9 July 2024

Mr Tyson Self
Economic Regulation Authority
4th Floor Albert Facey House
469 Wellington Street
Perth 6000

Via email: publicsubmissions@erawa.com.au

**Expert Consumer Panel members Noel Schubert, Chris Alexander and Luke Skinner's submission on the ERA's Draft Decision and ATCO Gas' revised access arrangement for the Mid West and South West Gas Distribution Systems.**

Dear Mr Self,

Thank you for the opportunity to make a submission in response to ATCO Gas' revised AA6 proposal and the matters raised in the Economic Regulation Authority's (ERA) Draft Decision.[1]

The WA Expert Consumer Panel (ECP) is supported by the State Government's Western Australian Advocacy for Consumers of Energy (WA ACE) grant funding, to engage in consumer advocacy and contribute to major decision making in the sector.

As we set out in our December 2023 submission to the ERA's Issues Paper, network costs are a significant contributor to energy bills. Households and businesses are relying on WA's energy network providers, like ATCO Gas, to deliver a smart and efficient strategy in a time of transformative change. The submission went on to identify issues in four key areas in ATCO Gas' proposal that needed to be addressed to bring it into alignment with the long term interests of Western Australian household and small business consumers. Specifically:

1. Insufficient evidence in the proposal that recovering from consumers the costs of renewable gas blending will promote efficient investment in and use of services.
2. Overly optimistic forecasts of its customer base from 2025 to 2029, and in particular, its forecasts of new connections to and disconnections from the network.
3. Concerns that accelerating depreciation shifts too much of the risk of asset stranding onto consumers and away from ATCO and its shareholders; and
4. Disagreed that ATCO's proposed step increase in tariffs from 2024 to 2025, and the two-tiered usage charge, promote efficient use of the gas distribution network, nor is the latter consistent with meeting emissions reduction targets.

[1] https://www.erawa.com.au/gas/gas-access/mid-west-and-south-west-gas-distribution-systems/access-arrangements/access-arrangement-for-period-commencing-2025

The focus of our review has been to assess how the revised proposal and the Draft Decision engage with these issues. The ERA's draft decision reduces the total revenue to be recovered from consumers by $234m compared to what ATCO Gas sought in its proposal, which the ECP welcomes given the acute financial pressure Western Australian households and small businesses are under. However, we believe that there are significant further efficiencies that can and must be found given that even under the ERA's draft decision, the costs passed through to retailers are to increase by 12.5% in January 2025, and at the rate of inflation for the remaining years of the period.

Our contribution is informed by a review by TRAC Partners, included at **Attachment A**, who have deep expertise in best practice regulation of monopoly gas networks, including in relation to the forecasting, depreciation, pricing and other matters that are in contention. The TRAC Partners review identifies a set of material outstanding issues with the revised proposal which in the ECP's view would need to be addressed for it to align with the long term interests of consumers and be capable of acceptance.

Members of the ECP recognise that the challenging economic environment, particularly higher interest rates, as well as the costs of labour and materials, puts upward pressure on the costs of maintaining and running gas distribution businesses. The critical need to transition away from gas to renewables to reduce emissions also looms over access arrangement processes. What the TRAC Partners review makes clear however, are a range of ways by which risks and costs could be more effectively managed to reduce the impact on consumers, mitigating the need to, for example, recover tens of millions of dollars of future costs from households and businesses over the period.

We would be pleased to provide any further information to support this submission and to engage with the ERA and ATCO Gas as the process continues. TRAC Partners are also available to discuss its high-level findings with the ERA and ATCO Gas if that would be helpful.

Yours sincerely,

WA Expert Consumer Panel members Noel Schubert, Chris Alexander and Luke Skinner[2]

**Attachments A** - Review of ERA draft decision on ATCO Gas' revised proposal for 2025-29, TRAC Partners

[2] Of note is that from the 1st July 2024 the ECP membership was updated, with two members joining the Panel. Given the timing, these new members have not contributed to this submission, with the content representing the views of the ECP members whose membership carried over from last financial year. .

# Technical Report: Response to ERA Draft Decision & ATCO Gas' Revised Access Arrangement #6 Proposal - 2025-29

**Prepared by**

***Date: 8/07/2024***

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# 1. EXECUTIVE SUMMARY

This report has been prepared by TRAC Partners for the purposes of being submitted to the Economic Regulation Authority (**ERA**) in response to both the ERA's draft decision (**ERA DD**) on ATCO Gas Australia's (**ATCO**) proposed access arrangement for 2025 to 2029 (**Initial AA6 Proposal**) and ATCO's proposed revised Access Arrangement that it submitted in response to the ERA DD (**Revised AA6 Proposal**)[1].

In preparing this report, we engaged with the WA Expert Consumer Panel (**ECP**)[2] which made a submission in response to ATCO's Initial AA6 Proposal.

Notwithstanding the above, the views expressed in this report do not necessarily reflect the views of the Government of Western Australia, DEMIRS, Energy Policy WA or the WA Expert Consumer Panel.

## Aspects of ATCO's Revised AA6 Proposal that need further refinement to be in Consumers' Long-Term Interests

Central to the ERA's role in assessing the Revised AA6 Proposal is to ensure that it is consistent with the National Gas Objective[3] (NGO). In that regard, the access arrangement that the ERA approves for AA6 must promote efficient investment in, and efficient operation and use of, gas services for the long-term interests of gas consumers with respect to both of the following limbs:

- price, quality, safety, reliability and security of supply of gas; and
- the achievement of targets for (or which are likely to contribute to) reducing greenhouse gas emissions.

Based on the information submitted by ATCO in support of its Revised AA6 Proposal, is our view that there are several aspects of the Revised AA6 Proposal that need to be modified so that the access arrangement as a whole can be considered to be in the long-term interests of gas consumers and therefore consistent with the National Gas Objective.

Firstly, the level of the overall increases being proposed in both the total revenue and reference tariffs are unlikely to promote efficient use of gas services for the long-term interests of gas consumers with respect to at least the first of the above limbs in the NGO. Both the ERA DD and ATCO's Revised AA6 Proposal, if implemented, would result in significant increases in:

- the total revenue allowed over the AA6 period; and

[1] This project was funded by the Government of Western Australia (Energy Policy WA) as part of its grants process for consumer advocacy projects and research projects for the benefit of consumers of electricity and gas.

[2] The ECP is a part of the WA Government's WA Advocacy for Consumers of Energy Program. It has been established to assist interested WA consumers contribute to public consultations and rule making processes. Further details about the ECP can be found here.

[3] Rule 100, NGR. The ERA has advised that it has elected to assess the Revised AA6 Proposal against the version of the NGO that became law earlier in 2024.

- the level of the distribution charge component of an average B3 residential tariff customer's retail tariff in 2025 (when compared with the level of that same component payable by the average B3 residential tariff customer in 2024).

While it is acknowledged that a large proportion of these increases (relative to current AA5 levels) is driven by changes in the values of market derived parameters used in the rate of return calculation and in the value of inflation, the overall increases are being proposed in a context where consumers are currently facing significant cost of living pressures. The cost of energy is a significant driver of those pressures, particularly for vulnerable consumers. As acknowledged by the WA Council of Social Service, the cost of energy disproportionately impacts households on the lowest incomes, as they spend a significantly higher percentage of their disposable income on energy bills and have little, if any, capacity to absorb additional costs[4].

Given this current context, the fact that these changes in market parameters alone are driving such significant increases means that every effort should be made to look at ways to offset these causes of price increases and to limit other drivers that increase the level of both the total revenue and reference tariffs.

This needs to be addressed in order to have more confidence that the Revised AA6 Proposal is consistent with the NGO.

While the analysis undertaken by ATCO and the ERA indicate that consumers are generally in support of initiatives that are aimed at transitioning to a decarbonised economy, any transition should be undertaken in an orderly manner and not in a way that causes undue financial hardship for consumers (either today or in the future), particularly consumers with vulnerabilities who are not able to themselves choose the timing for their transition away from the use of natural gas. Causing undue financial hardship for consumers today will not be in either their short, or long-term, interests.

The second aspect of the Revised AA6 Proposal that should be modified in order for it to be in consumers' long-term interest is with respect to some of the building blocks used to determine the Total Revenue in the Revised AA6 Proposal. It is our view that the following aspects of the Revised AA6 Proposal need to be modified in order to be able to best promote efficient use of gas services for the long-term interests of gas consumers with respect to either of the above limbs in the NGO:

- the proposal to include an amount of $87.2m for accelerated depreciation;
- the level of actual and forecast capital expenditure to be included in the proposed capital base; and
- the level of forecast operating expenditure during AA6.

The third aspect of the Revised AA6 Proposal that should be modified in order for it to be in consumers' long-term interest relates to the following aspects of the reference tariff setting framework in ATCO's Revised AA6 Proposal:

[4] Graham Hansen and Emily Hull, Cost of Living 2023, Western Australian Council of Social Service (Report, 2023)

- the proposed level of the 2025 reference tariff (given the significant step change from the level of the 2024 reference tariff) and the proposed tariff path (CPI + 3%) for each remaining year of AA6.
- the forecast demand, particularly in relation to the rate of disconnections; and
- the proposal to continue with declining block tariff structures for each of the reference tariffs other than the B3 reference tariff.

Table 1 summarises the key aspects of ATCO's Revised AA6 Proposal which we believe need to be modified before they can be considered consistent with the long-term interests of consumers and therefore consistent with achieving the National Gas Objective. This report contains reasoning in support of these conclusions and recommendations.

**Ineffective consumer engagement has occurred to substantiate what is in the consumers' long-term interests**

While the NGR and NGL do not prescribe the extent of consumer engagement that must be undertaken by a service provider in the development of its access arrangement proposal, it is well established that effective consumer engagement is critical component in being able to identify proposals for inclusion in an access arrangement proposal that can then be substantiated as being consistent with the NGO.

Based on discussions with the ECP, it would appear that ATCO needs to undertake engagement more effectively with consumers on some of the more important provisions of its Revised AA6 Proposal – particularly in relation to:

- the proposal to include $87.2 million for accelerated depreciation in the provisions on depreciation;
- the proposed starting reference tariffs for 2025 and the tariff path for each of the remaining years of AA6;
- the level of actual and forecast capital expenditure to be included in the proposed capital base;
- the level of forecast operating expenditure during AA6; and
- the forecast demand, particularly in relation to the rate of disconnections.

This is addressed in more detail in section 2 of this report.

**Failure to consider some of the Expert Consumer Panel's initial submissions.**

Finally, our analysis indicates that there were a number of points raised in the ECP's initial submission made in response to the Initial AA6 proposal and the ERA's Issues Paper that were not addressed by the ERA in its DD. ATCO also does not appear to have specifically addressed most of these points in its Revised AA6 Proposal.

As a matter of fair process, we recommend that the ERA explicitly address them in the final decision given that the points raised are equally relevant to the Revised AA6 Proposal. This is dealt with in section 10 of this report.

**Table 1: Key aspects of ATCO's Revised AA6 Proposal**

| Element of Revised AA6 Proposal | In consumers' long-term interests | Key Findings |
|---|---|---|
| Accelerated Depreciation | No | We are of the view that ATCO's Revised AA6 Proposal to include an amount of $87.2m of accelerated depreciation should be removed from the AA6 by the ERA for a number of reasons:<br>- the ERA and ATCO should follow and apply the criteria established by the AER in its information paper and used in other gas distribution network access arrangements as the proxy test for allowing accelerated depreciation.<br>- The ERA DD focused on assessing whether there has been an increase in the risk of declining usage of natural gas as the justification for allowing accelerated depreciation, rather than whether there has been an increase in the risk of asset stranding. An increased risk in declining usage of natural gas, of itself, does not mean there is an increased risk in the service provider's ability to recover its capital, particularly if there is a possibility that the asset could be used to haul other commodities (such as renewable gases - eg hydrogen and biogas – on their own or combined with natural gas). While ATCO's Revised AA6 Proposal focuses on assessing whether there has been an increase in asset stranding risk, the evidence it submits is the same as the evidence it used to claim only an increase in the risk of declining demand.<br>- ATCO has not assessed whether specific parts of the network are more exposed to an increase in the risk of reduced demand – instead it has assumed that the entire network will be exposed to the increased risk at the same rate and degree. This is important given that ATCO proposes to recover accelerated depreciation uniformly across all pipeline assets. |

| Element of Revised AA6 Proposal | In consumers' long-term interests | Key Findings |
|---|---|---|
| | | - Both the ERA and ATCO should have assessed whether other aspects of the Revised AA6 Proposal warrant a change in approach if there has been an increased risk in asset stranding such as:<br>○ adjusting the approach to maintenance, repair and operation of the network that determines the level of capital and operating expenditure required – instead continuing with a "BAU" approach, notwithstanding the recognition that asset lives are expected to be shorter;<br>○ expansion and augmentation of the network – ATCO is continuing to propose expansion of the network and to seek to recover a significant portion of the costs associated with that expansion from existing customers (rather than solely from the new customers).<br>- there should also be consideration given by the ERA or ATCO to implementing other regulatory tools available to manage the perceived increased risk of reduced gas demand (either in lieu of or in combination with accelerated depreciation) rather than just relying solely on accelerated depreciation. Other tools include:<br>○ adjusting the tariff structure for each of the reference tariffs;<br>○ assessing the extent to which the cost of debt allowance already has factored into it the risk of asset stranding, particularly in respect of long-term debt; and<br>○ requiring customers who are forecast to be new connecting customers during AA6 to pay for the cost of the new connections (rather than smearing most of these costs across all customers; |

| Element of Revised AA6 Proposal | In consumers' long-term interests | Key Findings |
|---|---|---|
| | | - There has been no consideration given to non-network solutions to avoid or reduce the level of forecast capex required to augment the existing network; and<br>- Further stakeholder engagement should be undertaken by ATCO and the ERA before consideration is given to allowing accelerated depreciation.<br><br>And even if an amount for accelerated depreciation were to be allowed, consideration should be given to:<br>- including a mechanism whereby some of the funds from this earlier recovery of capital are retained for the purposes of ensuring there is funding available to fund future operations, repairs and maintenance and sustaining capex that is needed at a point in time where the service provider may not be incentivised to provide the funding itself;<br>- capping the amount of accelerated depreciation that does not give rise to an unacceptable price shock; and<br>- ensuring the recovery of the accelerated depreciation is weighted more so towards the end of the AA6 period (as outlined in the initial submission of the Energy Consumers Panel).<br><br>See section 3 for more detail. |
| Depreciation Schedule | Largely, yes | The ERA should check that the asset lives adopted by ATCO are consistent with regulatory precedent. There doesn't appear to be any reason why asset lives should differ from asset lives adopted for east coast networks for comparable asset categories. There appears to be at least one asset category that is not consistent. See section 4. |

| Element of Revised AA6 Proposal | In consumers' long-term interests | Key Findings |
|---|---|---|
| Rate of Return | Largely, yes | While ATCO has adopted the ERA's methodology outlined in its rate of return instrument, the values for key elements that are market derived values will need to be updated in time for the final decision. |
| Actual AA5 Capital Expenditure | Largely, yes | We support ATCO's proposal to remove capex associated with renewable gas readiness and to cover contingencies for projects to be incurred in 2024 (although it is noted that not all contingency accounts have been removed).<br><br>We do, however, believe that the additional information provided by ATCO to substantiate the network sustaining capital expenditure program and the IT program warrant further consideration by the ERA.<br><br>See section 5. |
| Forecast AA6 Capital Expenditure | No | See section 6. We have identified a number of issues with the proposed forecast capital expenditure, at a general level and also in respect to the following discreet items of forecast expenditure:<br><br>- Mains and Meters Replacement<br>- Enabling Renewable Gases<br>- ERP Replacement<br>- Network Growth |
| Forecast Operating Expenditure | No | The approach in relation to the forecast input price growth rate is dealt with in section 7. |

| Element of Revised AA6 Proposal | In consumers' long-term interests | Key Findings |
|---|---|---|
| Demand | Partly | Given the uncertainty of demand forecasts (relative to those adopted for AA5), regard should be had to the inclusion of a trigger event mechanism. See section 8. |
| Reference Tariff Matters | Partly | We believe the ERA should consider the revised proposals relating to the tariff path, the tariff structure for the haulage service and the permanent disconnection service and the reference tariff variation mechanism. See section 9. |

## 2. EFFECTIVENESS OF CONSUMER ENGAGEMENT

Before commenting on specific elements of ATCO's Revised AA6 Proposal, this section deals with how ATCO has addressed, in the Revised AA6 Proposal, the ERA's criticisms in the Draft Decision concerning ATCO's stakeholder engagement process.

The ERA commented that "participants did not have a sufficient understanding of the implications of many investment strategies and that they were ill equipped to make judgments that the customers were being asked to make in relation to aspects of ATCO's Initial AA6 Proposal"[5].

Effective stakeholder engagement is relevant in two respects.

Firstly, in the case of ATCO's initial proposal to include an amount of $80 million for accelerated depreciation in its Initial AA6 Proposal, ineffective stakeholder engagement was one of the reasons for the ERA's rejection of this particular proposal[6].

Barring any fundamental flaw in the ERA's reasoning for concluding that ATCO's stakeholder engagement in connection with accelerated depreciation was ineffective, ATCO would need to have undertaken more detailed and effective stakeholder engagement on any revised modelling work relied on in support of any amount of accelerated depreciation it proposes to include in its Revised AA6 Proposal.

Section 3.3 of ATCO's revised plan (submitted in support of its Revised AA6 Proposal) seeks to challenge the veracity of the ERA's criticisms of its stakeholder engagement methodology. But then ATCO concedes that the future engagement program that it will develop to provide informed feedback to ATCO's AA7 deliberations will incorporate the ERA's criticisms into the design of ATCO's future engagement program. It seems that ATCO has acknowledged the veracity of the ERA's criticisms in the draft decision.

With that in mind, ATCO has not:

- changed its approach to stakeholder engagement when it comes to the revised proposal to continue to pursue accelerated depreciation; and
- engaged with anyone representing the major user group on the network – residential consumers.

Section 3 of ATCO's Revised Plan document submitted in support of its Revised AA6 Proposal states that while ATCO has engaged with selected industrial consumers (representing about 17% of the demand on the network) and retailers before submitting its revised proposal, ATCO opted not to engage residential consumers during this time. Instead, it has committed to developing an ongoing strategic stakeholder engagement program to shape ATCO's business plans and decisions going forward that will provide informed feedback to the AA7 deliberations (see 3.4 Ongoing Engagement of the Revised Plan).

[5] This was a criticism that was also explicitly made by the Expert Consumer Panel in its submission to the ERA in response to ATCO's Initial AA6 Proposal

[6] The ERA rejected ATCO's accelerated depreciation proposal due (in part) to the lack of effective stakeholder consultation in respect of the modelling methodology and the approach ATCO followed to justify including this amount.

Given the above, it follows that the ERA should continue to reject any claim for accelerated depreciation in the Revised AA6 Proposal.

The second relevant respect associated with stakeholder engagement is a more general point. The NGL and NGR require that there are specific factors that the ERA must consider when performing its statutory function of assessing an AA Proposal (for example, the National Gas Objective and the Revenue and Pricing Principles, among other factors). The ERA cannot acquit itself of its statutory function solely by relying on the service provider claiming that its AA Proposal is a direct reflection of customers' preferences. While the customer engagement undertaken by ATCO in the lead up to its Initial AA6 Proposal is important in understanding what might be in the long-term interests of consumers, the direct outcomes from that engagement process should not, in themselves, be taken as a proxy for what are the consumers' long-term interests. There are several matters relevant to determining what is in the consumers' long-term interests.

In light of this, the stakeholder engagement undertaken by ATCO should be put into its proper context having regard to the statutory framework that is to be applied by the ERA in assessing proposals - it is an important consideration in assessing what is in the consumers' long-term interests, but it is only one of many considerations that must be taken into account by the ERA.

# 3. ACCELERATED DEPRECIATION

## ERA Draft Decision

In the ERA DD, the ERA has agreed in-principle that accelerated depreciation is a reasonable regulatory tool to manage the potential for reducing levels of customer demand. However, the ERA decided that ATCO's claim in the Initial AA6 Proposal to include $80 million of accelerated depreciation in the total revenue calculation for the AA6 period was not robust, nor was it supported by a strong modelling methodology. So, the ERA did not accept any amount of accelerated depreciation and indicated that ATCO would need to undertake further consultation before an amount of accelerated depreciation would be allowed.

## ATCO's Revised AA6 Proposal

ATCO's Revised AA6 Proposal:

- does not accept the ERA amendment in the Draft Decision to remove proposed accelerated depreciation; and
- proposes a revised amount of accelerated depreciation of $87.2m in AA6.

The amount of accelerated depreciation being claimed has been supported by:

- a revised accelerated depreciation model that, according to ATCO, addresses the requirements of the ERA DD; and
- a scenario analysis that it claims demonstrates that a significant asset stranding risk is apparent in two of the four Future of Gas scenarios.

## TRAC's Submissions

There are several aspects of both the ERA's reasoning in the ERA DD and in ATCO's Revised AA6 Proposal in relation to accelerated depreciation which are dealt with in this section of the report. They are:

- The importance of ensuring that there is consistency in the approach taken by regulators under the NGL and NGR when assessing whether accelerated depreciation should be allowed as a matter of principle and in determining any amount of accelerated depreciation that should be allowed.
- The focus should be on assessing whether the risk of asset stranding has increased sufficiently rather than on whether the risk of declining usage of gas has increased in order to decide whether accelerated depreciation should be allowed as a matter of principle.
- The adequacy of the demand scenarios analysis, including the pricing assumptions for gas into the future.
- Whether accelerated depreciation should be the only measure used to address the alleged increase in risk.
- The extent to which the forecast capex / investment profile is limited (ie limited growth/expansions and limited new connections or significantly reduced replacement and non-network capex/opex).
- Whether maintaining the status quo is not an appropriate default option.
- Whether there are other measures already included in the Revised AA Proposal to adequately cater for any increase in risk.
- Whether there has been adequate stakeholder consultation by ATCO in connection with its proposal for accelerated depreciation.

### *1. Consistency in regulatory approach to determine whether accelerated depreciation be allowed as a matter of principle and if so, any amount of accelerated depreciation*

While it is noted that the ERA DD did not allow any amount for accelerated depreciation, the ERA acknowledges that accelerated depreciation is accepted as a matter of principle in the current circumstances. In reaching this conclusion (ie that it should be allowed as a matter of principle), the ERA appears to have applied only one criterion – whether there has been a sufficient increase in the risk of a decline in the use of gas on the network since AA5.

This is a markedly different approach to that adopted by the AER in its recent determinations for access arrangements under the NGR and as set out in the AER's information paper released in connection with investing in uncertainty[7].

The AER has, in these recent decisions and in its information paper, set out the criteria to be met by a service provider before accelerated depreciation would be allowed as a matter of principle. They are:

- Criterion #1 - There is evidence that stranded asset risk has increased.
- Criterion #2 - Reliable and reasonable scenarios showing a spectrum of demand outlooks need to be undertaken and an estimate of the likelihood of each scenario should be assessed and modelled.
- Criterion #3 - There is evidence of pricing risk – i.e. capacity of future users to pay for higher prices as a result of deferring accelerated depreciation.
- Criterion #4 - Consideration should be given to the capacity of today's consumers to pay higher prices if accelerated depreciation is introduced now, particularly when it is coupled with the impact of rising inflation and interest rates.
- Criterion #5 - The forecast capex / investment profile must be limited (ie no growth/expansions and no new connections or significantly reduced replacement and non-network capex).
- Criterion #6 - Evidence must be submitted that maintaining the status quo should not be an appropriate default option.

While the ERA acknowledges the AER's information paper, as mentioned above, it has not applied the above criteria when assessing ATCO's proposal for accelerated depreciation and nor does ATCO appear to address them in its Revised AA6 Proposal.

The development and application of criteria to be consistently applied by regulators under the NGR in assessing proposals for including an amount of accelerated depreciation is important for a number of reasons:

- The relevant provisions of the NGR and NGL relating to depreciation are high level principles that don't, in themselves, clearly articulate how to assess proposals for accelerated depreciation;
- Under the NGR, regulators have broad discretion when assessing these aspects of an AA proposal and applying the relevant rules;

[7] AER, Regulating gas pipelines under uncertainty, Information Paper, November 2021

- The creation of a proxy set of criteria that meets the relevant provisions of the NGR/NGL will:
  - give all stakeholders better clarity on how to deal with any claim for treating increased risk through the use of accelerated depreciation (wholly or partly);
  - lead to consistency in decision making; and
  - give stakeholders greater confidence that the decisions are consistent with the NGO and revenue and pricing principles in the NGL; and
- this is particularly important in the case of attempts to introduce accelerated depreciation, which represents a fundamental shift to the established regulatory precedent relating to the return of capital building block that has been developed over the last 25 years.

The criteria developed by the AER would seem to be the more appropriate criteria than what the ERA has adopted in its ERA DD for the above reasons (and for the reasons outlined in subsection 2 below).

***2. The focus should be on assessing whether there has been an increase in stranded asset risk when assessing whether accelerated depreciation should be allowed as a matter of principle.***

In assessing whether accelerated depreciation should be allowed as a matter of principle, the ERA appears to have only focused on assessing whether there has been an increase in the ***risk of a reduction in the use of natural gas on the network***, rather than the ***risk in the reduction in the use of the network*** – this is stranded asset risk.

Both ATCO and the ERA appear to only focus on the former rather than the latter type of risk in the Initial AA6 Proposal and ERA DD respectively. While ATCO's Revised AA6 Proposal is now claiming asset stranding risk has increased, it has not provided any additional information to substantiate this claim than what it relied on to substantiate its claim that the increased risk in declining use of natural gas. It does not follow that an increase in the risk of declining use of natural gas, of itself, equates to an increase in asset stranding risk

While it is not contested that there has been an increase in the risk of declining demand for use of natural gas, the ERA should explicitly consider whether the information relied on by ATCO and the ERA to date is sufficient to be able to substantiate the case for a sufficient increase in asset stranding risk. Rule 89 of the NGR (relating to depreciation) requires (among other things) a depreciation schedule to be designed to recover the capital costs of the assets over their economic lives. This means their usefulness for the purposes of providing any pipeline services, not just for the purpose of transporting natural gas.

Given this and the fact that consideration is being given to renewable gases being transported through the network (either combined with or, in substitution for, natural gas), it is wrong to focus solely on whether there is an increase in the risk of a reduction in the use of natural gas on the network in assessing whether accelerated depreciation should be allowed in principle.

In relation to the information that both ATCO and the ERA have claimed substantiate an increase in the risk of demand for natural gas declining, the following points should be considered:

- Increased risk driven by technological developments - there appears to have been no analysis undertaken by the ERA in the ERA DD to substantiate the claim that there has

been an increase in the risk as a result of technology developments (see paras 13, 45 & 46 of attachment 6 of the ERA DD);

- Increased risk driven by changes in policy developments - when considering changes in policy developments:
  - consideration must be had to the full suite of climate policy developments, not just specific elements of these policy developments and assess whether the full suite manifest an increase in risk. In this regard, the WA Government's climate policy, released in 2020, includes a broad range of actions that are aimed at enhancing climate resilience and supporting a low carbon transition. While transitioning away from the use of fossil fuels is central to the policy, so too is there explicit support for the development of a renewable hydrogen industry (as set out in the State Renewable Hydrogen Strategy, released in 2019 and currently being refreshed following consultation in 2023). Part of this strategy includes establishment of a renewable hydrogen industry in WA and the blending of hydrogen in natural gas networks. The Renewable Hydrogen Roadmap that forms part of the strategy originally targeted for gas pipelines and networks to contain up to 10% renewable hydrogen by 2030 although in 2021, this part of the strategy was modified to bring the target date forward to 2022 but not being specific about the percentage blending figure (instead it currently refers to "low concentrations of hydrogen"). This explicit policy position puts WA in a different position to the policy positions of other Australian jurisdictions. It is acknowledged that there are many technical and commercial issues that need to be addressed before the use of hydrogen for domestic purposes can be considered a likely scenario.
  - As ATCO mentions in its Revised AA6 Proposal, since the ERA DD was issued, the Commonwealth Government released the Future Gas Strategy (April 2024). Key principles of this strategy are to ensure there is continued gas field developments together with more flexible gas infrastructure to meet demand and keep the costs down as we transition to net zero. In addition, the government will be promoting the geological storage of $CO_2$ and continue with the development of regional hydrogen hub programs.
  - While the ERA considered the issue of the uncertainty of gas networks in its 2021 decision on the DBNGP AA and concluded that usage of the DBNGP would decline over time due to technological and policy change, and accepted DBP's proposed reduction in the economic life of the pipeline, the above policy developments that have occurred since that decision warrants an explicit reconsideration of the issue by the ERA in its decision making process for this access arrangement.

### *3. The adequacy of the demand scenarios analysis and modelling approach, including the pricing assumptions for gas into the future*

ATCO claims, in its Revised AA6 Proposal, that it has addressed the issues identified by the ERA in its ERA DD on the demand scenario analysis and modelling approach.

However, the ERA should consider the following matters further:

While the ERA DD identifies a number of issues with respect to the scenario modelling work undertaken by ATCO (see paras 104-119 of Attachment 6 to the DD – the ERA's reasoning is supported by advice from Frontier Economics), all of which we support as a basis for not

allowing an amount for accelerated depreciation, there are a number of other issues that the ERA has not identified in its reasoning for not allowing an amount for accelerated depreciation and which also do not appear to be addressed by ATCO in its Revised AA6 Proposal:

- While ATCO acknowledges in its supporting information that it is unclear the extent to which, if at all, the Commonwealth Government's Future Gas Strategy is likely to impact gas consumption on the distribution network, it would be important to undertake sensitivity analysis on demand in the various scenarios given the importance of the strategy.
- ATCO assumes that only gas wholesale prices will vary over the period of the modelling period. However, this is unlikely to be the reality – transmission, network and retail prices are likely to change more, particularly if the producers have alternative markets in which to sell their commodity (eg the LNG export market). That this is the more reasonable scenario is acknowledged by government policy considerations which assume that maintaining gas in the decarbonisation transition out to 2050 is to support other countries in their own transitions.
- There is a lack of transparency on some of the key assumptions that underpin the modelling that has been adopted to come up with the outputs for each scenario, thereby making it difficult to assess the veracity of the modelling methodology and approach. In particular:
  - What is the pace of transition to full electrification?
  - Are consumers being asked to pay for all costs, such as R&D costs for hydrogen?
  - What assumptions are made about the wholesale price of gas?
- While ATCO does appear to have presented, in its supporting information, scenarios showing a spectrum of outlooks and to estimate the likelihood of each scenario, the way in which the regulatory building block model and the consumer choice model interact seems to indicate that there is an iterative process which seeks to "goal seek" for the optimum demand and depreciation to match current pricing or thereabouts. It seems like depreciation is being used to recover revenue that would otherwise be "lost" as a result of the reduction in demand in the relevant scenario. This seems problematic on a number of fronts:
  - It is transferring all risk to the customer; and
  - It is counter-intuitive to be increasing prices if there is a reduction in network as this will only increase the rate at which network customers switch to electrification.
- The nature of the modelling that appears to have been done to date seems to be based on assumptions that are not very precise estimates. This leads to a series of problems:
  - Because there are a number of assumptions in the model, when compounded together, it can lead to very significant differences in the outcomes if each assumption is inaccurate; and
  - Therefore, the reliability of the modelling must be called into question as to whether they are the best estimates arrived at on a reasonable basis (as required under the NGR for all forecasts).
- In relation to the evidence of pricing risk (both the capacity of future users to pay for higher prices as a result deferring accelerated depreciation and the capacity of today's customers to pay high prices as a result of allowing accelerated depreciation), there doesn't appear to be consideration of the likelihood that increased costs for gas consumers could make the switch to alternative energy (eg electrification) even more economic, thereby accelerating the voluntary moving away from the use of gas network. It will result in higher costs for

remaining customers who are less able to switch to alternative energy (eg electrification) because of either the cost involved, or they are reliant on gas for their downstream operations. Further, it exacerbates existing stresses of consumers who are already facing increased debt levels for energy usage and it partly incentivises service providers to continue spending on expansions to the infrastructure and R&D for alternatives to natural gas, which costs are also being proposed to be passed through to consumers.

### *4. ATCO's investment profile is not limited*

As noted in the capital and operating expenditure sections of this report, ATCO does not appear to have modified its approach to investment since AA5 (in either the Initial AA6 Proposal or its Revised AA6 Proposal), whether that be in terms of its approach to operating, maintaining or repairing the network, asset replacement or how costs are to be recovered for capex associated with network growth.

In relation to network growth:

- even the most recent AEMO GSOO has concluded that that domestic natural gas demand is forecast to increase by an average of 2.2% pa out to 2033. Even the most pessimistic forecasts expect both customer numbers and gas volumes to be at least stable for the next 5 years. These are supported by recent announcements of gas developments to supply gas to the WA domestic gas market; and
- ATCO has not proposed to modify the way in which the capex for new connections growth will be recovered. It is still proposed that some of the costs of new connections be shared amongst all users, rather than having the new customers pay for all the costs.

In relation to ATCO's approach to operating, repairs and maintenance:

- ATCO does not appear to have modified its approach to how it operates and maintains the asset in light of an increased risk of reduced demand and the associated level of expenditure for maintenance and repair of the assets;
- ATCO has not demonstrated that it has undertaken an options analysis of the costs involved in different approaches (which don't compromise safe operations); and
- Even the costs of managing reputational risk associated with current use of hydrocarbons (ie purchasing carbon credits) is being sought to be passed on to consumers.

### *5. Are there other measures already included in the Revised AA Proposal to adequately cater for any increase in risk*

For the above reasons, it would appear that, at this point in time, maintaining the status quo with respect to ATCO's depreciation schedule would seem the most appropriate default option. Furthermore, it would appear that, when combined with the following other features of the Revised AA6 Proposal, ATCO appears to be unfairly transferring entirely to consumers the risk of asset stranding:

- The tariff structures are such that consumers already wear a large portion of demand risk (with the fixed component of the charge and a declining block tariff structure);
- Debt financiers place a significant importance on demand and asset stranding risk. In deciding whether to lend and if so, what term of debt should be offered, debt financiers will assess the expected revenues of the business at the end of the proposed term of the debt

facility and whether the cashflows at that point are likely to be sufficient to pay back the principal owed. Accordingly, this risk should already be, at least partly, factored into the allowed cost of debt.
- ATCO is seeking to pass on to consumers the costs of assessing alternative (renewable) energy to use the asset. While the ERA DD has not allowed this, it appears that this is only because the regulatory regime had not, at the time of the decision, been modified to specifically allow for such costs to be included.

Additionally, it is wrong to seek to use one "tool" – being accelerated depreciation - to address a perceived increase in risk of asset stranding. Consistent with the AER's information paper on investing in uncertainty, there are other "tools" in the NGR/NGL that should be considered (together with, or in place of, accelerated). Moreover, the "tools" to be used should not be restricted to those "tools" that exist in the NGR & NGL. This is because the move to a decarbonised economy and society is largely being led by government (rather than being driven by the market). While it is acknowledged that the ERA cannot, on its own, implement those "tools/measures" that sit outside of the NGR (because of its statutory remit), addressing the impact of decarbonisation policies should be led by Government and the ERA should "follow" by implementing tools or measures that are clearly set by Government. For the ERA to "lead" (by allowing an amount for accelerated depreciation, for example) before the Government has articulated the suite of tools to be implemented, this risks creating greater market distortions than if the Government were to lead with its suite of "tools/measures".

The Government is yet to articulate all of its detailed plans (ie its tools/measures) to achieve net zero. To the extent that the WA and Commonwealth Governments have outlined tools and measures:

- governments have not specified that accelerated depreciation should be the exclusive tool to be used to manage network stranding asset risk; and
- neither the ERA or ATCO has considered those other tools/measures outside of the regulatory framework in the NGR and the extent to which they may be adequate, in themselves (ie without the need to allow any amount for accelerated depreciation), to manage the increase in the risk of asset stranding as a result of the move to decarbonise the economy and society. These tools/measures include (but are not limited to):
    - Support for consumers unable to manage a transition away from the use of gas infrastructure (eg appliance replacement subsidies, financial support for hardship);
    - Government support for network operators to invest in R&D for alternative, decarbonised energy sources to replace natural gas, rather than seeking to have consumers pay; and
    - A strategy to fund assets that become underutilised to avoid spiralling costs – this may include asset write downs and government support.

While in the ERA DD, the ERA did consider some of the other "tools/measures" that exist within the regulatory framework of the NGR to address the perceived increase in risk (albeit to only address an increase in the risk of reduced gas demand, rather than reduced demand for use of the network):

- The ERA concluded that these other tools/measures could only be complementary to the use of accelerated depreciation rather than as substitutes for accelerated depreciation –

see paras 94-97 of Attachment 6 of DD). But then, the ERA did not actually use any of them nor did the ERA explain why they should not be used.

- In relation to some of these other (complementary) "tools/measures":
  - Who should fund expenditure to augment the network - The ERA appears to have wrongly concluded that the costs of gas network augmentation, if they are required, could not be funded solely by either the consumers who directly benefit from them or the government – the ERA has considered that augmentation capex costs are likely to meet the criteria that allows for them to be included in the capital base and included in the reference tariff. However, the reference tariff setting and cost allocation provisions of the NGR give the ERA the flexibility to recover specific costs from specific categories of users or classes of users.
  - Expenditure incurred on research and development into alternative, renewable gas research or readiness – while the ERA has not allowed this as part of the forecast capital or operating expenditure in any tariff calculation, the ERA has flagged in the DD that the primary reason for not doing so is because the regulatory framework currently doesn't allow such expenditure to be included.
- The ERA did not consider the appropriateness of the following other "tools/measures" that exist within the regulatory framework of the NGR to address the perceived increase in risk:
  - creating an incentive mechanism to encourage for ongoing use of the assets
  - the use of the speculative capital expenditure account (in accordance with Rule 84NGR) for any growth-related capex or renewable gas readiness capex
  - modifying the approach that ATCO should adopt to repairing and maintaining the network given a potential decline in its usage over time. This would most likely result in a reduction in the amount of expenditure (operating and capital) required to be included in the forecasts of opex and capex
  - accelerated depreciation should not be applied to assets that ATCO voluntarily chooses to invest in from now on – eg expansions of the network and new connections
  - There should not be a levelised amount of accelerated deprecation recovered each year of the AA period. As per the Expert Consumer Panel's original submission, if any amount of accelerated depreciation is to be allowed, it should be back ended to offset the price shock already being seen in the change from 2024 to 2025 tariffs (already close to a 10% increase (without accelerated depreciation) for the average B3 class customer.

### *6. Adequacy of Stakeholder Engagement*

While ATCO may claim to have addressed, in its Revised AA6 Proposal, the issues identified by the ERA in the ERA DD with its modelling methodology and approach, it was noted that another reason the ERA did not allow any amount for accelerated depreciation in the ERA DD was because of the lack of stakeholder consultation by ATCO in respect of its modelling work.

It is equally as important that ATCO undertake more detailed stakeholder engagement with the revised modelling work that it undertook in support of its Revised AA6 Proposal. Leaving that engagement to a one-month period following the submission of its Revised AA Proposal does not appear to be sufficient.

## 4. ASSET LIVES

### ERA Draft Decision

In the ERA DD, the ERA has agreed with ATCO's Initial AA6 Proposal in so far as it has adopted the same asset categories and asset lives for each asset category that were used in AA5 for the purposes of determining the amount of "base" depreciation to be allowed when calculating the total revenue.[8]

While the ERA's reasoning does not explain why it has made this decision, the report by EMCa that the ERA has relied on to support its reasoning on other building blocks states that "with the exception of "meter and service pipes", ATCO's AA6 asset lives are within the range of corresponding asset lives applied by other utilities."[9]

### ATCO Revised AA Proposal

ATCO's Revised AA6 Proposal continues with the same asset categories and asset lives as were used in the ERA DD and Initial AA6 Proposal.

### TRAC's Submissions

Since AA5 was approved by the ERA, there have been several decisions concerning other gas distribution access arrangements that have set different asset lives for similar asset classes to those proposed by ATCO. As mentioned above, while the ERA does not appear to have considered whether this warrants different asset lives being adopted for the AA6, EMCa concludes the values for asset categories are, with one exception, within the range of values allowed for other networks.

We recommend that the ERA specifically consider whether different values for asset categories should be adopted in AA6. There are a number of reasons for this.

Firstly, it would appear that ATCO's Revised AA6 Proposal adopts asset lives for more than one asset category that are not consistent with regulatory precedent. The following table contains a summary of the asset lives adopted by regulators of gas distribution networks in other jurisdictions. The red cells indicate where the ERA appears to have adopted shorter asset lives than appears to have been allowed in most other regulatory decisions for similar asset classes on other distribution pipelines.

| Asset class | ATCO | Evo Energy | JGN | AGN SA | MNG | Ausnet | AGN Vic |
|---|---|---|---|---|---|---|---|
| HP mains | 80 (steel)<br>60 (PE) | 50 | 80 | 60 | 50 | 60 | 60 |
| MP mains | 60 | 30 | 50 | 60 | 50 | 60 | 60 |
| MP Services | 25 | 30 | 50 | 60 | 50 | 60 | 60 |
| Buildings | 40 | - | 48 | 40 | 50 | 40 | 50 |

[8] See DD Overview, page 31 and DD Attachment 6, Tables 6.1 and 6.2. Although, note amendment 6.1 requires a different amount to be set for depreciation because of changes to the values of other building blocks.

[9] EMCa Review of technical aspects of ATCO revised access arrangement 2025-29, para 208

| Asset class | ATCO | Evo Energy | JGN | AGN SA | MNG | Ausnet | AGN Vic |
|---|---|---|---|---|---|---|---|
| Telemetry & Monitoring | 10 | 5 | - | 20 | 15 | 15 | 15 |
| Meters | 25 | 15 | 15 | 15 | 15 | 15 | 15 |
| Regulators / valve stations | 40 | 15 | 50 | 40 | 50 | 50 | 15 |
| CP | - | - | - | 40 | 50 | 60 | 15 |

Secondly, more than half of the base depreciation allowance for AA6 is attributable to these two asset categories[10]. Therefore, a change in the asset lives for depreciation purposes for these two asset classes is likely to have a meaningful impact on the level of the allowable total revenue and therefore the level of each reference tariff. This logic applies even if the only asset category that adopts asset lives that are inconsistent with regulatory precedent is the "meter and services" asset category.

Thirdly, given that the setting of the values for asset lives for depreciation is based on their "useful asset lives", there does not appear to be any reason that would justify shorter economic lives being applied in Western Australia (relative to other networks), in circumstances where:

- Government policy and legislative frameworks in Western Australia are not currently designed to restrict the use of gas networks like is occurring in other jurisdictions; and
- Demand for the use of gas and the networks is forecast to increase (at least for the next regulatory period).

[10] ERA DD, Attachment 6, Table 6.4

## 5. AA5 EXPECTED ACTUAL CAPITAL EXPENDITURE

### ERA Draft Decision

In this section of this report, we comment on three aspects of ATCO's AA5 capital expenditure proposal that the ERA did not accept, thereby requiring the total AA5 capex to be reduced by an amount of $15.6 million from that proposed by ATCO (Amendment 4.1):

- $0.7 million (for expenditure undertaken during the period 2020 to 2022) connected with ATCO's Clean Energy Innovation Hub and hydrogen blending project (**Renewable Gas Capex Amendment**) because they are for the introduction of gases that are not yet feasible under the economic regulatory framework that applied at the time of the ERA DD.
- $8.9 million of network sustaining capex (covering a range of network reinforcement, pipeline inspection, environmental, social and governance projects and blending projects) (**Network Sustaining Capex Amendment**) based on these reasons:
  - ATCO had included contingencies of between 10-30% for each project to be undertaken over 2023-24. Because ATCO manages projects as a portfolio, and it is likely that some projects will come in over budget and some under budget, it is unnecessary to add project contingency to every project. In addition, most of the projects attracting project contingency are the continuation of an existing AA5 project or repeat work or tendered work, where ATCO, as a prudent provider of services, can produce robust project cost estimates and manage its costs within the overall capital expenditure amount approved by the ERA.
  - Some projects are at a very early stage and may not proceed (eg Atwell and Secret Harbour)
- $3.6 million of Information Technology (IT) expenditure (application renewal and digitisation project) (**IT Expenditure Amendment**).

### ATCO Revised AA6 Proposal

ATCO's Revised AA6 Proposal includes a revised AA5 forecast capital expenditure total of $400.1 million ($ real as at 31 December 2023) which includes:

- Removal of some of the 2020-2022 actual capex items that were determined by the ERA in the ERA DD as non-conforming expenditure. This includes the removal of all of the Renewable Gas Capex. However, capex associated with some of the Network Sustaining Capex items have been retained (see sections 7.5.1.1 to 11 of the Revised Plan) and ATCO has retained contingency amounts totalling $1.1m (Real, 31 December 2023) with respect to 25 sustaining capex projects it forecasts will be undertaken in 2024 (see section 7.5.1.12 and Table 7.7 of the Revised Plan). ATCO's key justifications for retaining the contingency amounts for these projects are:
  - projects that have not yet commenced at the time of this response and refined forecasts cannot be provided, and,
  - projects where there are expected additional costs to be incurred due to site or project conditions (such as heritage and environmental matters).
- Replacement of the previous 2023 forecast with actual expenditure incurred in that year.
- Provision of a revised 2024 forecast expenditure amount. This includes the following amounts for IT Expenditure (relating to the two projects that the ERA disallowed in the ERA DD):
  - $1.1m for Application Renewal items

- $0.8m for Network digitisation and intelligence program

**TRAC Partners Submissions**

Before addressing the way ATCO has responded to the above amendments in its Revised AA6 Proposal, there are two overarching points to be made about capital expenditure generally.

***1. Assessing Capex against the NGO***

ATCO introduces its Revised AA Proposal by outlining a general ground to dismiss the ERA's relevant capex amendments (see page 2-3 of the "Revised Plan" document) - being that:

- the ERA relied on an EMCa report to reject certain capex amounts, but that report didn't assess the capex against the National Gas Objective because, at the time the report was prepared, there was no requirement to do so.
- with the most recent amendments to the NGR that became law in February 2024 (including the amendments to the national gas objective to include the emissions reduction limb), there is now an express obligation for the regulator to consider capex against the NGO.
- had the ERA/EMCa assessed the capex against the new version of the NGO, they would have concluded that the proposed capex levels should have been allowed and they could not have concluded that the DD capex levels were consistent with the NGO. This is because under the new version of the NGO, the regulator should not be focusing on ensuring that the lowest sustainable cost of delivering pipeline services is an absolute requirement in assessing capex levels. Rather, the addition of the second limb into the NGO (ie the emissions reduction limb) means that the ERA must allow for a level of expenditure which is more than the lowest sustainable level of expenditure.

While it is not clear the extent to which (if at all), this ground is then relied on by ATCO to either reject any specific item of capex that the ERA disallowed or to justify revised capex amounts for specific items (other than the proposal to include an amount of $9.6 million in forecast capex to allow ATCO to install injections points so it can purchase a portion of its UAFG as biomethane and allow customers to inject renewable gas into the network), we suggest that the ERA should still check the reasoning of this ground because:

- ATCO's interpretation of version of the NGR that applied at the time the EMCa report was prepared does not appear to be correct.
- ATCO's claim about the proper interpretation of the new version of the NGO should be challenged, particularly when it is relied on to claim that both the ERA's DD levels of capex are inconsistent with the new version of the NGO and ATCO's proposed levels of capex (in the Revised AA6 Proposal) are consistent with the new version of the NGO.

In relation to the first point above, it was never the case that, before the most recent amendments to the NGL/NGR, there was no requirement to consider capex against the NGO. Rule 100 of the NGR has applied in WA since the beginning of the NGR. That Rule makes it expressly clear that the ERA must ensure that "all provisions of an AA must be consistent with the NGO".

In relation to the second point above, the ERA's decisions on access arrangements made before the recent change to the NGO do not appear to adopt the position that the previous version of the NGO (ie the version without the emissions reduction limb included in it) required it to allow only the "lowest sustainable cost of delivering pipeline services". Rather those previous

decisions adopt the position that it required the regulator to approve capex levels which promoted efficient investment in, and efficient operation and use of, natural gas services for the long-term interests of consumers (with respect to price, safety, reliability and security of supply of natural gas). This does not equate to "lowest sustainable cost".

If however, this is an incorrect understanding of how the ERA has interpreted the previous version of the NGO (ie it did mean that regulator must focus on achieving the lowest sustainable cost outcome), the ERA should clarify in the final decision whether it interprets the new NGO (ie with the addition of the emissions reduction limb) as meaning that ERA must allow a level of expenditure which is more than the lowest sustainable level of expenditure. This is particularly important given the drafting of the new version of the NGO requires the regulator to be satisfied of the first **and** second limbs of the NGO. So, expenditure levels must be lowest sustainable cost and they must assist in achieving emissions targets.

Stakeholders would benefit from the ERA making its position clear on these issues in the final decision that it releases.

***2. Assessment of appropriateness of BAU approach to capex***

ATCO has claimed that there is a significant increase in the risk of declining use of natural gas on its network. While this does not, of itself, equate to an increase in the risk that the network will cease to be used, ATCO continues to claim that it should be compensated now for this increase in risk through the inclusion of an amount to represent an earlier recovery of the capital cost of the asset than would otherwise occur through the normal depreciation schedule (ie accelerated depreciation). Its Revised AA6 Proposal is now seeking to recover $87.2m through this means.

While this issue is addressed in more detail elsewhere in this report (see section 3), there is a growing recognition within regulatory decision makers that the use of accelerated depreciation should not be used as the sole regulatory tool to address an increase in the risk of asset stranding. Consideration should be given to a range of regulatory tools (including accelerated depreciation) to address any increase in this risk such as:

- the extent to which capex associated with growth in the network is to be addressed – should it be (partly or totally) recovered from existing users or should only new users pay for this capex (eg through surcharges);
- reviewing the approach to the way in which a service provider undertakes repairs and maintenance and incurs expenditure to sustain the network – a "business as usual approach" (BAU approach) that has been adopted up until now may no longer be appropriate. This should lead to changes in the level of capital expenditure that is allowed for this type of work;
- the level of capex relative to the level allowed in previous periods. It does not seem fitting that higher levels of capex should be allowed going forward particularly if there is a forecast of declining demand for use of the network;
- implementing other, non-capex related, ways to address service reliability – such as demand side management; and
- reviewing the tariff structure to ascertain whether consumers or the service provider are bearing demand risk.

To the extent that the increase in asset stranding risk has already manifested itself, it is relevant that the service provider consider its BAU approach to both forecast capex and actual capex being proposed by the service provider.

However, it is not apparent that ATCO has considered any change to its approaches on the above capex related matters as part of the Revised AA6 Proposal. Given the impact that ATCO's proposal for accelerated depreciation has on the level of the reference tariffs, we encourage the ERA to investigate, as part of its deliberations in making its final decision, the extent to which these matters have been considered by ATCO and the extent to which they should be implemented in AA6, particularly whether a change in the BAU approach to sustaining capex has been considered.

***3. Renewable Gas Capex Amendment***

We support ATCO's decision to not seek to include the $0.7 million (for expenditure undertaken during the period 2020 to 2022) incurred in connection with ATCO's Clean Energy Innovation Hub and hydrogen blending project as conforming capex for AA5 and to also not claim the costs incurred in 2019 for this project in the Revised AA6 Proposal.

Consideration should however, be given to creating a speculative capital expenditure account (in accordance with Rule 84 NGR) for this expenditure.

***4. Network Sustaining Capex Amendment***

We do not consider that ATCO has provided sufficient justification for continuing to include amounts as contingencies for certain network sustaining projects to be undertaken in 2024. This is particularly relevant for those projects whose estimates are based on actual expenditure incurred during the first quarter of 2024. Given it is almost halfway through 2024, ATCO should, by now, have a clear understanding of the expected costs of each of the projects to be undertaken this year.

***5. IT Expenditure Amendment***

In our review of the above two IT expenditure items of actual capital expenditure, we would encourage the ERA's experts to review the adequacy of the additional information provided by ATCO in support.

# 6. FORECAST CAPITAL EXPENDITURE

## ERA Draft Decision

For the purposes of this report, the ERA DD did not accept the following aspects of ATCO's forecast capex for AA6 in its Initial AA6 Proposal, thereby requiring the total AA6 capex to be reduced to $443.1 million ($real as at 31/12/23) (being a 4.9% (or $22.7m) reduction from ATCO's proposal of $465.8 million) (Amendment 4.2):

- The inclusion of contingency allowances for routine expenditure programs within the asset replacement category. The ERA concluded that, while the underlying cost estimate based on historical unit costs seemed a reasonable estimate for the future, the addition of individual project contingencies results in an over estimation and are considered non-conforming with the NGR (**Contingency Capex Amendment**)
- As part of the overall asset replacement program allowance of $196 million that forms part of the network sustaining capex program, the ERA only allowed:
  - an amount of $132.8 million for a mains replacement program (**Mains Replacement Capex Amendment**).
  - an amount of $25.7 million for a meter replacement program (**Meter Replacement Capex Amendment**).
- Also, as part of the network sustaining capex program, the ERA only allowed an amount of $22.1 million for an asset performance and safety capex program, which is less than half of the $57.6 million proposed by ATCO for this program. The relevant changes under this program were:
  - Enabling renewable gases – the ERA did not allow any of the $15.5 million proposed by ATCO (**Enabling Renewable Gases Amendment**);
  - Inline inspections – The ERA allowed only $13.0m of the $24.9 million ATCO had proposed (**Inline Inspections Capex Amendment**)
- The ERA also proposed that the expenditure that ATCO had proposed as part of its forecast operating expenditure for the ERP replacement program be capitalised instead of being expensed (**ERP Replacement Capex Amendment**). But the ERA required that the level of expenditure should be reduced from the amount proposed by ATCO because ATCO could have instead, upgraded the existing system at a lower cost (cheaper by 30%) and ATCO's own consultant recommended an upgrade rather than a replacement.

## ATCO Revised AA6 Proposal

ATCO's Revised AA6 Proposal includes a revised AA6 forecast capital expenditure total of $490.7 million ($ real, 31 December 2023). This is higher than not only the total it originally proposed ($465.8 million) but also the total the ERA allowed in the ERA DD ($443.1 million).

ATCO claims there are some general drivers for the change in the total forecast capex being proposed, as outlined below (**General Cost Increase Drivers**):

- The removal of contingency allowances at the project portfolio level
- An increase in contractor rates for many projects (the rate of the increase has been kept confidential by ATCO). In all programs that rely on cost forecasts of contractors, ATCO advises that it is undertaking competitive tender processes in 2024, with new rates expected to be effective in May 2025.
- An increase in both key items of equipment and services that are consistent with supplier and industry trends

In relation to the specific amendments outlined in the ERA DD summary above, ATCO has:

- **Mains Replacement Capex –** increased the total forecast from the ERA's $132.8 million allowance to $141.2 million. There is no change in the scope of work forecast to be undertaken from the scope that was originally proposed and so, the $8.4m increase is driven entirely by the General Cost Increase Drivers.
- **Meter Replacement Capex** - increased the total forecast from the ERA's $25.7 million allowance to $27.7 million. There is no change in the scope of work to be undertaken, the $2.0m increase is also driven entirely by the General Cost Increase Drivers
- **Enabling Renewable Gases Capex** – increased the total forecast from $0 allowed by the ERA to $9.6 million. ATCO claims that this is to enable the construction of 3 injection points to facilitate the purchase of biomethane for UAFG and to allow customers to inject biomethane into the network. The forecast capex does include a 10% contingency allowance, which ATCO justifies including because of the rapidly evolving technical standards and novelty of these programs. ATCO has justified it on the basis that it:
    - considers the expenditure to be consistent with the updated NGO;
    - considers ATCO to be the most appropriate party to construct (and fund) the infrastructure (as opposed to the producer or the customer); and
    - considers the overall economic value of the expenditure to be positive by taking into account a broad range of economic values

  However, ATCO has not sought to include the capex in a speculative expenditure account
- **Inline Inspections Capex** – increased the total forecast from the ERA's $13.0 million allowance to $13.8 million. ATCO has reduced the scope of work to align with the scope allowed in the ERA DD. But the increase is due to the General Cost Increase Driver (although ATCO has removed the contingency allowance).
- **ERP Replacement Capex** – proposed $39.3 million for this project, being the largest expenditure item in ATCO's Information Technology capex program during AA6 (see Table 7.30 of ATCO's Revised Plan).
- **Network Growth Capex** – proposed $151 million for growth capex to reflect a lower new connections compared to the forecast of connections adopted by the ERA in the ERA DD.

**TRAC Partners Submissions**

In addition to addressing the way ATCO has responded to the above specific amendments in its Revised AA6 Proposal, the same two overarching, general points we made about the AA5 actual expenditure proposal in the Revised AA6 Proposal apply to the forecast AA6 capital expenditure proposed in the Revised AA6 Proposal (see section 5 of this report).

***1. General Cost Drivers Increases***

Given ATCO has indicated that it is currently undertaking competitive tender processes for a variety of contracted services, for the programs of expenditure in the AA6 forecast capex rely heavily on the costs of contractors, we recommend that the ERA make enquiries of ATCO closer to the time of making the final decision for up-to-date information on rates being proposed by Contractors in these tender processes. To the extent that the updated information reveals different rates to those that ATCO has relied on in its Revised AA6 Proposal. This will ensure the best estimates are being used in the forecast.

***2. Mains Replacement Program Capex in AA6***

In relation to asset replacement allowance – for mains replacement ($132.8m):

- The ERA should challenge whether a mains replacement program of a similar magnitude to that incurred in the AA5 should be undertaken at times of claims of increased risk of declining utilisation of natural gas and increasing cost of living pressures. This is particularly important given the capex for this program is proposed to make up more than half of the forecast asset replacement capex in AA6. The ERA did not appear to do this in the Draft Decision. Nor does ATCO appear to have done so in the supporting information provided by ATCO in support of the Revised AA6 Proposal.
- There also does not appear to be any challenging of the status quo approach to asset replacement, yet ATCO is arguing that there is a significant increase in uncertainty in the future of the network and as such, there should be an acceleration of the rate of return of capital invested. This issue is addressed in more detail in section 3 of this report
- The level of capex associated with this program also should not be supported by the ERA if it is being justified to enable ATCO to be hydrogen ready – this doesn't appear to have been questioned by the ERA's consultants in the ERA DD. And if it was being undertaken to be hydrogen ready, the ERA's consultants do not appear to have asked whether another solution was available that was not hydrogen ready and which would have delivered a lower present cost.
- Even though the program is being justified primarily on safety grounds, the ERA should test whether ATCO has analysed what, if any, additional risks arise if this program were to be extended over a longer period. Figure 4.1 in Attachment 4 of the ERA DD outlines a number of options, including a "do nothing" option and a "condition-based replacement" option but neither of these address the deferred by 5 years type of option. Such analysis also appears to be missing from the Revised AA6 Proposal.
- In relation to the capex associated with the high-pressure mains replacement, no analysis or risk assessment appears to have been undertaken to assess whether it is appropriate to move to a proactive replacement program or whether it is more prudent to continue with a reactive replacement program or prolong the remainder of the replacement program. Such an assessment should be undertaken before we could recommend supporting the proposed expenditure for high pressure and medium pressure mains replacement.
- The further analysis that should be undertaken should consider a range of factors such as the impact that maintaining the status quo on the replacement program has on future UAFG replacement expenditure, reductions in greenhouse gas emissions and improved safety outcomes.

### *3. Forecast AA6 Meter Replacement Program Capex in AA6*

In relation to the allowed meter replacement program capex ($25.7m), similar issues as outlined above for mains replacement capex apply.

### *4. Enabling Renewable Gas Capex*

In relation to the proposed forecasts expenditure for "enabling renewable gases":

- The ERA appears to have rejected all of the forecast capex ATCO proposed in the Initial AA6 Proposal for the following reasons:
    - because ATCO is not subject to the Commonwealth legislation requiring businesses with high emissions to reduce emissions each year (ie the Safeguard Mechanism), and there are no other regulatory obligations that would require it to reduce its emissions, even though the NGO has been amended to include the emissions reduction limb
    - the expenditure has not been addressed by adequate economic analysis of the options versus the counterfactual that demonstrate that the expenditure is the most efficient option (see para 212 of Attachment 4 of the ERA DD). In particular:

    - ATCO has not effectively demonstrated that injection of renewable gas for UAFG (unaccounted for gas) is the most efficient cost option. EMCa finds that based on current market prices the lowest cost option is for ATCO to continue using natural gas to meet its UAFG.
    - ATCO has not effectively demonstrated that there is sufficient customer demand to require the additional gate stations. The market in Western Australia is relatively immature. EMCa has not seen evidence to confirm customer demand for renewable gases, or that distribution using the GDS is more efficient than via road transport for transportation of these gases, such that the economic value is positive from this investment.
    - Additionally, the question arises as to whether ATCO is the appropriate party to establish the infrastructure, or will it become a "taker" of whatever blend of covered gases a customer wants to deliver into the network, whether from a transmission pipeline or from a production facility. The proposed facilities would be for the benefit of a party wishing to develop renewable gas production facilities and as such this party would therefore need to meet the cost of any investment needed for the associated connection and blending facilities.
- ATCO's Revised AA6 Proposal does not appear to be accompanied by supporting information to address all of these issues and accordingly, we could not support it being included in the total forecast AA6 capex in the final decision.
- In relation to the point of who is best to fund and construct new injection points to allow renewable gases to be injected, consideration should be had to the position for transmission lines where inlet points to allow producers to supply gas into these pipelines are generally funded by the producers. No case appears to be made as to why this should not be the position adopted for renewable gas inlet points.
- To the extent that the ERA may be inclined to support some of ATCO's proposal:
    - The case for including a 10% contingency allowance does not appear to have been made.
    - No explanation has been given by ATCO for why it considers appropriate to install injection points each with a capacity of around 100-200TJ per site per year when the forecast amount of renewable gas demand does not seem to be of that magnitude. No options analysis has been included to look at smaller capacity points.
    - There is no suggestion about the use of the speculative expenditure account into which this type of capex could be allocated. At least this would allow it to be considered at a future point in time for inclusion in the capital base, along with any return on capex that would have been built up in the account.

### *5. ICT ERP Replacement forecast capex*

The ERA's justification for capitalising the expenditure for this project (instead of including it as part of the forecast operating expenditure) does not appear to be strong. Whether the expenditure is capitalised or allowed as operating expenditure should be dependent on the proper interpretation of the accounting standards. It is not apparent that this has been applied by either the ERA or ATCO. To justify capitalising the expenditure (as the ERA did) because of the uncertainty associated with this expenditure, given the project is in its early stages does not appear to be the proper interpretation of the accounting standards.

It is also noted that ATCO has continued to include a contingency allowance for some IT projects, but it is not clear whether this project's forecast capex includes such an allowance. To the extent that it does include such an allowance, as with other projects including contingency

allowances, we do not consider a case has been made for making an exception to include this amount in this case

### *6. Network Growth forecast capex*

The ERA allowed $177.9 million in network growth capex, which is $20.5m more than what ATCO had originally proposed ($157.4m) and in its Revised AA6 proposal ($151.7 million). The reasons for this are:

- ERA assumed higher connection forecasts during AA6, resulting in more capex (although the ERA has used the same average connection costs for mains, meters and feeders as ATCO had proposed)
- ERA used the same unit rate assumption for brownfields connections (which is based on historical averages for these connections)
- ERA accepted ATCO's allowance of $6.6m of capital contributions towards growth development expenditure

On the issue of the appropriateness of the connection rates, see section 8 of this report.

In relation to the other matters to determine the appropriateness of this amount of forecast capex:

- ATCO has retained the same methodology for the NPV assessment that it adopted for the purposes of its Initial AA6 Proposal – see table 7.25 of the Revised Plan - other than:
  - changes in values for some parameters in the methodology due to the passage of time;
  - the adoption of more aggressive disconnection rates for B2 and B3 customers after 10 years
  - the adoption of more aggressive rate of reduction in the average gas demand for new customers, based on the updated forecast from Core Energy
- it does not seem consistent with the NGO that the existing users be required to fund part of the new growth capex as well as provide the service provider with an earlier recovery of capital costs (through accelerated depreciation). If an amount of accelerated depreciation is to be allowed, requiring existing customers to partly subsidise new customers with the cost of connecting to the network (through allowing for new growth capex to be included in the AA6 forecast capex) does not appear to be consistent with the NGO in that:
  - it increases the cost of natural gas services for existing customers
  - it partly transfers risk from new customers to existing customers
- To the extent that the ERA does not accept the above point, given the difficulty of the forecasting environment, a conservative approach should be adopted to determine the extent to which this category of capital expenditure should be recovered from all haulage customers (instead of customer contributions from new customers alone). It would therefore be prudent to analyse whether the NPV analysis would be passed even by adopting a lower demand and a higher disconnection rate for the analysis period (currently 25 years).

# 7. OPERATING EXPENDITURE

## ERA Draft Decision

The ERA only allowed $337.4million in forecast operating expenditure for AA6, 26% less than what ATCO had proposed ($455.9 million). This compared to total expected actual operating expenditure for AA5 of $355.9 million.

While both the ERA and ATCO's Initial AA6 Proposal determined the level of AA6 operating expenditure using the base-step-trend method combined with specific forecasts for unaccounted for gas (UAFG) and ancillary services, relevant elements of difference in applying that methodology were as follows (see Amendments 5.1 to 5.8):

- The ERA required the use of the 2022 actual operating expenditure of $50.7 million as the base year amount (**Base Year Amendment**).
- ATCO proposed 7 recurrent step change items totalling $22.5m whereas ERA allowed only 4 items totalling $5.1m, one of which only allowed a lesser amount (ERP Replacement Program) (**Recurrent Step Change Amendment**)
- ATCO proposed 4 non-recurrent step change items totalling $40.3m whereas ERA allowed only 2 step changes totalling $9.3m, although, for the step change item "software as a service", the ERA proposed that $17.6m of the ATCO proposed $27.3m should be allowed but it should be capitalised instead of being expensed (**Non-recurrent Step Change Amendment**).
- ATCO proposed Output growth escalation of $10.4m but ERA allowed $14.4m because it has assumed higher demand forecasts than ATCO (**Output Growth Escalation Amendment**).
- ATCO proposed Input cost growth escalation of $12.4m but ERA has only allowed $4.1m (**Input Cost Escalation Amendment**).
- ATCO proposed an amount of $30.8 million for Unaccounted For Gas but the ERA allowed only $31.8 million (**UAFG Amendment**).
- The ERA allowed only $19.6 million for the provision of ancillary services (**Ancillary Services Amendment**).

## ATCO Revised AA Proposal

ATCO's Revised AA6 Proposal includes a revised AA6 forecast operating expenditure total of $441.6 million ($ real, 31 December 2023) again using the base step trend method but adopting the following changes in the application of that method compared with what the ERA DD adopted:

- In relation to the **Base Year Amendment** - ATCO adopted the actual operating expenditure from 2023 to determine the base year level of expenditure but increased the total from $50.7 million to $66.4 million (see table 8.15 in the Revised Plan);
- In relation to the **Recurrent Step Change Amendment** – ATCO did not agree with the ERA's decision to disallow 3 of the 7 recurrent step change items and instead it has proposed a total of $27.6 million for the recurrent step change adjustment (see table 8.36 in the Revised Plan) which covers the following items:

  - Updated estimates for the three uncontested recurrent items totalling $3.8 million;
  - A reinstatement of the 3 recurrent items disallowed in the ERA DD, each with updated estimates of expenditure, totalling $9.3 million;
  - An updated estimate for the full scope of the ERP Replacement Program recurrent item of $4.1 million; and
  - An additional 9 recurrent step change items totalling $10.4 million.
- In relation to the **Non-recurrent Step Change Amendment** – ATCO:
  - agreed with the ERA's decision to reclassify the expenditure associated with the item "software as a service" as capital expenditure; and
  - proposed a total expenditure of $11.0m to be adjusted for three non-recurrent step change items.
- In relation to the **Output Growth Escalation Amendment** – ATCO proposed a $9.3 million adjustment for output growth, the difference from the ERA's amount being due to a different growth rate assumed because ATCO adopted different demand forecasts to those adopted by the ERA in the ERA DD.
- In relation to the **Input Cost Escalation Amendment** – ATCO proposed a higher amount of $9.6 million because it has adopted more up to date price index growth rates from WA Treasury (May 2024) and also it included an EGWWS premium of $0.37% given the fact that ATCO relies heavily on workers from this sector in the provision of services on the network.
- In relation to the **UAFG Amendment** – ATCO has proposed a lower amount for UAFG ($29.6 million) than was allowed by the ERA in the ERA DD. The drivers for this lower amount are:
  - Adopting a less optimistic demand forecast to that proposed by the ERA
  - Offset by ATCO adopting a higher unit price for purchasing gas to replace UAFG, so it can purchase a combination of natural gas and biomethane.
- In relation to the **Ancillary Services Amendment** – ATCO has increased the forecast expenditure for providing ancillary services to $22.2 million (broken down by each service in table 8.48 of the Revised Plan). This is because:
  - ATCO did not accept the ERA's demand forecasts for ancillary services;
  - The ERA was wrong to rely on the ancillary services unit cost data in the 2022 RIN because this did not include all indirect costs;
  - It is more appropriate to adopt cost estimates that are based on more recent cost data than from 2022 and so, ATCO's revised estimate is based on the 2023 RIN data. Although the recalculation required to come up with the unit rates has not been disclosed by ATCO (due to confidentiality claims)

ATCO also made three general claims to justify not adopting the ERA's required operating expenditure total:

- it would significantly constrain its ability to operate and maintain the network under ATCO's distribution licence and exposes ATCO to increased risk, including constraining its ability to

efficiently deliver pipeline services in a safe, reliable and secure manner. It provided a number of examples to substantiate this general claim[11] (**Increased Risk Claim**); and

- when benchmarked against industry peers, it would place ATCO as the lowest cost provider (using a number of different benchmarking measures), even though its original forecast already placed ATCO as performing better than most gas distribution businesses under a number of measures[12] and in circumstances where some of the benchmarking measures make it difficult to undertake a "like-for-like", comparison (eg given ATCO's network has a much lower customer density than its comparators, the reliability of the "average opex per km" measure becomes more questionable) (**Unrealistic benchmarking Claim**).
- The ERA relied on a report by EMCa to set the level of forecast operating expenditure in circumstances where EMCa failed to have regard to the NGO, in particular the version of the NGO as amended in February 2024. Had it had regard to this version of the NGO, it would have arrived at a different, and higher, level of forecast operating expenditure in the ERA DD (**NGO Claim**).

**TRAC Partners Submissions**

Table 8.49 in ATCO's Revised Plan contains a useful comparison of the differences between ATCO's Initial AA6 Proposal, the ERA DD and ATCO's Revised AA6 Proposal for each of the steps in the "base – step – trend" method used to derive the forecast total of operating expenditure for AA6.

**Table 8.49:** AA6 Forecast Opex ($M real as at 31 December 2023)

| OPEX CATEGORY | ATCO ORIGINAL PROPOSAL | ERA DRAFT DECISION | ATCO REVISED PROPOSAL |
|---|---|---|---|
| Base year | 312.6 | 253.5 | 332.2 |
| Recurrent step changes | 22.5 | 5.1 | 27.6 |
| Non-recurrent step changes | 40.3 | 9.3 | 11.0 |
| Output growth escalation | 10.4 | 14.0 | 9.3 |
| Input cost escalation | 12.4 | 4.1 | 9.6 |
| **Sub-total network, corporate & IT** | **398.1** | **286.0** | **389.8** |
| UAFG | 30.8 | 31.8 | 29.6 |
| Ancillary services | 27.1 | 19.6 | 22.2 |
| **TOTAL** | **455.9** | **337.4** | **441.6** |

We comment on the following aspects of the ERA's amendments and ATCO's response to each of them in the Revised AA6 Proposal.

[11] See Revised Plan, page 121
[12] Opcit, p122

### *1. ATCO's General Claims*

In relation to ATCO's three general claims, while ATCO's Unrealistic Benchmarking Claim appears valid:

- with respect to the Increased Risk Claim:
    - ATCO is simultaneously seeking to bring forward $197 million in the return of capital earlier than would otherwise be the case. ATCO's shareholder has a choice as to whether to reinvest that return in ensuring the ongoing safe operation of the network or to invest it elsewhere. There doesn't appear to be any recognition of this point by ATCO in its Revised AA Proposal; and
    - as is the case with respect to our submissions on ascertaining the appropriate level of capital expenditure that should be undertaken to maintain the asset at a time where ATCO claims there is an increased risk in declining demand for use of natural gas on the network (see section 5 of this report), ATCO should have demonstrated that it has reconsidered the appropriateness of its "business as usual" approach to operating the asset before setting the proposed level of forecast operating expenditure. Neither ATCO or the ERA appear to have undertaken this task – as evidenced by the adoption by both of the "base-step-trend" method to determining the appropriate level of operating expenditure. The importance of undertaking this analysis is heightened in times where:
        - the level of expenditure being proposed in the forecast is significantly higher than the level of expenditure incurred by ATCO in AA5; and
        - consumers are facing increased cost of living pressures – particularly when energy costs are acknowledged to be a major driver of this increase in cost of living; and
- with respect to the NGO Claim, the points made in section 5 of this report about the assessment of capital expenditure apply equally to forecast operating expenditure.

### *2. Base Year*

We make submissions in relation to two aspects of ATCO's proposed base year expenditure.

Firstly, we support an approach to forecasting which takes into account the most recent actual information. While that ordinarily would justify a base year being derived from the 2023 actuals, as noted immediately above, at a time where ATCO is claiming an increased risk in declining demand for the use of natural gas (and also seeking to be compensated for that through accelerated depreciation), it should not be the case that the starting point should be a "business as usual" level of operating expenditure.

Consideration should be given to either adjusting (downwards) the level of the base year operating expenditure or including an adjustment item in the "base-step-trend" methodology to reflect any changes in the approach to operating and maintaining the network as a result of this increased risk in reduced demand for natural gas. In the absence of both ATCO and the ERA having undertaken that analysis, it is difficult to determine which approach to adopt or what adjustment should be made.

Secondly, in ATCO's revised proposal for the base year level of operating expenditure, it has not accepted the ERA's removal of $6.8 million for "Other Corporate Costs" from the base year. ATCO has sought to re-instate an amount for Other Corporate Costs into the base year level of

expenditure. The main items that make up this cost category are short term incentive payments to staff ($2.9 million) and Canadian Head office costs ($8.7 million). This raises a number of points:

- ***Allowance for STIP expenditure -*** It is difficult for us to pass comment on the retention in the base year of an amount for short term incentive payments given that a large proportion of ATCO's justification has been redacted from the Revised AA6 proposal. However, it would seem prudent to allow an efficient amount for this nature of expenditure in a base year if it is consistent with regulatory practice (which ATCO claims it to be in the Revised Plan) and there is no offsetting allowance in a productivity factor. This should be tested by the ERA in making its final decision.
- ***Canadian Head office costs –*** while ATCO's revised plan includes more detail to explain the inclusion of an amount for this item in the base year, given the description of corporate services that ATCO has claimed that these costs relate to[13] appear to overlap somewhat with functions that are already claimed in other corporate overhead costs (eg risk management, support for IT, support for HR functions), we would expect the ERA to satisfy itself that there is no double counting occurring.

***3. Recurrent Step Change adjustments***

We provide comments on the following aspects of ATCO's response to the ERA's Recurrent Step Change Amendment:

- The reinstatement by ATCO of the expenditure associated with the recurrent step items named "Enabling Renewable Gases" ($1.7m), "O&M for Renewable Gas Injection Points" ($0.6 million),"Renewable Gas Injection Point Regulatory Obligations" ($0.5 million) and "Revised Forecast Expenditure" ($1.7 million) cannot be supported based on the additional information ATCO has provided to justify it, particularly at a time where there are significant increases in cost of living pressures for consumers and where we are not supporting the capital costs associated with installing additional injection points capable of receiving biomethane into the network.
- The inclusion of an item for purchasing ACCUs ($0.6 million) also should not be supported based on the justification provided in the Revised Plan and the Business Case documentation. Another reason for why it should not be allowed, is that recent regulatory decisions have not allowed other service providers to include amounts for the cost of purchasing carbon credits[14].
- In relation to the expenditure proposed for the 9 additional recurrent step change items that ATCO has proposed in its Revised AA6 Proposal ($10.4 million), we would expect the ERA's technical advisors to review the appropriateness of these claims, in particular the following:
  - Critical Infrastructure Act ($1.4 million) – to make sure that these are really additional compliance costs over and above previous compliance costs for this legislation that are already allowed for in the base year
  - Control Room Fatigue Management ($1.6 million) – given that ATCO acknowledges that it is not yet known whether these additional resources are in fact, required to address the improvement notice issued by the safety regulator, further enquiries should be made

[13] See Revised Plan, p150-155

[14] See the AER's decision on the APA VTS Access Arrangement

once the regulator has indicated what is required under the improvement notice. In the absence of that, we would have expected that the justification for this expenditure would have disclosed the risk assessment undertaken and a consideration of options to address this risk to reduce it down to ALARP.

- ESG Reporting System ($0.5 million) – given the ATCO itself is not proposing to include other ESG related expenditure (see Table 8.46 in the Revised Plan), it would follow that this expenditure should not be allowed. If some amount were to be considered appropriate to include for this type of system, it is not clear that this isn't already covered off in corporate overhead costs (particularly the Canadian Head Office Costs category). The ERA should therefore check that there is no double counting.

***4. Output Growth Step Change Adjustment***

While the methodology for determining the amount is non-controversial, see our comments on the demand and growth forecasts in the section 8 of this report. This may warrant therefore an adjustment to the amount being proposed in this step change.

***5. Non-inclusion of a productivity adjustment***

It would appear that ATCO has provided sufficient information to substantiate its proposal to not include this type of adjustment in the methodology for establishing the forecast operating expenditure.

***6. UAFG Specific cost estimate***

ATCO's proposal to include in its forecast expenditure for purchasing replacement gas for UAFG an amount for purchasing biomethane cannot be supported based on the additional information ATCO has provided to justify it, particularly at a time where there are significant increases in cost-of-living pressures for consumers and where we are not supporting the capital costs associated with installing additional injection points capable of receiving biomethane into the network. In light of these factors, where there exist other, lower cost, options for reducing the amount of UAFG or purchasing gas to replace UAFG, the unit cost should be set by reference to the lowest cost option. This does not, however, prevent ATCO from purchasing biomethane at some time during the AA6 period.

In relation to the updated unit price ATCO has proposed for the cost of purchasing natural gas, while it has (rightly) not been disclosed, the ERA should be able to support the adoption of such a unit price that has been determined following a competitive tender process (as ATCO claims).

***7. Ancillary Services cost estimate***

Our only comments in relation to Ancillary Services are in connection with the costs attributable to the Permanent Disconnection Service ($7.7 million) to derive a unit rate for that service (which is confidential).

It is not clear that the forecast expenditure total reflects the efficient costs of providing this service. This is so because:

- A benchmarking comparison should be made of the unit costs for similar services offered on other distribution networks in Australia.
- Before basing costs on actual costs in 2023, there should be consideration of whether there are (or are about to be) other safe, but lower cost, disconnection methods than the method ATCO has assumed to derive its proposed forecast costs. It is not apparent that this has

been considered. This is an issue that is being considered by gas distribution safety regulators throughout Australia (at least in Victoria and the ACT).

- If lower cost, but safe, alternative disconnection methods get developed during AA6, then there should be included a mechanism to allow for the lower costs to be passed on the customers, particularly B3 class customers.

## 8. DEMAND FORECASTS

### ERA Draft Decision

Amendments 2.1 and 2.2 of the Draft Decision required ATCO to amend its demand forecasts for haulage reference services and ancillary reference services to reflect the customer connections and demand forecasts as outlined in Table 2.20.

### ATCO Revised AA6 Proposal

ATCO has:

- not accepted the ERA's draft decision amendments in relation to demand forecasts because:
  - the ERA's criticisms of ATCO's methodology and approach to developing the forecast are not justified; and
  - ATCO considers the ERA's demand forecasts are overestimated, mainly due to:
    - The use of econometric variables to forecast customer numbers and gas consumptions for industrial (A1 and A2 tariff class) and commercial (B1 and B2 tariff class) customers;
    - Weather normalising demand forecast for A1 and A2 tariff classes; and
    - The use of a higher penetration rate to forecast B3 gross connections as a result of using the historical trend of actual dwelling completions and historical trends from 2014 to 2021;
- continued with the same methodology and approach to developing a demand forecast as it adopted in its Initial AA6 Proposal (ie relying on historical trends as a basis for developing the forecast but with appropriate adjustments for any future events which are expected to depart from historical trends); and
- updated its demand forecast in the Revised AA6 Proposal in the following respects:
  - the number of net new customers is forecast to grow at 1.1% pa during AA6; and
  - consumption per customer is forecast to increase at an overall rate of 0.4% pa during AA6.

### TRAC Partners Submission

***Demand forecasts for haulage reference services***

In deriving any forecast to be used in the access arrangement proposal, for it to best meet the relevant requirements under the NGR (in the case of demand forecasts, this is Rule 74(2)(b)NGR), regard should be had to a variety of data sets (rather than just one of the data sets) and a transparent methodology for the use of these data sets to establish the set of forecasts.

In relation to the data sets, we make the following points:

- caution should be applied to developing forecast annual rates of change (particularly for disconnection rates and gross new customer rates) that rely on actual data from the years prior to 2020. This is primarily because of the changes in market circumstances (pre-COVID) and government policies that have occurred since 2021. Any trends from that period are likely to be less indicative of trends for forecasting;

- however, since the release of the draft decision, the Commonwealth released its Future Gas Strategy (April 2024). Key principles of this strategy are to ensure there are continued gas field developments out to 2050 together with more flexible gas infrastructure to meet demand and keep the costs down as we transition to net zero. In addition, the government will be promoting the geological storage of CO2 and continue with the development of regional hydrogen hub programs. This points to the possibility of an ongoing role for gas and the usage of networks for some time which potentially points to a more optimistic forecast than prior to the release of the strategy.

- the ERA's methodology for deriving its forecasts (for all tariff classes) included (in part) a historical trend analysis. But at the same time, the ERA accepted that relying on historical trends for the purposes of assessing whether AD should be allowed was not prudent. There is a potential inconsistency in the ERA's logic in using forecasts derived (in part) from historical trend analysis that uses lengthy time series;

- as demand forecasting is an estimation process, it must be a best estimate arrived at on a reasonable basis (as required by the NGR). As such, it would give more confidence to stakeholders that forecasts are best estimates arrived at on reasonable bases if forecasts were derived from a range of data sources than just from one source (ie solely from the NIEIR forecasts); and

- we support data sets that take into account the most recently available actual data, as ATCO has done in its Revised AA6 Proposal with the incorporation of 2023 actuals.

In relation to the issue of a transparent methodology, we make the following points:

- More weight should be placed on demand forecasts for the distribution network from AEMO's Gas Statement of Opportunities than on other data sets. AEMO's forecasts are credibly derived and are not subject to the same potential issues as are the forecasts that have been developed by each of ATCO and ERA.

- We agree with the submissions from ATCO that the use of econometric variables alone does not provide the best estimate of either forecast demand or forecast connections, either generally or for forecasts for specific categories of customers (such as for A1 and A2 customers).

- We also would support giving greater weight to data sets that are derived from independent sources. Accordingly, deriving a forecast connection rate based (in part) on dwelling completion data sourced from the HIA gives stakeholders greater confidence that they are more reliable estimates/forecasts. This is further supported by regulatory precedent for other regulated gas distribution network forecasts.

- We do not think it is good regulatory practice to base a decision on forecast connection and disconnection rates based on the Patterson Research Group's report that the ERA commissioned to gauge the views of West Australian home builders and developers on the

installation of gas in new homes during ATCO's sixth access arrangement period (AA6) because of the following reasons:

- The report does not outline the methodology that was adopted by the research company in making its findings. For example, the report does not indicate the total number of individuals interviewed – while section 2.1.2 of the report mentions that 418 potential new homebuyers were interviewed, the report also refers to other categories of interviewees such as "prospective new homebuyers", "major land developers" and "new homes builders" but there is no mention of the total number of individuals in each category that were interviewed. If anything, it seems to suggest that there were only a handful of individuals in certain categories who were interviewed. It is not entirely clear what was the list of the specific questions that were asked by interviewees (unless it is to be inferred that the headings in section 2.1 of the report were the specific questions). It also does not outline whether any of the questions included specific estimates of costs involved for different energy supply options for new homes.
- It is not clear what categories of individuals were interviewed and what was the feedback received from some of the categories. As outlined in the above bullet point, there is a reference to four categories of interviewees but the detailed feedback outlined in section 2 of the report only outlines the feedback received from two categories of individuals - being "major land developers" and "new homes builders". Furthermore, section 2.1.2 includes statistics from 418 potential new homebuyers but it is not sure what question the statistics relate to. In addition, one would have expected to see individuals representing other categories being interviewed – eg existing home owners for new residential estates, developers of apartments etc.
- The report is qualitative in nature rather than quantitative – relying solely (or primarily) on a qualitative report to justify a decision that underpins an estimate/forecast could not be said to deliver a forecast/estimate that complies with the requirements of the NGR – ie a best estimate arrived at on a reasonable basis.
- There would appear to be quantitative evidence available in this respect – given WA has delayed the move to a 7 Star rating (relative to other jurisdictions), the ERA should look at what occurred in jurisdictions such as Queensland and NSW to see if there was a change in the rate of electrification of homes as a result of those states adopting the 7 Star requirement earlier than WA.

***Demand Forecasts for Ancillary Reference Services – Permanent Disconnection Service***

ATCO's proposal to estimate a forecast average permanent disconnection rate for B3 customers of 0.46% pa by applying a methodology that relies (in part) on analysing the trend in permanent disconnection rates going as far back as 2009 seems somewhat contradictory to its approach with respect to haulage reference service forecasts. But there does not appear to be any logic provided for taking this approach.

***Potential Trigger Event or Tariff Variation Mechanism***

As a final point, given the uncertainty associated with demand forecasting and the impact that demand forecasting has on the level of the reference tariffs payable by the consumers, the ERA should consider including either of the following in the Access Arrangement:

- A trigger event mechanism to the extent that the actual demand in any year of AA6 is above the approved forecasts by, say, 10%. This is consistent with trigger event mechanisms that the ERA's predecessor adopted for the Parmelia Pipeline access arrangement when there was a significant uncertainty associated with forecast demand.
- A tariff variation mechanism that requires ATCO to revisit its demand forecasts for haulage services each year and, to the extent that the updated demand forecasts are above the approved AA6 forecasts for the relevant year by, say, 10%, this will require the haulage reference

If the ERA were to agree to this proposal, either (or both) of these mechanisms would only need to be asymmetrical in nature (ie they only need to operate if the actual forecasts (or revised forecasts, as the case may be) are higher than the originally approved forecasts) because, if the actual (or revised forecast) demand is lower than the originally approved forecasts, ATCO:

- can voluntarily submit a revised access arrangement at any point in time during AA6; and
- should be financially incentivised to submit a revised access arrangement proposal given the price cap form of regulation that applies under the NGR.

## 9. REFERENCE TARIFF MATTERS

This section of the report deals with the following matters in relation to the reference tariffs for haulage and certain ancillary reference services:

- The level of the step change in haulage reference tariffs from 2024 to 2025 and the nature of the tariff path for haulage reference tariffs during AA6;
- The structure of the usage reference tariffs for haulage reference services other than the B3 reference service;
- Cost pass through events; and
- The level of the charge for the permanent disconnection ancillary reference service.

Submissions on some of the building blocks for the total revenue calculation and on the demand forecasts (both of which are relevant to the first issue above) are dealt with elsewhere in this report.

**ERA Draft Decision**

Relevantly, the ERA DD required:

- Haulage reference service tariffs to be amended to reflect the tariffs in Table 3.12 of the ERA DD (Amendment 3.2) **(Tariff Level and Tariff Path Amendment)**;
- ATCO to demonstrate why usage tariffs for reference services, other than the B3 reference service, should remain as declining block tariffs, instead of moving to a flat tariff structure (Amendment 3.3) (**Haulage Reference Tariff Structure Amendment)**;
- Ancillary reference service tariffs to be amended to reflect the tariffs in Table 3.14 of the ERA DD (Amendment 3.4) (**Ancillary Reference Tariff Amendment**); and
- The cost pass through events, as set out in Annexure B (clauses 2.1(a)(iv) & 2.1(a)(v)) of the proposed revised access arrangement, must be deleted (Amendments 3.5 & 3.6) (**Tariff Variation Amendment**).

There were also two other relevant matters raised by the ERA in its consideration of the Tariff Level and Tariff Path Amendment:

- the ERA decided to maintain ATCO's proposed one-off step increase in tariffs for 2025 (and for the reference tariffs to vary during the remainder of AA6 as a result of CPI related increases, changes in the trailing average cost of debt and any cost pass through changes) given that the increase for the draft decision is significantly more modest than ATCO's proposal. While this would result in the average B3 customer facing a 9.1% increase (in real terms) in its network component of its bill from 2024 to 2025, the ERA stated that "if the required one-off step increase for the final decision [from the 2024 tariff to the 2025 tariff] was going to be materially higher than set in the draft decision, the ERA will select a smoothed real price option for the final decision (**2025 Tariff Step Change issue**); and
- the ERA did not change the form of price control proposed by ATCO (a weighted average price cap - which allows average prices to increase by the annual change in CPI, plus or

minus an X-factor that is varied for debt risk premium updates and cost pass-through items) because no submissions were received on this issue before the ERA DD (**Tariff Path issue**).

There was also one other relevant matter discussed by the ERA in its consideration of the Haulage Reference Tariff Structure Amendment:

- The level of the fixed charge for the haulage reference tariff (in particular for the B3 customers) was set to a level that recovered fixed costs, while lowering the level of the usage charge for the tariff to be closer to the incremental costs of providing haulage services (**Fixed Charge Level**).

**ATCO Revised AA6 Proposal**

ATCO's Revised AA6 Proposal dealt with the above amendments and issues as follows:

**Tariff Level and Tariff Path Amendment** – ATCO has proposed:

- setting the level of the expected increase in the distribution charges component of the average retail bill from 2024 to 2025 to be 10%, although for B3 customers, the change in the distribution component of the average B3 retail bill from 2024 to 2025 is expected to be a 34% increase (from $200 to $268)[15]; and
- amending the tariff path for the remaining term of AA6 to help reduce the initial step up in tariffs from 2024 to 2025 by applying a 3% real increase in tariffs each year from 2026 to 2029. According to ATCO, this also has the effect of maintaining the tariff revenue and cost of service within approximately 3% of each other in the final year of AA6 and brings cost of service and tariff revenue closer in 2025.

**Haulage Reference Tariff Structure Amendment** – ATCO has proposed:

- that the B3 Haulage Reference Service tariff structure include a fixed charge and a variable two-usage band declining block tariff structure.
- setting the level of the fixed (or standing) charge for the B3 haulage reference tariff so that it doesn't quite cover all of the fixed costs. According to ATCO, including an annual repayment of the capital cost to connect a new customer, and the incremental operating cost of a new customer, results in a fixed charge of approximately $188 per year. This compares to the proposed fixed charge of $178 in 2025. Although it is noted that the level of the 2025 tariff is influenced by the forecast of demand for each service during AA6.
- retaining the same declining block usage charge tariff structure for all haulage reference services (but for the B3 Haulage Reference Service) that was adopted in AA5. ATCO's reasoning for not moving to a flat tariff structure is outlined in section 6.5 of the Revised Plan, including:
    - the uncertain effect that flat tariff charges would have on both ATCO's customers and their emissions, as well as the need to maintain relative stability in the pricing structure;
    - similar reasoning to that outlined above for why ATCO has decided to not adopt a flat tariff structure for the B3 service;

[15] ATCO Redacted Revised Plan for 2025-2029, Figure 6.1

- o the structure of the commercial and contractual arrangements between the retailers and the A1 and A2 tariff customers may prevent any changes in the tariff structure being passed through to these customers by the retailer.
- o A tariff structure that increases the unit cost for commercial and industrial gas consumers may act as a disincentive to attract more users of higher emissions fuel sources (such as LPG and diesel) to transfer to using natural gas (which generates relatively lower greenhouse gas emissions than LPG or diesel). ATCO claims to have transferred customers from these higher emissions fuel sources (it claims to have increased utilisation of the network by 2 petajoules) based on the declining block tariff structure.

**Ancillary Reference Tariff Amendment** – ATCO has proposed setting the reference tariffs for each of the ancillary reference services to the levels outlined in table 6.9 of its Revised Plan (page 47). ATCO claims that these tariffs have been set at a level that reflects the most current estimate of costs of providing the ancillary services (as reported in the 2023 Regulatory Information Notice (RIN)) as a starting point. Relevantly, for the purposes of this report, the level of the Permanent Disconnection Service reference tariff has been set at $1,208.88 for 2025 ($, nominal) and the level of the Disconnect Service reference tariff has been set at $100.33 for 2025 ($, nominal).

**Tariff Variation Amendment** – ATCO has proposed retaining two cost pass through events included in that tariff variation mechanism in its Initial AA6 Proposal (with minor modifications) – being the events outlined in:

- Clause 2.1(a)(iv) of its Revised AA6 Proposal – ATCO incurs additional expenditure in connection with an Emissions Control Law.
- Clause 2.1(a)(v) of its Revised AA6 Proposal – ATCO incurs expenditure that was included for projects included in business cases for renewable gases (other gases), but which were rejected by the ERA solely because of the fact that, at the time of the ERA's decision, there was no legislation enacted which referenced renewable gases. ATCO justifies not removing this provision:
  - o In the event that the legislation is amended before or after the ERA's Final Decision, and those costs become justifiable under the amended regulatory framework, the only other mechanism available to it for recovery of such (capital and operating) costs is to apply to re-open the Access Arrangement for AA6 under NGR 65. But this would be an inefficient mechanism;
  - o Were the event to be removed from the cost pass through mechanism, ATCO would be financially incentivised not to take any action in relation to other gases for the remainder of AA6.
  - o It is not correct for the ERA to have claimed that the assessment process for this type of expenditure is likely to be complex and stakeholders will not be afforded an opportunity to comment on the proposed cost pass through event or events. ATCO claims it has already submitted business cases to the ERA that stakeholders can comment on already. Furthermore, ATCO will be required to submit a variation report for the ERA's approval under Annexure B.

**TRAC Partners Submissions**

Our comments on ATCO's responses to each of the ERA's DD Amendments in turn:

***1. Tariff Level and Tariff Path Amendment***

At a time when customers are experiencing increasing cost of living pressures, with respect to which energy price increases are a key driver, minimising the level of the increase in the tariff from 2024 to 2025 should be a key goal.

While ATCO's Revised AA6 Proposal attempts to keep the level of the increase in the average retail bill from 2024 to 2025 to be 10%, as outlined above, for B3 customers, the change in the distribution component of the average B3 retail bill from 2024 to 2025 is expected to be a 34% increase (from $200 to $268)[16].

While the ERA did not specify in the ERA DD what was meant by "materially higher", an average 34% increase for B3 customers in the distribution component of their retail bills in 2025 would justify the ERA selecting a smoothed real price option for tariffs. It is noted that ATCO has proposed a real 3% (ie CPI +3%) annual tariff increase for tariffs to assist in maintaining the level of the step change in the average distribution tariffs for 2025 to 10%. However, a 34% increase in the distribution component outlined above would appear to be too much of a price shock. This would appear to be reinforced by the ERA's Patterson Group's research which indicated that customers would be comfortable with a one-off step increase of no more than 11%.

If however, accelerated depreciation is not allowed by the ERA in the final decision, the tariff path could be adjusted to:

- reduce the level of the step change in the tariff change from 2024 to 2025; and
- reduce the amount of the smoothing required during the AA6 period.

But, if the ERA is to allow an amount for accelerated depreciation, the tariff adjustment for this amount should be back ended in the latter years of the AA period to not compound the impact of the high one-off step change in tariff from 2024 to 2025.

***2. Haulage Reference Tariff Structure Amendment***

ATCO's reasoning for not adopting a flat usage tariff structure for the B3 service is outlined on pages 41 - 44 of the Revised Plan, including:

- the declining block tariff structure allows:
  - fixed charges to be, as far as reasonable, set to recover fixed costs while considering the impact on new connections, retail fixed charges and the relativity to them and low use, and possibly vulnerable, customers;
  - the balance of fixed costs to be recovered by the first usage band tariff;
  - the second usage band tariff to approximate the cost of incremental gas hauled; and
  - reduced revenue volatility for service providers at the margin, due to weather variability.

[16] ATCO Redacted Revised Plan for 2025-2029, Figure 6.1

- this structure is consistent with the structure adopted by the AER for other gas distribution networks;
- ATCO has not had time to consult with customers on moving away from a declining block structure; and
- ATCO has also not had time to consider, or consult with stakeholders on, the likely impact on customers (in particular vulnerable customers) and emissions reductions, as a result of moving away from a declining block structure. Although it is to be noted that, in Western Australia, the structure of the retail tariff (which includes distribution network charges) is also still a declining block structure.

This reasoning does not appear to justify ATCO not complying with the ERA's required amendment. This is so for the following reasons:

- Firstly, the above arguments do not appear to adequately address all of the ERA's reasons in the ERA DD for adopting a flat usage tariff structure.
- Secondly, it is self-evident that adopting a flat usage tariff structure will be more favourable to vulnerable customers (than retaining a declining block tariff structure) when considered from the perspective of the unit cost of gas per customer.
- Thirdly, it removes the inefficiency and inequity within the B3 tariff class group of customers when the declining block structure is adopted as lower usage B3 customers are paying more per unit of gas consumed compared with higher usage B3 customers. A flat tariff structure removes that inefficiency and inequity.
- Finally, a flat usage tariff structure could better assist in complying with the second limb of the NGO (when compared with a declining block structure). While even under the present declining block structure, ATCO is forecasting a reduction in the rate of growth (when compared to historical average rate of growth), the flat structure may have the effect of slowing the rate of growth more effectively.

### *3. Ancillary Reference Tariff Amendment*

In this section of the report, are comments are restricted to the level and structure of the charge for the permanent disconnection ancillary reference service being proposed by ATCO.

Our first comment is that it is not clear that the level of the tariff reflects the efficient costs of providing this service. This is so because:

- A benchmarking comparison should be made of the tariffs for similar services offered on other distribution networks in Australia. In Victoria, cost reflective tariffs for permanent disconnection (called abolishment in Victoria) were assessed by the AER as varying between $822.44 and $950 across the three Victorian distribution service providers. It is not apparent why ATCO's cost for the same service is up to 22% higher than for part of the Victorian distribution network.
- Also, as mentioned in section 7 of this report, the ERA should consider whether there are (or are about to be) other safe, but lower cost, disconnection methods than the method ATCO has assumed to derive its proposed permanent disconnection tariff. It is not apparent that this has been considered. This is an issue that is presently being considered by gas distribution safety regulators throughout Australia (at least in Victoria and the ACT).

Our second point is that it is not clear that adopting a fully cost reflective, user pays, tariff for this service is consistent with the NGO, particularly the emissions reduction and safety limbs of the objective. This has been discussed in the AER's assessment of the most recent access arrangements for Victorian distribution networks. The following matters warrant consideration by the ERA as to the structure for the permanent disconnection service reference tariff for ATCO's access arrangement as they were considered relevant to the AER when deciding on the structure of the tariff for the equivalent permanent disconnection service:

- Given the level of the tariff, a potentially large proportion of customers who decide they no longer want a reticulated gas supply may seek to avoid the tariff by not requesting a permanent disconnection. This was something that has begun occurring in the east coast networks, as evidenced by:
  - retailer reports that they are already experiencing this type of customer behaviour; and
  - a submission from EvoEnergy, the gas distributor in the ACT, in response to the Victorian distributors' initial proposals, describing the same behaviour occurring in the ACT.
- Whether there has been growth in the number of temporary disconnections without corresponding growth in reconnections (and whether the number of permanent disconnections remains steady or even decline). An audit has been conducted in the ACT for EvoEnergy's network to show that this has begun occurring.
- Social media sites have appeared where customers are sharing tips on how to avoid permanent disconnection tariffs.

In the case of the Victorian network access arrangement decisions, the AER concluded that capping the costs for the disconnection service at a certain level (to match the tariff cost of a temporary disconnection service) while recovering the balance of the direct costs from disconnection through the haulage reference tariff achieves a balance between competing objectives regarding public safety, efficient price signals, bill impacts for customers and distributor revenue recovery, even though socialising a large proportion of permanent disconnection costs to all users (through the haulage tariff) has the following drawbacks:

- remaining gas customers will carry a disconnection cost burden through their retail bills
- vulnerable customers may remain connected to gas networks longer than customers with greater resources, meaning that socialising abolishment costs may be regressive.

It was also noted that this can only be an interim approach while governments, networks, market bodies and investors develop a long-term strategy for taking gas networks forward. Should the number of gas customers permanently leaving gas networks each year grow, so the annual permanent disconnection cost burden on remaining customers will also grow. Moreover, if total customer numbers decline, then the socialised abolishment cost burden will fall on a diminishing customer base, magnifying retail bill impacts for remaining gas customers.

Our third point is that it is not clear that adopting a fully cost reflective tariff for this service is consistent with the safe operation of the network. If a customer request for a permanent disconnection is currently the only trigger for disconnection to be undertaken by ATCO, then if the level of the tariff would result in an unacceptably large number of gas connection pipes remaining in situ with gas in them, this would mean that gas remaining in pipework could expose the community to unacceptable safety risks, particularly if a permanent disconnection is

necessary to ensure that hazards and risks to the safety of the public and customers arising from gas are minimised as far as reasonably practicable.

Finally, regardless of the structure of the tariff for this service that is to be implemented, consideration should be given to the inclusion in the access arrangement of a mechanism to allow for the lower costs to be passed on the customers, particularly B3 class customers. This is particularly important given there is work being undertaken to research lower cost, but safe, alternative disconnection methods for permanent disconnections.

That mechanism could be in the form of either a true-up mechanism (as part of a cost pass through mechanism) to lower (or raise) haulage tariffs in subsequent financial years if the number of small customer permanent disconnections is lower (or higher) than forecasts in any given year or a cost pass through mechanism if the forecast cost of permanent disconnections reduces significantly to pass through to customers the benefit of any lower cost permanent disconnection methods approved by the safety regulator, via this mechanism.

### *4. Tariff Variation Amendment*

*(a) Clause 2.1(a)(iv) – additional expenditure in connection with an Emissions Control Law*

ATCO justifies the retention of clause 2.1(a)(iv) in its Revised AA6 Proposal (ATCO incurs additional expenditure in connection with an Emissions Control Law) by claiming that the ERA was wrong to conclude that all of the events likely to be covered by this provision were already captured by the events in clause 2.1(a)(iii) and so, the clause was effectively a double up.

The drafting of this clause is quite broad and it is difficult to know the range of circumstances that it could apply to. ATCO outlines two examples of such events which would not be covered by clause 2.1(a)(iii) (to provide some guidance and also to explain that there is no double up). The first is if UAFG levels significantly increase for an unforeseen reason outside of ATCO's control. It is difficult to identify what may be an unforeseen reason to drive an increase in UAFG levels other than if it increases because demand on the network significantly increases above forecast demand. But if this circumstance were to occur, it would give rise to a need to undertake a more fulsome review of the access arrangement, particularly if the ERA is to allow an amount for accelerated depreciation.

In this report, we have suggested that the ERA consider including a trigger event mechanism in the final decision to address any material variance in demand from the forecasts that get used for the purposes of setting the tariffs in the final decision. If this proposal is supported by the ERA, then at this point in time, ATCO would put forward revised UAFG forecasts in its revised forecast of operating expenditure. This would therefore place ATCO into a similar situation than had this type of clause been

The second example ATCO gives to explain when this clause would be used (but clause 2.1(a)(iii) would not be able to be used) is if AEMO miscalculates ATCO's UAFG under the Retail Market Procedures. If this situation were to arise, ATCO should use the mechanism in the Retail Market Procedures to challenge the miscalculation. That should be the process followed to address any issues. By allowing this clause to be included in the access arrangement, this could incentivise ATCO to not challenge any miscalculation under the Procedures.

As a final matter, ATCO does not appear to have addressed the other reasons outlined by the ERA in the ERA DD for requiring its removal.

For the above reasons, we don't believe that the case has been made for the retention of this clause in the Revised AA6 Proposal.

*(b) Clause 2.1(a)(v) – expenditure that was included for projects included in business cases for renewable gases (other gases), but which were rejected by the ERA solely because of the fact that, at the time of the ERA's decision, there was no legislation enacted which referenced renewable gases*

ATCO justifies not removing this provision on the following grounds:

- In the event that the NGL is amended before or after the ERA's Final Decision, and those costs become justifiable under the amended regulatory framework, the only other mechanism available to it for recovery of such (capital and operating) costs is to apply to re-open the Access Arrangement for AA6 under NGR 65. But this would be an inefficient mechanism;
- Were the event to be removed from the cost pass through mechanism, ATCO would be financially incentivised not to take any action in relation to other gases for the remainder of AA6.
- It is not correct for the ERA to have claimed that the assessment process for this type of expenditure is likely to be complex and stakeholders will not be afforded an opportunity to comment on the proposed cost pass through event or events. ATCO claims it has already submitted business cases to the ERA that stakeholders can comment on already. Furthermore, ATCO will be required to submit a variation report for the ERA's approval.

In relation to the first ground above, we remind the ERA of the other mechanisms in the NGR which could be used in the case of items of proposed capital expenditure:

- Rule 80 NGR is available to ATCO to apply to the ERA to have it make an advance determination with regard to the item. The ERA would be required to consult on the application and if approved, it would be forced to accept the items of expenditure in the next revised access arrangement. While there may be a time value of money impact, it is noted that most of the capital expenditure projects that ATCO has proposed are proposed to be incurred towards the back end of the AA6 period.
- Rule 65 NGR – to create a speculative expenditure account – as outlined earlier in this report.

In relation to the second ground, the use of a speculative expenditure account for this type of expenditure would increase in value by a return on capital component and so, there is no adverse impact to ATCO to leave this to the next access arrangement review process after any change in the legislation has been enacted. This should address ATCO's concerns that it would not be financially incentivised to take action in relation to other gases for the remainder of AA6.

In relation to ATCO's last point, it is important to note that, for the proposed items of expenditure for renewable gas related projects, the reasons they have not been allowed were not solely limited to the fact that, at the time, there was no legislation enacted which referenced renewable gases. Moreover, other submissions made have outlined other reasons why these projects should not be allowed. If the legislation is subsequently enacted, this mechanism should not be allowed to allow costs in the tariff calculation if there were other reasons for not allowing them and they are either not addressed or, if ATCO seeks to address them at the time, stakeholders are unable to be consulted on these issues at the time.

For the above reasons, we don't believe that the case has been made for the retention of this clause in the Revised AA6 Proposal.

# 10. MATTERS RAISED BY ENERGY CONSUMERS' PANEL BUT NOT ADDRESSED BY THE ERA DD OR ATCO'S REVISED AA6 PROPOSAL

We have reviewed the points raised by the WA Expert Consumer Panel in its submission on ATCO's Initial AA6 Revised Proposal to assess the extent to which they have been addressed by the ERA in the ERA DD and by ATCO in its Revised AA6 Proposal. This is summarised in the table below.

The colour coding adopted in the table below means:
Red – ERA has considered the matter but has adopted a fundamentally different position on the matter in the ERA DD to what was suggested by the ECP submission. This report contains further submissions on the issue.
Amber – ERA has not considered the matter in its reasoning for the ERA DD. This report contains further submissions on the issue.
Yellow – ERA has considered the matter in its reasoning for the ERA DD and has adopted the same or similar position to what was suggested by the ECP submission but, this report contains further submissions and either provides additional arguments in support or to justify taking a different approach.

We have not included in this table any matter raised in the submission which the ERA DD has considered and agreed with.

| Issue | ERA DD & Revised AA6 Proposal | Relevant section of report with further submissions |
|---|---|---|
| **Accelerated Depreciation** | | |
| Should not be allowed in principle/concept | ERA has allowed AD as a matter of principle | Section 3 |
| If it is to be allowed in principle, a smaller amount should be allowed in the earlier years of AA6 | Not addressed by ERA in DD<br>Partly addressed by ATCO in Revised AA6 Proposal | Section 3 |
| If AD is to be allowed, it should not be applied to assets that ATCO voluntarily chooses to invest in from now on – eg expansions of the network and new connections | Not addressed in ERA DD or ATCO Revised AA6 Proposal | Section 3 |
| **Demand Forecasts** | | |
| The forecast network penetration rate (and therefore the number of new connections) proposed by ATCO is overly optimistic. In particular:<br>- it should follow a declining trend and<br>- the rate of disconnections should follow an | Covered by Amendment 2.1 but ERA is proposing higher customers and higher gas usage than had been proposed by ATCO | Section 8 |

| Issue | ERA DD & Revised AA6 Proposal | Relevant section of report with further submissions |
|---|---|---|
| increasing trend, rather that remain flat during the AA period | | |
| **Expenditure for renewable gas** | | |
| Does not consider ATCO's proposed expenditure on renewable gas readiness to be conforming expenditure | No such expenditure (capex or opex) allowed - Covered by Amendments 3.1, 3.5, 4.1, 4.2, 5.1, 5.2, 5.3, 5.6 & 8.3 | Sections 5, 6 and 7 |
| Does not support the $0.4m of capex for the first stage of the hydrogen blending initiative to be conforming capex or the opex associated with this project | | |
| **Tariff Path** | | |
| A tariff path that avoids the large one-off step increase in the tariff from 2024 to 2025 (with no real increases from 2025-2029) and instead has a smooth tariff path from 2024 to 2029 has the potential to drive customers off the network sooner (than a smoother tariff path from 2024-2029) | ERA has maintained a one-off step increase in the tariff from 2024 to 2025 and with no real increases from 2025-29<br>ATCO has proposed a 10% initial average increase with a CPI+3% increase for each year of AA | Section 9 |
| **Permanent disconnection tariff** | | |
| ATCO has not provided enough information to enable the Panel to understand why the cost of providing the permanent disconnection service (and therefore the tariff) is so much higher than the tariff for the "Disconnect" ancillary service. | Covered by DD. But, while the ERA has proposed a lower permanent disconnection tariff, it is still significantly higher than the level of the "Disconnect" ancillary reference service tariff. | Section 9 |
| The Panel questions why, if a set fee is charged by ATCO, a retailer is then able to also charge their customer a fee for the removal of metering equipment. Consideration should be given to removing this from ATCO's proposed permanent disconnection contract if | Not addressed in DD | Section 9 |

| Issue | ERA DD & Revised AA6 Proposal | Relevant section of report with further submissions |
|---|---|---|
| reasonable reasons for allowing it cannot be provided. | | |
| **Stakeholder Engagement** | | |
| Ineffective engagement to enable consumers to make fully informed judgments on the proposed AA | | Sections 2 and 3 |