22 August 2017

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Electronic lodgement – ref. GPR0004

Dear John

Issues Paper: Review into the scope of economic regulation applied to covered pipelines

AusNet Services welcomes the opportunity to make this submission to the AEMC's Issues Paper on its review into the scope of economic regulation applied to covered pipelines.

This review is timely given the significant changes the East Coast gas market is currently undergoing, which have triggered a number of interrelated and concurrent reviews. However, based on our experience as a gas distribution business, we consider the existing provisions of Parts 8-12 of the National Gas Rules (NGR) remain fit for purpose and, importantly, are promoting the long-term interests of gas consumers. The remainder of this submission elaborates on why this is the case.

AusNet Services also advises its support for the responses made in the submission by Energy Networks Australia on the broader issues canvased by the Issues Paper.

The objectives of the NGR remain appropriately set

First and foremost, the objectives of Parts 8-12 of the NGR are to ensure access to essential gas facilities on fair and reasonable terms. Accordingly, the Rules provide a governance framework and regulatory process for this to be achieved through the periodic review and variation of access arrangements (AA), and the application of incentive-based regulation to set efficient prices and revenues.

We consider these objectives remain appropriately set, and strike a balance between providing access on fair and reasonable terms and ensuring gas network owners face incentives to operate, maintain and invest efficiently.

This is evidenced by the 20 year history of stable or declining distribution prices and improving network safety and reliability in Victoria, outcomes reinforced in recent gas access arrangement reviews (GAARs). For example, AusNet Services' Revised Access Arrangement Proposal set out a 15.8% real reduction in charges across the 2018-22 AA period, reflecting stable levels of capital expenditure, improved operating efficiencies and lower capital costs.[1] The consultation process underpinning that Proposal revealed that customers were satisfied with the current, high levels of reliability provided by the network.[2]

While there may be merit in a broader examination of consumer outcomes across the industry, these developments indicate that the current Rules are generating outcomes that are consistent with the long-term interests of gas consumers, as defined by the National Gas Objective (NGO). We consider the NGO provides an important, overarching objective that all decisions made under the NGR should look to promote.

[1] AusNet Services, *Gas Access Arrangement Review 2018-2022: Revised Access Arrangement Information*, August 2017, p.3
[2] AusNet Services, *Gas Access Arrangement Review 2018-2022: Access Arrangement Information*, December 2016, p.77

The NGR provide levels of discretion and flexibility that are fit for purpose

In our view, the NGR provide a regulatory framework for regulating gas distributors that is effective, transparent and flexible enough to reflect the specific circumstances of the industry.

We support the general flexibility and non-prescriptive nature of the current NGR provisions, which extends to a number of elements of an access arrangement, such as incentive schemes. By being not overly prescriptive and onerous in their requirements on both networks and the AER, the Rules generally provide for a relatively streamlined review process which in some cases can reduce the regulatory burden that is ultimately borne by consumers. For example, our recent acceptance of the AER's Draft Decision for the 2018-22 GAAR simplified and shortened the review process, and provided earlier certainty to our customers on future gas distribution charges.[3]

The recent introduction of a contingent Capital Expenditure Sharing Scheme (CESS) in the Victorian 2018-22 GAAR also demonstrates the benefits of the flexibility of the NGR. AusNet Services' and AGN's proposal to strengthen the incentive arrangements through a CESS was consistent with NGR Rule 98, which allows networks to propose new or varied incentive mechanisms, avoiding the need for rule changes and the associated processes (e.g. guideline development). AusNet Services also sought to include a Network Innovation Allowance (NIA) in its AA for the forthcoming period as a means of funding innovation trials (e.g. hydrogen trials). While not accepted by the AER, the ability to propose the NIA provides a further example of how the non-prescriptive nature of the Rules provides scope for networks to adapt to changing circumstances and customer needs.

For the reasons above, we support the current NGR's approach to incentives. We also note that the 'fuel of choice' nature of gas strengthens the incentives for gas networks to drive efficiency and ensure their prices and service levels are competitive and consistent with customers' needs. Furthermore, even without the prescription of specific incentive schemes, the use of ex ante expenditure allowances provides strong incentives for efficient investment and operation and maintenance of gas networks.

Another key, positive feature of the current regime is the clarity and transparency it provides in respect of regulatory discretion. By specifying where the regulator has full, limited or no discretion when making regulatory determinations, the Rules help to focus and streamline the AA review process. In particular, the current arrangements provide clarity to networks on where there is scope for flexibility across the elements of an AA, such as in proposing the depreciation methodology or the AA period. Accordingly, AusNet Services supports these arrangements as helpful features of the framework.

We also note that a number of recent regulatory proposals submitted by gas distributors have been supported by extensive customer engagement programs. For instance, our 2018-22 GAAR Proposal was underpinned by a comprehensive research program that sought to understand the needs, wants and preferences of our customers. This included a range of engagement activities aimed at understanding our customers' attitudes to network investment and trade-offs between reliability and costs. Over 700 customers and stakeholders participated in the program across a range of customer categories.[4]

This demonstrates that, despite customer engagement not being prescribed by the NGR, gas networks and the AER recognise the importance of engaging meaningfully with customers to understand their preferences. This understanding is crucial to being able to deliver the services that customers value, and ensure that natural gas' position as a low-cost, efficient energy

[3] AusNet Services, *Gas Access Arrangement Review 2018-2022: Revised Access Arrangement Information*, August 2017, p.3

[4] AusNet Services, *Gas Access Arrangement Review 2018-2022: Access Arrangement Information*, December 2016, p.77

source is maintained. In particular, recent trends of declining penetration rates and consumption per household, as experienced on our network, mean that customer engagement is critical to the long-term sustainability of network businesses and, therefore, a key element of our AA proposal development.[5]

We also support the spectrum of regulation that is facilitated by the NGR. This allows the regulatory arrangements to be tailored to the specific circumstances of the network (e.g. light regulation where appropriate), and ensures the regulatory burden is commensurate to the problem or market failure the regulation is seeking to address.

For the reasons set out above, AusNet Services considers the regulatory framework as structured is fit for purpose, and that further prescription is not warranted, nor is seeking to adapt the NGR's AA review process to be more reflective of the National Electricity Rules approach to revenue regulation.

Notwithstanding this, we are concerned the current timeframe for the submission of a Revised AA Proposal of 15 business days is not adequate,[6] given the time needed to engage meaningfully with stakeholders and work through the complex issues that may arise at this stage of the review process. Accordingly, we would support extending the existing timeframes to be commensurate with the significance and complexity of the issues and processes that may need to be addressed during this phase of the process.

Existing service classification and tariff setting arrangements are meeting the needs of consumers

In our experience as a gas distributor, the current approach to establishing services and tariffs is functioning well and most importantly, is meeting the needs of our customers. As the Issues Paper recognises, the suite of services and tariffs is incorporated in the AA submitted to the regulator for approval.[7] This allows for it to be assessed as appropriate by the regulator, and provides opportunity for customers and other parties to review the suite of services and request any new services.

Our recent regulatory proposal for the 2018-22 AA period maintained the suite of tariffs from the current period, which we considered remained reflective of the services sought by our customers.[8] This approach was not raised as an issue of concern by our customers during the review. Where any new services were sought for the forthcoming AA period, they were given due consideration by AusNet Services and the AER, including whether they are sought by a significant part of the market. Where services are not sought by a significant part of the market, but may be sought by some customers, our practice is to provide a schedule of non-reference services, which are charged for at rates set to recover our efficient costs.

We consider that the arrangements described above reflect an efficient approach that avoids the need for an overly complex suite of services and tariffs, as well as the associated regulatory burden.

The Issues Paper suggests adopting the framework and approach process as an alternative to the current approach of classifying services.[9] We consider the additional regulatory burden this

[5] AusNet Services, *Gas Access Arrangement Review 2018-2022: Revised Access Arrangement Information*, August 2017, pp.8-10
[6] NGR Rule 59 (3)
[7] AEMC, *Review into the scope of economic regulation applied to covered pipelines – Issues Paper*, June 2017, pp.52-54
[8] AusNet Services, *Gas Access Arrangement Review 2018-2022: Access Arrangement Information*, December 2016, p.294
[9] AEMC, *Review into the scope of economic regulation applied to covered pipelines – Issues Paper*, June 2017, p.54

would impose is not warranted, particularly when the current approach has been a non-contentious aspect of our GAAR process and has resulted in a tariff structure that meets the needs of our customer base.

If the experience with transmission pipelines differs, we consider that any Rule changes to modify the existing process should be quarantined to those facilities.

Both flexibility and consistency in performance reporting are desirable

The current arrangements provide flexibility for networks to nominate key performance indicators (KPIs) to be reported against during the forthcoming AA. In our view, these arrangements are fit for purpose. There is merit in networks being able to identify and report on the KPIs that are appropriate to their specific circumstances, and adapt to the changing information requirements of their customers and other stakeholders.

For example, AusNet Services' 2018-22 AA features a multilateral total factor productivity (MTFP) KPI for the first time, reflecting the prominence given to economic benchmarking in recent years as a useful comparative measure of efficiency both over time and with other networks. The asset performance and safety-related KPIs from the current AA period have also largely been maintained, allowing our performance over time on these measures to be tracked and assessed by stakeholders.[10]

The introduction of a contingent CESS in Victoria will also provide a further obligation in respect of network performance reporting. While this is not a universal obligation, it will create increased transparency for stakeholders in respect of the Victorian networks' performance. This may expand over time to include other networks if the contingent CESS is applied more broadly.

Despite this, we recognise the AEMC's concerns that the current arrangements have the potential for KPI reporting that is of limited value.[11] Two key purposes of KPI reporting that should be achieved are performance trend and comparability. We consider that it is good industry practice for networks to report a consistent set of KPIs over time, to allow network performance to be accurately tracked and to improve transparency for customers and other stakeholders. In our experience in the fully regulated sector, there is a broad range of KPIs reported that supports these objectives.

On balance, we think an approach that allows the network to present a suite of KPIs, developed through its GAAR process and engagement with customers and other stakeholders, provides for the most adaptive and flexible approach. This process, consistent with the current Rules, should allow the most meaningful KPIs to be determined and reflected in AAs.

Please contact Rob Ball, Senior Economist on 03 9695 6281 if we can assist you further in relation to this submission. We look forward to opportunities to provide further input into this review as it progresses.

Yours sincerely,

Kelvin Gebert

Kelvin Gebert
Manager Regulatory Frameworks

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[10] AusNet Services, *Gas Access Arrangement Review 2018-2022: Access Arrangement Information*, December 2016, p.47
[11] AEMC, *Review into the scope of economic regulation applied to covered pipelines – Issues Paper*, June 2017, p.52