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27 November 2023

Economic Regulation Authority
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RESPONSE TO ISSUES PAPER ON PROPOSED REVISIONS TO THE MID-WEST AND SOUTH-WEST GAS DISTRIBUTION SYSTEMS ACCESS ARRANGEMENT

Synergy welcomes the opportunity to make a submission in response to the Economic Regulation Authority's (**ERA**) issues paper on ATCO Gas Australia's (**ATCO**) sixth access arrangement (**AA6**) proposal.

Synergy notes the national gas objective (**NGO**) requires an access arrangement to:

> *"promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas."*

Synergy has highlighted several key matters below that requires the ERA to determine whether the AA6 proposal will or is likely to contribute to the achievement of the NGO, in particular, the long-term interest of consumers in relation to the impact on pricing and the operation of reference services under an access contract.

Changes to the Legislative Framework

ATCO's access arrangement proposal assumes that three key legislative amendments to the National Gas Law (**NGL**) and National Gas Rules (**NGR**) are likely to be adopted in the Western Australian legislative framework at some stage during the AA6 review process. The three proposed amendments provide for a simpler regulatory framework to be adopted, which will incorporate hydrogen, blended gases and an emissions reduction objective incorporated into the NGO.

The ERA has highlighted that proposed legislative amendments to the NGL and NGR may directly affect the ERA's decision on ATCO's access arrangement proposal. In addition, the incorporation of an emissions reduction objective into the national regulatory framework commenced in Australia (except Western Australia) on 21 September 2023[1]. These proposed amendments have not currently been adopted in Western Australia but may be adopted sometime during the ERA's review process of the proposed AA6. The ERA has indicated that it will not speculate on whether legislative amendments will occur or not, nor will it speculate on the

[1] South Australian Government, Statutes Amendment (National Energy Laws) (Emissions Reduction Objectives) Act 2023, 21 September 2023.

timing for such amendments. Therefore, the ERA has proposed it will apply the existing applicable regulatory framework at the time of making each of its AA6 determinations. In addition, the ERA also intends to assess the AA6 proposal and separately set out the ERA's considerations directly related to the possible amendments to the regulatory framework in its draft decision[2].

Synergy notes, ATCO's AA6 proposal does not fully reflect the current regulatory framework in Western Australia and has, to some extent, speculated the regulatory framework that may apply during the AA6 consultation and review process. Synergy supports the ERA's approach to review the AA6 proposal and agrees that it should not speculate on whether legislative amendments are likely to occur or not including whether proposed investments based on potential legislative amendments should be approved. In addition, Synergy also supports the ERA's approach to consider the implications of potential legislative amendments and ensure stakeholders are provided sufficient time and opportunity to provide comments if these legislative amendments were to occur between the publication of the draft and final decisions.

Demand Forecast

ATCO has forecast in their access proposal that the number of gas customers will grow at 1.1% per annum. However, consumption per customer during the access arrangement period is forecast to decline resulting in an overall demand forecast decrease of 0.8% per annum.

The ERA considers that, with an increased focus on renewable energy to achieve lower carbon emission targets, demand for natural gas is expected to decline in the long term. In addition, increasingly compelling and cost-efficient alternatives to natural gas as an energy source for consumers supports an expected decline in gas demand over time. The ERA has also indicated that a bill to introduce proposed climate legislation to the Western Australian Parliament is anticipated in late 2023 which will, among other things, drive investment in clean energy infrastructure and technologies and position the State to become a clean energy powerhouse.[3]

Demand forecasts directly affect the allocation of costs, step changes in tariffs and tariff price paths. If customer numbers are increasing and demand is decreasing it would be reasonable to expect that the average cost a customer would pay would decrease, assuming network investment is kept at a fixed level.

Synergy, in principle, supports the ERA's view, in the issues paper, in relation to the expected long term market decline for natural gas and therefore requests the ERA to review whether the:

1. forecast decrease of 0.8% is reasonable and whether it should be greater over the AA6 period given the proposed climate bill to drive investment in clean energy infrastructure; and
2. whether the proposed levels of new investment[4], in relation to the network, is required including determining whether it is necessary and consistent with the NGO and the long-term interests of consumers. In particular ATCO's proposed investment in its renewable gas delivery strategy, hydrogen blending program and proposed recovery of $0.4 million.

Accelerated Depreciation

For its AA6 proposal ATCO has not used the straight-line method for depreciation. Instead, ATCO has proposed to use accelerated depreciation as a method to bring forward capital recovery while

[2] ERA Proposed revisions to the access arrangement for the Mid-West and South-West Gas Distribution Systems page 7.
[3] ERA Proposed revisions to the access arrangement for the Mid-West and South-West Gas Distribution Systems pages 7, 12 and 14.
[4] Given the forecast decline in demand.

maintaining its current asset lives. ATCO's proposed accelerated depreciation of $80 million (in real terms) represents a 23 per cent of the increase in ATCO's calculated total revenue requirements for AA6 and is in addition to its straight-line depreciation revenue. ATCO has taken this approach because it has speculated that under various possible future scenarios its distribution gas pipeline network may have a reduced useful life.

Synergy notes the ERA currently considers in Western Australia the cost of natural gas is still generally viewed as a cost-effective energy source[5]. Maximum residential gas pricing is still set by the Western Australian State Government and there are no government policies prohibiting natural gas connections in new residential areas or when requested by a customer in an existing residential area. Therefore, the current natural gas pricing and policy measures in Western Australia mean that the expected demand for natural gas in Western Australia may be different to the expected demand for natural gas elsewhere in Australia. In addition, the ERA considers the NGO requires that the depreciation schedule should be used to create prices that promote the efficient usage of the network, including recognising the long-term interest of consumers[6].

Synergy considers it is important that there is minimal or no speculation in relation to forecasting asset lives and depreciations because of the direct impact it has on tariffs and the potential to create price distortions. In addition, Synergy considers the NGR provides adequate mechanisms for network operators to recover costs for redundant assets[7]. Synergy notes the proposal to use accelerated depreciation has a direct impact on price shock and the step increase in tariffs for AA6 that consumers must pay. Synergy also considers that there does not seem to be sufficient evidence to indicate that ATCO's network is at risk of becoming redundant within the AA6 period.

In addition, Synergy considers any industry risk or systemic risk network operators may be exposed to, due to potential emission reduction regulations, should be addressed through the market risk premium[8] and the WACC.

ERA Action

Therefore, Synergy seeks the ERA to determine whether:

1. The speculation in relation to the reduced useful life of the network is consistent with the NGR, in particular NGR 89.
2. The proposal to use accelerated depreciation and its contribution to the step increase in tariffs is consistent with the NGO and the long-term interest of consumers.

Revenue Price Paths

ATCO is seeking a target revenue of $1,298 million for the AA6 period which is $343 million (36 per cent) higher than the AA5 period. ATCO is also proposing an unsmoothed price change with a step increase in 2025 followed by annual price increases based on inflation. ATCO considers that the proposed price path provides stability for its customers and aligns its costs with revenue to provide efficient incentives for the use of and investment in the gas distribution network.

The ERA considers that adjusting tariff revenue to the approximate cost of service helps ATCO send efficient price signals to customers and make the efficient use of and investment in the gas network. In addition, the NGO requires price paths that promote the efficient usage of the

[5] ERA Proposed revisions to the access arrangement for the Mid-West and South-West Gas Distribution Systems page 7
[6] ERA Proposed revisions to the access arrangement for the Mid-West and South-West Gas Distribution Systems page 19
[7] NGR Rule 85
[8] ERA 2022 final gas rate of return instrument.

network. The ERA also highlighted that regard should be given to the economic costs and risk of the potential for under-and-over utilisation of a pipeline[9].

Synergy supports approved target revenue being efficiently allocated and recovered from reference tariffs. However, Synergy considers, in order to be consistent with the NGO, the expected or approved target revenue to be recovered from reference tariffs should be recovered in such a way that:

1. minimises distortions or changes in prices and price signals for each (pricing) regulatory year of the access arrangement period;
2. to the extent possible it does not create a price shock between access arrangement periods; and
3. allow users and customers to understand in advance (with reasonable certainty) how costs and tariffs will change between each (pricing) regulatory year of the access arrangement period.

Synergy understands that forecast investment, rate of return and depreciation methods all can have a material effect on how revenue is recovered (price paths) and reference tariffs are determined. For example, the proposed accelerated depreciation has the effect of creating a step change in tariffs between access arrangements with the potential benefit of minimising distortions to tariffs (flat pricing).

Synergy's analysis shows that ATCO's proposal creates a proposed step change in 2025 in the region of a 38-52 per cent increase across reference tariffs. Synergy considers that this level of step change is inconsistent with the NGO, in particular the long term interest of consumers, and could see an increase in small use customers experiencing hardship when the transport charges flow through to retail tariffs. Synergy further notes that the accelerated depreciation strategy contributes to 23 per cent of the revenue proposal impacting the initial step change in the proposed price path. Synergy considers that there is a requirement for a moderate step change consistent with the NGO. Synergy considers this could potentially be achieved by adopting straight line depreciation in AA6.

Synergy requests the ERA determine if the proposed revenue price path is consistent with the NGO and the long term interests of consumers. This includes giving regard to the economic costs and risks for under-and-over utilisation of the network. Synergy seeks for the ERA to determine a moderate step change consistent with the NGO that also balances the long-term interests of the network operator, retailers and consumers.

Cost Recovery for Permanent Disconnection Reference Service

AA6 includes a reference service for the permanent disconnection of gas supply. The service was developed and approved in accordance with NGR 47A. ATCO has proposed this reference service is only available where there is no meter at the property or for delivery points that previously received the B2 or B3 haulage service and have also sought the deregistering of the delivery point service and in accordance with the Gas Retail Market Procedure approved by the ERA.

ATCO has proposed to make this reference service available to persons who do not have an access contract. That is, end users, property owners and those authorised on behalf of property owners. ATCO has also proposed the reference tariff for this reference service will consist of:

1. A fixed price charge approved by the ERA.

[9] ERA Issues Paper page 19

2. Other charges not approved by the ERA and subject to another contract (but not the access contract).
3. A Permanent Disconnection Contract which is not the access contract provided to the ERA to approve for AA6.

ATCO's proposal in relation to the Permanent Disconnection reference service means:

1. The reference service will not be provided under an access contract to pipeline users.
2. Some of the charges (reference tariffs) required to be paid will not be reviewed and approved by the ERA in accordance with the NGR.
3. There is regulatory uncertainty whether a reference service can be provided under a contract that is not the AA6 access contract.

Synergy notes the Gas Retail Market Procedure contains a regulated process for market participants to deregister and permanently remove a delivery point. Synergy considers it is not clear how the reference service and proposed contracting arrangements align with or is consistent with the Gas Retail Market Procedures. ATCO appears to be contemplating that parties other than a market participant or a pipeline user[10] may permanently remove a delivery point. Such customer action will affect a pipeline user's access rights. Synergy considers the proposal lacks regulatory clarity or certainty.

In addition, Synergy considers the NGR requires an access contract to be the contract that applies to the pipeline services (reference services) approved by the ERA in accordance with NGR 47A and 48(1)(d)(ii). In addition, the NGR requires the ERA to review and approve the distribution reference tariffs in accordance with NGR 72(j) and 94.

Therefore, Synergy considers ATCO's proposal may not be consistent with the requirements of the NGR. Synergy requests the ERA to determine whether the proposed approach to providing the Permanent Disconnection references service and charging arrangements for the service is consistent with the:

1. NGR, NGO and long term interests of consumers.
2. The regulated process and time frames for permanently removing delivery points under the Gas Retail Market procedure.

Please contact Rebecca Cant, Networks Regulation and Compliance Analyst on [redacted] should you have any queries in relation to this submission.

[redacted]

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HEAD OF REGULATION AND COMPLIANCE

[10] Under an access contract.