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29 November 2024

To: **Mr Arek Gulbenkoglu**
General Manager
Australian Energy Regulator
GPO Box 1313
Canberra ACT 2601

Re: **AusNet Services – Access Arrangement 2023-28 – Variation proposal**

Dear Mr Gulbenkoglu,

Thank you for the opportunity to provide a submission to AusNet Services' 2023-28 Access Arrangement variation proposal.

IEEFA is an independent energy finance think tank that examines issues related to energy markets, trends, and policies. The Institute's mission is to accelerate the transition to a diverse, sustainable and profitable energy economy.

AusNet Services has proposed to vary its 2023-28 access arrangement, on the basis of material policy developments around gas usage in Victoria. Significantly, AusNet has requested an additional $70 million in accelerated depreciation, on top of the $105 million approved by the Australian Energy Regulator (AER) in its original decision.

In response to this proposal, the AER must consider whether AusNet Services' reasoning for varying its 2023-28 Access Arrangement is valid, and whether increasing accelerated depreciation is an appropriate response to the issues it has raised.

In IEEFA's view, while there is uncertainty surrounding the likely pace of gas demand reduction, its future direction is increasingly clear, and recent policy developments in Victoria are not unexpected. Accelerated depreciation is not the right regulatory tool to manage stranded asset risks in a scenario where gas demand is set to decline. We also argue that the AER must consider the broader context of this proposal – and how its response may set a precedent for other gas networks impacted by the issues raised by AusNet.

Please do not hesitate to contact us if you would like to discuss any of the matters in our proposal further.

Kind regards,

Jay Gordon, Energy Finance Analyst, Australian Electricity

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While the pace of gas demand reduction is uncertain, the future direction is clear

The AER first proposed accelerated depreciation in its 2021 information paper, *Regulating gas pipelines under uncertainty*. In this paper, the AER identified a number of factors contributing to uncertainty over long-term gas demand, including decarbonisation policies, competitiveness of renewable energy, future gas prices, consumer sentiment towards gas, and the viability of hydrogen and biomethane for residential use.[1]

Since 2021, the direction of many of these factors has become more clear. The rise in gas prices has continued to outpace electricity prices[2]; the poor economics of hydrogen or biomethane for household use is better understood[3]; and as AusNet observes, consumer sentiment is shifting in favour of electrification[4].

Policy has also moved in support of electrification, particularly in the state of Victoria. Victoria has legislated ambitious 2035 emissions targets[5], and has signalled an intention to support residential electrification through the development of its Gas Substitution Roadmap[6].

AusNet has proposed to vary its access arrangement based on recent and speculative future policy decisions in Victoria. However, these developments are not unforeseen.

Victoria's first Gas Substitution Roadmap was released in July 2022. This document observed that "Over the course of the transition, more investment and reform will be essential to accelerate the decarbonisation of the gas sector", with the government committing to "publish a Roadmap update in 2023 to further progress the transition".[7]

In an addendum to its final 2023-28 access arrangement proposal, AusNet acknowledged that "the Roadmap provides more certainty around the primacy of the electrification pathway to decarbonise."[8]

This implies AusNet's 2023-28 access arrangement was finalised with the understanding that Victoria was likely to implement further policies to support electrification. There has been, and remains, uncertainty around the exact nature and timing of policies that may be implemented. However, the AER acknowledged this uncertainty by approving an accelerated depreciation

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[1] AER. Regulating gas pipelines under uncertainty. November 2021. Page 3.
[2] IEEFA. Submission to Senate inquiry on residential electrification. 28 September 2023. Page 3.
[3] IEEFA. 'Renewable gas' campaigns leave Victorian gas distribution networks and consumers at risk. 17 August 2023. Page 9.
[4] AusNet. Gas access arrangement review 2024-28. Variation proposal. 30 September 2024. Page 18.
[5] Department of Energy, Environment and Climate Action (DEECA). Victoria's 2035 Emissions Reduction Target. May 2023.
[6] DEECA. Victoria's Gas Substitution Roadmap. July 2022.
[7] Ibid. Page 21.
[8] AusNet Services. Access Arrangement Information: Gas access arrangement review 2024-28. Addendum to proposal. September 2022. Page 7.

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allowance, and by applying gas demand forecasts from AEMO's *Step Change* scenario.[9] This scenario is aligned with emissions objectives of state and territory governments, effectively assuming that the Victorian government will continue to implement policies to decarbonise the residential sector in line with its whole-of-economy goals.

The fact that specific policies have now been legislated or proposed does not automatically constitute an unforeseen change to AusNet's operating environment.

Accelerated depreciation is not an appropriate tool to manage the decline of gas

The AER has presented accelerated depreciation as a regulatory response to uncertainty. However, it is not an appropriate tool for a context where there is growing certainty around the future decline of the gas distribution system.

For example, two advantages of accelerated depreciation cited by the AER are that it "can be reviewed at each access arrangement review and it can be adjusted as circumstances change in the future", and that it "may provide for reduced price impacts associated with a transition to hydrogen."[10]

These are only advantages in a scenario where there is genuine uncertainty around the future role of the gas network. However, the present context calls for regulatory solutions that protect the long-term interests of consumers amid a trend towards electrification. This would imply not exposing them to additional stranded asset risk.

The default exposure of stranded asset risk lies with gas networks, due to there being no formal guarantee of full cost recovery in the existing regulations.[11] Reallocating stranded asset risk from networks to consumers via accelerated depreciation represents a significant alteration to the risk profile of gas distribution businesses.

We also note the Justice and Equity Centre's submission to Jemena's 2025-30 access arrangement proposal. When commenting on Jemena's request for accelerated depreciation, they observed that:

- "There is no provision that allows for Jemena to be compensated for a mere risk of capital redundancy."
- Rule 85 (that addresses capital redundancy) "does not create an initial situation whereby investment risks shift from network companies to consumers".

[9] AER. Final decision: AusNet Gas Services Gas distribution access arrangement – Attachment 12 – Demand. June 2023. Page 4.
[10] AER. Regulating gas pipelines under uncertainty. November 2021. Page 31.
[11] Justice and Equity Centre. Submission to Jemena Gas Networks access arrangement 2025-30: Issues paper. 20 September 2024. Page 14.

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- While there are provisions to vary the depreciation schedule (Rule 89), networks would have to satisfy a regulatory test as provided in that rule (which Jemena had not).[12]

A holistic response is needed

The developments discussed in AusNet's proposal impact other gas distribution businesses, and cannot be made in a vacuum. Policies impacting gas demand are likely to continue evolving, which raises the possibility that AusNet and other networks continue to seek access arrangement variations.

Rather than focusing on tweaking the parameters of AusNet's specific access arrangement, the AER should consider the following broader factors in its response:

Are all elements of AusNet's proposal consistent with a managed decline of its network?

In this proposal, AusNet clearly expresses the view that "long term network decline is now inevitable".[13] This does not only impact its request for accelerated depreciation, or its demand forecasts – but potentially many other aspects of its access arrangement.

We note for example that AusNet has proposed to indefinitely delay $4.7 million of its original $19.8 million in approved augmentation capex.[14] This shows some consistency with a long-term declining demand forecast. However, if the AER accepts AusNet's justification for reopening its access arrangement, it ought to also review all capex and opex in AusNet's proposal, to ensure it is kept to the minimal level required to continue safely operating the network while AusNet's demand declines.

Have gas networks been afforded the reasonable opportunity to recover their efficient costs?

IEEFA analysis has noted that the weighted average price cap mechanism exposes gas networks to demand risk by design. Between 2014 and 2022, gas networks recovered $1.8 billion in supernormal profits above their regulated profit allowance of $2 billion. The largest driver of supernormal profits was the over-recovery of revenue, due to actual network demand being consistently higher than forecast levels.[15]

AusNet Services experienced less revenue over-recovery than other distribution networks.[16] However, in aggregate terms these findings suggest that gas distribution networks have been provided with adequate opportunity to recover more than their efficient costs.

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[12] Ibid.
[13] AusNet. Gas access arrangement review 2024-28. Variation proposal. September 2024. Page 3.
[14] Ibid. Page 24.
[15] IEEFA. Gas networks are making persistent and significant supernormal profits. 6 June 2024. Page 5.
[16] Ibid. Page 25.

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Are access arrangement variation proposals the most efficient way to address these issues?

AusNet's variation proposal highlights the challenges of regulating gas distribution networks in the context of a long-term decline, without coordinated planning. There is a risk that multiple other gas distribution networks may seek to vary their access arrangement proposals mid-access arrangement, leading to a piecemeal response.

We strongly recommend that the AER engages with relevant federal and state government departments to develop consistent guidelines for regulating gas distribution networks facing a decline.

Engagement with the Victorian government would be particularly advisable. Victoria is more advanced than most other jurisdictions in its planning for the phase-down of residential gas, and has implemented a number of reforms to its state regulations to better facilitate a managed phase-down.