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Economic Regulation Authority
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Draft decision on revisions to the access arrangement for the Mid-West and South-West Gas Distribution Systems and ATCO Gas 2025-29 Revised Plan

Alinta Sales Pty Ltd (**Alinta Energy**) is pleased to provide comment on the ERA's Draft Decision on ATCO's proposed access arrangement for the Mid-West and South-West Gas Distribution Systems for the five-year period from 1 January 2025 to 31 December 2029 (**AA6**) and on ATCO's response.

We note that the Draft Decision required some 30 amendments to be made by ATCO and that ATCO has addressed fewer than one-third of these in its Revised Plan.

We have limited our comments to a few key matters for the ERA's further consideration. Our primary concerns relate to:

- The proposed accelerated depreciation and its considerable size ($87.2 million), for which ATCO has not sufficiently demonstrated stranded asset risk and the justification for regulatory intervention;
- ATCO's B3 demand forecast, which is inconsistent with WA Government policy and consumer sentiment regarding gas usage;
- The tariff path proposed in the ERA Draft Decision, which would place an unreasonable burden on customers and retailers; and
- The proposed capital and operating expenditures, in particular the amounts related to ATCO's proposed spend for enabling renewable gases on its network.

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

Yours sincerely

Chris Campbell
Executive Director, Retail Markets
Alinta Energy

1 Demand forecasts

Alinta Energy considers the B3 (residential) haulage reference service demand forecast in ATCO's Revised Plan to be significantly underestimated, despite ATCO having updated its demand forecasts using actual consumption and connection data through to December 2023. As demonstrated in our previous submission in response to the ERA's Issues Paper, ATCO's systematic under-forecasting of gas demand for both AA4 and AA5 has returned ATCO considerably higher revenue than if forecasts had been more accurate.

Our points of disagreement with ATCO's revised B3 demand forecast can be grouped into two main reasons:

1) As outlined in our response to the ERA's Issues Paper, we consider that ATCO's forecast decline in demand for AA6 is inconsistent with the economic fundamentals affecting gas demand in WA. We have summarised our points of difference in section 1.1 below.
2) Methodological issues in ATCO's B3 demand forecast. Our key points in this regard are discussed in section 1.2.

1.1 Inconsistency of ATCO's B3 demand forecasts with WA economic fundamentals

In our response to the ERA's Issues Paper we discussed some of the key factors likely to have the highest effect on demand for natural gas in WA and our views on how these factors are likely to develop in the short-term i.e. the AA6 time horizon. Below, we have briefly summarised these points, refreshed with recent statistical data published subsequent to our previous submission.

Population growth: Population growth is a fundamental driver of natural gas demand. WA had the highest population growth rate of all Australian states and territories in 2023 at 3.3%, compared to a national average of 2.5%.[1] WA's population growth is forecast to remain positive through to at least 2036.[2]

Government policy: WA Government policy towards natural gas remains favourable. As acknowledged by the ERA, 'there are no government policies in place restricting natural gas connections'.[3] This is in stark contrast to policies in other jurisdictions such as Victoria, which has a comprehensive Gas Substitution Roadmap requiring that new homes be all-electric from 1 January 2024.[4] Additionally, the Australian Government's recently-released Future Gas Strategy notes that 'Under all credible net zero scenarios, natural gas is needed through to 2050 and beyond'.[5]

WA consumer sentiment: ATCO's own research has identified favourable attitudes towards gas among its current customers and communities in which it operates.[6] The recent customer survey conducted for the ERA by Patterson Research Group also provides valuable insights into consumer preferences and behaviours, indicating that a significant portion of customers would prefer to retain their gas appliances when considering end-of-life replacements. This

[1] Australian Bureau of Statistics, National, state and territory population, December 2023 | Australian Bureau of Statistics (abs.gov.au), June 2024, accessed 27 June 2024

[2] Department of Planning, Lands and Heritage, Western Australia Tomorrow Population Forecasts (www.wa.gov.au), March 2024, accessed 27 June 2024

[3] ERA, *Draft decision on revisions to the access arrangement for the Mid-West and South-West Gas Distribution Systems (Attachment 2: Demand)*, p. iii

[4] Victoria State Government, Victoria's Gas Substitution Roadmap (energy.vic.gov.au), accessed 27 June 2024

[5] Australian Government, Future Gas Strategy | Department of Industry Science and Resources, May 2024, pp. 4&42, accessed 27 June 2024

[6] ATCO Gas, *2025-29 Plan (Attachment 03.004A: Renewable Gas Delivery Strategy)*, p. 30

was especially the case for gas cooktops, with almost 70% of survey respondents indicating they would replace with gas and only 17% preferencing electric.[7]

1.2 Methodological issues in ATCO's B3 demand forecasts

Alinta Energy considers that there are several methodological weaknesses in ATCO's demand forecasting methodology. Below we summarise our views in this regard.

1.2.1 Use of econometric variables

In its Revised Plan, ATCO states that it has 'not forecast B3 demand using econometric variables, as ATCO and the ERA has (sic) recognised that using econometric (top-down) methodology does not allow for best forecast to be derived'.[8] However, this is a misleading representation of the ERA position as, in its Draft Decision, the ERA supports using a bottom-up approach 'because there are separate underlying drivers for forecasts for gross dwelling completions, gross new connections and disconnections which will allow a better forecast to be derived.'[9]

Consistent with the ERA, we also support using econometric variables in the demand model for B3 customers, including consumers' disposable income, gas price elasticity, weather data and other demographic and economic variables.

We believe a bottom-up approach is likely to yield a more accurate and detailed forecast than ATCO's approach because it analyses the specific components and behaviours within the customer base, rather than relying solely on aggregated historical data. ATCO seems to interpret the ERA's recommendation as suggesting that a bottom-up approach does not require the use of econometric variables. This has led ATCO to rely more on historical trends and scenario analyses without integrating the critical economic factors that affect gas consumption.

Connected to this point, ATCO states that it 'analysed econometric variables such as household disposable income and gas price elasticity. However, these were not incorporated into the consumption forecast as it was observed the impact was not large if most price sensitive customers receive Government support.'[10] We believe that it is fundamentally inaccurate to assume that econometric variables such as household disposable income and gas price elasticity can be excluded from ATCO's gas consumption forecast.

Excluding econometric variables from the forecasting model results in an overly simplistic and potentially inaccurate forecast. Incorporating these variables would provide a more robust and resilient forecast, better reflecting the dynamic economic environment and ensuring that demand projections are more reliable and responsive to actual market conditions.

1.2.2 Use of consumer survey results

We support using the consumer survey results conducted by the Patterson Research Group to inform the B3 demand forecast.[11] The survey results provide insights into consumer behaviour and preferences, which were then used to inform the ERA's demand forecasts and decisions.

There is no evidence indicating that ATCO has considered the results of this consumer survey in its demand forecast model. Using the results of the consumer survey provides an advantage

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[7] Patterson Research Group, March 2024, *Survey of ATCO Gas Residential Customers – Undertaken for the Economic Regulation Authority (ERA)*, p. 20

[8] ATCO Gas, *2025-29 Revised Plan*, p. 23

[9] ERA, *Draft decision on revisions to the access arrangement for the Mid-West and South-West Gas Distribution Systems (Attachment 2: Demand)*, p. 13

[10] *ATCO Gas 2025-29 Revised Plan*, p. 28

[11] Patterson Research Group, March 2024, *Survey of ATCO Gas Residential Customers – Undertaken for the Economic Regulation Authority (ERA)*

in that the results reflect the most up-to-date residential consumer preferences as to how they will consume gas in the future. This can help ATCO understand potential shifts in demand due to changing consumer preferences, such as the move towards electrification.

1.2.3 New customer connections forecasts

To determine new customer connection forecasts, ATCO did not use historical data as they consider 'Historical trends do not capture the current new housing market and the challenges that builders are facing in Western Australia due to increasing costs.'[12] Rather, ATCO has used the forecast housing commencements in WA developed by the Housing Industry Association (**HIA**) with a lag factor applied to derive dwelling completions.[13]

We make the following observations:

- HIA's forecasts are primarily focused on immediate market conditions and construction trends. While they do factor in economic indicators, they might not fully account for longer term population growth projections, especially in dynamic regions like WA, where population growth can significantly impact housing demand. If this is the case, there is a risk of underestimating future housing completions, thereby impacting ATCO's demand forecasts.
- HIA acknowledges the current challenges faced by builders, including rising costs and supply chain disruptions. While these factors are crucial for understanding near-term construction activity, they may not fully capture the anticipated recovery and expansion phases supported by government interventions or economic adjustments.
- While ATCO argues that historical data might not reflect current market conditions, completely discarding historical trends can be problematic. Ignoring historical data entirely is likely to lead to inaccuracies. Historical trends, adjusted for current conditions, can provide a more balanced perspective. Completely disregarding historical completions could mean missing out on cyclical patterns and long-term growth trends.
- ATCO has applied a revised flat forecast penetration rate of 71% over AA6 without considering gradual decline.[14] In contrast, the ERA's connection penetration rate starts at 80.56% and gradually declines to 78% over the AA6 period.[15] We believe that consumers' consumption patterns and their preferences regarding future gas consumption are critical to measuring a more realistic penetration rate. Ignoring the Patterson Research Group consumer survey results in this regard can result in missing valuable information, leading to the lower and flat penetration rates implemented by ATCO.

1.2.4 Disconnection rate forecast

We believe the electrification trend adopted by ATCO for AA6, which results in a significant jump in the permanent disconnection rate from an historical 0.36% to 0.46% from 2024, should be revised to reflect a smaller uplift, consistent with the historical rate of 0.36%.[16]

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[12] *ATCO Gas, 2025-29 Revised Plan*, p. 25

[13] CORE Energy, *Gas Demand Forecast Report (Attachment 0.5.101),* p. 46

[14] CORE Energy, *Gas Demand Forecast Report (Attachment 0.5.101),* p. 46

[15] ERA, *Draft decision on revisions to the access arrangement for the Mid-West and South-West Gas Distribution Systems (Attachment 2: Demand)*, p. 14

[16] CORE Energy, *Gas Demand Forecast Report (Attachment 0.5.101),* p. 33

Despite the increasing focus on reducing emissions, there is no evidence of a rapid shift from gas to all-electric appliances in WA households. Indeed, a recent investigation by Patterson Research Group into the rate of electrification in the new homes market indicates otherwise:

> This exercise has shown that the prospect for a material change in the balance between gas and electric energy usage in the new homes market over the AA6 period is remote. It is unlikely that there will be a material movement towards electric-only land developments without government intervention along the lines of the Victorian experience.[17]

1.2.5 Forecast rate of decline in consumption

We consider that ATCO's forecast rate of decline in consumption of 1.80% per annum per B3 customer, calculated as a weighted average of the consumption levels of both legacy and new customers, is too high.[18]

Legacy customers tend to show a decline in consumption over time, likely due to the replacement of older, less efficient gas appliances with newer, more efficient models or switching to non-gas alternatives. On the other hand, new customers tend to have stable consumption once the initial ramp-up period is complete. As the consumption of these two groups follows different patterns driven by various drivers, applying a uniform rate of decline to all customers oversimplifies the actual consumption behaviour, leading to inaccurate forecasts.

We believe the customer survey conducted by Patterson Research Group provides valuable insights into consumer preferences and behaviours, particularly regarding gas appliance replacement, as discussed in section 1.1. The survey results suggest that the rate of decline in gas consumption is likely to be slower than the rate ATCO has projected.

2 Tariff path

As articulated in our earlier submission on the ERA's Issues Paper, Alinta Energy considers the long-term stability in underlying network tariffs to be in the long-term interest of consumers and believes this can be achieved by applying a smaller step increase in 2025, followed by a smoother year-on-year increase over the remainder of AA6.

The ERA's Draft Decision provides a B3 (residential) customer tariff path whereby all of the real tariff increase is given effect in the first year of AA6, with the increases in remaining years consisting of CPI only and therefore holding the value of the tariffs constant in real terms. The effect of this is a 9.1% increase in the network component of an average B3 customer bill in real terms in 2025.[19] The ERA's reasoning for this tariff path includes that:

1) The one-off step price increase in the Draft Decision is more modest than in ATCO's original proposal. The ERA has noted that if this is going to be materially higher in the Final Decision then the ERA would use a real price smoothing approach.[20] We summarise our points of disagreement with this reasoning in section 2.1. We note also that even if the ERA's Final Decision is for only a small increase in ATCO's total revenue

[17] Patterson Research Group, *The potential for new housing developments to affect the rate of new gas connections and volumes over the AA6 Period*, June 2024, p. 6

[18] ERA, *Draft decision on revisions to the access arrangement for the Mid-West and South-West Gas Distribution Systems (Attachment 2: Demand)*, p. 3

[19] ERA estimate; *Draft decision on revisions to the access arrangement for the Mid-West and South-West Gas Distribution Systems, Attachment 3: Revenue and tariffs,* paragraph 57

[20] *Draft decision on revisions to the access arrangement for the Mid-West and South-West Gas Distribution Systems, Attachment 3: Revenue and tariffs,* paragraph 55

allowance compared to the Draft Decision, the B3 tariffs in the ERA's Final Decision will likely exceed the 11% percentage change threshold that the ERA has adopted.

2) The Patterson Research Group survey of ATCO residential customers commissioned by the ERA indicated that the preferred tariff path option among consumers surveyed is a one-off step increase of up to 11% followed by smaller increases for inflation only.[21] We summarise our points of difference regarding this reasoning in section 2.2.

We also disagree with an unsmoothed tariff path because of the unreasonable impact this would have on retailers. ATCO has acknowledged retailers' views on this point and has adopted a smoother price path over AA6 that distributes real tariff increases over AA6 more evenly than the ERA's approach.[22] We summarise our points in this regard in section 2.3.

The ERA has itself observed:

> All tariff path options would provide ATCO with a reasonable opportunity to recover its efficient costs and would not be inconsistent with promoting economic efficiency and minimising distortions to efficient pricing signals.[23]

Based on this and the reasons outlined below, Alinta Energy considers that a smoothed tariff path, rather than a path reflecting a steep one-off real increase in year 1 of AA6, would moderate impacts to both consumers and retailers, while preserving ATCO's opportunity to recover its efficient costs as set out under the National Gas Rules (**NGR**).

2.1 The connection between the quantum of tariff increases and the tariff path

Alinta Energy's view is that, aside from cases where forecast price increases are immaterial, the quantum of the increases should not be the main consideration in determining the tariff path.

The NGR mandate that the provisions of an access arrangement must be consistent with the National Gas Objective (**NGO**).[24] Under the NGO, the interests of consumers is paramount. A more gradual rate of increase provides consumers a better opportunity to adjust to price increases than a steep one-off increase at the start of the period.

The means with which consumers meet their day-to-day expenses (salary and income) generally increases gradually over time, rather than in sudden increments. Logically, then, spreading price increases over the access arrangement period will more likely give consumer cash flows a chance to "catch up" with their bill increases and better mitigate the impacts of these increases on those consumers. Consistent with Prospect Theory, consumers perceive losses more intensely than gains. A sudden large price increase is perceived as a significant loss, leading to greater dissatisfaction compared to smaller, gradual increases, which are easier for consumers to accept and adjust to.[25]

2.2 Validity of survey results on preferred tariff path

Alinta Energy does not consider that the customer survey results the ERA has cited in support of the Draft Decision tariff path sufficiently support that this tariff path would best serve consumer interests.

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[21] *Draft decision on revisions to the access arrangement for the Mid-West and South-West Gas Distribution Systems, Attachment 3: Revenue and tariffs,* paragraph 54

[22] ATCO Gas, *2025-29 Revised Plan*, pp. 37-38

[23] ERA, *Draft decision on revisions to the access arrangement for the Mid-West and South-West Gas Distribution Systems (Attachment 3: Revenue and tariffs),* paragraph 49

[24] *Western Australian National Gas Rules*, Version 12, 100 (1)(a)

[25] Kahneman, D. & Tversky, A., *Prospect Theory: An Analysis of Decision under Risk,* Econometrica, Volume 47, Number 2, March 1979 pp. 263-291

The question posed to surveyed respondents on their tariff increase preferences presented three options for the tariff path in AA6 and asked which option respondents would prefer:

> **Option 1:** 'One-off increase in the first year and constant prices for the remaining years (**least overall cost option over five-year period**)' (Alinta Energy emphasis). The tariff path presented in this option was an 'annual percentage change' of 11% in year 1, followed by 0% increases in years 2 to 5.
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> **Option 2:** 'The same percentage increase in prices each year (much lower percentage increase than first year of Option 1 but you will pay more over the five-year period)' i.e. a 3.5% increase in year 1 with 3.5% increases in years 2 to 5.
>
> **Option 3:** 'Some combination of options 1 and 2, which results in a higher increase in the first year/s and lower annual percentage increases thereafter (pay more than Option 1 but less than Option 2 over the five-year period' i.e. a 6% increase in year 1 with 2.5% increases in years 2 to 5.[26]

Whilst there was a preference for Option 1 as worded in the survey (41% of respondents, versus 28% and 20% for Options 2 and 3 respectively), we believe, and request the ERA to consider, whether the respondents would likely have chosen differently if the context for the options had been framed otherwise. As conceded in the survey report itself:

> The preference for option one is probably due to the reference to the "least overall cost over the five-year period", along with the relatively modest increase of just 11% in the first year.[27]

A more fulsome and accurate explanation of these options would have included that the present value of Options 2 and 3 (smoothed tariff paths) is the same as the present value of Option 1, as acknowledged by the ERA in the Draft Decision:

> The revenue recovered through tariffs would be greater in nominal terms for a price path that smoothed tariffs compared to a one-off increase, but the same present value of costs would be recovered.[28]

We do not agree with, and note that no corroborating evidence was provided for, the statement in the survey report that the respondents' choice of Option 1 could be because:

> Given the scale of cost increases experienced by households over the course of 2023 – 2024 the prospect of an 11% increase to a relatively modest gas bill, with a lower overall cost, is easy to choose.[29]

An increase of 11% would be considered significant by most consumers; when compared with the CPI inflation of 3.6% and the WA WPI (Wage Price Index) of 4.2% for the 12 months to March 2024, 11% is an outsized increase for any category of household expenses. [30]

2.3 Impact on retailers

In addition to being contrary to the interests of consumers, the Draft Decision tariff path places an unreasonable burden of price increases on retailers. Regulation 7(1) of WA's local gas

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[26] Patterson Research Group, March 2024, *Survey of ATCO Gas Residential Customers – Undertaken for the Economic Regulation Authority (ERA)*, pp. 28-29

[27] Patterson Research Group, March 2024, *Survey of ATCO Gas Residential Customers – Undertaken for the Economic Regulation Authority (ERA)*, p. 29

[28] *Draft decision on revisions to the access arrangement for the Mid-West and South-West Gas Distribution Systems, Attachment 3: Revenue and tariffs,* paragraph 50

[29] Patterson Research Group, March 2024, *Survey of ATCO Gas Residential Customers – Undertaken for the Economic Regulation Authority (ERA)*, p. 29

[30] https://www.wa.gov.au/organisation/department-of-treasury/wages, accessed 30 May 2024

access provisions sets out that the ERA must consider the impact on customers *and* retailers when making or approving an access arrangement:

> 7. Impact on small use customers and retailers to be taken into account
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> (1) When exercising a discretion in approving or making an access arrangement for a distribution pipeline the ERA must take into account the possible impact of the proposed reference tariffs, the method of determining the tariffs and the reference tariff variation mechanisms on –
>
> a) users to whom gas is or might be delivered by means of a small delivery service provided for in the access arrangement; and
>
> b) small use customers to whom gas is or might be delivered by those users.[31]

Under the *Energy Coordination (Gas Tariffs) Regulations 2000* there is no direct pass through of network tariff increases to customers, so implementing an uneven tariff path as set out in the Draft Decision would clearly have adverse implications for retailers. The WA Expert Consumer Panel has noted that 'if regulated retail prices are not changed to accommodate changes in ATCO's tariffs, it is retailers' margins that are compromised'.[32] In turn, consumers would be impacted as retailers moderate or even withdraw their competitive market offers. Since 2013, WA gas consumers have significantly benefited from the introduction of retail market competition through a larger choice of retailers offering a wider range of products and greater levels of discounting.

3 Accelerated depreciation

Alinta Energy acknowledges the ERA's comprehensive analysis of ATCO's proposed depreciation as presented in the Draft Decision. We are aligned with the ERA's view on ATCO's initial depreciation proposal that it "does not consider that ATCO's AA6 proposal is robust nor is it supported by a strong modelling methodology".[33]

While ATCO has subsequently submitted its Revised Plan, we retain our view that ATCO has not made the case that accelerated depreciation is justified. We also have significant concerns with the methodology applied by ATCO to estimate the proposed accelerated depreciation of $87.2 million.

Our points of contention with ATCO's proposal are twofold:

1) ATCO has not made the case that accelerated depreciation is justified based on the circumstances of the WA market. We expand on our views in this regard in section 3.1.
2) The modelling used by ATCO to underpin its proposed depreciation of $87.2 million has a number of methodological points that are not substantiated nor tested. These include the definition and weighting of scenarios, the "tilt function" and the general sensitivity of input variables which can significantly affect accelerated depreciation estimates. We request the ERA to examine these methodological points carefully in formulating its Final Decision. We expand on our views in this regard in section 3.2.

3.1 Level of stranded asset risk for gas infrastructure in WA

Alinta Energy supports the ERA's views that:

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[31] *National Gas Access (WA) (Local Provisions) Regulations 2009*

[32] WA Expert Consumer Panel, November 2023, *Submission to the ERA's Issues Paper About ATCO AA6 Proposed Access Arrangement,* p. 26

[33] ERA, *Draft decision on revisions to the access arrangement for the Mid-West and South-West Gas Distribution Systems (Attachment 6: Depreciation)*, p. iv

> The future of gas transmission and distribution networks cannot be assumed to be the same given the differing exposures to demand factors, customer types and market, technological and regulatory forces now and into the future.[34]

We note the similar view expressed by the Australian Energy Regulator (**AER**), emphasising the need for a case-by-case approach when quantifying stranded asset risk:

> In exercising our regulatory role in access arrangement reviews, we will carefully consider the surrounding circumstances of a regulated business to determine the materiality of the demand risk it faces and assess the efficiency and prudency of the measures it proposes to mitigate pricing risks.[35]

Alinta Energy considers that, whilst accelerated depreciation has been approved for application elsewhere, notably for a recent Victorian gas network access arrangement, there are several factors within WA that demonstrate less uncertainty than in other Australian markets and therefore a lower stranded asset risk. [36] Having considered these factors, we do not consider that the case for allowing accelerated depreciation of ATCO's network in AA6 has been substantiated.

The factors to which we refer are:

- A significantly more supportive policy environment for gas in WA. As the ERA has stated 'The future of gas is likely to be different in each Australian state and territory, given differing levels of government policy support'.[37] The policy environment for gas in WA is considerably more favourable than the policy environment in other states owing to:
    - WA's Domestic Gas Policy (**DomGas**), which requires the reservation of 15% of WA gas production for in-state consumption. The recent DomGas Inquiry noted that 'Western Australia has not experienced a shortfall of domestic gas since the Policy's inception, and the State has generally been spared the gas price and supply volatilities which have troubled the east coast'.[38] In other words, because of DomGas, wholesale gas prices in WA have historically been relatively low compared to in other Australian states and territories which lack similar policies and are therefore exposed to higher price levels and volatility.
    - An absence of policies explicitly seeking to limit the role of gas in WA's energy mix, as opposed to curbing emissions more generally. While WA has its own state-level decarbonisation goals, steps have not been taken, nor proposed, to pursue the curtailment of gas as its own end, unlike Victoria's Gas Substitution Roadmap and the ban on new residential gas connections in the ACT.[39]
- Markedly different short-term outlooks for demand. In the AER's recent decision allowing accelerated depreciation, the AER's final forecast of residential demand was for an approximately 15% decline in both total volume and total number of

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[34] ERA, *Draft decision on revisions to the access arrangement for the Mid-West and South-West Gas Distribution Systems (Attachment 6: Depreciation)*, paragraph 60

[35] Australian Energy Regulator, *Regulating gas pipelines under uncertainty: Information paper*, November 2021, p. ix

[36] Australian Energy Regulator, *Final decision: Australian Gas Networks (Victoria & Albury) Gas Distribution access arrangement 1 July 2023 to 30 June 2028,* June 2023

[37] ERA, *Draft decision on revisions to the access arrangement for the Mid-West and South-West Gas Distribution Systems (Attachment 6: Depreciation)*, paragraph 62

[38] Economics and Industry Standing Committee, *Report 7 Domestic Gas Security in a Changing World, Inquiry into the WA Domestic Gas Policy: Interim Report*, February 2024, p. ix

[39] This was given effect in the ACT by the *Climate Change and Greenhouse Gas Reduction (Natural Gas Transition) Amendment Act 2023*

connections.[40] In contrast, the ERA's Draft Decision forecast is for ATCO's B3 connections to increase by 1.35% over AA6, with a decline in total volume of less than 1%.[41] Thus the downward trajectory for gas demand in other states has not occurred in WA and is not predicted to occur in the shorter term. Structural factors such as the policy environment (described above) are also likely to support a stronger role for gas in WA than elsewhere in the longer term.

In summary, Alinta Energy does not consider that stranded asset risk for ATCO's network has been substantiated to warrant accelerated depreciation in AA6, neither through consideration of the circumstances of the network or ATCO's modelling exercise (further commentary is provided on ATCO's modelling below). We recommend that the ERA, to achieve a more optimal outcome, apply accelerated depreciation during a later access arrangement period if and when the case for accelerated depreciation is clearer. This would still provide the ERA plenty of scope to make the decision before the claimed "window of opportunity" is passed.

If, during the early years of AA6, it is identified by ATCO that accelerated depreciation can be justified, ATCO has the option under NGR 65(1) of submitting an access arrangement variation proposal to the ERA, which the ERA could consider managing through a subsequent adjustment to AA6 for the final years. Based on the 50-year period to asset stranding risk in 2074 calculated under ATCO's "electricity dominates" scenario, such an adjustment would have an inconsequential impact on the long-term financial impact to ATCO.[42]

3.2 Methodological points regarding ATCO's Future of Gas Model

As outlined above, Alinta Energy does not consider that stranded asset risk for ATCO's network currently warrants the application of accelerated depreciation. In addition, while ATCO's Revised Plan provides information on its methodology, we do not consider that it represents the "best forecast or estimate possible" for depreciation as required by the NGR.[43] However, should the ERA believe that some level of accelerated depreciation is justified in AA6, we request the ERA consider the following reservations and commentary on the modelling underlying ATCO's proposed accelerated depreciation amount.

3.2.1 Definition and weighting of scenarios

We maintain our strong concern with the definition and weighting of the Future of Gas scenarios underpinning ATCO's methodology. These are:

- The four scenarios do not represent a genuine and robust assessment of the future of gas in WA. They do not appear to have been based on the WA context and do not represent a complete or balanced set of viable outcomes, noting that the ACIL Allen report prepared for ATCO states that the four scenarios 'represent plausible futures but do not represent the complete set'.[44]
- Scenario probabilities should be provided and applied. The ACIL Allen report states that scenario weightings or probabilities were not used in deriving its conclusions or in

[40] Australian Energy Regulator, 2023, *Final decision: Australian Gas Networks (Victoria & Albury) Gas Distribution access arrangement 1 July 2023 to 30 June 2028 (Attachment 12 – Demand)* June 2023, p. 4

[41] ERA, *Draft decision on revisions to the access arrangement for the Mid-West and South-West Gas Distribution Systems (Attachment 2: Demand)*, p. 18

[42] ATCO Gas, *2025-29 Revised Plan*, p. 229

[43] *Western Australian National Gas Rules*, Version 12, rule 74 (2)(b)

[44] ACIL-Allen, *Future of gas: Scenario development and modelling for the ATCO gas distribution system*, June 2024, p. 47

developing its recommendations to ATCO. This is inconsistent with the AER's expectation regarding demonstrating stranded asset risk:

> To demonstrate stranded asset risk, we expect regulated businesses to provide plausible future energy scenarios that covers a spectrum of outlooks from the most pessimistic to the most optimistic for their networks, and to estimate the likelihood (probability) of each scenario. We expect regulated businesses to demonstrate the magnitude of stranded asset risk and possible divestment and investment plans under each scenario. In particular, to demonstrate the materiality of stranded asset risk and the justification for early regulatory intervention, we expect a regulated business to provide compelling evidence to identify:
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> - the factors that influence the estimates of expected economic lives, such as applicable government policies, evidence of their customers' sentiments in switching away from gas, developments in competing technology etc
> - those assets that may be repurposed for transporting hydrogen and those that cannot be
> - those assets whose economic lives may need to be adjusted to reflect the potential decline in long-term demand
> - the value of stranded assets under the different forecasting scenarios
> - the costs that may be avoided or incurred in the different forecasting scenarios
> - the level of customer support for the business's proposed action to manage the risk and the quality of that customer engagement
> - analysis of the price impact for the business's proposed action. [45]

3.2.2 General sensitivity of assumptions and input variables

We note the ERA's conclusion regarding ATCO's accelerated depreciation modelling that 'the amount of accelerated depreciation provided as a model outcome is extremely sensitive to a wide range of parameters'.[46] It is observed that, in some instances, the accelerated depreciation amount more than doubles or becomes negative due to relatively small input changes.[47]

ATCO's accelerated depreciation modelling is complex and involves a multitude of assumptions and parameters. Should the ERA consider that accelerated depreciation is justified in AA6, Alinta Energy requests the ERA carefully examine the robustness of the input assumptions for the modelling, particularly in light of the sensitivity of the final accelerated depreciation estimate and the appropriate allocation of forecast risk between ATCO and consumers. In particular, we offer comments on the tilt function incorporated into the revised modelling below.

3.2.3 Tilt function

We understand that the tilt function is a crucial variable in the accelerated depreciation model. It adjusts the depreciation rate applied to assets over their lifespan and is determinative of the rate at which depreciation is brought forward. ATCO's proposed accelerated depreciation amount is based on a tilt-value of 0.02, the selection of which value

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[45] Australian Energy Regulator, *Regulating gas pipelines under uncertainty: Information paper,* November 2021, p. 45

[46] ERA, *Draft decision on revisions to the access arrangement for the Mid-West and South-West Gas Distribution Systems (Attachment 6: Depreciation),* paragraph 153

[47] ERA, *Draft decision on revisions to the access arrangement for the Mid-West and South-West Gas Distribution Systems (Attachment 6: Depreciation),* paragraph 154

was a 'matter of judgement'.[48] Given the potential financial impact on consumers, we do not consider this to be a reasonable basis upon which to make such a decision.

In Alinta Energy's view, should an accelerated depreciation model be adopted by ATCO, the tilt-value should be kept low. A lower tilt-value would better balance the interests of ATCO (advancing depreciation to reduce asset stranding risk) with the interests of consumers and present-day retailers, who face the risk of depreciation charges being excessively front-loaded.

In terms of incentive effects, a lower tilt-value would also provide for network efficiency; as noted by the AER, 'Exposing regulated businesses to some stranded asset risk may be desirable to reduce discretionary network expenditures given the current levels of uncertainty'.[49]

4 Capital expenditure

Alinta Energy supports the ERA's Draft Decision forecast of ATCO's capital expenditure (**capex**) for AA6. The analysis detailed in the Draft Decision demonstrates a solid and thorough basis for the ERA's reductions to the forecast capex.

Alinta Energy does not consider that ATCO has sufficiently demonstrated that its subsequent revised proposals for AA6 capex meet the regulatory criteria for new capex.[50] Our most significant concern relates to ATCO's proposed spend for enabling renewable gases on its network. Our views in this regard are outlined in section 4.1. We also have some general remarks on the remainder of ATCO's proposed AA6 capex spend, outlined in section 4.2.

4.1 ATCO's proposed capex for enabling renewable gases

Alinta Energy objects to ATCO's proposed AA6 capex of $9.6 million for enabling renewable gases because we do not consider that this proposed capex satisfies the regulatory criteria for capex under the NGR, including consistency with the NGO.

Much of ATCO's offered justification for the proposed spend is that it aligns with the new emissions reduction element incorporated in the NGO subsequent to ATCO's initial proposal. However, having reviewed the information in ATCO's Revised Plan and considered this against the new NGO (and the regulatory criteria for capex), we maintain our view that this is not the case.

While the NGO has indeed incorporated an emissions reduction objective, it continues to define the long-term interests of consumers along multiple dimensions, including the price, quality, safety, reliability and security of supply of gas. These dimensions need to be balanced against each other and considered together; the emissions reduction component is not elevated above the other components of the NGO.

We consider that, due to the risk profile of renewable gases (and biomethane specifically), there isn't a reasonably probable expectation of attaining suitably high benefits for consumers (i.e., benefits that would justify the risks incurred) from the proposed capex in terms of price, quality, safety, reliability, security of supply or emissions reduction.

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[48] *ATCO Gas, 2025-29 Revised Plan*, p. 234

[49] Australian Energy Regulator, *Regulating gas pipelines under uncertainty: Information paper*, November 2021, p. 28

[50] *Western Australian National Gas Rules*, Version 12, rule 79

ATCO itself has acknowledged the risks associated with renewable gas, including biomethane. In its Revised Plan, ATCO has included a contingency amount in its proposed capex for enabling renewable gases, stating that this is because:

> Given the rapidly evolving technical standards and novelty of these programs, there is a higher likelihood of encountering unforeseen risks such as customisation of gate station design and specific location requirements, making the inclusion of contingency prudent.[51]

"Unforeseen risks" and the evolution of technical standards are common to most newer energy generation technologies (and technologies in general). Usually, as these technologies mature, undergo optimisation and travel the cost curve, the associated assets and technical standards are redesigned or respecified. Therefore, early adopters of newer technologies bear the risk of rapid obsolescence and turnover of assets connected to these new technologies. While ATCO has highlighted the need to proactively enable its network for transport of biomethane, we don't consider that there will be a first-mover advantage to consumers on ATCO's network from incurring capex for this purpose now, as opposed to adopting it later when the technology is more mature and competitive with other technologies.

As it stands, there are currently superior alternatives for consumers to reduce their total emissions from energy consumption. Among others, these include renewable energy sources which are more cost-effective and technologically proven than renewable gases, and abating emissions through the purchase of offsets. Given the relative merits of energy sources other than biomethane, including greater cost-effectiveness (both current and in terms of future outlook) and technological certainty, we do not consider that ATCO has proven that its proposed investments would benefit consumers. This includes providing greater choice for cost-effective emissions reduction, contributing to the realisation of government climate objectives, or other components of benefit the ERA is required to consider under the current NGO and capex criteria. Rather, given the current risk profile of renewable gases, the investments proposed are of a more speculative nature and, as such, the risks of these investments should not be underwritten by consumers.

4.2 ATCO's other proposed AA6 capex

In total, ATCO's revised proposal for AA6 capex is $490.7 million, which exceeds the ERA's Draft Decision amount for AA6 capex by $47.6 million and even exceeds ATCO's own initial proposal by $24.9 million. Much of these differentials arise due to differences in forecasts for certain large AA6 programs such as ATCO's mains replacement program, other assets replacement program, enabling renewable gases program (discussed above) and information technology program. We strongly recommend that the ERA applies suitable knowledge and assessment in evaluating the reasoning for, and costing of, all the proposed capex programs against the capex criteria and other relevant requirements of the NGR.

5 Operating expenditure

Alinta Energy has reviewed ATCO's revised proposals for AA6 operating expenditure (**opex**). One point of general concern is ATCO's systematic overforecasting of opex for previous access arrangement periods. Our views in this regard are outlined in section 5.1.

In sections 5.2 to 5.4 we outline the specific elements of ATCO's analysis and proposals for its AA6 opex forecast which we do not support. These are:

- Selection of 2023 as the base year;

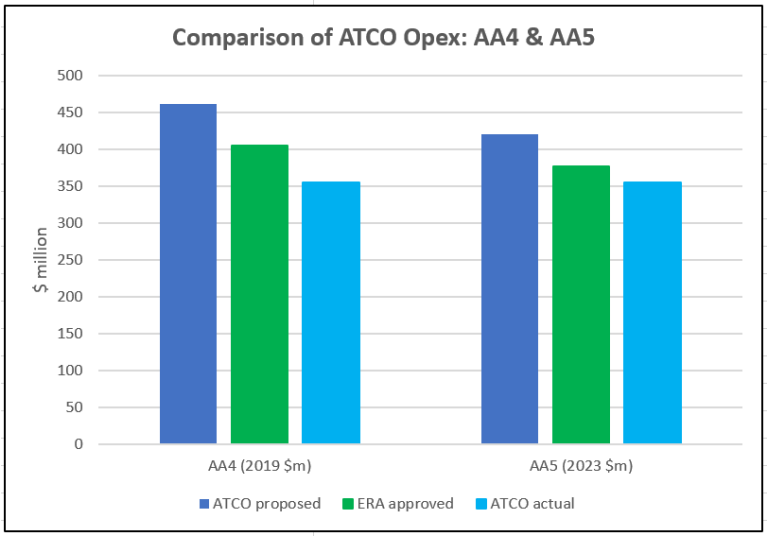
[51] ATCO, *2025-29 Revised Plan*, p. 84

- Proposed opex for ATCO's enabling renewable gases initiative; and
- The proposal to include a sector premium in the labour cost escalation forecast.

Many parts of the analysis underlying ATCO's proposed opex are not available to all stakeholders, including Alinta Energy. We trust the ERA will review this detail in assessing the proposed opex programs against the criteria for operating expenditure and other relevant requirements of the NGR.[52] As part of this, we also request that the ERA evaluate the level of reductions that should be applied to the AA6 opex forecast to reflect efficiencies gained from previous capex and opex spend.

5.1 Systematic overforecasting of opex

Alinta Energy has observed a systematic pattern of ATCO overforecasting its opex over time and underspending ERA allowances. As shown in the figure below, for both AA4 and AA5 ATCO's actual opex was significantly below its proposed and below the ERA's approved forecasts for those periods. Alinta Energy considers that this trend and the level of confidence that can be reasonably attributed to these forecasts should be taken into account in assessing ATCO's AA6 opex forecast.



5.2 Selection of 2023 as the base year

ATCO has updated its base year for forecasting opex from 2022 in its original proposal to 2023 in its Revised Plan because it is 'the most recent year of actual expenditure'.[53] While acknowledging the ERA's view expressed in the Draft Decision that 'the most recent full year of actual costs is an appropriate selection' for the base year, Alinta Energy maintains its view that this is not what the NGR require, nor what the base-step-trend forecasting method logically requires.[54] Rather, the most efficient year should be selected as the base year, balanced also against consideration of selecting a year that is likely to be reflective of future costs. This is the lowest cost year selected at a granular cost level where compliant operations

[52] *Western Australian National Gas Rules*, Version 12, rule 91

[53] ATCO, *2025-29 Revised Plan*, p. 125

[54] ERA, *Draft decision on revisions to the access arrangement for the Mid-West and South-West Gas Distribution Systems (Attachment 5: Operating expenditure)*, p. 9

occurred. Objectively, this would represent selection of a base year which best activates the efficiency incentivisation properties of the gas regulatory framework.

5.3 Proposed opex for ATCO's enabling renewable gases initiative

As outlined in section 4.1, we object to ATCO's proposed AA6 capex of $9.6 million for enabling renewable gases. Based on much the same reasoning and assessment against the regulatory criteria for capex, we also disagree with ATCO's proposal for $1.7 million of opex in AA6 for the same program.

As outlined, even with the inclusion of an emissions reduction criteria in the NGO, we do not consider that the enabling renewable gases initiative serves the best interests of consumers. This is due to the cost ineffectiveness and technological uncertainty of renewable gases (and biomethane specifically) relative to other renewables technologies. As a result, renewable gases (including biomethane) do not currently represent an efficient method for cost-effective emissions reduction (either for consumers or for ATCO's UAFG), for contributing to the realisation of government climate objectives, or for other components of benefit the ERA is required to consider under the current NGO.

For the same reasons, we don't consider that the opex proposed for the enabling renewable gases program would be incurred by a prudent service provider acting efficiently and in accordance with accepted good industry practice. The proposed opex therefore does not satisfy the criteria governing operating expenditure set out under the NGR.

We note that $0.6 million of the proposed opex for the enabling renewable gases programs is for the purchase of Australian Carbon Credit Units (**ACCUs**) to 'support ATCO's emissions reduction targets' and to ensure ATCO has 'improved access to investors and financiers'.[55] We make the following comments on these reasons respectively:

- ATCO is not and will not be subject to the Safeguard Mechanism during AA6 and therefore will not be required to purchase ACCUs or to mitigate its emissions from current levels under the Safeguard Mechanism.[56]
- ATCO's regulatory rate of return on capital is established via the methodology in the ERA's Rate of Return Instrument.[57] Due to current market conditions, the rate of return ATCO will receive on its regulatory asset base in AA6 is significantly higher than the rate in AA5. Under the methodology in the Rate of Return Instrument, network service providers' costs of capital are set according to rates of return on debt and equity capital set by reference to benchmarked 'efficient' funding costs for these two components of its capital base. Should a provider be able to attain a cost of funding lower than its regulatory rate of return, it is essentially able to 'keep the difference'. Alinta Energy does not consider that consumers should underwrite the costs of improving the terms of ATCO's access to finance when consumers do not share in the savings stemming from those reductions in financing costs. We also note that a reduced cost of finance would benefit the profitability of ATCO's non-regulated business, however it is unclear if ATCO is proposing to allocate a portion of its ACCUs cost to its non-regulated business.

5.4 Proposed sector premium

ATCO has maintained its initial proposal to include an Electricity, Gas, Water and Waste Services (**EGWWS**) sector premium of 0.37% in the labour cost escalation for its opex forecast. We do not agree with this proposal and consider the ERA's decision to not include a sector

[55] ATCO Gas, *2025-29 Revised Plan*, p. 159

[56] Safeguard Mechanism - DCCEEW accessed 4 July 2024

[57] ERA, *2022 final gas rate of return instrument,* December 2022 (amended September 2023)

premium has a sound basis. Whilst we acknowledge that WA has faced a tight labour market in recent years, as ATCO itself has noted there has been some degree of 'labour market stabilisation' which has contributed to efficiencies in some of its opex programs in 2023.[58] Further, and as acknowledged by ATCO, the EGWWS premium has reduced over time.[59] Alinta Energy therefore does not consider it appropriate to apply an EGWWS sector premium in the labour cost escalation for ATCO's AA6 opex forecast.

6 Summary

Alinta Energy requests the ERA to closely review the following elements of ATCO's Revised Plan before making its Final Decision on AA6:

- ATCO has not made the case that accelerated depreciation is justified. There are several factors within WA that demonstrate less uncertainty than in other jurisdictions where accelerated depreciation has been approved, most notably that the policy environment for gas in WA is considerably more favourable than elsewhere.
- We consider that if, during AA6, ATCO identifies that accelerated depreciation can be justified, ATCO should activate the option under the NGR of submitting an access arrangement variation proposal to the ERA. The ERA should require ATCO to demonstrate the magnitude of stranded asset risk and the justification for early regulatory intervention under a range of plausible future energy scenarios, similar to the evidence expected by the AER as noted in section 3.2.1.
- ATCO's forecast decline in demand is inconsistent with the economic fundamentals affecting gas demand in WA, where Government policy towards natural gas remains favourable and consumer sentiment for retaining household gas appliances is strong.
- The methodology applied by ATCO to derive its B3 demand forecast does not appear to have used demographic and econometric variables, which would provide a more robust forecast that better reflects the current economic environment. In particular, the use of survey results that provide insights into consumer behaviour and preferences regarding future gas consumption are critical to determining penetration rates.
- Despite the increasing focus on reducing emissions, there is no evidence of a rapid shift from gas to all-electric households in WA. The permanent disconnection rate adopted by ATCO for AA6 should be revised downward accordingly.
- The consumer survey commissioned by the ERA results suggests that the rate of decline in gas consumption might be slower than the 1.80% per annum per B3 customer projected by ATCO.
- We consider that a smoothed tariff path, rather than a path reflecting a steep one-off increase at the start of AA6, would moderate impacts to both consumers and retailers, while preserving ATCO's opportunity to recover its efficient costs as set out under the NGR. Implementing an uneven tariff path as set out in the ERA's Draft Decision would place an unreasonable burden on retailers in the current regulatory environment, where there is no direct pass through of network tariff increases to customers. In turn, consumers would be impacted as retailers act to moderate their competitive market offers.
- We do not consider that ATCO has sufficiently demonstrated that its revised proposals for AA6 capex meet the regulatory criteria for new capex. In particular, we do not

[58] ATCO, *2025-29 Revised Plan*, p. 147

[59] ATCO, *2025-29 Revised Plan*, p. 184

consider ATCO's proposed spend for enabling renewable gases on its network satisfies the regulatory criteria for capex under the NGR or that it is consistent with the NGO.

- For previous access arrangements, ATCO's actual opex was observed to be significantly below the ERA allowances. This trend should be taken into account in assessing ATCO's AA6 opex forecast. Additionally, the ERA should review whether it is appropriate to select 2023 as the base year, or whether another year would be considered more efficient.