Kleenheat

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Economic Regulation Authority
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Kleenheat response to the Draft Decision on Proposed Revisions to the Mid-West and South-West Gas Distribution Systems ("GDS") Access Arrangement for 2020 to 2024 ("Draft Decision") and ATCO's 2020 – 24 Revised Access Arrangement ("AA5") for the GDS ("Revised Plan")

Dear Sir/Madam,

Thank you for the opportunity to provide feedback on the Economic Regulation Authority's ("ERA") Draft Decision and ATCO's Revised Plan.

Kleenheat is a retailer of natural gas on the GDS, with almost 200,000 business and residential customers.

Kleenheat's view remains consistent with its first submission, that although AA5 should provide reasonable returns for the GDS operator, it is very important for its customers, and for the broader business community, that access to the GDS remains affordable. Kleenheat is concerned with the proposed large increases in reference tariffs by ATCO and the impact this is likely to have on WA households and businesses.

Kleenheat appreciates the key role the ERA plays in ensuring AA5 satisfies the requirements of the National Gas Rules ("NGR") and acknowledges the recommended amendments included as part of the Draft Decision.

Kleenheat is concerned that ATCO has rejected many of the ERA's Draft Decision amendments in its Revised Plan. In particular, capital expenditure covering both the AA5 and AA4 periods, and the AA5 operating expenditure forecasts. The impact of these items will result in higher tariffs to those recommended in the Draft Decision, putting further pressure on WA households and businesses.

In response to this submission, Kleenheat would like to make the following comments:

1. AA5 Forecast Capital expenditure

Kleenheat acknowledges the ERAs significant reduction to ATCO's proposed AA5 forecast capital expenditure, as outlined in the Draft Decision.

Kleenheat's main concern regards ATCO's revised AA5 capital expenditure forecast, in which the majority of the ERA amendments were rejected by ATCO. Kleenheat questions whether ATCOs revised forecast truly satisfies the requirements of the NGR, for that of a 'prudent service provider acting efficiently', especially considering this was the basis upon which the ERA amended the original expenditure forecasts in the Draft Decision.

After reviewing ATCO's Revised Plan, there appears to be a number of issues and questions Kleenheat wishes to highlight for consideration by the ERA.

a) Removal of residential brownfield growth capex from the NPV calculation and subsequent 'growth test':

I. ATCO claims the residential brownfield growth capex meets the requirements of the NGR separately, and has therefore excluded this expenditure from the NPV calculation[1].
Kleenheat would like to understand why this expenditure was not excluded from the NPV calculation in the original AA5 submission. If this statement is correct, then why wasn't this excluded in ATCO's original submission?

II. Kleenheat would like to understand how ATCO's treatment of residential brownfield growth capex in its Revised Plan compares to the treatment, and final decision in AA4. Are these consistent?

III. If ATCO's assertion is correct, in that this capex satisfies the requirements of NGR 79(2)(c)(iii), Kleenheat would like to understand whether this expenditure still needs to satisfy the requirements of a 'prudent service provider acting efficiently'? Kleenheat assumes the 'prudent and efficient service provider' test would still need to be satisfied.

IV. ATCO notes it has an obligation under its distribution licence to "*offer to connect customers that are within 20 meters of an existing gas main*"[2]. Given all the capex for residential brownfield growth has been excluded from the NPV calculation, this statement implies that all the brownfield residential new connections fall within the 20 meter range of a gas main.
This statement could also imply that some sort of probability weighting has been applied in order to determine the percentage of customers who are 'offered' a gas connection and those who actually 'accept' the offer of connection. Kleenheat urges for these assumptions to be questioned.

b) Incremental operating expenditure

I. ATCO revised its incremental opex assumption for B3 customers over AA5. This is a significant reduction from the assumptions used in ATCO's original proposal. It also appears this change in assumption has been a significant driver in increasing the NPV. Kleenheat recommends the ERA question the reasonableness of this revised assumption, and the underlying incentives behind making the change.

2. Forecast operating expenditure

Kleenheat continues to question the level of conservatism inherent within the operating expenditure forecasts, and the potential for over-estimation. As noted in Kleenheat's response to the original AA5 proposal, this concern is raised as a result of ATCO's actual and forecast operating expenditure for the AA4 period, which appears significantly lower than the ERAs approved amounts.

Kleenheat supports the ERA's draft decision amendment which requires ATCO to use a base year that reflects actual, as opposed to forecast expenditure. Kleenheat also acknowledges ATCO's approach of using the most recent actual year of 2018 as the base year, as opposed to 2017 as recommended by the ERA.

[1] ATCO Revised Plan, 12 June 2019, p. 165, Section 10.4.2.1
[2] ATCO Revised Plan, 12 June 2019, p. 165, Section 10.4.2.1

However, Kleenheat is concerned with the differences in base year adjustments recognised by the ERA for the 2017 base year and those recognised by ATCO for the 2018 base year. The ERAs adjustments were made on the basis that certain expenditure items were not representative of efficient expenditure levels.

Of note are Business Development (BD) & Marketing expenditure and Staff Incentives.

BD & Marketing:

ATCO claims that although this level of expenditure is higher than historical trends, there has been a sufficient shift in its operating environment which warrants the additional expenditure[3]. ATCO also rejects the ERA's claim that this expenditure cannot be justified based on the benefit it would provide to consumers[4].

Kleenheat believes these statements and assumptions need to be challenged further. In particular whether or not, and if so, by how much, the operating environment has actually changed since AA4. Also as to whether the 'benefits' to consumers are in fact tangible.

It is Kleenheat's opinion that business development costs relating to investigating or developing new technologies should not be classed as conforming operating expenditure. Research and development expenditure of this type should not be funded through reference tariff revenue.

Staff Incentives:

ATCO has not accepted the ERAs adjustment for staff incentives. ATCO claims, among other things, that the ERA made an error in its calculation adjustment. ATCO claims the adjustment was in contradiction to another statement made elsewhere in the Draft Decision, which claimed the expenditure was in fact acceptable[5]. Because of this, ATCO has assumed no adjustment should have been made.

Kleenheat recommends that this assumption and approach be challenged. Although it appears some inconsistency exists, it should be determined whether the ERA's calculation adjustment is still justifiable.

3 AA4 Capital Expenditure

Kleenheat acknowledges the ERA's Draft Decision to reject a significant portion of AA4 capital expenditure on the grounds that ATCO were unable to adequately justify how this capital expenditure was conforming under the NGR.

Kleenheat raises concerns over ATCO's Revised Plan, which has rejected a significant portion of the ERA's amendments and urges the ERA to fully scrutinise the revised capital expenditure forecasts. Given this expenditure relates to the current AA4 period, there is a high likelihood the majority of this expenditure has already been incurred. ATCO is highly incentivised to ensure this expenditure is deemed conforming and forms part of the opening capital base for AA5. Otherwise, full recovery of this expenditure via future increased tariffs, is likely to be reduced.

In summary, the issues raised above all align with Kleenheat's aim to ensure that access to the GDS remains affordable for WA households and businesses, in order to allow for continued, healthy competition and growth in the WA natural gas market.

[3] ATCO AA5 Revised Plan, 12 June 2019, p 100, s. 9.4.2.2
[4] ATCO AA5 Revised Plan, 12 June 2019, p 101, s. 9.4.2.2
[5] ATCO AA5 Revised Plan, 12 June 2019, p 109, s. 9.4.2.4

Kleenheat would welcome the opportunity to discuss these issues further with the ERA.

For further information, or to discuss any of the points raised above, please contact Toby Devenish at tdevenish@kleenheat.com.au or 9312 9450.

Yours faithfully

[redacted]

Sarah York
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