customers that can take reasonable steps to modify their energy inputs). Given that consumers who can readily switch are the consumers that are most likely to switch, this seeks to

Element of our draft rule	Rationale
	replicate outcomes that would be observed in a workably competitive market. • Under existing rules 94(2) and 94(3) the upper and lower bound is calculated in relation to customers who belong to each tariff class, and tariff classes must be constituted with regard to the need to group customers together on an economically efficient basis and to avoid unnecessary transaction costs. In practice, service providers group together consumers (end users) into tariff classes, rather than grouping together customers (shippers or retailers), as explained in section 6.1. Our draft rule is consistent with the practical application of the existing rules and is clear that service providers and the regulator are to incorporate competition from alternative energy services into the upper bound based on a hypothetical consumer (end user) who can readily switch to such alternatives.

Source: AEMC

Our draft rule differs from our directions paper where we suggested that the NGR could be amended to help service providers and the regulator identify the appropriate methodology to apply at different phases of the transition.[346] Our draft rule does not prescribe the methodology to apply at different phases of the transition, which provides more flexibility for the service provider and regulator.

The draft rule, as explained in Table 6.1 above, provides discretion for service providers and the regulator to determine a more detailed methodology to apply rule 94(3)(a) of our draft rule in practice. A more detailed methodology may include (but may not be limited to):

- whether to apply a representative consumer for each tariff class (e.g. based on assumed consumption characteristics)
- whether to provide a set or indicative time period over which the competitive analysis of reference services vs alternative sources of energy is carried out.

The Commission is interested in stakeholder views on:

- whether the elements to incorporate competition from alternative energy services into the upper bound in rule 94(3)(a)(ii) of our draft rule are appropriate, and if not, how these elements should be amended?
- whether it would be useful for the AER and ERA to provide guidance on how competition from alternative energy services in the upper bound would be assessed?

How we have addressed stakeholder concerns

Retailers, COTA, ECA and VEFN supported our proposed change to the upper bound. They supported guidance to enable clear and consistent application of the upper bound concept, across a range of scenarios, to ensure that tariffs remain economically efficient and minimise the risk of cross-subsidies.[347]

346 AEMC, *directions paper - National Gas Amendment (Gas Networks in Transition)*, 19 March 2026, p. 123.

347 Submissions to the directions paper: AGL, p. 4; Alinta, p. 5 Origin, p. 6; COTA, p. 2; ECA, p. 20; and VEFN, p. 12.

Jemena suggested that the rules should provide guidance on the interaction between capital redundancy and how competition would be incorporated into the upper bound.[348] Jemena suggested that, where capital redundancy is being considered as a last resort, the rules should provide guidance that service providers and the regulator are to err on the side of assumptions that result in higher amounts for competitive alternative energy services.[349] Our draft rule does not include an explicit link that would require a service provider or the regulator to use partial redundancy, if reference tariff are set above the upper bound. Instead, the draft rule would explicitly allow service providers to propose tariffs above the upper bound where doing so contributes to the achievement of the NGO and the regulator approves it having regard to the NGO.[350]

The AER did not consider that regulator discretion should be limited.[351] We acknowledge that our draft rule would, by incorporating an additional factor to have regard to in upper bound, change the way in which the upper bound of revenue a service provider expects to recover from a tariff class is determined. However, beyond the explicit requirements in rule 94(3)(a)(ii) of our draft rule, the regulator would have discretion in how to incorporate competition from alternative energy services into the upper bound. For example, the regulator would have discretion over whether to apply a representative consumer for each tariff class and an indicative time period over which the competitive analysis, as explained above.

Service providers also did not support incorporating competition from other sources of energy into the upper bound as they considered that the analysis would be challenging, may not be accurate and retail prices would not represent an appropriate upper limit for setting distribution reference tariffs.[352] While it may be challenging to undertake such analysis, the Commission considers that it is important to carry out this analysis to support efficient prices that would prevail in a workably competitive market. We consider that the current upper bound provisions are not fit for the future for all demand scenarios, so the upper bound should be broadened to take into account competition from alternative energy services. We set out how competition from alternative energy services would be calculated in rule 94(3)(a)(ii) of our draft rule and provide discretion for service providers and the regulator to determine a more detailed methodology to apply this rule in practice. While our draft rule would not require the regulator to provide guidance on how to incorporate competition from alternative energy services into the upper bound, our draft rule provides discretion for the regulator to provide such guidance, which we seek stakeholder feedback, as noted above.

Service providers also considered that the proposed direction would limit the ability of service providers to recover costs, which could result in systematic under-recovery of revenue.[353] We note that our draft rule would not change the structure of revenue and price regulation in the NGR whereby:

- the total revenue allowance is set for each regulatory year of the AA period using the building block approach in which the building blocks are:[354]
  - a return on the projected capital base for the year

348 Jemena, submission to the directions paper, p. 9.

349 Jemena, submission to the directions paper, p. 9.

350 Draft rule, NGR and WA NGR rule 94(3A).

351 AER, submission to the directions paper, p. 2.

352 Submissions to the directions paper: Evoenergy, p. 6; AGIG, p. 16; AusNet, p. 7; ENA, pp. 2-3; APGA, p. 11; ATCO, p. 19, Jemena, p. 13; and APA, pp. 10-11.

353 Submissions to the directions paper: Evoenergy, p. 7; AusNet, p. 7; APGA, p. 3; and APA, p. 10.

354 NGR rule 76.

- depreciation on the projected capital base for the year
- the estimated cost of corporate income tax for the year
- increments or decrements for the year resulting from the operation of any incentive mechanism
- a forecast of operating expenditure for the year

- if, as a result of the operation of NGR rule 94(4), the service provider may not recover the expected revenue, the tariffs must be adjusted to ensure recovery of expected revenue with minimum distortion to efficient patterns of consumption.[355]

Our draft rule would promote the NGO

We consider that our draft rule would promote the NGO, as explained below.

- **Outcomes for consumers:** Our draft rule would broaden the application of the upper bound to include a new level that reflects the competitive price of alternative energy services, so that consumers who remain connected to the network pay efficient prices, that are not in excess of what would prevail in a workably competitive market.
- **Supporting principles of efficiency:** Our draft rule would support efficient outcomes for consumers by taking into account competition from alternative energy services.

6.2.2 The revenue expected to be recovered from each tariff class must lie on or between the upper bound and lower bound, unless justified by the service provider and approved by the regulator

Under the existing rules, the revenue expected to be recovered from each tariff class should lie on or between the upper bound and lower bound. The Commission considers that additional guidance is required in the NGR on how these upper and lower boundaries are to operate in practice.

Our draft rule would amend the existing rules by:

- amending existing rule 94(3) from 'should' to 'must' lie on or between the upper and lower bound[356]
- adding rule 94(3A) so that the revenue expected to be recovered from each tariff class may exceed the upper bound or be less than the lower bound, if justified by the service provider and approved by the regulator, having regard to the NGO.

Our draft rule would promote the NGO because it provides a firmer safeguard for customers against cross-subsidies between tariff classes, by not allowing revenue for a tariff class to exceed the upper bound or be less than the lower bound unless justified by the service provider and approved by the regulator, having regard to the NGO. This improves transparency, while retaining flexibility for revenue to be outside these boundaries if it promotes the NGO.

6.2.3 Service providers and the regulator would need to have regard to the efficient use of the network when designing reference tariffs

Our draft rule would replace the current approach to designing reference tariffs based on LRMC with a broader approach that supports efficient use of the network. Our draft rule would require that a tariff and each charging parameter (e.g. fixed or variable charges) for a tariff (where a tariff consists of two or more charging parameters) must be determined having regard to:[357]

355 NGR and WA NGR rule 94(5).
356 Draft rule, NGR and WA NGR rule 94(3).
357 Draft rule, NGR and WA NGR rule 94(4)(a).

- the efficient use of the reference service, or
- in the case of a charging parameter, the efficient use of the element of the service to which the charging parameter relates.

The current requirement for service providers and the regulator to take into account the LRMC in designing reference tariffs is no longer relevant in all demand scenarios

Under the existing rules, service providers are required to take into account the LRMC of providing the relevant service when they are designing reference tariffs.[358] LRMC measures the future costs that would be caused by an incremental change in demand, including any need to expand the capacity of the network to serve the incremental change in demand.

Requiring service providers to take LRMC into account when setting tariffs and charging parameters remains relevant in some demand scenarios. It is based on the economic principle that prices should reflect the underlying cost of providing the service. By reflecting the incremental change in costs caused by a small change in volume, reference tariffs based on LRMC can theoretically support efficient use of the network where the value of using the network exceeds the additional costs caused by the change in consumption.

In a scenario where the service provider is facing declining demand and the LRMC is trending towards zero (or potentially negative), LRMC is not a relevant factor, so the service provider and regulator should not be required to take LRMC into account in designing reference tariffs. For example, in a scenario where the network is under-utilised:

- any modelled increase in demand would likely not require any additional expenditure to serve that change in demand
- any modelled decrease in demand is unlikely to cause a change in future expenditure in network capacity, given that the network investment has already been made.

The AER, Evoenergy, AusNet and Origin considered that LRMC was not always relevant to the design of reference tariffs, particularly for service providers in declining demand scenarios.[359]

On the other hand, ATCO considers that LRMC promotes economic efficiency by informing consumption, investment and asset management decisions over time.[360] ATCO considers that there are established methodologies that remain capable of producing meaningful LRMC estimates in declining demand scenarios.[361]

Our draft rule would replace LRMC with a broader approach that service providers and the regulator should have regard to the efficient use of the network when designing reference tariffs

Our draft rule would apply a broader outcomes-based approach to efficiency than the current arrangements. Our draft rule would provide flexibility for service providers and the regulator to apply different reference tariff arrangements that support efficient use of the network, suited to the specific circumstances of each service provider.

Our draft rule would support reference tariff arrangements that support efficient outcomes in a declining demand scenario. This may include designing reference tariffs that:

- optimise the utilisation of existing infrastructure by encouraging customers to remain on the network, where it is efficient to do so
- set a balance of fixed and variable components that supports efficient use the gas network

358 NGR and WA NGR rule 94(4)(a).

359 Submissions to the directions paper: AER, p. 7; Origin, p. 6; AGL, p. 4; Evoenergy, p. 7; and AusNet, p. 7.

360 ATCO, submission to the directions paper, p. 20.

361 ATCO did not provide examples of such established methodologies. ATCO, submission to the directions paper, p. 20.

- avoid or minimise triggering the need for additional capital or operating expenditure.

Our draft rule would avoid the need to use LRMC modelling while providing flexibility to use LRMC in designing reference tariffs if it supports efficient use of the network

Various stakeholders were open to moving away from a requirement to use LRMC in designing reference tariffs, but also expressed concerns about whether the benefits of such a change would outweigh the costs or how these concepts may be defined.[362] We consider that the benefits of removing the requirement to use LRMC outweigh the costs. The modelling exercise to estimate LRMC is complicated and can add time and cost to the process of designing and proposing reference tariffs. In the context of declining demand where a service provider does not anticipate a need for capacity growth, LRMC may not be a well-defined or meaningful measure of the efficient use of the network and therefore will likely not provide an accurate or effective basis to set network tariffs. Our draft rule reduces regulatory costs by removing the requirement for service providers and the regulator to apply LRMC in all cases.

Our draft rule would provide flexibility for service providers and the regulator to take LRMC into account in designing reference tariffs if it is expected to support efficient use of the network. For example, in an increasing demand scenario, reference tariffs based on LRMC may support efficient use of the network where the theoretical value to customers of using the network exceeds the additional costs caused by a change in consumption.

Our draft rule would promote the NGO

We consider that our draft rule would promote the NGO, as explained below.

- **Supporting efficiency** by ensuring that reference tariffs are designed to support efficient use of the network.
- **Supporting good regulatory practice** by avoiding regulatory costs associated with the current requirement for service providers and the regulator to always model LRMC. Our draft rule would improve regulatory flexibility and transparency as service providers and the regulator may apply LRMC or other methods in designing reference tariffs, and explain how their chosen approach supports efficient use of the network. Our draft rule would improve flexibility to cater for all demand scenarios, compared to the current LRMC-only approach which is relevant for some, but not all, demand scenarios.

6.2.4 Service providers and the regulator would need to consider and explain the impact of reference tariff arrangements and tariff variation mechanisms on customers

Our draft rule includes a package of changes that would explicitly require service providers and the regulator to consider and explain the impact of reference tariff arrangements on customers within the next AA period and over the long-term outlook period. These changes would apply to both transmission and distribution service providers.

In relation to the next AA period, our draft rule would:

- include explicit new requirements for service providers and the regulator to have regard to how reference tariff arrangements and tariff variation mechanisms would impact customers within the next AA period[363]
- amend existing concepts related to reference tariff arrangements, as explained in section 6.2.1, section 6.2.2 and section 6.2.3 above.

362 Submissions to the directions paper: ECA, p. 21; AGIG, p. 18; ENA, p. 10; APGA, p. 11.

363 Draft rule, NGR and WA NGR rules 72(1)(j1) and (k1), and 59(4)(c) - (d). Reference tariff arrangements are defined in rule 3 of the draft rule to mean - in respect of reference services provided by means of a distribution pipeline - tariff classes, tariff structures and charging parameters for tariff classes.

In relation to the long-term outlook period, our draft rule would include explicit new requirements for:

- service providers to explain the consequences of their AA proposal on the service provider and its customers over the long-term outlook period, including on reference tariffs and the provision of reference services[364]
- the regulator are to explain the consequences of their AA draft decision and AA final decision on customers over the long-term outlook period, including on reference tariffs and the provision of reference services.[365]
- service providers to prepare a long-term outlook which includes a forecast of reference tariffs for each reference service and tariff class over the long-term outlook period[366]
- service providers to state in their long term outlook how the price of gas to be paid by customers is expected to compare with the costs of alternative energy sources, taking into account the cost of switching to those alternative sources.[367]

Considering the impact of reference tariff arrangements on customers would build on existing considerations in the rules and work that service providers and the regulator do to understand customer needs and behaviours

Service providers and the regulator are already required to consider the long-term interests of consumers when designing reference tariffs that promote the NGO. The existing rules include concepts (such as standalone costs, avoidable costs and LRMC) that service providers and the regulator use when proposing and approving reference tariff arrangements. We consider that existing concepts remain relevant in designing reference tariff arrangements, however due to practical challenges related to declining demand scenarios, our draft rule would amend and supplement existing concepts with other requirements, as explained in section 6.2.2 above.

Service providers already employ a range of tools and processes to understand the needs, views and responses of their customer base, as noted by a number of stakeholders.[368] This includes active engagement with large and small customers, retailers and other stakeholders, including holding consumer forums, interactive workshops and conducting surveys. Service providers have engaged extensively with their stakeholders to help them develop future plans and AA proposals that better reflect customer and stakeholder views.[369] We acknowledge service providers' increased engagement on the future of gas and the role of the network in recent AA proposals given the changing demand environment. In relation to tariffs, we note that there has been strong engagement by service providers to ensure that any proposed changes align with stakeholder and consumer views.

The regulator also employs various tools and processes to build and refine their understanding of customer views, needs and behaviours. For example the AER *Better Resets Handbook* sets out expectations of how network businesses should engage with consumers and how the outcomes of that engagement should be reflected in their proposals.[370] Also, the AER may establish a Consumer Challenge Panel to inform their decision-making through an AA process.[371]

364 Draft rule, NGR and WA NGR rule 72(q)(ii).
365 Draft rule, NGR and WA NGR rule 59(4)(b) and 62(4)(b).
366 Draft rule, NGR and WA NGR rule 45(2)(a)(vii).
367 Draft rule, NGR and WA NGR rule 45(2)(a)(ix).
368 Submissions to the directions paper: APGA, p. 11; ATCO, p. 19; JEC/SACOSS, p. 20.
369 For example, see AGIG and AusNet Final Engagement Plan for Engaging Victorians on the Future of our Networks – July 2021, Jemena Customer Forums Participant Feedback – Research Report June 2024 and Evoenergy Engagement strategy for our gas network 2026-2031 access arrangement regulatory process - March 2024.
370 AER, Better resets handbook, July 2024.

The Commission acknowledges that service providers and the regulator are continually updating and refining their understanding of consumers views, needs and behaviours and have a particular focus on this throughout the AA process. Our draft rule would leverage these existing practices, formalise them and set clear expectations on what service providers and the regulator should consider and document for the purposes of a reference tariff proposal.[372] This would also encourage the regulator to engage more explicitly with this analysis when assessing proposals. This would improve transparency and support consistency in how the impacts on consumers are considered by service providers and the regulator.

We acknowledge that explicit requirements to consider and explain how reference tariff proposals and decisions are expected to impact customers would improve transparency, while increasing the regulatory obligation on both service providers and the regulator.

Considering the impact on consumers of reference tariff arrangements and tariff variation mechanism would support transparency and trust in the regulatory process

The new requirements in our draft rule - for service providers and the regulator to consider and explain how reference tariff arrangements and tariff variation mechanisms are impacting consumers - are expected to achieve the outcomes below:

- Greater consideration and explanation by service providers and the regulator of the impact on consumers of:
  - reference tariff classes, structures [373]and tariff variation mechanisms within the next AA period
  - reference tariffs and tariff classes over the long-term outlook period.
- Improved information and transparency for stakeholders over the consequences of AA proposals and regulatory decisions on consumers over the long-term outlook period supports stakeholder engagement and trust in the regulatory process.
- Improved information on reference tariffs for the next AA period, and how the forecast retail price of gas would compare with forecast prices of alternative energy services over the long-term outlook, would promote an orderly transition.

AGL and EUAA supported changes that would improve transparency and customer decision-making.[374]

ENA and some service providers were concerned about whether the level of detail required to analyse customer impacts of reference tariff arrangements would be proportionate to the potential benefits and did not support additional prescription in the NGR.[375] APGA were concerned that analysis of the impacts of reference tariff arrangements on customer behaviour may be complex as there may be too many variables to consider.[376] We sought to address these stakeholder concerns by avoiding overly prescriptive new requirements. Our draft rule is less prescriptive than our directions paper as it does not require service providers and the regulator to

371 The Consumer Challenge Panel (CCP) assists the AER to make better regulatory determinations by providing input on issues of importance to consumers.

372 We note that under regulation 7 of the *National Gas Access (WA) (Local Provisions) Regulations 2009*, when approving or making an AA for a distribution pipeline, the ERA is required to take into account the possible impact of the proposed reference tariffs, the method of determining tariffs and the reference tariff variation mechanisms on small use customers and retailers. Our draft rule would effectively broaden the existing requirement on distribution pipelines to take into account the possible impact on consumers under regulation 7 of the *National Gas Access (WA) (Local provisions) Regulations 2009*, so that transmission pipelines must also consider consumer impacts under the NGR.

373 Service providers have traditionally structured reference tariffs around the two common charging parameters - fixed (supply) and variable (consumption) charges.

374 Submissions to the directions paper: AGL, p. 4; EUAA, p. 5.

375 Submissions on directions paper: AGIG, p. 19, AusNet, p. 7, and ENA, p. 10.

376 APGA, submission to the directions paper, p. 11.

consider and explain the impact on consumers of reference tariff structures and tariff variation mechanisms over the long-term outlook period as the costs would likely outweigh the benefits. Our draft rule refines requirements on service providers and the regulator to consider and explain the impact on consumers of reference tariff classes, structures and tariff variation mechanisms to only the next AA period, and not over the long-term outlook period. [377]

Our draft rule would promote the NGO

- **Outcomes for consumers:** Greater consideration and explanation by service providers and the regulator of the impact on consumers of reference tariff arrangements and tariff variation mechanisms within the next AA period, and the impact on consumers of reference tariffs and tariff classes over the long-term outlook period, would promote an orderly transition.
- **Support good regulatory practice:** Improved information and transparency over the consequences of AA proposals and decisions on consumers over the long-term outlook period supports stakeholder engagement and trust in the regulatory process and a stable regulatory framework.

6.2.5 Minor changes to provide consistent terminology related to the revenue and pricing principles

The draft rule also provides consistency in terminology in the NGR by clarifying the obligation to have regard to the revenue and pricing principles in determining reference tariffs for transmission pipelines and the allocation of costs between reference and other services, which would apply to both distribution and transmission service providers.[378] Our draft rule would amend the terminology in the NGR from "which is consistent with the revenue and pricing principles" to "having regard to the revenue and pricing principles".[379]

The Commission considers that these minor changes would not affect the practical operation of these provisions, and will contribute to the achievement of the NGO by making the NGR clearer to stakeholders.

6.3 How our draft rule on reference tariffs compares with our directions paper

This section sets out other matters that were raised in our directions paper and remain unchanged in our draft rule. Our draft rule:

- is different from our direction paper as it would not amend the lower bound of revenue expected to be recovered from each tariff class, which would remain based on avoidable costs as per the existing rules (section 6.3.1)
- is the same as our directions paper as it would maintain the current level of discretion for service providers and the regulator in proposing and approving tariff variation mechanisms, as per the existing rules (section 6.3.2)

The current arrangements promote the NGO by:

- **supporting outcomes for consumers** by retaining the lower bound concept, which minimises the risk of cross-subsidies between consumers
- **supporting good regulatory practice** by retaining regulatory flexibility for service providers and the regulator on the methodology to apply to calculate avoidable costs for the lower bound, so

377 Draft rule, NGR and WA NGR rules 72(1)(j1) and (k1), and 59(4)(c)-(d).
378 Draft rule, NGR and WA NGR rules 93(2)(c), 95(2)(b) and 95(3)(b).
379 Draft rule, NGR and WA NGR rules 93(2)(c), 95(2)(b) and 95(3)(b).

that it can be tailored to the specific circumstances of the service provider under different demand scenarios.

6.3.1 The lower bound of revenue a service provider expects to recover from each tariff class would remain based on avoidable costs as per the existing rules

Our draft rule aligns with the current rules, where the calculation of the lower bound of revenue a service provider expects to recover for each tariff class is based on avoidable costs. That is, the cost the service providers would avoid, were it not to supply those customers.[380] Estimates of avoidable costs tend to be based on the costs associated with the assets dedicated to supplying a tariff class (i.e. assets that serve only one particular group of customers).[381]

In the directions paper we sought stakeholder feedback on whether to amend the reference tariff provisions in the NGR to clarify how service providers and the regulator are to apply the concept of avoidable costs under different circumstances that may arise during the transition.[382]

Most stakeholders did not consider there was a need to change the basis for the lower bound

Most stakeholders did not support changing the calculation of the lower bound based on avoidable costs. Service providers did not consider there was an issue with the existing rules.[383] Evoenergy did not consider that any changing of the basis for the calculation of the lower bound would deliver benefits that outweigh the costs.[384] The AER did not consider that there was an issue with the current arrangements and did not support any changes that may limit regulatory discretion.[385]

ECA supported a lower bound that was robust and appropriate for the context of the service provider, however were unclear on how much of a constraint they apply in practice.[386] Retailers supported guidance that would support clear and consistent application of existing concepts in the rules (including avoidable costs), across a range of scenarios, to help ensure that tariffs remain economically efficient, support decisions and minimise the risk of cross-subsidies.[387]

The concept of avoidable costs is well understood in economic regulation and remains a sound basis for the lower bound in all demand scenarios

After considering stakeholder views, the Commission considers that avoidable costs remains an appropriate basis for calculating the lower bound. The idea of using avoidable costs as a price floor remains sound under the broad range of scenarios that could arise through the energy transition.

The concept of avoidable costs is well-understood in economic regulation. For example, the ACCC noted that a service is the recipient of a subsidy if the revenue generated by that service is not sufficient to cover the incremental cost of providing it, defined as the costs that would be avoided, in the long run, if the service were no longer offered.[388] Avoidable costs are also used in the National Electricity Rules (NER).[389]

380 NGR and WA NGR rule 94(3)(b).
381 For more information see: AEMC, *National Gas Amendment (Gas Networks in Transition) directions paper*, 19 March 2026, p. 120.
382 AEMC, National Gas Amendment (Gas Networks in Transition) Rule, directions paper, p. 121.
383 Submissions to the directions paper: AER, p. 7; ATCO, p. 20; AusNet, p. 7; AGIG, p. 18; and Evoenergy, p. 7.
384 Evoenergy, submission to the directions paper, p. 7.
385 AER, submission to the directions paper, p. 7.
386 ECA, submission to the directions paper, p. 21.
387 Submissions to the directions paper: AGL, p. 4; Alinta, p. 5; and Origin, p. 6.
388 ACCC, *Tests for assessing cross-subsidy,* June 2014, p. 5.
389 Avoidable costs are also used in NER clause 6.18.5(e) for similar reasons to NGR 94(3).

The existing rules provide flexibility for service providers to propose and the regulator to approve different avoidable cost methodologies. While methodologies to calculate avoidable costs differ across service providers in practice, this allows for different avoidable cost methodologies that account for the specific circumstances of the service provider.

We consider that the existing rules, combined with the need for regulatory approval of service provider's proposals, provides sufficient clarity on how to determine the lower bound and minimise the risk of cross-subsidies between customers. In addition, under our draft rule, service providers and the regulator would need to justify and approve an amount of revenue for a tariff class that is less than the lower bound,[390] as explained in section 6.2.2 above.

The Commission also notes that our proposed change to the basis for calculating the upper bound does not cause a need to make similar changes to the lower bound. The intent of the change to the upper bound is to incorporate workable competition into the regulatory framework to better inform the price ceiling, so that it reflects the equivalent price of competitive energy services, as explained in section 6.2.1.

6.3.2 The current level of discretion for service providers and the regulator in proposing and approving tariff variation mechanisms would be maintained as per the existing rules

The Commission considers that the optionality or discretion available to service providers and the regulator when proposing and approving tariff variation mechanisms under the existing rules is appropriate. We consider that different forms of control could be required during different phrases of the transition and restricting the options could lead to inefficient outcomes for both consumers and service providers. The current provisions that govern tariff variation mechanisms are sufficiently flexible to support a range of future demand scenarios.

Our draft rule aligns with our directions paper. In the directions paper we considered that it was important to retain the flexibility within current arrangements to propose and approve different types of variation mechanisms, but considered that additional NGR guidance would help ensure that service providers and the regulator give consideration to the expected impacts of proposed tariff variation mechanisms on consumers. Our draft rule would provide additional NGR guidance in the form of explicit new requirements for service providers and the regulator to have regard to how tariff variation mechanisms impact customers within the next AA period,[391] as explained in section 6.2.4.

Stakeholders expressed mixed views regarding the current arrangements. AusNet, ATCO and ENA considered that the current framework provides sufficient flexibility to accommodate different network characteristics over time.[392] IEEFA were concerned that service providers have the ability to request changes to their tariff variation mechanisms as this changes the allocation of demand risk between service providers and consumers within an AA.[393] IEEFA and JEC/SACOSS proposed to require that service providers use price cap regulation or require service providers to meet stricter criteria to change their tariff variation mechanism.[394] We consider that the discretion available to service providers and the regulator when proposing and approving tariff variation mechanisms under the existing rules is appropriate, as explained above in this section.

390 Draft rule, NGR and WA NGR rule 94(3A).
391 Draft rule, NGR and WA NGR rule 72(1)(k1) and rules 59(4)(d) and 62(4)(d).
392 Submissions to the directions paper: AusNet, p. 7; ATCO, p. 19; and ENA, pp. 10-11.
393 IEEFA, submission to the directions paper, p. 8.
394 Submissions to the directions paper: IEEFA, p. 8 and JEC/SACOSS, p. 20.

Stakeholders proposed other changes to tariff variation mechanism provisions that we have not included in our draft rule

Alinta proposed more guidance concerning the use of 'proxy' inflation mechanisms between AA periods where actual CPI data is not available at the time of the regulator's final decision.[395] Alinta was concerned that, if these inflation mechanisms were applied incorrectly it could result in over-recovery by the service provider that may produce an outcome that is inconsistent with the need for the regulator to have regard to efficient tariff structures.[396] While the Commission recognises Alinta's concern, we consider that the rules provide flexibility for the regulator to address this matter when they consider and approve the tariff variation mechanism in their AA decisions.

Evoenergy proposed to include a new factor in the NGR that would explicitly require consideration of the interrelationship with the other regulatory elements and explicitly allow for a return commensurate with the regulatory and commercial risks associated with a regulatory decision.[397] We note under the existing rules the regulator must have regard to any other relevant factor,[398] and the regulator may consider it relevant to have regard to the specific circumstances, including jurisdictional arrangements, of the service provider in relation to the decision on the tariff variation mechanism. On this basis, we do not consider it necessary to add such a factor in the NGR as the economic regulatory framework is designed to incentivise efficient investment for the safe and reliable provision of pipeline services. The rate of return is set under the National Gas Law (NGL) through the AER's Rate of Return Instrument (RORI) which determines the allowed rate of return on capital invested in regulated gas networks.[399]

Evoenergy proposed to remove NGR rule 97(3)(c) as it is no longer fit for the future and would not necessarily be consistent with jurisdictional circumstances.[400] Under rule 97(3), the regulator must have regard to a number of considerations in deciding whether a particular reference tariff variation mechanism is appropriate to a particular AA, including any jurisdictional regulatory arrangements applicable to the relevant reference services.[401] The Commission notes that while the regulator would need to consider the jurisdictional regulatory arrangements applicable to the relevant reference services, the regulator would have discretion to approve a reference tariff variation mechanism that differs from those regulatory arrangements if the AER considers it appropriate to do so.

Evoenergy further proposed to provide additional clarity to existing rule 97(3)(d) to include the consideration of ensuring productive and allocative efficiency between energy substitutes within the relevant jurisdiction, so that no one can be made better off without making someone else worse off.[402] The Commission considers that the appropriate place to incorporate the concept of energy substitutes into the reference tariff provisions is through the upper bound in rule 94(3)(a) of the draft rule, and not through additional clarity in the rule 97(3)(d).

395 Alinta Energy, submission to the directions paper, p. 5.
396 NGR and WA NGR rule 97(3)(a).
397 Evoenergy, submission to the directions paper, p. 9.
398 NGR and WA NGR rule 97(3)(e).
399 AER, Rate of return instrument 2026, link: https://www.aer.gov.au/industry/registers/resources/guidelines/rate-return-instrument-2026.
400 Evoenergy, submission to the directions paper, p. 9.
401 NGR rule 97(3)(c).
402 Evoenergy, submission to the directions paper, p. 9.

6.4 How we have addressed other matters raised by stakeholders on reference tariffs

This section sets out how we have addressed other matters raised by stakeholders on reference tariffs and clarifies how:

- our draft rule would apply to transmission service providers in a more limited way than to distribution service providers (section 6.3.1)
- We retain the existing regulatory approach where the service provider proposes, and the regulator decides, on all elements of an AA proposal, rather than applying a different approach where reference tariffs are not proposed by the service provider but are decided by the regulator (section 6.3.2).

6.4.1 Our draft rule would apply to transmission service providers in a more limited way than to distribution service providers

While our draft rule includes a package of changes that would explicitly require transmission and distribution service providers and the regulator to consider and explain the impact of reference tariff arrangements on customers, as explained in section 6.2.4, our draft rule would not change the provisions relating to the design of reference tariffs for transmission pipelines under rule 95 of the NGR.[403] An exception to this is the minor change in our draft rule to terminology related to the revenue and pricing principles in rule 95(3)(b), as explained in section 6.2.5.

Rule change proponents ECA and JEC did not explicitly raise any concerns or propose amendments to reference tariff provisions for transmission or distribution service providers. Our directions paper focused on proposed amendments to reference tariff provisions for distribution service providers and did not propose changes to tariff provisions for transmission pipelines.

EUAA supported improving transparency in both transmission and distribution pricing as it would support customers and end users in better understanding price increases that may occur during the transition.[404] Our draft rule would improve transparency for consumers in transmission and distribution prices over the next AA period and long-term outlook period, as explained in section 6.2.4.

APA did not support incorporating competition from alternative energy services into transmission tariff provisions because gas transmission charges represent a small proportion of consumers' residential gas bill and transmission pipelines are unlikely to exhibit the same decline in demand as distribution pipelines.[405] We consider that there is already competition at the transmission level because:

- transmission pipelines may compete with each other to attract shippers[406]
- shippers are generally sophisticated and well-informed parties with sufficient bargaining power to negotiate with transmission pipelines.

For these reasons, we consider that there is not a need to introduce competition from alternative energy services into the tariff provisions for transmission pipelines under rule 95 of the NGR.[407] Our draft rule would instead incorporate competition from alternative energy services into the upper bound for distribution pipelines, as explained in section 6.2.1.

403 NGR and WA NGR rule 95.

404 EUAA, submission to the directions paper, p. 2.

405 APA, submission to the draft determination, p. 10.

406 Shippers are responsible for arranging the movement of gas through pipelines and participating in market-based trading. AEMO, Gas market participant types.

407 NGR and WA NGR rule 95.

6.4.2 Reference tariff arrangements would continue to be applied using the propose-and-respond framework

ECA proposed to move away from the existing regulatory framework where a service provider proposes, and the regulator approves, reference tariffs, to a different approach where the regulator decides on reference tariffs. ECA propose that the regulator could decide on reference tariffs by taking into account the service provider's costs, other information from service providers, and customer views.[408]

We consider that, given the inter-related nature of different elements of AA proposals submitted by service providers and AA decisions made by the regulator, all elements of an AA should be proposed by the service provider and decided by the regulator. An alternative approach where the service provider proposed all elements of an AA, except for reference tariffs, may result in different elements of AA proposals not being internally consistent with each other.

6.5 Our draft rule would promote the NGO

Our draft rule would promote the NGO as explained below.

- **Outcomes for consumers:**
  - Our draft rule would provide a firmer safeguard for customer against cross-subsidies between tariff classes, by not allowing revenue for a tariff class to exceed the upper bound or be less than the lower bound unless justified by the service provider and approved by the regulator, having regard to the NGO. This improves transparency, while retaining flexibility for revenue to be outside these boundaries if it promotes the NGO.
  - Our draft rule would also broaden the upper bound to include a new level that reflects the competitive price of alternative energy services, protecting customers who remain connected to the network from paying reference prices in excess of what would prevail in a workably competitive market.
  - Greater consideration and explanation by service providers and the regulator of the impact on consumers of reference tariff arrangements and variation mechanisms within the next AA period, and the impact on consumers of reference tariffs and tariff classes over the long-term outlook period, would promote an orderly transition.
- **Supporting principles of efficiency:**
  - Our draft rule would support efficient outcomes for consumers by taking into account competition from alternative energy services and require that distribution reference tariffs are designed to support efficient use of the network.
- **Supporting good regulatory practice:**
  - Avoiding regulatory costs associated with the current requirement for distribution service providers and the regulator to always model LRMC. Our draft rule would improve regulatory flexibility and transparency as service providers and the regulator may apply LRMC or other methods in designing reference tariffs, and explain how their chosen approach would support efficient use of the network. Our draft rule would be flexible to cater for different demand scenarios, which provides more flexibility than the current LRMC-only approach, given it is increasingly only relevant for some, but not all, demand scenarios.

408 ECA, submission to the directions paper, p. 20.

- Improved information and transparency over the consequences of AA proposals and decisions on consumers over the long-term outlook period supports stakeholder engagement and trust in the regulatory process and a stable regulatory framework.

7 Extending AA revision timeframes to provide more time for service providers and the regulator to consider our package of changes to the NGR

An AA revision is the regulatory process carried out between the service provider and regulator, with engagement from stakeholders, to revise an AA for the next AA period.

Our draft rule would support good regulatory practice by extending AA revision timeframes so that service providers and the regulator have more time to consider our package of new and changed NGR requirements in their AA proposals and decisions. Figure 7.1 below provides an overview of how our draft rule would change AA revision timeframes.

Figure 7.1: Summary of our draft rule that would change AA revision timeframes

AA revision timeframes would be extended to provide more time for service providers and the regulator to take into account our package of new and changed requirements in their proposals and decisions.

Extending the timeframe from a service provider's AA proposal to the regulator's AA final decision	**Our draft rule would:**
	• extend this timeframe from 8 to 12 months under NGR rule 62(7)
	• simplify how this timeframe can be further extended by:
	  • retaining time limit ("stop the clock") provisions under NGR rule 11 so that the overall timeframe under our draft rule could be longer than 12 months in practice
	  • removing the separate ability to extend by up to 2 months under NGR rule 62(8).

Extending the time for a service provider's revised proposal in response to the regulator's AA draft decision	**Our draft rule would:** • extend the time for a service provider to submit their revised proposal in response to the regulator's draft decision from a minimum of 30 business days to 45 business days.
Extending the minimum time from a service provider's AA proposal to the commencement of the next AA period	**Our draft rule would:** • extend the time from the service provider submitting their AA proposal and the commencement date for the next AA period, so that it must not be less than 14 months, rather than not less than 12 months under existing NGR rules 50(1) and 50(2)

Our draft rule to extend the time from the service providers' submission of their AA proposal to the commencement date for the next AA period would align with other extended timeframes in our draft rule and provide flexibility for service providers and the regulator to apply a longer period of time, if appropriate.

We did not propose changes to existing AA revision timeframes in the directions paper.

This chapter outlines how:

- it is challenging to finalise AA revision processes under the existing timeframes and our package of new and changed requirements would make this more challenging for service providers and the regulator
- our draft rule would extend timeframes to provide more time for service providers and the regulator to propose and decide on AA revisions
- our draft rule would promote the NGO.

7.1 It is challenging to complete AA revision processes under current timeframes and our new and changed requirements would make this more challenging for service providers and the regulator

Under the propose and respond regulatory model, an AA revision process involves the following steps:

1. Service provider's AA proposal
2. Regulator's AA draft decision
3. Service provider's AA revised proposal
4. Regulator's AA final decision.

It is challenging to finalise the AA revision process under existing rules timeframes

Recent experience demonstrates that it is challenging to finalise the AA revision process in the timeframes in the existing rules. Table 7.1 below shows that, for AA's currently in effect, the time taken from submission of the service provider's AA proposal to the regulator's AA final decision:

- was always longer than eight months
- was usually between 10 and 12 months, and up to a period of 14 months.

This means that, in all of the AA revision processes for AA's currently in effect, the regulator was required to apply at least one of the existing rules mechanisms to extend the AA revision timeframe. Such extensions impose administrative costs on the regulator because the:

- regulator must give notice of its decision to extend the time limit using stop the clock provisions to the service provider, and publish this notice on the regulator's website[409]
- regulator must give notice of its decision to extend the AA revision process by up to two months and give reasons.[410]

Table 7.1: Time taken from service provider's AA proposal to the regulator's AA final decision for AA's currently in effect

Service provider and AA period	Date of AA proposal	Date of AA final decision	Time taken
Roma to Brisbane Pipeline 2022-27	1 July 2021	6 May 2022	Around 10 months
Victorian Transmission System 2023-27	1 December 2021	9 December 2022	Around 12 months
AGN (Vic and Albury) 2023-28	1 July 2022	2 June 2023	Around 11 months
AusNet Services 2023-28			
Multinet Gas Networks 2023-28			
Mid-West and South-West Gas Distribution Systems 2025-29	1 September 2023	8 November 2024	Around 14 months

409 NGR and WA NGR rule 11(2).

410 NGR and WA NGR rule 12 and rule 62(8).

Service provider and AA period	Date of AA proposal	Date of AA final decision	Time taken
Goldfields Gas Pipeline 2025-29	21 December 2023	18 December 2024	Around 12 months
Jemena 2025-30	29 June 2024	14 May 2025	Around 10.5 months
Dampier to Bunbury Natural Gas Pipeline 2026-30	2 January 2025	18 December 2025	Around 11.5 months
AGN SA 2026-31	30 June 2025	21 May 2026	Around 10.5 months
Amadeus Gas Pipeline 2026-31			
Evoenergy 2026-31			

Source: **AER website:** Roma to Brisbane Pipeline 2022-27: *https://www.aer.gov.au/industry/registers/access-arrangements/roma-wallumbilla-brisbane-pipeline-access-arrangement-2027-32*; Victorian Transmission System 2023-27: *https://www.aer.gov.au/industry/registers/access-arrangements/apa-victorian-transmission-system-access-arrangement-2023-27*; AGN (Vic and Albury) 2023-28: *https://www.aer.gov.au/industry/registers/access-arrangements/australian-gas-networks-victoria-and-albury-access-arrangement-2023-28*; AusNet Services 2023-28: *https://www.aer.gov.au/industry/registers/access-arrangements/ausnet-services-access-arrangement-2023-28*; Multinet Gas Networks 2023-28: *https://www.aer.gov.au/industry/registers/access-arrangements/multinet-gas-access-arrangement-2023-28*; Jemena 2025-30: *https://www.aer.gov.au/industry/registers/access-arrangements/jemena-gas-networks-nsw-access-arrangement-2025-30*; AGN SA 2026-31: *https://www.aer.gov.au/industry/registers/access-arrangements/australian-gas-networks-sa-access-arrangement-2026-31*; Amadeus Gas Pipeline 2026-31; *https://www.aer.gov.au/industry/registers/access-arrangements/amadeus-gas-pipeline-access-arrangement-2026-31*; Evoenergy 2026-31: *https://www.aer.gov.au/industry/registers/access-arrangements/evoenergy-access-arrangement-2026-31/draft-decision*. **ERA website:** Mid-West and South-West Gas Distribution Systems 2025-29: *https://www.erawa.com.au/access/gas-access/mid-west-and-south-west-gas-distribution-systems/access-arrangements/access-arrangement-2025-2029-aa6*; Goldfields Gas Pipeline 2025-29: *https://www.erawa.com.au/access/gas-access/goldfields-gas-pipeline/access-arrangements/access-arrangement-2025-to-2029*; Dampier to Bunbury Natural Gas Pipeline 2026-30: *https://www.erawa.com.au/access/gas-access/dampier-to-bunbury-natural-gas-pipeline/access-arrangements/access-arrangement-2026-to-2030*.

The package of new and changed requirements in our draft rule would make it more challenging for service providers and the regulator to meet AA revision timeframes

Our draft rule would include a package of new and changed NGR requirements on service providers and the regulator that need to be taken into account in the AA revision process. Service providers and the regulator would have new requirements relating to long-term outlooks and changed requirements relating to capital cost recovery, expenditure assessment, incentive mechanisms and reference tariffs. Our package of changes are explained in sections 3 - 6 of this draft determination.

The Commission considers that, given it is challenging to finalise AA revision process under the existing rules and our draft rule would place new and changed requirements on service providers and the regulator to be taken into account in the AA revision process, the timeframes for the AA revision process should be extended. Our proposed extensions to the AA revision timeframe are explained in section 7.1 below.

7.2 Our draft rule would extend timeframes to provide more time for service providers and the regulator to propose and decide on AA revisions

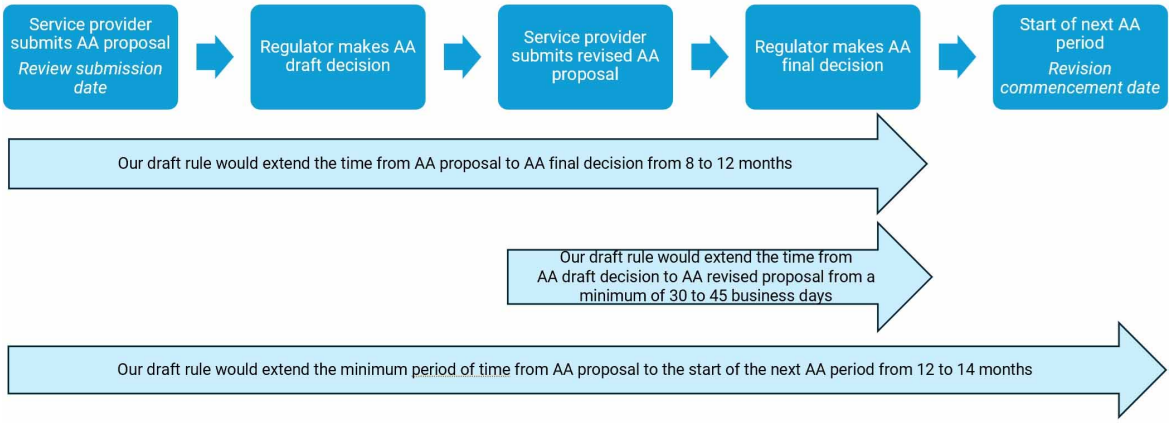
Our draft rule would extend timeframes for the AA revision process by extending the time from:

- the service provider submitting their AA proposal to the regulator's final AA decision, from 8 to 12 months

- the regulator's AA draft decision to the service provider's AA revised proposal, from a minimum of 30 to 45 business days
- submission of the service provider's AA proposal to the commencement date for the next AA period, so that it must not be less than 14 months, rather than not less than 12 months under the existing rules.

Figure 7.2 below illustrates the extended timeframes that would apply in our draft rule.

Figure 7.2: How our draft rule would extend timeframes for the AA revision process



Source: AEMC

The sections below explain our reasons for extending each of these timeframes.

7.2.1 Our draft rule would extend the timeframe from submission of the service provider's AA proposal to the regulator's final AA decision

Our draft rule would:

- extend the AA revision timeframe, from submission of the service provider's AA proposal to the regulator's final decision, from eight to 12 months[411]
- simplify how the AA revision timeframe can be extended by:
  - retaining time limit ("stop the clock") provisions under rule 11 so that the AA revision timeframe under our draft rule could be longer than 12 months in practice
  - removing the separate ability to extend to the AA revision timeframe by up to two months[412].

The existing rules require that the regulator's AA final decision must be made within eight months of the service provider's AA proposal[413] and includes the following two separate methods to extend this timeframe:

411 Draft rule, NGR and WA NGR rule 62(7).
412 See draft rule which omits NGR and WA NGR rule 62(8).
413 NGR and WA NGR rule 62(7).

- by using stop the clock provisions[414] which allow elapsed time in the AA revision process to be disregarded for various reasons.[415]
- by a period of up two months.[416]

As noted in section 7.1 above, it is challenging to finalise the AA revision process under existing rules timeframes and the package of new and changed requirements in our draft rule would make it more challenging for service providers and the regulator to meet these timeframes. To address this issue, our draft rule would extend the AA revision process from 8 to 12 months.[417]

The Commission considers that it is good regulatory practice to simplify the NGR so that there is only one mechanism, rather than two separate mechanisms, to extend the AA revision timeframe. Our draft rule would do this by amending the NGR so that AA revision timeframes may only be extended by using the stop the clock provisions.

The Commission notes that our draft rule to extend the AA revision timeframe would mean that, for service providers with AA's currently in effect, the AA review submission date for service providers to submit their AA proposal for the next AA period would need to be brought forward. To address this matter we have included transitional provisions that would apply under the draft rule, as explained in the Transitionals chapter. The transitionals chapter also explains why the extended period of time, from submission of the service provider's AA proposal to the regulator's final AA decision, would not apply to the 2028-33 AA revision processes for the Victorian distributors.

7.2.2 Our draft rule would extend the timeframe for service providers to submit their revised AA proposal in response to the regulator's draft decision

Our draft rule would extend the time for a service provider to submit their revised AA proposal, in response to the regulator's draft decision, from a minimum of 30 business days to 45 business days.

The existing rules require that service providers must submit their AA revised proposal within a period fixed by the regulator, which must be at least 30 business days from the regulator's AA draft decision.[418] The Commission considers that the current time period may be challenging to meet, and is likely to be more challenging under our draft rule due to the package of new and changed requirements on service providers. By extending the minimum period of time to 45 business days, service providers would have more time to consider the regulator's draft decision and develop their revised proposal. A period of 45 business days is consistent with the time allowed for electricity network service providers (transmission and distribution) to submit their revised proposals under the NER.[419]

414 NGR and WA NGR rule 11

415 NGR and WA NGR rule 11 sets out a number of reasons that the regulator can decide to disregard elapsed time in the AA revision process. This includes, but is not limited to, any period allowed for the service provider to correct or revise their proposal, any period allowed for submissions on a proposal by the AER to disclose confidential information and any period then taken by the AER to consider the submissions and decide whether to disclose the information.

416 NGR and WA NGR rule 62(8).

417 Draft rule, NGR and WA NGR rule 62(7).

418 NGR and WA NGR rule 59(3).

419 NER clause 6.10.3(a) and NER clause 6A.12.3(a)(i).

7.2.3 Our draft rule would extend the minimum period of time between an AA proposal and the commencement of the next AA period

Our draft rule would extend the period of time between the service provider submitting their AA proposal and the revision commencement date for the next AA period, so that it must not be less than 14 months,[420] rather than not less than 12 months under the existing rules.[421]

We have extended this period of time so that it:

- incorporates the extended period of time from the service provider submitting their AA proposal to the regulator's final AA decision, which would be extended from 8 to 12 months under our draft rule, as explained in section 7.2.1 above, and
- allows for at least two months after the regulator's AA final decision until the revision commencement date for the next AA period so that retailers can incorporate distribution reference tariffs into their retail prices for the next year.

We note that this is a minimum period of time and in practice it may be longer as fixed by the regulator, as explained in the example below. Our draft rule would align with other extensions to timeframes we are making and provides flexibility for service providers and The regulator to apply a longer period of time, if appropriate.

Box 1: How the extended period of time between an AA proposal and the commencement of the next AA period could work in practice

Our draft rule would require that the period of time between the service provider submitting their AA proposal and the commencement date for the next AA period must not be less than 14 months. This period of time must be proposed by the service provider under NGR rule 50(1) and must be approved by the regulator under NGR rule 50(2) if it is satisfied that this period of time is consistent with the NGO, having regard to the RPPs.

In practice we expect that service providers would propose, and the regulator would approve, a period of time that is longer than 14 months (e.g. around 16 months) to provide flexibility in case there is a need to use 'stop the clock' provisions. If, for example, a longer period of 16 months was proposed by the service provider and approved by the regulator then indicative dates for a service provider's AA revision that commences on 1 July of any year would be:

- the service provider submits their AA proposal in March of the year before the next AA period commences
- the regulator makes its final AA decision in April/May, around 2 months before the next AA period commences
- the AA period commences on 1 July.*

Source: AEMC
Note: *We note that not all service providers' AA periods commence on 1 July. Where a service providers' AA period commences on 1 January these indicative dates would be adjusted to fit in with that timeline.

We do not expect that any changes are needed to the existing 2028-33 AA revision timeframes for Victorian distributors

The Victorian distributors are currently due to submit their 2028-33 AA proposal to the AER on 1 June 2027, [422]which provides 13 months between submission of their AA proposals and commencement of the next AA period for 2028-33.

420 Draft rule, NGR and WA NGR rule 50.
421 NGR and WA NGR rule 50(1).
422 AER, Multinet Gas Networks - Access arrangement 2028–33, Initiation, 1 June 2026.

Our draft rule includes transitional provisions for Victorian distributors to apply the old timeframe of 8 months from submission of the AA proposal to the AA final decision for their 2028-33 AA revision processes, as explained in chapter 8 of this draft determination. Given these transitional provisions, we do not expect that there would be a need to change the 13-month timeframe for the Victorian distributors 2028-33 AA revision processes.

7.3 Our draft rule would promote the NGO

Our draft rule would promote the NGO by supporting good regulatory practice. Our draft rule is an improvement on the current arrangements as it addresses issues, including insufficient timeframes for service providers and the regulator to propose and decide on AA revisions and complexity through multiple NGR mechanisms to extend an AA revision process. Our draft rule would provide more time for service providers and the regulator to propose and decide on AA revisions, and simplify the way in which the AA revision process can be further extended to a single mechanism in the NGR.

The extended time from the service providers' submission of their AA proposal to the commencement date for the next AA period would align with other extended timeframes in our draft rule and provide flexibility for service providers and the regulator to apply a longer period of time, if appropriate.

8 How transitional arrangements would operate

Our draft rule would support good regulatory practice by clarifying how and when our package of new rules for *Gas Networks in Transition* would start to apply to each scheme distribution and transmission pipeline.

Figure 8.1 below provides an overview of the transitional provisions that would apply under our draft rule.

Figure 8.1: Summary of transitional provisions that would apply under our draft rule

Transitional provisions clarify how and when the amendments in the draft rule for *Gas Networks in Transition* would start to apply for each service provider, supporting implementation as soon as practicable.

Victorian gas distribution networks would start to apply the amendments in the draft rule from 2028	**Transitional provisions for the three Victorian gas distribution networks** • The amendments in the draft rule would start to apply for the 2028-33 AA period, except that the timeframes for the 2028-33 AA revision process would remain as per the existing rules and not be extended as would otherwise apply under our draft rule.
Service providers with an AA in force when our rule commences would start to apply the amendments in the draft rule from 2030 or 2031	**Transitional provisions for the seven service providers with an AA in force when our rule commences** • The existing rules would apply to any application by these service providers to vary their existing AA. • The commencement date for the next AA period can not be earlier than the revision commencement date set out in the current AA. • The amendments in the draft rule would start to apply for their AA revisions for their next AA periods. • The regulator must vary each current AA to bring forward the review submission date to the extent necessary or desirable to reflect the extended AA revision timeframes that would apply in the amendments in the draft rule.
Service providers that have submitted their AA proposal for the next AA period before our rule starts would start to apply the amendments in the draft rule from 2032 or 2033	**Transitional provisions for the two service providers that would have submitted their AA revision proposals for the next AA period before our rule commences** • The existing rules would apply for the remaining steps in the AA revision process for the next AA period and any application to vary their AA decision for the next AA period. • The amendments in the draft rule would apply for their subsequent AA periods, starting in 2032 or 2033. The commencement date for those subsequent AA periods cannot be earlier than the revision commencement dates set out in their next AA.
The regulator must amend, substitute or revoke financial models	**Transitional provisions for the regulator to amend, substitute or revoke financial models** • By no later than 12 months after the commencement date of the Amending rule, the regulator must amend, substitute or revoke each of its financial models published under rule 75A to take into account the Amending Rule.

Our draft rule would be implemented as soon as practicable, while avoiding additional regulatory costs that would occur if regulatory proposals and decisions based on the existing rules were re-opened to be based on the amendments in the draft rule.

Our draft rule would also provide clarity that the AER must amend, substitute or revoke financial models to take into account the amendments in the draft rule, within 12 months of the commencement of the final rule (if made).

We did not propose transitional provisions in the directions paper.

This chapter outlines how:

- transitional provisions would apply under our draft rule to enable implementation of the rule as soon as practicable for each service provider
- our draft rule promotes the NGO.

8.1 Transitional provisions support implementation of the *Gas Networks in Transition* rule as soon as practicable for each service provider

This section sets out transitional provisions that clarify how and when the amendments in the draft rule would start to apply. The transitional provisions would be applied by both the service provider and the regulator.

The table below below summarises when the *Gas Networks in Transition* rule would start to apply to each scheme distribution and transmission service provider.

Table 8.1: When the *Gas Networks in Transition* rule would start to apply to each scheme distribution and transmission service provider

Service provider	When the GNT rule would start to apply
Victorian gas distribution networks	
AusNet Distribution Network	1 July 2028
Multinet Gas Distribution Network	
Australian Gas Networks (AGN)'s Victorian Gas Network and Albury Gas Distribution Network.	
Service providers with a current AA in effect when our rule commences	
ATCO Gas Australia Pty Ltd's Mid-West and South-West Gas Distribution Systems (ATCO)	1 January 2030
Goldfields Gas Pipeline (GGP)	
NSW Gas Network (otherwise known as Jemena Gas Network) (Jemena)	1 July 2030
Dampier to Bunbury Natural Gas Pipeline (DBNGP)	1 January 2031
SA Gas Distribution Network operated by Australian Gas Networks Limited (AGN SA)	1 July 2031
Amadeus Gas Pipeline	
Canberra Network (otherwise known as the ACT and Queanbeyan-Palerang Gas Distribution Network) operated by Evoenergy (Evoenergy)	
Service providers that would have submitted their AA proposal for the next AA period before our rule commences	
Roma to Brisbane Pipeline (RBP)	1 July 2032
Victorian Transmission System (VTS)	1 January 2033

Source: AEMC

8.1.1 Victorian gas distribution networks would start to apply the amendments in the draft rule from 2028

Transitional provisions clarify that, in relation to the Victorian distributors the amendments in the draft rule would start to apply for their AA revisions for the 2028-33 AA period, except that the

timeframes for the AA revision process would remain as per the existing rules and not be extended as would otherwise apply under our draft rule.[423]

These transitional provisions apply to the three Victorian gas distribution networks:

- AusNet Distribution Network
- Multinet Gas Distribution Network
- Australian Gas Networks (AGN)'s Victorian Gas Network and Albury Gas Distribution Network.

More information on these transitional provisions is set out below.

The amendments in the draft rule would start to apply for the Victorian distributor's next AA period starting in 2028

Our draft rule would provide for the new rules to be used as soon as practicable for the Victorian distribution networks. After our final rule (if made) commences on the proposed date of 18 December 2026, the Victorian distributors would have around 5 months to engage with stakeholders and develop their AA proposals, which must be based on the amendments in the draft rule, before their AA proposals are due to be submitted to the AER on 1 June 2027.[424]

An exception to the use of the amendments in the draft rule for the Victorian distribution networks' 2028-33 AA revision processes is that the shorter timeframes in the existing rules would apply.[425] That is, transitional provisions clarify that, under the draft rule, the:

- AA revision process would be the shorter timeframe in the existing rules of 8 months, rather than the extended timeframe of 12 months in the amendments in the draft rule[426]
- Victorian distributor's revised proposals in response to the AER's draft decisions would be required in the shorter timeframe of 30 business days in the existing rules, rather than the extended timeframe of 45 business days under the amendments in the draft rule.[427]

By not applying the extended AA revision timeframes in the draft rule, the Victorian distributor's AA proposals remain due on 1 June 2027 and would not need to be brought forward to earlier in 2027. This provides more time for the Victorian distributors to engage with stakeholders in developing their 2028-33 AA proposals.

Another exception to the use of amendments in the draft rule for the Victorian distribution networks' 2028-33 AA revision processes relates to the use of financial models. If a Victorian distribution network proposes to use a nominal approach to the treatment of inflation under rule 73 (as amended by the draft rule), or an approach to recovering depreciation that includes acceleration of depreciation under rule 89 (as amended by the draft rule), then the service provider is not required to use the financial models published by the regulator. The service provider may instead provide AA information using its own financial model.[428] This is because the AA proposals would be due on 1 June 2027 but, as noted below, the regulator would have until 18 December 2027 to amend, substitute or revoke each of its financial models to take into account the amendments in the draft rule.

423 Draft rule, transitional provisions, NGR and WA NGR rule 144(2).

424 Indicative timetable to submit AA proposal. For example, see AER website: https://www.aer.gov.au/industry/registers/access-arrangements/ausnet-gas-services-access-arrangement-2028-33/initiation

425 Draft rule, transitional provisions, NGR and WA NGR rule 144(2) and definitions of "new timeframes rules" and "old timeframes rules" in NGR and WA NGR rule 142.

426 The AA revision timeframes in the existing rules and under the amendments in the draft rule can be extended as explained in section 7.2.1 the AA timeframes chapter.

427 Draft rule, NGR rule and WA NGR rule 59(3).

428 Draft rule, transitional provisions, NGR and WA NGR rule 144(3)

8.1.2 Service providers with a current AA in effect when our rule commences would start to apply the amendments in the draft rule from 2030 or 2031

Transitional provisions that would apply under our draft rule clarify that, in relation to other service providers with a current AA in effect when the amending rule commences on 18 December 2026:

- the existing rules would apply to any application by these service providers to vary their existing AA[429]
- the revision commencement date for the next AA period cannot be earlier than the revision commencement date set out in the current AA[430]
- the draft rule would start to apply for their AA revisions for their next AA periods[431]
- the regulator must vary each current AA to bring forward the review submission date to the extent necessary or desirable to reflect the extended AA revision timeframes in the draft rule.[432]

These transitional provisions apply to the following seven pipelines:

- ATCO
- GGP
- Jemena
- DBNGP
- AGN SA
- Amadeus Gas Pipeline
- Evoenergy.

More information on these transitional provisions is set out below.

The existing rules would apply to any application by these service providers to vary their current AAs

Given that the existing rules were used by these seven service providers to propose, and the regulator (AER and ERA) to decide on AA revisions currently in effect, for consistency any application by any of these service providers to vary their current AA should also use the existing rules.

Alternatively, if these service providers could vary a current AA using the amendments in the draft rule, it may constitute a material variation, which would require the regulator to deal with and consult on the AA variation proposal as an AA proposal.[433] This would mean that if any of these seven service providers applied to vary their AA, the AA would be re-opened and all of the steps of AA revision process would be repeated from the service provider's AA proposal through to the regulator's final decision, increasing regulatory costs on the service provider (and as such ultimately consumers), stakeholders and regulator.

The commencement date for these service providers' next AA periods cannot be earlier than the revision commencement date set out in their current AAs

The amendments in the draft rule would not permit service providers to propose a revision commencement date for the next AA period that is earlier than the revision commencement date

429 Draft rule, transitional provisions, NGR and WA NGR rule 145(3)(a).
430 Draft rule, transitional provisions, NGR and WA NGR rule 145(3)(b).
431 Draft rule, transitional provisions, NGR and WA NGR rule 145(2).
432 Draft rule, transitional provisions, NGR and WA NGR rule 145(4).
433 NGR and WA NGR rule 66(3).

set out in the current AA.[434] This provides clarity that each existing AA revision decision would remain in effect for the remainder of each five year AA period, so that it reflects current AA revision decisions.[435]

Alternatively, if these service providers could vary a current AA to bring forward the revision commencement date for the next AA period, and therefore shorten the length of the current AA period, it may constitute a material variation, which would require the regulator to deal with and consult on the AA variation proposal as an AA proposal.[436] This would mean that if any of these seven service providers applied to vary their AA, the AA would be re-opened and all of the steps of AA revision process would be repeated from the service provider's AA proposal through to the regulator's final decision, increasing regulatory costs on the service provider (and as such ultimately consumers), stakeholders and regulator.

The amendments in the draft rule would start to apply to these pipelines from their next AA periods in 2030 or 2031

The amendments in the draft rule would start to apply for their AA revisions for the next AA period, that is from the:[437]

- 2030-34 AA period for ATCO and GGP
- 2030-35 AA period for Jemena
- 2031-35 AA period for DBNGP
- 2031-36 AA period for AGN SA, Amadeus Gas Pipeline and Evoenergy.

The regulator must vary each current AA to bring forward the review submission date to the extent necessary to reflect extended AA revision timeframes

The regulator must bring forward the review submission date for the service provider to submit their AA proposal to the regulator for the next AA period to the extent necessary or desirable to reflect the extended AA revision timeframes in the draft rule.[438]

When the regulator makes these variation decisions for each of the seven service providers, the regulator must:

- make its decision no later than 18 months before the review submission date in the current access arrangement,
- give a copy of the decision to the service provider whose current AA has been varied,
- publish the decision on the regulator's website.[439]

8.1.3 Service providers that have submitted their AA proposal for the next AA period before our rule commences would start to apply the amendments in the draft rule from 2032 or 2033

Transitional provisions in our draft rule would provide that, in relation to service providers that have submitted their AA proposal for the next AA period before the final rule (if made) commences on 18 December 2026:

- the existing rules would apply for the remaining steps in the AA revision process for the next AA period and any application to vary their AA decision for the next AA period

434 Draft rule, transitional provisions, NGR and WA NGR rule 145(3)(b).

435 Note that under our draft rule service providers would be able to apply to vary their current AA using the current rules, however would not be able to vary their current AA in relation to the revision commencement date.

436 NGR and WA NGR rule 66(3).

437 Draft rule, transitional provisions, NGR and WA NGR rule 145(2).

438 Draft rule, transitional provisions, NGR and WA NGR rule 145(4).

439 Draft rule, transitional provisions, NGR and WA NGR rule 145(5) and (6).

- the amendments in the draft rule would apply for their subsequent AA periods, starting in 2032 or 2033
- the commencement date for the subsequent AA periods (starting in 2032 or 2033) cannot be earlier than the revision commencement date set out in the next AA (starting 2027 or 2028).

These transitional provisions apply to the RBP and the VTS. More information on these transitional provisions is set out below.

The existing rules would apply for the remaining steps in the AA revision process for their next AA period and any application to vary the AA decision for their next AA period

Given that the existing rules were used by these two service providers to engage with stakeholders and develop their AA proposals for the next AA period, for consistency the existing rules should be used for the remaining steps in these AA revision processes and any applications by service providers to vary these AA decisions.

Alternatively, if the amendments in the draft rule started to apply part way through these AA revision processes, the AA proposals[440] and the AER's draft decision[441] that would have been made based on the existing rules, would likely need to be set aside so that they could be based on the amended rules. While the Commission supports timely implementation of the amendments in the draft rule, this would not be practical and would increase regulatory costs on the service provider and the regulator.

The commencement date for these service providers' subsequent AA periods cannot be earlier than the revision commencement date set out in their next AAs

Service providers would not be entitled to propose a revision commencement date for the subsequent AA period (i.e. 2032-37 for the RBP and 2033-37 for the VTS) that is earlier than the revision commencement date set out in the next AA (i.e. in the AA for 2027-32 for the RBP and 2028-32 for the VTS).[442] This provides clarity that each AA revision decision, in relation to AA proposals that service providers have submitted before the final rule commences (if made), would remain in effect for the remainder of each five-year AA period, unless the service provider applies to vary the AA using the existing rules and the regulator decides to vary the AA.

The amendments in the draft rule would start to apply to these service providers from their next AA periods in 2032 or 2033

The amendments in the draft rule would start to apply from the:[443]

- 2032-37 AA period for the RBP
- 2033-37 AA period for the VTS.

8.2 Transitional provisions clarify that the AER must amend, substitute or revoke financial models

Transitional provisions in our draft rule would clarify that, by no later than 12 months after the commencement date, the AER must amend, substitute or revoke each of its financial models published under rule 75A to take into account the amendments in the draft rule.[444]

440 RBP submitted its AA proposal to the AER on 30 June 2026 and VTS is required to submit its AA proposal to the AER on 1 December 2026.
441 The AER's indicative timetable is to make the RBP draft decision around November 2026.
442 Draft rule, transitional provisions, NGR and WA NGR rule 143(2)(b).
443 Draft rule, transitional provisions, NGR and WA NGR rule 143.
444 Draft rule, transitional provisions, NGR and WA NGR rule 146.

The proposed commencement date set out in the draft rule is 18 December 2026. This means that the AER would need to amend, substitute or revoke each of its financial models published under rule 75A by 18 December 2027.

8.3 Our draft rule would contribute to the NGO

Our draft rule would support good regulatory practice by clarifying how and when our package of new rules would start to apply to each scheme distribution and transmission service provider. This supports a predicable regulatory framework.

Our draft rule would support implementation of the proposed amendments as soon as practicable, while avoiding additional regulatory costs that would occur if regulatory proposals and decisions based on the existing rules were re-opened to be based on the amendments in the draft rule. Given there are nine service providers that may propose to re-open their AA to be based on the amendments in the draft rule (i.e., seven service providers with a current AA in effect and two service providers that would have submitted their AA proposal for the next AA period before our rule commences), our draft rule avoids the potential for significant regulatory costs on service providers, stakeholders and the regulator associated with re-opening AA decisions.

A Rule making process

A standard rule change request includes the following stages:

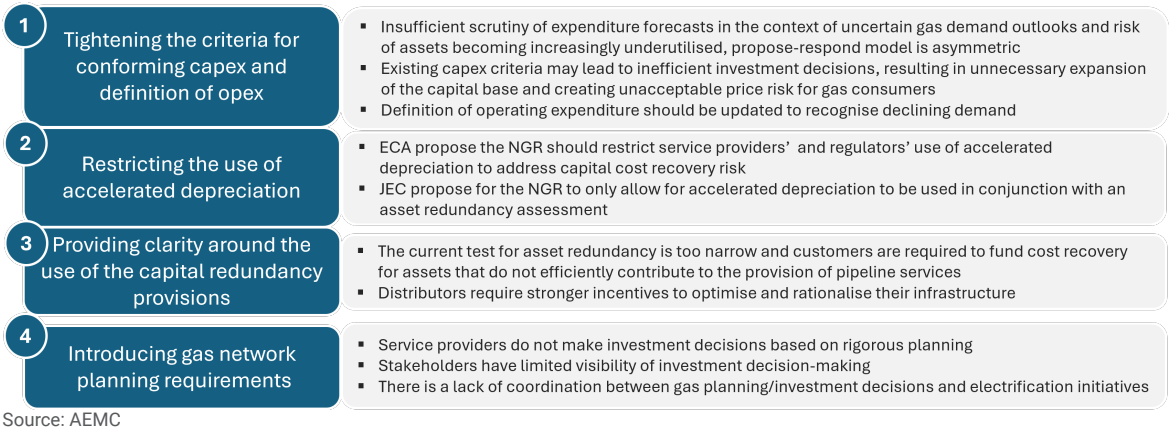
- a proponent submits a rule change request
- the Commission initiates the rule change process by publishing a consultation paper and seeking stakeholder feedback
- stakeholders lodge submissions on the consultation paper and engage through other channels to make their views known to the AEMC project team
- the Commission publishes a draft determination and draft rule (if relevant)
  - stakeholders lodge submissions on the draft determination and engage through other channels to make their views known to the AEMC project team
- the Commission publishes a final determination and final rule (if relevant).

We will consider the best approach to finalise this rule change request in a timely manner following stakeholder consultation. Given the complexity of the issues covered by the rule change request, the current date for the final determination may need to be extended.

You can find more information on the rule change process on our website.[445]

A.1 ECA and JEC proposed a number of changes to specific aspects of the regulatory framework to address declining demand

Figure A.1: Core issues raised in ECA and JEC's rule change requests



Source: AEMC

ECA and JEC's main concern is that the risk of stranded assets is being inappropriately shifted to consumers under the current regulatory framework. The proponents contend that the current framework is no longer fit for the future in an environment of uncertain demand because it is predicated on an assumption of continuing growth.

The rule change requests proposed changes to address issues in specific areas of the regulatory framework:

- **Capex criteria**: ECA proposed changes to the criteria that scheme pipelines that are gas distribution networks use to propose and the regulator uses to determine whether capex is

445 See our website for more information on the rule change process: https://www.aemc.gov.au/our-work/changing-energy-rules

justifiable. ECA consider that the current criteria do not adequately account for declining demand and could result in investment in new assets that subsequently risk becoming stranded.

- **Depreciation:** ECA proposed changes to the depreciation criteria to impose stronger conditions on when scheme pipelines that are gas distribution networks can propose and the regulator can approve the accelerated recovery of the capital base. ECA consider that the current depreciation criteria shift all risk and costs for assets with stranding risk to gas consumers, while imposing no costs nor risks to service providers.
- **Depreciation and redundancy:** JEC proposed changes to prohibit the use of accelerated depreciation for assets at risk of stranding unless the regulator has undertaken a redundancy assessment. That is, accelerated depreciation can only be used if the asset meets the proposed definition of a redundant asset or anticipated redundant asset, and the regulator has determined how the redundant asset costs should be shared. JEC proposed this as an alternative to ECA's proposal to amend the depreciation criteria.
- **Planning requirements:** ECA proposed changes to impose new planning reporting obligations on all distribution networks. ECA consider that stakeholders currently have limited information to understand the opportunities to minimise expenditure and energy system costs, including through the strategic decommissioning of the gas distribution networks.

A.2 ECA consider that new capex should account for the declining use of the gas network

A.2.1 Gas consumers could be exposed to unnecessary costs if there is over investment in the network

ECA's concern is that the regulatory framework is not protecting consumers against the risk of over investment in the network in an environment where demand is projected to decline, exposing gas consumers to the risk of stranded assets.

To support its view, ECA points to the fact that gas distribution networks have made relatively large claims for capex (at levels similar to previous access arrangements) while also claiming accelerated depreciation to manage the risk of stranding.[446] According to ECA, this demonstrates that potential capex is not being considered through the lens of declining demand and the implications for cost recovery in that context.

The problem, in ECA's view, is that the capex criteria are too broad and are predicated on an assumption of demand growth, which it submits "creates irresistible incentives for networks to seek ever-higher capex allowances".[447] It also considers that:[448]

> The propose-respond model provides distributors with too much discretion in their presentation of capex business cases. While such a model may be appropriate for a network that is growing and expected to grow indefinitely, networks projected to decline should invest in capital sparingly and only when absolutely necessary. Otherwise, they may increase the risk to consumers by over-investing in a network at risk of stranding.

Based on its review of recent access arrangements, ECA identified some key themes that it considers point to the deficiencies of the current rules for allowing capex.[449] For example, ECA submits that capex business cases are difficult for stakeholders to assess as they do not always

446 ECA, Rule change request - Capital expenditure, p. 15.
447 ECA, Rule change request - Capital expenditure, p. 15.
448 ECA, Rule change request - Capital expenditure, p. 15.
449 ECA, Rule change request - Capital expenditure, pp. 16-18.

consider alternative, lower cost options and provide limited information (due to confidentiality claims and qualitative cost benefit analysis) that prevent a proper evaluation of options. ECA further states that distributors rarely consider strategic decommissioning as an alternative to capex. Instead, distributors are proposing capex to support the use of renewable gases, despite electrification being a lower cost route to avoid natural gas emissions according to ECA.[450]

While the ECA proposal raised a number of different themes behind their concerns on the current rules, their issues can be grouped into 3 core issues:

1. The capex criteria do not provide sufficient prescription to ensure that only efficient capex is added to the RAB
2. The regulator is limited in considering the implications of declining demand under the propose-respond model
3. Stakeholders cannot adequately input into the regulator's considerations due to a lack of information.

A.2.2 ECA's proposed solution would impose stricter capex criteria

To address the issue outlined above, ECA proposed amendments to tighten the capex criteria to enable what it considers more 'careful and constrained' capex "in the context of network retreat". In ECA's view, more prescriptive rules around conforming capex will be most effective at reducing the risk to consumers of over-investment by a network in the face of uncertainty and the projected decline in gas demand.[451]

ECA's proposed amendments are also intended to drive greater rigour and better information around the service providers' capex proposals to enable stakeholders, including the regulator, to better respond to the proposals. ECA's intent is to ensure that the current criteria are sufficiently effective in constraining capex in the context of declining demand.[452]

The proposed amendments include requirements for:

- capex to explicitly consider the impacts of declining demand
- distributors to consider alternatives to investment
- distributors to consider the value that gas consumers place on reliability
- distributors to account for future abolishment costs in their cost benefit analysis
- distributors to explore lower cost options to meet regulatory obligations
- the regulator to closely scrutinise replacement capex
- reference tariffs to exclude capex on renewable gases.

We outline ECA's proposed amendments and suggested changes to the rules in the following sections.

Service providers should explicitly consider the impacts of declining demand when proposing capex

ECA proposed amendments to ensure that distributors more explicitly consider the impacts of declining demand in their capex proposals. ECA suggest that this could be achieved by clarifying rule 79(1)(a) so that service providers must also account for the impact of declining gas demand

450 ECA, Rule change request - Capital expenditure, p. 18.
451 ECA, Rule change request - Capital expenditure, p. 18.
452 ECA, Rule change request - Capital expenditure, p. 21.

by considering the impact national and jurisdictional targets would have on projected demand for services.[453] In ECA's opinion, this would result in a more robust quantitative cost analysis that includes a realistic assessment of asset lives and utilisation levels.

ECA also proposed amendments to rule 79(2)(c)(iv) to remove the reference to existing levels of demand and substitute in forecast levels of demand, to support service providers' consideration of declining gas demand in their capex proposals.[454] This would limit the ability of networks to seek replacement expenditure to maintain capacity on the basis of existing demand levels.

Service providers should consider alternatives to investment

ECA proposed several amendments to mandate that service providers consider alternatives to investment in replacement or new network equipment. ECA suggested that this could be achieved by:[455]

- requiring distributors to consider alternatives to investment when assessing whether the overall economic value of expenditure is positive and hence justifiable under rule 79(2)(a) and 79(3)
- amending rule 79(2)(c)(v) to clarify that the 'supply of services' could include the provision of energy services by other means, whether by the service provider or another party.

Service providers should consider the value that gas consumers place on reliability

ECA proposed amendments to require service providers to weigh the costs of capex to maintain reliability against the value that customers place on avoiding loss of supply.[456] ECA suggested that this could be achieved by amending rule 79(2)(c)(ii) to clarify that the capex incurred to maintain the reliability of the network should not exceed the value that customers place on reliability. This would mean that when assessing whether the proposed capex is necessary for the integrity of the services, the the regulator would also need to consider if the costs of improving reliability of the service are lower than the value customers will get from that improvement.[457]

Service providers should account for future abolishment costs in cost benefit analysis

ECA proposed amendments that would clarify that distributors should account for future abolishment costs in any cost benefit analysis they undertake in relation to capex.[458] The Commission understands that the intent of this proposal was to improve the assessment of the relative costs and benefits of proposed investments against a range of alternatives. These alternatives could include decommissioning, which would avoid any further capex and the risk of additional abolishment costs. Given the uncertainty of future demand, ECA is concerned that any new capex would result in extra future costs for customers if the resulting asset was decommissioned.

Service providers should explore lower cost options to meet regulatory obligations

ECA proposed to require service providers to explain the steps they have taken to explore lower cost options with the relevant regulatory agency[459] where there is a regulatory driver/obligation for

453 ECA, Rule change request - Capital expenditure, p. 20.

454 ECA, Rule change request - Capital expenditure, p. 20.

455 ECA, Rule change request - Capital expenditure, p. 20.

456 ECA, Rule change request - Capital expenditure, p. 19.

457 On 28 August 2025, the AEMC published a directions paper in response to a rule change request from the Chair of the Energy Senior Officials and the Victorian Minister for Energy and Resources seeking the implementation of a reliability standard and related reliability tools for the East Coast Gas System. You can find more information on this project here: https://www.aemc.gov.au/rule-changes/ecgs-reliability-standard-and-associated-settings.

458 ECA, Rule change request - Capital expenditure, p. 19.

459 The Commission understands that the relevant regulatory agency would depend on the nature of the regulatory obligation. This may be a jurisdictional safety regulator, the entity responsible for licencing (e.g., IPART in NSW), or a responsible Department.

new expenditure. In this regard, ECA suggested amendments to rule 79(2)(c)(iii) to specifically provide for distributors meeting a regulatory obligation through discontinuance of a service.[460]

The regulator should be required to closely scrutinise replacement capex

ECA proposed to require the regulator to assure itself that the service provider has acted prudently in its previous investment decisions before allowing capex to replace assets due to obsolescence, or where the current asset is no longer fit for purpose. Where a distributor seeks asset replacement before end of life, ECA's proposal would require service providers to provide more information on:[461]

- why replacement is required, including a comparison to a do-nothing approach
- why this eventuality was not foreseeable at the time of the original investment (and thus why customers are expected to pay in full for both the old and new asset)
- how many consumers benefit from the replacement and the impacts on the value of the replacement expenditure if significant declines in consumers served by the asset occur, and
- how the gas distribution network intends to ensure similar issues do not arise with the new asset.

The NGR should exclude capex on renewable gases from reference tariffs

ECA proposed that capex on renewable fuel projects be excluded from reference tariffs, so that distributors can only recover such expenditure (to the extent it is conforming capex) from customers who wish to take renewable fuels in the future.[462] ECA consider that distributors should recover capex on renewable fuel projects from non-reference tariffs so that the general customer pool does not fund this expenditure. ECA suggest that this could be achieved by including a new subrule that defines the circumstances in which capex is not justifiable and including capex on transitioning to renewable gases within this definition.

The regulator should publicly consult on advance determinations on capex proposals

ECA also questioned whether it is appropriate to allow the regulator to make advance determinations under rule 80(2) of the NGR that capex conforms with the new capex criteria. At the very least, ECA consider that the regulator must be required to consult on expenditure proposals before determining that the capex is conforming.[463]

A.2.3 ECA consider that changes to the definition of operating expenditure may also be necessary

While ECA's rule change request focused on capex, ECA noted that keeping operating expenditure to the efficient minimum level could help dampen the price impacts associated with capital recovery approaches, such as accelerated depreciation.

Operating expenditure is currently defined to mean operating, maintenance and other costs and expenditure of a non-capital nature incurred in providing pipeline services. The (non-exhaustive) list of expenditure falling within that definition includes "expenditure incurred in increasing long-term demand for pipeline services and otherwise developing the market for pipeline services".[464] ECA consider that this limb of the definition is obsolete and should be deleted, given it is predicated on an assumption of growing demand.[465] That is, expenditure to increase long-term

460 ECA, Rule change request - Capital expenditure, p. 20.
461 ECA, Rule change request - Capital expenditure, p. 19.
462 ECA, Rule change request - Capital expenditure, p. 20.
463 ECA, Rule change request - Capital expenditure, pp. 20-21.
464 NGR, rule 69.
465 ECA, Rule change request - Capital expenditure, p. 18.

demand for pipeline services and develop the market for pipeline services may still be permitted unless this type of expenditure is specifically carved out of the definition of operating expenditure. ECA consider that this kind of expenditure seeking to increase demand would be inconsistent in an environment where gas demand is projected to decline.

A.3 ECA and JEC consider that accelerated depreciation, as currently used, inappropriately shifts the risk of stranded assets entirely onto consumers

ECA and JEC share similar concerns that consumers are being unfairly burdened with the risk and costs of stranded assets, but differed in their proposed solutions to address the issue. The proponents stated that the NGR provides limited guidance to the regulator as to how accelerated depreciation should be used to manage stranded asset risk. ECA and JEC also raised fundamental questions about who should bear the risks and costs of stranded assets.

ECA's concern is that accelerated depreciation, as it is currently used by the regulator and service providers, implies consumers are the only entity that must pay for the costs of assets that are at risk of stranding, while imposing no costs to network investors.[466]

According to ECA, service providers are not automatically entitled to shift all their investment risks onto consumers under the NGL and NGR. ECA points to two aspects of the regulatory framework to highlight that service providers bear at least some of the risk of their investments. ECA note that:[467]

- service providers are only afforded a 'reasonable opportunity' to recover their efficient costs.[468]
- the asset redundancy provisions indicate that full cost recovery is not automatic in the case of redundancy or a decline in demand.[469]

In any event, ECA noted that accelerated depreciation, by itself, will not fully address stranded asset risk.[470]

JEC has similar views, noting that the use of accelerated depreciation to manage the broad and undefined future risk of stranding is inconsistent with the long-term interests of consumers. It "unfairly" shifts these "unquantified risks and costs to consumers".[471] According to JEC, accelerated depreciation (as currently allowed by the regulator) transfers a distributor's future redundancy risks and costs to consumers without robustly defining the scope of that risk, demonstrating what that cost relates to, and how consumers' fair share has been determined.[472]

The proponents also consider the AER's approach to manage consumer price impacts through a 'price path approach' as problematic.[473] ECA noted that this approach still fails to consider what proportion of risks consumers should bear.[474] Similarly,JEC noted that the regulator has adopted this approach in place of determining what consumers' fair share of stranded risk is, based on transparent and consistent principles.[475]

466 ECA, Rule change request - Depreciation, p. 15.
467 ECA, Rule change request - Depreciation, p. 15.
468 Under the revenue and pricing principles in section 24 of the NGL.
469 NGR, rule 85.
470 ECA, Rule change request - Depreciation, p. 17.
471 JEC, Rule change request - Accelerated depreciation and redundancy, p. 4.
472 JEC, Rule change request - Accelerated depreciation and redundancy, pp. 5-6.
473 In the most recent round of access arrangement decisions, the AER has focused on trying to reduce the risk of stranding while also minimising the extent of price increases for consumers, by allowing accelerated depreciation but placing a cap on what can be brought forward. See section 1.1.3.
474 ECA, Rule change request - Depreciation, p. 16.
475 JEC, Rule change request - Accelerated depreciation and redundancy, p. 6.

A.4 ECA proposed to impose conditions on the use of accelerated depreciation

A.4.1 ECA's preferred approach advocated for network businesses to propose and the regulator to approve 'contingent' accelerated depreciation

ECA's preferred option is 'contingent' accelerated depreciation. Under this approach, the NGR would only allow for accelerated depreciation if certain conditions are met.[476] ECA consider that the most appropriate conditions are those that would protect consumers from higher prices associated with accelerated depreciation. The intent of these conditions is to encourage service providers to act in the interest of gas consumers as "a quid pro quo" for consumers paying to help protect service providers from this risk.[477]

ECA broadly distinguished between 1) broader policy conditions and 2) conditions specified in the NGR.

1) Broader policy conditions could include:

- policies or regulations that ensure existing customers do not bear the cost of any new connections that are still allowed.
- established policies for ensuring sufficient funding to support permanent consumer disconnection and overall gas network decommissioning.

In relation to these broader policy conditions, ECA noted that not all of them are within the control of a gas distributor to implement, but that service providers would have an incentive to advocate for such policies on behalf of their customers if depreciation is linked to such conditions.

2) ECA noted that regarding the conditions/criteria specified in the NGR, these could be based on demonstrable actions and behaviour consistent with a service provider that is facing a material risk of stranded assets, including:[478]

- conservative assumptions about effective asset lives and demand projections in cost benefit assessments
- a reduction in debt gearing
- active consideration of non-network options such as demand management or decommissioning
- engagement with the jurisdictional safety regulator on how to meet safety requirements while minimising investment.

ECA's rule change request outlined amendments to the depreciation criteria in rule 89 to give effect to their proposed solution, including:[479]

- Addressing the presumption of indefinite growth in gas networks, by removing the words "promotes efficient growth in the market for reference services" in rule 89(1)(a), and deleting rule 89(2), which ECA consider is only appropriate in the context of ongoing demand growth.
- Expressly limiting the allocation of depreciation to customers to their 'fair and reasonable' share. The rule change request is silent on the considerations that the regulator would need to consider when determining what proportion of stranded asset risk should be fairly and reasonably borne by consumers. ECA also proposed consequential amendments to rule

476 ECA, Rule change request - Depreciation, pp. 17-18.
477 ECA, Rule change request - Depreciation, p. 18.
478 ECA, Rule change request - Depreciation, p. 18.
479 ECA, Rule change request - Depreciation, p. 19.

89(1)(e) to ensure that a distributor's reasonable needs for cash flow do not lead to consumers funding cash flow beyond what is fair and reasonable.

- Inserting a new rule 89(3) that would contain the conditions that the service provider would need to meet before the regulator could allow accelerated depreciation. Consequential amendments to rule 89(1)(c) would be required to limit changes to asset lives unless the conditions in proposed new rule 89(3) are met. ECA's proposed amendments suggest that *all* conditions would need to be met, and the types of conditions envisaged by ECA include:
  - where the relevant legislation or regulations of a participating jurisdiction support strategic decommissioning and electrification
  - there is no connections expenditure in the distributors conforming capex
  - timely publication of the proposed Gas Annual Planning Report
  - factors leading to proposed adjustment to economic life are also recognised in forecast of conforming capex
  - the distributor has reduced its capital base by a value that is commensurate with the cost of accelerated depreciation. That is, a gas distributor needs to have demonstrated that they are incurring the same or similar costs as their customers.

The main objective of the proposed amendments is to constrain the application of accelerated depreciation to where it can clearly be demonstrated to be in the long-term interest of customers and does not result in an inefficient shift in risks from the networks to customers.

A.4.2 ECA's alternative solution is to prohibit varying depreciation rates for existing assets

ECA proposed an alternative approach that would prohibit any variation to depreciation schedules for existing assets. ECA contend that service providers have been aware of, and have made investments in light of, Australia's emissions reduction commitments[480] for many years and should therefore alone bear the risks of investment decisions over this period.[481] However, this is not ECA's preferred option because the ECA consider it may be unduly inflexible and may also affect the incentives of distributors to recover capital costs through other levers.

A.5 JEC proposed to limit the use of accelerated depreciation unless used in conjunction with a process for dealing with redundant assets

JEC's rule change request proposed changes to the depreciation and asset redundancy provisions in the NGR. Their concern is that "while accelerated depreciation is a potential tool by which to share or transfer costs, absent a robust measure to define those costs, it involves an unacceptable risk to consumers that they will be assuming an unreasonable share of costs".[482]

JEC's issue with the depreciation provisions (NGR rule 89) is that they do not involve or require an assessment of which assets will become stranded, when they will become stranded, and what the costs of these assets are.[483] JEC submitted that in the absence of this assessment, it would not be in the long-term interest of gas consumers to use the depreciation provisions to accelerate recovery of capital to manage stranded asset risks.

According to the JEC, stranded asset risks are more appropriately managed via the specific rule on redundancy (NGR, rule 85). JEC proposed amendments to ensure that gas network redundancy

480 Including a domestic climate change target since 1990 and ratification of the Kyoto Protocol in 2007.
481 ECA, Rule change request - Depreciation, p. 19.
482 JEC, Rule change request - Accelerated depreciation and redundancy, p. 5.
483 JEC, Rule change request - Accelerated depreciation and redundancy, p. 9.

risks and costs are more accurately identified and appropriately allocated to consumers. The key elements of the JEC proposal are to:

- clarify and strengthen the redundant asset process by providing for:
  - an expanded and more detailed definition of redundancy
  - a principles based decision-making framework to guide the apportionment of stranded asset costs
- prohibit accelerated depreciation (for the purpose of managing stranded asset risk) unless used with the redundant asset process.

A.5.1 JEC proposed to more clearly define 'redundant assets' and improve the framework for determining asset redundancy

Amendments to the definition of 'redundant assets'

JEC consider that the definition of 'redundant asset' is too absolute to be of practical application, requiring that an asset cease to contribute in any way to the delivery of pipeline services.[484] JEC noted that this does not recognise the reality where a pipeline is no longer able to provide services in an economically efficient way. In the context of the projected decline in demand, JEC noted that this could be a pipeline to which only a handful of customers remain connected.[485] In addition, JEC noted that there is no mechanism for service providers to identify assets that are likely to become redundant in the future.

To address this, JEC proposed amendments to rule 85(1) to broaden the definition of 'redundant assets' to include assets "no longer economically efficient to use in the delivery of pipeline services". JEC proposed that the parameters of the assessment of economic efficiency would be defined in guidelines to be developed by the regulator (redundancy guidelines).[486]

JEC also proposed adding a new definition of 'anticipated redundant assets' and providing additional incentives to encourage gas distribution businesses to identify assets likely to become redundant in advance of redundancy. JEC's intent is to encourage service providers to efficiently identify which assets are likely to become redundant in the context of projected declining gas demand. The incentive to do so is that a greater proportion of costs would be able to be apportioned to consumers.[487]

Develop a principles-based framework to guide regulator decisions on redundancy

JEC noted that there is currently no guidance to the regulator on how or when to undertake an assessment of redundancy for the purposes of sharing costs with consumers. According to JEC, the lack of a more comprehensive decision-making framework to guide the regulator undermines the utility of the asset redundancy process.[488]

To address this issue, JEC proposed adding a principles-based decision-making framework in rule 85 to guide a gas distributor's 'redundancy assessment' and the regulator's determination and apportionment of redundancy costs (via the cost sharing mechanism proposed or required by the regulator under rule 85(1)). The regulator's decision-making would be supported by the

484 NGR, rule 85(1).
485 JEC, Rule change request - Accelerated depreciation and redundancy, p. 11.
486 JEC, Rule change request - Accelerated depreciation and redundancy, p. 11.
487 JEC, Rule change request - Accelerated depreciation and redundancy, pp. 11-12.
488 JEC, Rule change request - Accelerated depreciation and redundancy, p. 12.

'redundancy guidelines' to be developed by the regulator. The key elements of JEC's proposed framework are:[489]

- A requirement for service providers to prepare a 'redundancy assessment' as part of their access arrangement proposals that identifies redundant assets (including any assets that are anticipated to become redundant). The gas distributor would be required to provide a range of supporting information to enable the regulator to make an assessment of redundancy in relation to the asset, including:
  - specific economic information relating to that asset (e.g. costs already recovered, remaining asset life, expected utilisation)
  - identified reasons the asset is redundant, or anticipated to become redundant
  - quantum of stranded asset costs for the identified assets.
- The regulator must develop redundancy guidelines that set out guidance on the contents of a redundancy assessment and on the establishment and use of a cost sharing mechanism.
- The regulator must make a determination of redundancy, having regard to the information provided in the redundancy assessment. The regulator is required to determine the remaining capital base as part of this assessment (i.e. stranding cost).
- In determining whether to approve a cost sharing arrangement proposed by the gas distributor, the regulator must ensure that;
  - a conforming redundancy assessment has been provided by the gas distributor
  - the proportion of costs to be transferred does not exceed 50% of the redundancy cost. JEC emphasise the importance that some limit is imposed on the share of redundancy costs that can be assigned to consumers.
  - the cost sharing arrangement represents an equitable sharing of costs between the service provider and users. The regulator must make a decision in respect of each individual asset and must have regard to the redundancy guidelines and the information provided in the redundancy assessment.

A.5.2 JEC proposed to prohibit the use of accelerated depreciation to manage stranded asset risk

JEC proposed to amend the depreciation criteria in rule 89 to prohibit accelerated depreciation by inserting a new subrule 89(1A) that prohibits the adjustment of depreciation schedules for assets unless undertaken in conjunction with the proposed redundant asset process in rule 85. JEC clarified that their rule change proposal does not seek to limit the general ability of service providers to request, and the regulator to approve, changes to depreciation schedules for reasons unrelated to redundancy or stranded asset risk.[490]

JEC's rule change request provided two alternative options for amending rule 89 to demonstrate the intent of their proposal:[491]

- prohibit outright any accelerated depreciation – by either shortening the economic life of assets or front-loading depreciation with a lump sum payment so there is a more rapid paydown of the capital base
- rule 89 is substantially amended, or possibly even deleted in its entirety, to create a requirement that only straight-line depreciation from the point of investment is allowed. The possibility to vary depreciation schedules is removed.

489 JEC, Rule change request - Accelerated depreciation and redundancy, p. 14.
490 JEC, Rule change request - Accelerated depreciation and redundancy, p. 9.
491 JEC, Rule change request - Accelerated depreciation and redundancy, p. 10.

A.6 ECA consider planning requirements on gas distribution networks are insufficient in the context of declining demand

ECA is concerned that planning requirements for service providers are insufficient to allow stakeholders to make informed decisions about the future of the gas networks in the context of projected declining demand. According to ECA, the problem is exacerbated by service providers' limited provision of public information in their access arrangement proposals.[492]

ECA identified a broad range of stakeholders that would benefit from improved planning and better information. These included jurisdictional and local governments, non-government organisations, businesses offering products and services that support the energy transition, and electricity networks planning for electrification.

According to ECA, service providers do not provide enough granular and regular information over an adequate time horizon to enable these stakeholders to better understand the future of the gas distribution networks. This is in contrast to electricity transmission and distribution networks that are required to provide more comprehensive information as part of their annual planning reports. In ECA's view, requiring service providers to provide similar levels of information would improve stakeholders' understanding of emerging issues and constraints and opportunities for strategic decommissioning of the networks. ECA contend that the lack of appropriate information is inhibiting a coordinated response from stakeholders to successfully manage the energy transition.[493]

ECA acknowledged that the current information provisions, which are spread across the NGL and NGR, may be flexible enough to allow for changes. However, they contend that any changes would be limited to existing processes for which information is collected, namely the access arrangement every five years, Regulatory Information Notices issued by the AER, and the annual GSOO.[494] According to ECA, none of these provide a longer-term outlook that would more suitably inform planning decisions for gas distribution networks.

A.6.1 ECA's proposed solution would require service providers to publish a Gas Annual Planning Report

ECA proposed that service providers release a Gas Annual Planning Report (GAPR) to address the need for stakeholders to have more granular and regular information to enable a coordinated approach to reduced gas use.[495] ECA suggest that the that new planning requirements on service providers could be split into two rules: one rule setting out the process for producing the GAPR – the Gas Annual Planning Review - and another rule setting out the parameters for publication of the GAPR.[496]

ECA suggested that the GAPR would provide stakeholders (such as jurisdictional and local governments, electricity networks, consumer groups and businesses) with a multi-year forecast for each gas distribution network that includes:[497]

- a 20-year planning horizon with scenario-based analysis
- expected useful life for all assets
- demand forecast numbers of connections/ disconnections

492 Appendix B.2.1. outlines the access arrangement information required to be submitted with an access arrangement proposal.
493 ECA, Rule change request - Planning requirements, p. 15.
494 ECA, Rule change request - Planning requirements, p. 16.
495 ECA, Rule change request - Planning requirements, p. 16.
496 ECA, Rule change request - Planning requirements p. 17.
497 ECA, Rule change request - Planning requirements, p. 17.

- energy consumption, relevant laws and regulations that may impact forecasts
- potential augmentation/ replacement projects and the relevant drivers for these
- alternative investment projects
- a consumer engagement strategy for the review and a strategy for eliciting demand response (like electricity).

In addition to helping to inform the interaction between declining gas demand and the shift to electrification, such a report may also assist stakeholders in assessing capex business cases and enable parties to offer potential alternatives to new investment (such as demand management).

ECA suggested that the GAPR should be published, and include mandatory consultation with relevant stakeholders, including specifically the relevant electricity network who may need to plan for an increase in demand on their network if a strategic decommissioning and electrification project is carried out. Consultation with local councils and state governments in areas with fast-declining customer numbers should also be mandatory.[498]

ECA also suggested that the frequency of all outputs in a GAPR may not need to be annual to minimise administrative costs and burden. For example, in even years, the GAPR could include simple statistics on current gas use and rates of disconnection. In odd years, it could include a more complete forecast and plan for the future of the gas network.[499]

A.7 The process to date

On 18 September 2025, the Commission published a notice advising of the initiation of the rule making process and consultation in respect of the rule change request.[500] A consultation paper identifying specific issues for consultation was also published. Submissions closed on 30 October 2025. The Commission received 26 submissions as part of the first round of consultation.

On 19 March 2026 the Commission published a Directions paper. Submissions closed on 30 April 2026. The Commission received 21 submissions to the Directions paper.

The Commission considered all issues raised by stakeholders in submissions. Issues raised in submissions are discussed and responded to throughout this draft rule determination.

498 ECA, Rule change request - Planning requirements, p. 17.
499 ECA, Rule change request - Planning requirements, p. 17
500 This notice was published under section 303 of the NGL.

B Legal requirements to make a rule

This appendix sets out the relevant legal requirements under the NGL for the Commission to make a draft rule determination.

B.1 Draft rule determination and draft rule

In accordance with section 308 of the NGL, the Commission has made this draft rule determination for a more preferable draft rule in relation to the rule proposed by the proponents.

The Commission's reasons for making this draft rule determination are set out throughout this draft determination.

A copy of the more preferable draft rule is attached to and published with this draft determination. Its key features are described throughout this draft determination.

B.2 Power to make the rule

The Commission is satisfied that the more preferable draft rule falls within the subject matter about which the Commission may make rules.

The more preferable draft rule falls within section 74 of the NGL and WA Gas Law as it relates to rules regulating access to pipeline services under section 74(1)(i). The more preferable draft rule also falls within the matters set out in Schedule 1 as it relates to:

- regulatory economic methodologies under items 46-53 of the NGL and items 40-48 of the WA Gas Law; and
- AER economic regulatory functions or powers under items 54-55 of the NGL and items 49-50 of the WA Gas Law.

B.3 Commission's considerations

In assessing the rule change request the Commission considered:

- its powers under the NGL to make the draft rule
- the rule change request
- submissions received during first round and second round consultation
- stakeholder input received at the public workshop held on 9 April 2026
- the Commission's analysis as to the ways in which the draft rule will or is likely to contribute to the achievement of the NGO
- the application of the draft rule to Western Australia
- the revenue and pricing principles

There is no relevant Ministerial Council on Energy (MCE) statement of policy principles for this rule change request.[501]

The Commission may only make a rule that has effect with respect to an adoptive jurisdiction (relevantly, Victoria) if satisfied that the proposed rule is compatible with the proper performance of AEMO's declared system functions in that jurisdiction.[502] The more preferable draft rule is compatible with AEMO's declared system functions because it would not affect those functions.

501 Under s. 73 of the NGL the AEMC must have regard to any relevant MCE statement of policy principles in making a rule. The MCE is referenced in the AEMC's governing legislation and is a legally enduring body comprising the Federal, State and Territory Ministers responsible for energy.

502 Section 295(4) of the NGL.

B.4 Making gas rules in Western Australia

Under the *National Gas Access (WA) Act 2009* (WA Gas Act), a modified version of the NGL was adopted, known as the National Gas Access (Western Australia) Law (WA Gas Law). Under the WA Gas Law, the NGR applying in Western Australia is version 1 of the NGR, as amended by rules made by the South Australian Minister for Energy[503] and rules made by the AEMC in accordance with its rule making powers under section 74 and 313 of the WA Gas Law (WA NGR).[504]

The draft rule falls within the subject matters about which the Commission may make rules under the WA Gas Act.[505]

Schedule 3 of the draft would rule amend Parts 8 and 9 of the WA NGR, while Schedule 4 of the draft rule would amend the transitional provisions in Schedule 1 of the WA NGR. Section 2A(1) of the WA Gas Act provides that references to the AER in the NGL are read as a reference to either the ERA or the AER as applicable.

The National Gas Rules (Gas Pipelines) Amendment Rules 2023 and the National Gas Amendment (Other Gases) Rule 2024 are expected to commence operation in Western Australia in late 2026 or early 2027. We have made our draft rule to accommodate for the changes that would be introduced in Western Australia under those rules. For example, the commencement of the National Gas Amendment (Other Gases) Rule 2024 in Western Australia would introduce rules 72(1)(n) and (o) into the WA NGR. We have reflected this in the numbering of the subrules in rule 72(1) that Schedule 3 of the draft rule would insert in the WA NGR.

Accordingly, the draft rule will apply in Western Australia.

503 The Statutes Amendment (National Energy Laws) (Binding Rate of Return Instrument) Act 2018 and the National Gas (South Australia (Pipelines Access—Arbitration) Amendment Act 2017.

504 See our website for further information at https://www.aemc.gov.au/regulation/energy-rules/national-gas-rules/western-australia.

505 Section 74 and Schedule 1 of the WA Gas Law specify the subject matter for rules that can be made by the AEMC in Western Australia.

Abbreviations and defined terms

ACCC	Australian Competition & Consumer Commission
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
AGIG	Australian Gas Infrastructure Group
APGA	Australian Pipelines and Gas Association
BSL	Brotherhood of St. Laurence
CEPA	Cambridge Economic Policy Associates
Commission	See AEMC
DBNGP	Dampier to Bunbury Natural Gas Pipeline
DCAN	Darebin Climate Action Now
ECA	Energy Consumers Australia
ECMC	Energy and Climate Ministerial Council
ENA	Energy Networks Australia
ERA	Economic Regulation Authority Western Australia
EUAA	Energy Users Association of Australia
GAPR	Gas Annual Planning Report
GCCN	Gippsland Climate Change Network
GGP	Goldfields Gas Pipeline
GSOO	Gas Statement of Opportunities
IEEFA	Institute for Energy Economics and Financial Analysis
JEC	The Justice and Equity Centre
LPG	Liquefied Petroleum Gas
LRMC	Long-run marginal cost
NEL	National Electricity Law
NEO	National Electricity Objective
NER	National Electricity Rules
NERL	National Energy Retail Law
NERO	National Energy Retail Objective
NERR	National Energy Retail Rules
NGL	National Gas Law
NGO	National Gas Objective
NGR	National Gas Rules
NT Act	*National Electricity (Northern Territory) (National Uniform Legislation) Act 2015*
Proponent	The individual / organisation who submitted the rule change request to the Commission
RBP	Roma to Brisbane Pipeline
RPPs	Revenue and Pricing Principles
SACOSS	South Australian Council of Social Services
VEFN	Victorian Energy Futures Network

VTS	Victorian Transmission System
WA Gas Act	*National Gas Access (WA) Act 2009*
WA Gas Law	National Gas Access (Western Australia) Law
WA NGR	National Gas Rules as in force in Western Australia