Submission to Jemena Gas Networks' 2020 Plan

9 August 2019

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About the Public Interest Advocacy Centre

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit legal centre based in Sydney.

Established in 1982, PIAC tackles barriers to justice and fairness experienced by people who are vulnerable or facing disadvantage. We ensure basic rights are enjoyed across the community through legal assistance and strategic litigation, public policy development, communication and training.

Energy and Water Consumers’ Advocacy Program

The Energy and Water Consumers’ Advocacy Program (EWCAP) represents the interests of low-income and other residential consumers of electricity, gas and water in New South Wales. The program develops policy and advocates in the interests of low-income and other residential consumers in the NSW energy and water markets. PIAC receives input from a community-based reference group whose members include:

- NSW Council of Social Service;
- Combined Pensioners and Superannuants Association of NSW;
- Ethnic Communities Council NSW;
- Salvation Army;
- Physical Disability Council NSW;
- St Vincent de Paul NSW;
- Good Shepherd Microfinance;
- Affiliated Residential Park Residents Association NSW;
- Tenants Union;
- Solar Citizens; and
- The Sydney Alliance.

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Contents

1. Introduction

PIAC welcomes the opportunity to provide input to Jemena Gas Network's 2020 Plan for its 2020-25 access arrangement period. We commend Jemena for the engagement they have conducted with consumers and consumer advocates.

PIAC staff have engaged with Jemena on various issues related to the 2020-25 access arrangement as part of Jemena's customer council, as observers at the numerous rounds of deliberative engagement which Jemena have run throughout NSW, as part of a deep dive along with other consumer advocates in February 2019, a written submission to the draft 2020 Plan and through one-on-one meetings with Jemena staff on more specific issues.

This submission builds on and complements these interactions.

2. Principles

2.1 Gas as a 'fuel of choice'

In 2014, the Alternative Technology Association (ATA, now Renew) found that due to improvements in common household electrical appliances, connecting new gas supply was no longer an economic option for residential consumers when efficient electric options are available.[1] These findings also held true when ATA redid the analysis in 2018 and concluded that:

> To continue to promote reticulated gas to new Class 1 dwellings is to lock most of those new home buyers into significantly higher energy costs for the medium to longer term.
>
> …
>
> Continued expansion of reticulated gas to most greenfield developments across the NEM fails [the National Gas Objective] on at least two important counts:
>
> - The infrastructure delivered could not, by any credible measure, be considered 'efficient investment'; and as such
> - such programs are clearly no longer in the 'long term interests of consumers', with particular reference to price.[2]

These findings have also been supported through analysis by the Grattan Institute, Melbourne Energy Institute, AEMO and other independent researchers. They are evidenced by a trend away from connecting new homes to gas and many existing gas homes moving appliances to electricity.

Given this, PIAC contends that significant investment in new gas pipelines to connect households to the gas system is likely to be inherently inefficient and, arguably, not in consumers' long-term interests.

Industry claims that gas is a 'fuel of choice', and therefore subject to competitive pressures from electricity. For many consumers this is simply not the case. For some consumers, the cost of changing household appliances from gas to electricity may be too high, while for renters it is a

1 ATA, *Are we still cooking with gas?*, November 2014, p 5.
2 ATA, *Household Fuel Choice in the National Energy Market*, July 2018, p 7.

decision they cannot make. For households that only use gas for cooking and hot water, the fixed service charge is a greater portion of their bills than for similar households with both gas and electricity (i.e. dual fuel customers). Furthermore, it is estimated that dual fuel customers pay up to $900 a year in fixed charges, with gas supply charges for some networks comprising approximately 54% of the bill.[3] These customers, who remain connected to gas because of inability to switch, will be the most affected by the consequences of any changes to the economic coverage of pipelines.

Therefore, PIAC does not consider that expenditure on the marketing of gas or the provision of appliance rebates is necessarily in the long-term interests of individual consumers. In its advice to the AER on the access arrangement proposals by the Victorian gas networks, the Consumer Challenge Panel noted:

> By its nature, the proposed marketing campaign in large part represents a transfer of wealth (or cross subsidy) from one group of Victorian residential gas consumers to another. It is therefore imperative that the proposed expenditure by each network business has the support of its residential customers.[4]

2.2 Risk allocation between consumers and business

In general, PIAC considers that risk should be allocated so that those exposed to risks have the ability and incentive to manage them. This is particularly important in the regulated network segments of the energy supply chain. Under the current regulatory frameworks, any network investment costs have been borne by consumers – i.e. socialised – through a regulated fee, regardless of actual asset utilisation or benefits accrued. PIAC does not consider this to be an appropriate allocation of risk. Instead, risk should be shared between consumers and businesses based on an assessment of which party has the ability and incentive to manage it.

To address this, we support incentivising pipeline service providers to use the speculative capital expenditure account with appropriate return on the risk associated with that expenditure. However, we remain concerned about the operation of this mechanism. PIAC is particularly concerned about this risk as it relates to distribution networks' supply of residential consumers.

For example, when a distribution pipeline service provider builds a network to supply a residential development, they may wish to invest in extra capacity to ensure they can serve future gas demand in that area. Given the changing economics of residential gas demand,[5] this investment would be inherently speculative.

We agree with comments made by Jemena at the AER's public forum that, as an industry, we need to become better at making decisions in an uncertain world and with incomplete information. However, this does not necessarily mean that deferring an investment or policy decision until conditions are more certain is the wrong or a bad decision. This is particularly

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3 St Vincent de Paul Society, *Queensland Energy Prices July 2016: An update report on the Queensland tariff-tracking project*, July 2016, pp 21-23.

4 Consumer Challenge Panel, *Consumer Challenge Panel Sub-Panel CCP11: Response to proposals from AGN, AusNet and Multinet for a revenue reset/access arrangement for the period 2018 to 2022*, March 2017, p 57.

5 Alternative Technology Association, *Are We Still Cooking with Gas?*, November 2014.

relevant to the proposal for accelerated depreciation of new investments and is discussed further in Section 3.2.

2.3 Consumer engagement

PIAC commends the consumer engagement that Jemena has conducted in the lead up to preparing its initial proposal for the 2020-25 access arrangement. This has included:

- public consultation on a Draft 2020 Plan;
- a deep dive for consumer advocates in February on the Draft 2020 Plan;
- a deep dive for consumer advocates in April specifically on their proposed CESS design;
- the use of Jemena's customer council of consumer representatives, of which PIAC has been a member;
- multiple rounds of deliberative engagement with a broad, representative group of consumers across NSW;
- targeted workshops with more select groups of consumers – in particular the workshops held entirely in language with both residential and small business customers through the support of the Ethnic Communities Council of NSW; and
- various bilateral meetings on specific issues.

The discussion of more fundamental topics in a manner that allowed for meaningful and informed input, such as accelerated depreciation, directly with customers through the deliberative forums and with consumer representatives such as PIAC should be commended.

We also note that Jemena has highlighted in its 2020 Plan where and how it has taken stakeholder feedback onboard and made changes to its Plan – demonstrating an open-mindedness and willingness to compromise in the long-term interests of consumers.

Not only has this engagement been broad and comprehensive, but it also commenced early (over 18 months before the initial proposal was due to the AER) allowing for more fulsome discussion and more meaningful input on all sides.

While we have not formally assessed Jemena's engagement as we did for the NSW electricity distribution businesses,[6] Jemena's engagement would rank highly on the evaluation criteria PIAC has developed – which is reproduced in Attachment 1.

2.4 Energy Charter

The Energy Charter is a voluntary, principles-based disclosure regime that can be applied to all businesses across the gas and electricity supply chains. The Charter is intended to embed customer-centric culture and conduct in energy businesses, so as to create tangible improvements in price and service delivery.[7] PIAC has also been actively involved in the formation of the Energy Charter both through being a member of the End User Consultative Group.

6 PIAC, *PIAC Evaluation of Consumer Engagement by NSW DNSPs 2017-18*, August 2018.
7 See the Energy Charter website: https://www.theenergycharter.com.au/about

We note that Jemena was one of the founding signatories to the Charter. We welcome the link that Jemena has made between the development process and content of the 2020 Plan and how works towards meeting its undertakings under the Charter.

3. Specific issues in Jemena's plan

3.1 Boundary metering and embedded networks

PIAC supports Jemena's intent in proposing to minimise its capital expenditure through the use of volume boundary metering for new high-rise sites with centralised hot-water systems. Any measure which leads to more efficient network expenditure and helps to manage the potential risk of growing RAB is worthy of consideration.

Under Jemena's proposal, the high-rise site would become an embedded gas network, with a third-party (the Embedded Network Operator) owning, operating and maintaining the infrastructure within the high-rise site. While this reduces the amount of money that Jemena must spend to connect new high-rise sites (and hence benefits all Jemena's customers), the ultimate impact on the households within the site depends also on the costs from the Embedded Network Operator.

Embedded networks have been a concern in the electricity market and has been the subject of several recent submissions by PIAC and a recent review by the AEMC. Therefore, PIAC recommends Jemena continue to work with the AEMC and other stakeholders to ensure that the prospective customers who would be served by volume boundary metering continue to receive appropriate protections and support.

3.2 Accelerated depreciation

As noted earlier, PIAC considers as a foundational principle that risk should be allocated so that those exposed to risks to have the ability and incentive to manage them. Jemena's proposal to use accelerated depreciation for new network investments to address potential future asset stranding risk is a prime example of where this principle can be applied.

As Jemena have noted: "Although we are investing in innovative technology in an effort to secure the future of our gas network beyond 2050, success is by no means certain—it is possible that our network will no longer be viable beyond 2050."[8] If this were to happen, Jemena's shareholders would face the risk of being unable to recover the costs of the physical assets without significant consumer harm and impacting Jemena's social license to operate – as Jemena points out, "there will be fewer customers over which to spread our largely fixed costs. The customers remaining on the network at this time are likely to be those who are constrained in their ability to switch technologies."[9]

As such, we reiterate our position from our submission to the Draft Plan that it represents a transfer between consumers in the shorter term and Jemena's shareholders in the longer term.[10]

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8 Jemena, *2020-25 Access Arrangement Proposal*, June 2019, p 83.
9 Ibid, p 83.
10 PIAC, *Submission to Jemena Gas Networks' Draft 2020 Plan*, March 2019.

While PIAC is generally supportive of the analysis Jemena has done in arriving at its proposal and the engagement it has conducted to minimise negative impacts on consumers we suggest that doing the "least bad" version of accelerated depreciation doesn't necessarily make it good.

We urge Jemena and the AER to continue to think beyond the current regulatory framework and consider whether it is really reasonable to expect consumers to foot the bill for the full risk that Jemena does not have an attractive product in the future.

As noted earlier, we agree with comments made by Jemena at the AER's public forum that, as an industry, we need to become better at making decision in an uncertain world and with incomplete information. However, this does not necessarily mean that deferring an investment or policy decision until conditions are more certain is the wrong or a bad decision.

Therefore, we recommend that Jemena and the AER do not make a change to the asset lives for new investments in this access arrangement. Instead, we consider this should be considered at a policy-level for regulated businesses in general and not limited Jemena Gas Networks.

3.3 CESS

We welcomed the deep dive Jemena held in April on the design of their proposed Capital Efficiency Saving Scheme (CESS) involving consumer representatives, the CCP and AER as well as the changes they have made in response to feedback provided at the deep dive. In particular we are pleased that the proposed scheme will not apply to connections capex and the reduced weighting of expenditure related to metering assets.

In general, PIAC supports the judicious use of incentive schemes for regulated network businesses. However, as with the design and implementation of any incentive scheme, it is essential that:

- the metrics represent decisions the business has under its control;
- the targets are set at levels that truly represent achievements beyond business as usual such that the scheme does not simply represent a 'gimme' for the business; and
- the scheme is designed such that it is generally symmetric – i.e. the quantum of incentive payment and the probability of meeting the target is such that the business has a close to equal likelihood of earning a positive payment as a negative one.

3.4 Appliance rebates/incentives

In our submission to Jemena's draft plan, we stated:

> PIAC has a number of concerns regarding the use and implementation of rebates and incentives to encourage the purchase or replacement of gas appliances. As noted earlier …, gas has strong substitution potential with electricity and the point of purchasing or replacing household appliances is the strongest point for most consumers to choose whether to use gas or electricity. Therefore, it is essential that consumers make fully informed decisions regarding their choice of fuel and that this must not be influenced by distortionary rebates or incentives.[11]

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[11] PIAC, *Submission to Jemena Gas Networks' Draft 2020 Plan*, March 2019, p 6.

In response, Jemena have stated that:

> In contrast to PIAC's concerns about whether gas distributors should spend any money on marketing, the results of our rebate program demonstrate that it is in our customers long term interests to continue to grow the network and its utilisation.[12]

And that:

> To ensure that the incremental load is not inefficient for our customers, we work closely with manufacturers that produce and promote highly efficient five, six and seven star (equivalent) systems.[13]

We support this work in encouraging more efficient gas appliance uptake. However, this does not address the fundamental concern we raised in our submission around delivering the most efficient overall energy outcome for the customer given the substitution potential between gas and electricity.

For instance, replacing an existing gas cooker with an electric induction cooktop may be the most economically rational decision for a particular household due to the combination of upfront capital cost and expected electricity prices compared to gas prices. However, due to overly generous and untested incentives or rebates for gas appliances, the household may instead choose to purchase a lower efficiency gas appliance – locking in higher ongoing costs for the long-term. Ensuring that only a minimum efficiency rating for eligibility does reduce this risk somewhat but does not address the underlying issue of whether switching fuel sources would be preferable.

Therefore, while it may improve the gas bill for the particular household, it does not minimise the total energy – i.e. electricity and gas – bill and so fails to fully address the affordability pressures many households currently face. This would not be in the long-term interests of consumers.

As such, PIAC encourages the AER and Jemena to address the following questions:

- How is Jemena testing to ensure the appliances purchased via the rebates or incentives are energy efficient?
- How is Jemena testing to ensure the appliance(s) chosen is economically efficient for the purchaser, especially noting the potential for an electric alternative?
- How is the cost being recovered for these incentive payments?
- Which consumers are receiving these incentive payments – are low-income/vulnerable households with low efficiency appliances making use of these where it is economically efficient for them to do so?

3.5 Opex productivity

As noted in a number of processes, PIAC considers that one of the central purposes of the network regulation framework is to replicate the pressures of a competitive market on monopoly network businesses. In a competitive market, businesses plan for continuous productivity improvement. In such a market, firms are required to constantly reduce costs through productivity improvements or face losing market share and, eventually, going out of business. Therefore, as

12 Jemena, *2020-25 Access Arrangement Proposal: Attachment 6.1 Operating Expenditure*, June 2019, p 2.
13 Jemena, *2020-25 Access Arrangement Proposal: Attachment 6.1 Operating Expenditure*, June 2019, p 3.

noted in our submission to the AER's opex productivity review, it is inconsistent with the overarching goal of the regulatory framework that NSPs would not face a requirement to improve operating productivity. This is an outcome which PIAC and consumers cannot accept.[14]

As such, PIAC welcomes and commends Jemena committing to deliver operating expenditure savings of 0.74% per annum through the 2020-25 period. We also note that this higher than the 0.5% per annum productivity factor that was proposed in Jemena's Draft Plan and the AER's Forecasting productivity growth for electricity distributors.[15]

[14] PIAC, *Submission to Forecasting productivity growth for electricity distributors draft decision*, December 2018.
[15] AER, *Forecasting productivity growth for electricity distributors*, March 2019, p 10

Attachment 1 – PIAC evaluation criteria for network engagement

The following is from PIAC's report evaluating the consumer engagement conducted by NSW electricity distribution businesses as part of their 2019-24 revenue determination.[16]

PIAC's understanding of good consumer engagement by NSPs is informed by two sources:

- The AER's *Consumer Engagement Guideline for Network Service Providers*[17]; and
- A presentation given by the Alternative Technology Association (ATA) to the ENA/CSIRO Consumer Engagement Handbook workshop in September 2015.[18]

Using these sources, PIAC produced a two-tiered framework for grading the engagement practices of NSPs that links the AER's principles to a set of ATA-inspired criteria.

AER principles

The AER's *Consumer Engagement Guideline for Network Service Providers* sets out a principles-based consumer engagement approach for energy network service providers like the NSW DNSPs. According to the AER's principles, consumer engagement should be:

- Clear, accurate and timely;
- Accessible and inclusive;
- Transparent; and
- Measurable.

While the guideline is not binding, the AER states that it is an expression of its expectations regarding how energy network businesses will engage with their consumers.[19] Given that the NER requires DNSPs to report to the AER on this engagement,[20] PIAC considers the AER's expectations to be highly relevant.

PIAC considers the AER principles to broadly encompass the elements of consumer engagement that we expect to see from NSPs. Therefore, PIAC has used these principles in assessing good engagement by NSPs.

However, PIAC modified the AER principles slightly in our engagement evaluation. Firstly, PIAC added two further principles. These are:

- Culture of engagement; and
- Approach to engagement.

'Culture of engagement' refers to the overall commitment of an organisation to good consumer engagement practices. This commitment is a top-down process that requires a board and executive staff members to push for good consumer engagement practices to be embedded in

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16 PIAC, *PIAC Evaluation of Consumer Engagement by NSW DNSPs 2017-18*, August 2018.
17 AER, Consumer Engagement Guideline for Network Service Providers, November 2013.
18 Craig Memery, *Why are why here? An engagement snapshot*, September 2015.
19 Ibid, p 5.
20 NER, cil. 6.8.2(c1)(2).

the day-to-day operation of a business. While a culture of good engagement takes time to develop, PIAC expects all NSPs to have made a genuine effort to do so.

'Approach to engagement' refers to the actual engagement activities performed by NSPs. While the AER principles include the content and tone of engagement, they do not seek to prescribe what form that engagement should take.

PIAC, however, has expectations for how consumer engagement by NSPs should be structured. PIAC contends that good consumer engagement involves deliberative processes that do not treat consumers as homogenous and seek to achieve negotiated outcomes.

As well as adding two principles, PIAC interprets the 'Measurement' principle more broadly than the AER. The AER guideline focusses on internal measurement of engagement success by NSPs.[21] PIAC concurs that this is important, and encourages all NSPs to perform regular internal reviews.

In this project PIAC has used the 'Measurable' concept to refer to the impact of an NSPs consumer engagement program. That is, whether engagement with consumers and their representatives has a measurable impact on the actions, decisions and proposals of businesses.

PIAC criteria

While PIAC's framework is broadly consistent with the AER's guideline, we used a second source to assess NSPs at a granular level.

The second source used by PIAC was a presentation given by the Alternative Technology Association (ATA) to the ENA/CSIRO Consumer Engagement Handbook workshop in September 2015.[22] Compared with the broad AER principles, this document is much more specific about what does and does not work in consumer engagement. From the extensive list in the document, PIAC prioritised this list to 16 criteria for good engagement.

Each PIAC criterion is linked to an AER principle. By linking the two, PIAC assessed NSPs on each PIAC criteria and used these scores to derive an aggregate score for each AER principle. PIAC expects all NSPs to meet a high standard in each of these criteria.

The PIAC criteria, their descriptions and their relationship to AER principles are listed in Table 1.

Table 1 – Evaluation criteria

Criterion	Description	AER Principle
Genuine commitment to engagement process	NSPs have a top-down commitment to embedding good consumer engagement into business as usual business practice.	Culture of engagement
Willingness to compromise	NSPs are willing to compromise when they have a different view to consumers.	Culture of engagement

21 AER, Consumer Engagement Guideline for Network Service Providers, p 9.
22 Craig Memery, *Why are we here? An engagement snapshot*, September 2015.

Open-mindedness	NSPs are open to new ideas and information presented by consumers.	Culture of engagement
Deliberative engagement	NSPs use deliberative engagement processes to reach negotiated outcomes with consumers.	Approach to engagement
Ongoing engagement	NSPs integrate consumer engagement into their business as usual work, rather than limiting it to the months before a regulatory proposal is submitted.	Approach to engagement
Strategy-driven processes	NSPs design engagement programs that facilitate good consumer outcomes, not use 'process-driven strategies' to shape outcomes through a pre-determined engagement process.	Approach to engagement
Start talking early	NSPs begin engagement early enough to ensure that consumers can materially influence particular business decisions.	Clear, accurate and timely
Flexible planning	NSPs adapt their plans as circumstances change.	Clear, accurate and timely
Clarity of purpose	NSPs clearly articulate the purpose of consultation when they engage with consumers.	Clear, accurate and timely
Fair and balance information	NSPs provide balanced information that does not lead consumers to a particular answer.	Clear, accurate and timely
Providing the appropriate amount of information	NSPs provide the right amount of information to consumers, pitched at the right level; not so much that it is overwhelming, not so little that it is not useful.	Accessible and inclusive
Producing accessible communications	NSPs provide required information in a manner in which consumers can easily access it.	Accessible and inclusive
Effective inquiry	NSPs actively seek responses and do not just assume that no response means agreement.	Accessible and inclusive
Proactivity	NSPs are proactive in their consumer engagement.	Accessible and inclusive
Openness	NSPs are willing to share ideas and information without excessive confidentiality.	Transparent
Information by request	NSPs provide the information requested of them by consumers.	Transparent
Stakeholder identification	NSPs identify the consumers with whom they need to engage and share relevant information with them.	Transparent

Consumers influence business planning	NSPs demonstrate that consumers have had input into the business planning process.	Measurable
Consumers preferences are reflected in regulatory proposals.	NSPs demonstrate how revealed consumer priorities are reflected in their final regulatory proposals to the AER. In some ways, this the desired output of the criterion above.	Measurable