

9 October 2015

Australian Energy Market Commission
Via online lodgement: www.aemc.gov.au



Project Number EMO0030
2015 Strategic Priorities for Energy Market Development Discussion Paper

Australian Gas Networks Limited (AGN, previously Envestra)¹ is one of Australia's largest natural gas distribution companies. AGN owns approximately 23,000 kilometres of natural gas distribution networks and 1,100 kilometres of transmission pipelines, serving over 1.2 million consumers in South Australia, Victoria, Queensland, New South Wales and the Northern Territory.

AGN welcomes the opportunity to make a submission to the Australian Energy Market Commission (the Commission) on its *2015 Strategic Priorities for Energy Market Development Discussion Paper* (the Paper). AGN understands that the Commission reviews its strategic priorities for the development of Australia's energy markets every two years and that the Paper seeks to frame critical issues for consideration amongst consumer groups, market participants and relevant policy makers.

AGN is supportive of the Commission's open and transparent approach to setting strategic priorities and of the key focus areas and issues outlined in the Paper. AGN is particularly encouraged by the Commission's focus on the long-term interests of consumers. Importantly, AGN agrees that the strategic priorities established by the Commission in 2013 (the consumer priority, gas priority and markets and network priority) remain relevant and that 2015 priorities should therefore reflect an evolution of current priorities.

Attachment A to this submission provides further detail on AGN's review of the Paper. We have also contributed to and support the Energy Networks Association submission to the Commission on the Paper.

Please contact either Kristin Raman (08 8418 1117) or myself (08 8418 1129) if you would like to discuss the matters raised in this submission further.

Yours sincerely

A handwritten signature in blue ink, appearing to read "Craig de Laine".

Craig de Laine
General Manager – Regulation

¹ On 27 October 2014, Australian Gas Networks Limited was announced as the new name for Envestra Limited. The name change was effective from 3 November 2014 and has no impact on the service offering of the Company.

Attachment A – Detailed Response to the Paper

Consumer Priority

The Commission's current Consumer Priority is to strengthen, "... *consumer participation and [continue] to promote competitive retail markets.*"² The Commission's proposed Consumer Priority is to focus on the areas of engagement, participation and protection of consumers. AGN considers that these focus areas are critical to promoting the long-term interests of consumers, and as such, supports the ongoing focus on these issues.

Consistent with this, AGN has recently developed and implemented an expanded stakeholder engagement program to inform the development of our revised South Australian Access Arrangement (AA) proposal to the AER for the 2016/17 to 2020/21 period. AGN is pleased with the feedback received from stakeholders on our engagement program. Overall, the feedback suggested that our engagement program was genuine, comprehensive and well supported within the business.

AGN does however acknowledge that ongoing improvements can and will need to be made to ensure effective engagement with stakeholders. Some of the challenges faced by businesses in undertaking engagement include a:

- *Lack of understanding of the regulatory system:* the regulatory regime is complex and wasn't (understandably) readily understood by stakeholders;
- *Lack of understanding of the energy industry:* the industry structure and roles is also difficult to understand, including understanding those matters that AGN can and can not control;
- *Engagement fatigue:* the time commitment required of stakeholders to actively participate in engagement, including in a number of different review processes, is challenging; and
- *Technically-complex issues:* the concepts that are the subject of engagement can in some cases involve technically-complex concepts.

AGN therefore encourages the Commission to participate in the process of ensuring stakeholder engagement is effective, including identifying how processes can be improved. AGN considers this to be a key input into promoting the long term interests of consumers through facilitating improved regulatory outcomes, and as such, should continue to be a central focus of the Commission.

² Australian Energy Market Commission, "Strategic Priorities for Energy Market Development 2015: Discussion Paper", 10 September 2015, p. 1.

Gas Priority

Currently, the Commission's gas priority is to promote, "... *the development of efficient gas markets.*"³ Its proposed future priority is split into the following three focus areas:

- wholesale gas trading markets;
- pipeline capacity trading; and
- information.

In terms of the first and second points, AGN considers a focus of the AEMC could be to understand the causes of limited gas retail competition in smaller regional markets. AGN has observed in regional markets served by its gas networks, whether those networks are subject to economic regulation by the AER or have no economic regulation in place, gas retail competition is extremely limited.

In terms of the last point, AGN considers that there is a role for the Commission to ensure that stakeholders are provided with clear and accurate information across not only the operation of wholesale markets but also in other parts of the supply chain. Consistent with the ENA, AGN considers the Commission can further support the ability of consumers to make informed choices, through the achievement of greater clarity and consistency in the materials made available to consumers.

A key example of mis-information within the gas industry relates to the ongoing reference to "*increasing gas prices*", which commentary is driven by expectations regarding movements in wholesale gas prices (rather than the final delivered price of gas). It is important that consumers are aware that this forecast increase in price is in relation to wholesale gas prices only and simply forms a part (around 20%) of their final retail bill.

AGN notes that retail gas prices are stable or falling in many jurisdictions, which reflects the significant reduction in distribution charges that are primarily been driven by lower regulatory rates of return. AGN notes that distribution charges account for around 50% of the retail gas price, thereby offset any forecast increases in wholesale gas costs.

As gas is a fuel of choice, it is important to the industry that consumers have access to and are provided with accurate and clear information to ensure informed decision-making regarding their energy use.

³ *Ibid.*

Market and Network Priority

The Commission's current market and network priority is to promote, "... *market arrangements that encourage efficient investment and are flexible and resilient.*"⁴ AGN supports the Commission's continued focus on markets and networks as a key priority over the coming years. AGN is a strong supporter of the Commission's vision that market and regulatory arrangements "*contribute to the right environment for business model evolution, whilst still promoting the consumer outcomes that are the objective of regulation.*"⁵

Due to the Commission's proposed focus on ensuring an appropriate environment for the evolution of the regulatory regime and the promotion of long-term consumer interests, AGN considers there are three areas on which the Commission should focus, these being the:

- introduction of strengthened incentives for regulated businesses;
- financeability of regulated businesses; and
- policy integration.

In particular, AGN considers the Commission should advocate for the evolution of the regulatory regime to incorporate strengthened and broadened incentives for regulated businesses and should encourage an active consideration by regulators on the financeability of their decisions.

Incentives

AGN is a strong supporter of effective, outcome-based incentive arrangements as a regulatory tool to promote behaviour by regulated entities that is consistent with the long-term interests of consumers. This is reflected in our recent Access Arrangement Proposal for our South Australian gas distribution network⁶, in which we propose that a more comprehensive set of incentive arrangements apply over the next Access Arrangement (AA) period,⁷ including:

- the retention of the AER's operating expenditure incentive scheme (referred to as the efficiency benefit sharing scheme), albeit strengthened to provide an equal sharing of efficiency gains/losses between AGN and consumers;
- the introduction of the AER's capital expenditure incentive scheme, also modified to allow for an equal sharing of efficiency gains/losses in capital expenditure;
- the introduction of an incentive to promote lower cost and/or improved service delivery outcomes through innovation; and
- the development and introduction of a customer service incentive scheme during the next AA period.

AGN considers that these incentive arrangements will increase the scope for the business to further improve efficiency and customer service, thereby leading to outcomes that better promote the National Gas Objective (NGO).⁸ AGN considers the Commission should therefore also support the greater use of incentives to drive outcomes that are in the long term interests of consumers with respect to price and service levels.

⁴ Australian Energy Market Commission, "Strategic Priorities for Energy Market Development 2015: Discussion Paper", 10 September 2015, p. 1.

⁵ *Ibid.*, p. 25.

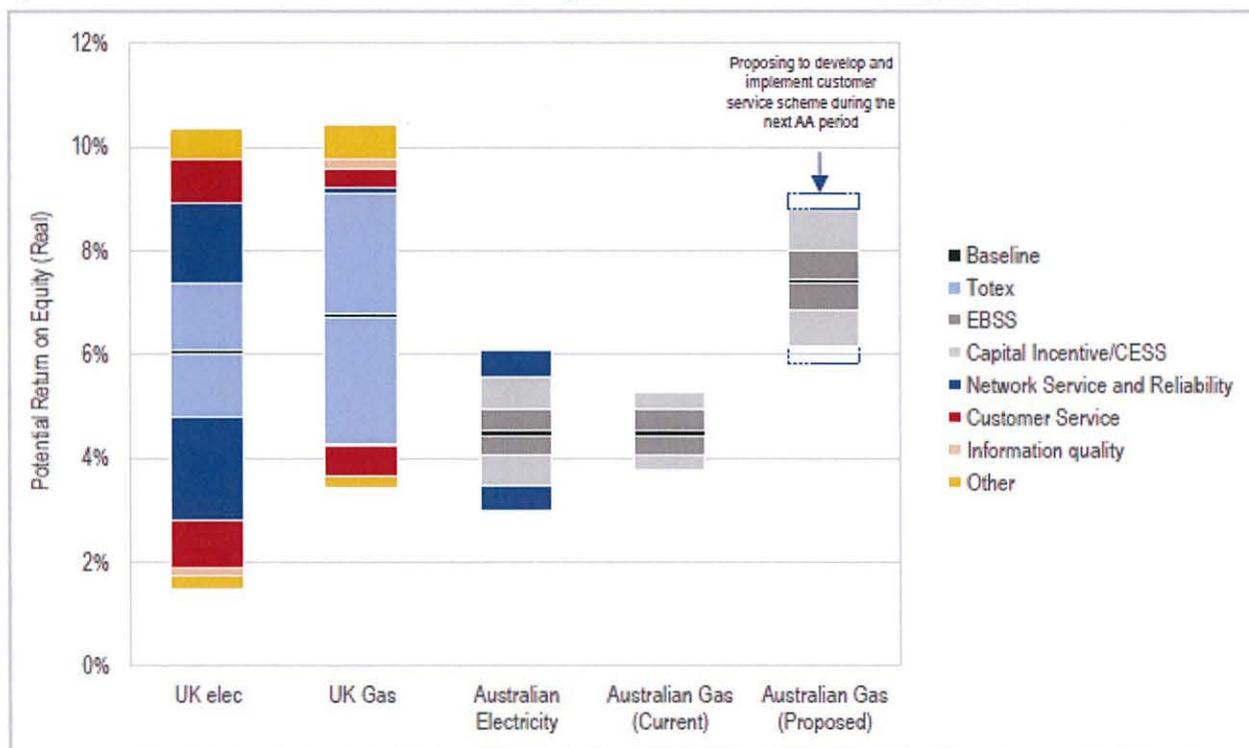
⁶ The AGN Access Arrangement Proposal for the South Australian gas distribution network is available on the AER's website: <http://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/australian-gas-networks-sa-access-arrangement-2016-21/proposal>.

⁷ The next Access Arrangement period is the five year period beginning 1 July 2016.

⁸ As set out in Section 23 of the National Gas Law, the National Gas Objective is "...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".

It is noteworthy that the use of incentives to promote a greater customer focus is a commonly used regulatory tool. For example, the number and magnitude of incentives provided in the United Kingdom (UK) is significantly higher than it is in Australia (see Figure 1).⁹ Indeed, the incentives provided to electricity distributors in Australia are also significantly higher than is available to gas distributors.

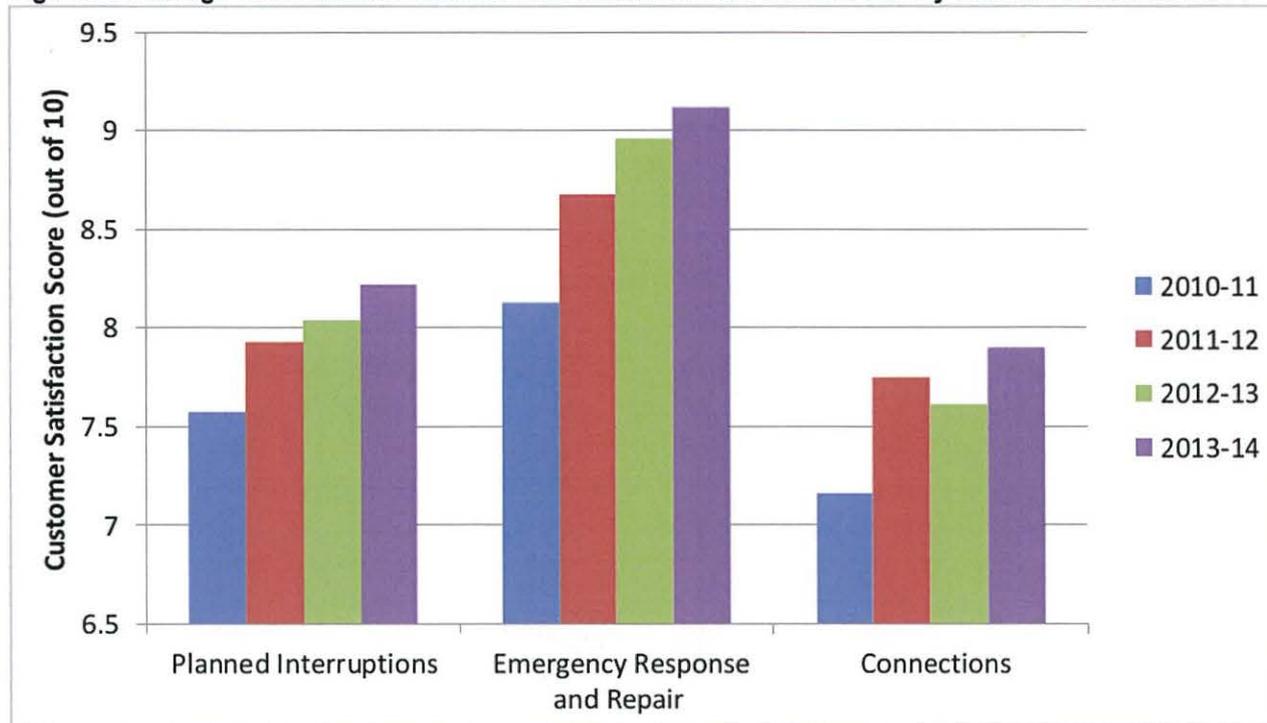
Figure 1: Economic Incentive Schemes – Comparison to Australian Gas Regulation



By increasing the strength of customer-focused incentives available to businesses, the focus of regulated businesses will be shifted away from the regulator and more toward improving outcomes for stakeholders, including through incentivising businesses to achieve lower prices (through increasing productivity) while at the same time improving supply reliability and customer service more generally. This is indeed evident in the UK. For example, the below figure shows the improvements in customer outcomes following the recent strengthening of the incentive regime in the UK.

⁹ AGN has discussed this comparison in more detail in its Access Arrangement Proposal for the South Australian gas distribution network, available on the AER's website: <http://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/australian-gas-networks-sa-access-arrangement-2016-21/proposal>.

Figure 2: Average Gas Distribution Networks Customer Satisfaction Survey Scores 2010/11-2013/14¹⁰



AGN puts this view forward against a background of moderated productivity growth rates over recent years (compared to previous years), due to the increased difficulty and cost in achieving further productivity gains under the current incentive regime. AGN therefore encourages the Commission to consider whether the current incentive regime is appropriate to facilitate the ongoing promotion of the NGO.

Financeability

AGN considers that the AER, like regulators elsewhere (particularly in the UK), should be required to actively consider the financial implications of their decisions. In particular, the AER should be required to consider whether their decisions result in stable credit metrics that are consistent with that assumed in making their decision, in particular in setting the allowed rate of return. Where this is not the case, adjustments should be made to ensure the AER decision is internally consistent.

AGN submits that ensuring a regulated business is financially viable is in the long term interests of consumers as it leads to lower financing costs, which in-turn leads to lower prices to consumers of natural gas. AGN notes that, while a requirement for the AER to consider financeability already exists under the National Gas Rules¹¹, the analysis has not been widely used in the past (although this might reflect that this is only now an issue given historically low regulated rates of return).¹²

¹⁰ Office of Gas and Electricity Markets, "RIIO-GD1 Annual Report 2013-14", p. 29.

¹¹ National Gas Rule 89 (1) (e)

¹² Further information is provided in AGN's Access Arrangement Proposal for the South Australian gas distribution network is available on the AER's website: <http://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/australian-gas-networks-sa-access-arrangement-2016-21/proposal>.

Policy Integration

In terms of better integration of energy market policies, AGN considers there are the following areas on which the Commission should consider:

- timelines for Access Arrangement decisions specified in the National Gas Rules; and
- carbon-abatement policy.

Access Arrangement Timelines

Currently, the National Gas Rules specify that the AER must allow a minimum period of 15 business days for gas distribution businesses to respond to an AER decision.¹³ In contrast, the National Electricity Rules provide electricity distribution businesses with a minimum period of 45 business days to respond to an AER decision.

This significantly lower timeline for gas has been reflected in AER practice, with AGN provided only 26 business days to respond to the AER decision on in South Australian network, with an expected AER Draft Decision release date of 26 November 2015 with submissions due on 6 January 2016 (which has proposed revenue of over \$1 billion). In contrast, the AER is providing the Victorian electricity businesses with 46 business days, from 29 October 2015 to 6 January 2016.

Access Arrangement reviews are large and complex processes. AGN considers that a 26 day period to respond to an AER Draft Decision is not sufficient and inconsistent with recent endeavours to improve stakeholder engagement (including our ability to meaningfully engage with stakeholders over this period). AGN therefore encourages the Commission to review the timelines currently detailed within the National Gas Rules.

Carbon-Abatement Policy

AGN encourages the Commission to advocate for technology-neutral carbon-abatement policy and ensure that policy objectives do not seek to 'pick winners'. It is AGN's view that, rather than offer support for a particular energy source (such as renewables), the Commission should be seeking to influence and establish policy objectives that:

- minimise energy prices;
- achieve the maximum reduction in emissions at minimum cost in a fuel and technology agnostic manner; and
- implement schemes that operate in harmony with existing national and state based schemes.

An example of the risks of 'picking winners' is the Small-Scale Renewable Energy Scheme (SRES), which provides subsidies of up to 30 percent for solar hot water systems based on their greenhouse gas abatement but does not recognise abatement achieved by gas hot water systems.

An instantaneous gas hot water system can achieve an 83 percent reduction in greenhouse gas emissions when compared against a standard electric resistance water heater. This is approximately the same abatement outcome as a solar water heater (85 percent) and greater abatement than electrically boosted heat pump water heaters (75 percent). Of the three alternate water heater types however, only solar and heat pump water heaters have access to a large range of incentives under SRES.¹⁴

¹³ National Gas Rules, Division 8, Clause 59(3).

¹⁴ ENA 2014, Taking Pressure Off Gas Prices; September 2014.

To this end, the SRES policy is not in our view consistent with achieving lowest cost carbon abatement. The Energy Networks Association (ENA) estimates that the SRES policy has cost in the range of \$95 to \$175 per tonne of CO₂ abatement, which is not consistent with delivering abatement at the least cost.¹⁵

The Commission should work to influence and ensure that policy objectives remain unbiased toward a particular energy source.

¹⁵ ENA 2014, Taking Pressure Off Gas Prices; September 2014.