



30 November 2023

Economic Regulation Authority
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www.erawa.com.au/consultation

Proposed revisions to the access arrangement for the Mid-West and South-West Gas Distribution Systems – Issues Paper

Alinta Sales Pty Ltd (**Alinta Energy**) is pleased to provide comment on the Issues Paper released by the ERA to assist in its review of ATCO's proposed access arrangement (**AA6**) for the Mid-West and South-West Gas Distribution Systems (**MWSWGDS**) for the five-year period from 1 January 2025 to 31 December 2029.

Alinta Energy sells natural gas to over 430,000 customers connected to the MWSWGDS and, as such, has significant interactions with ATCO with respect to customer connections and disconnections, meter readings and gas supply.

Below are our comments on the nine topics of interest identified by the ERA in the Issues Paper, as well as some additional commentary on other matters of concern raised in the *ATCO Gas 2025-29 Plan (2025-29 Plan)*.

Overall, we believe there are strong grounds for challenging key aspects of ATCO's proposed 2025-29 Plan. Regarding the proposed price path, Alinta Energy considers long-term stability in underlying network tariffs to be in the long-term interest of consumers and is of the view this can be achieved by applying a smaller step increase in 2025, followed by a smoother year-on-year increase over the remainder of AA6.

Yours sincerely

Daniel McClelland
Executive Director, Corporate Services
Alinta Energy

1 Stakeholder engagement

Alinta Energy is concerned that the findings of ATCO's customer research do not support its proposed additional expenditure over AA6 as claimed.

ATCO's Voice of the Customer stakeholder engagement found that:

- Customer bill size was overwhelmingly the largest influence in ATCO's Choice Model by a factor of at least 1.5 and up to a factor of 10, meaning 'customers are very responsive to a smaller shift in % change compared to the other attributes';
- For some customers, the \$38 increase per annum due to inflation and interest was described as 'very hard to comprehend' (noting that the proposed overall increase in 2025 is more than double this amount);
- Whilst customers understood and acknowledged their household bills would increase, they expected ATCO to absorb some of the cost; and
- There is little or no willingness to pay (**WTP**) for most areas of ATCO's proposed additional expenditure.¹

We note that ATCO's research did not appear to consider the impact of the proposed increases on vulnerable customers, nor the cumulative impact of all the proposed areas of expenditure on bill size.

Significantly, ATCO claims there is a high WTP for renewable gas (this is discussed in more detail in section 6 of this submission). However, we observe that:

- Customer responses were based on the *delivery* of renewable gas, which will not be achieved for many years and potentially never;
- Expenditure in AA6 is for preparatory work only (again, not delivery), for which there has been no customer research;
- The potential cost of appliance replacement, which may be required to accommodate renewable gases, does not appear to have been considered;
- The WTP of vulnerable customers, which presumably would be much lower, has not been considered; and
- Unlike electricity green power initiatives sold by retailers, renewable gas would not be an opt-in offering.

It is particularly worrying that, despite concerns raised by customers that overall bill size is the most important attribute and ATCO noting that 'This means customers are very responsive to a smaller shift in % change compared to the other attributes', ATCO has not appeared to take customers' feedback into consideration at all.

Rather, ATCO has proposed a significant increase of \$78, or 39%, for an average residential (B3) customer at the start of AA6, from \$199 in 2024 to \$277 in 2025. This represents an increase of 12% on an annual retail gas bill at the gazetted price, well above the annual CPI increase permitted under the Gas Tariffs Regulations.²

¹ Attachment 04.001: AA6 Voice of the Customer Insights Report, ATCO Gas 2025-29 Plan, pp. 7, 27, 109

² Energy Coordination (Gas Tariffs) Regulations 2000, Energy Coordination Act 1994, Western Australia

2 Changes to the legislative framework

Alinta Energy supports the ERA's position of applying the relevant regulatory framework from a 'point in time' perspective, whereby it does not seek to apply amended regulations and legislation in advance of those amendments being adopted. This appears to be the most sensible, practical approach to evaluating ATCO's proposed access arrangement revisions. Applying any proposed amendments in advance of those amendments being implemented would be inappropriate for the simple reason that proposed amendments may never be progressed to the implementation phase, or may be progressed, but with significant changes.

Impending changes to legislative framework create substantial uncertainty, including challenges for the ERA in reviewing ATCO's proposal. We support the ERA's initiative in proactively fostering dialogue on the practical implications of the possible changes to the framework and offer the following general comments on the proposed changes to the legislative framework as they currently stand. These comments are pertinent to our views on ATCO's proposed AA6 expressed in this submission.

The proposed changes to the framework that would, if adopted, have bearing on assessment of ATCO's proposed AA6 are:

- Amendments to the National Gas Law (**NGL**) to incorporate an emissions reduction objective into the National Gas Objective (**NGO**); and
- Amendments to the NGL and National Gas Rules (**NGR**), as they apply in WA, to extend the gas regulatory framework to hydrogen blends and renewable gases.

The NGO is central to the ERA's decision-making in respect of the entirety of AA6 given that the NGR, in both their current and expected future form, specify that the provisions of an access arrangement must be consistent with the NGO.³

The NGO as it currently applies through WA legislation is:

*The objective of this Law is to promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas.*⁴

The proposed revised NGO, pending implementation in WA is:

The objective of this Law is to promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to—

- *price, quality, safety, reliability and security of supply of natural gas.*
- *the achievement of targets set by a participating jurisdiction—*
 - *for reducing Australia's greenhouse gas emissions; or*
 - *that are likely to contribute to reducing Australia's greenhouse gas emissions.*⁵

Under both versions of the NGO, the ERA is required to promote the long-term interests of gas consumers. Both versions contain an economic efficiency component and other components including considerations of price, quality, safety, reliability and security of supply of natural gas. The key difference between the current and proposed revised NGO is that the latter includes an emissions reduction component.

³ NGR 68B

⁴ National Gas Access (WA) Act 2009, s. 23

⁵ Incorporating an emissions reduction objective into the national energy objectives - Information Paper, Energy Ministers, May 2023, p. 8

If the revised NGO comes into effect, the ERA will be required to balance the emissions reduction component of the NGO and the other considerations included in the NGO in its decision-making. This was recognised in the Consultation Paper on the proposed amendments to the legislative framework:

The provision of various relevant criteria for the objectives recognises that there are tradeoffs to be made. In practice, market bodies routinely have to balance and make trade-offs between them. This is currently achieved in a balancing act that considers each of the components in the objectives together, rather than consideration of each in isolation. Including an emissions reduction component under the energy objectives as proposed would compel decision makers to consider it as one of a number of components or 'outcomes' (alongside price, quality, safety, reliability and security of supply) but allow market bodies the discretion to balance the various components when making decisions, as they currently do.⁶

If adopted for WA, we do not consider that the emissions reduction component should be elevated above the other components of the revised NGO in decision-making.

Our view on the legislative framework underpins our position on ATCO's proposed investments in renewable gases, which will be discussed in section 6 of this submission.

3 Demand forecasts

Our comments regarding ATCO's proposed demand forecast for AA6 are presented in two subsections.

Firstly, we discuss our general, high-level comments on ATCO's forecast, including providing our own forecast for the residential (B3) customer tariff class and views on demand trends and factors.

Secondly, we provide specific comments on the methodology applied by ATCO and recommend some popular approaches to forecasting that are already in use in Australia.

3.1 General comments

Alinta Energy considers ATCO's B3 demand forecasts to be significantly underestimated. Whilst we note some domestic and international commentary that demand for natural gas will decrease in the long-term, driven in part by the shift towards renewable energy, these predictions are based on highly variable economic, environmental, policy and geopolitical factors.

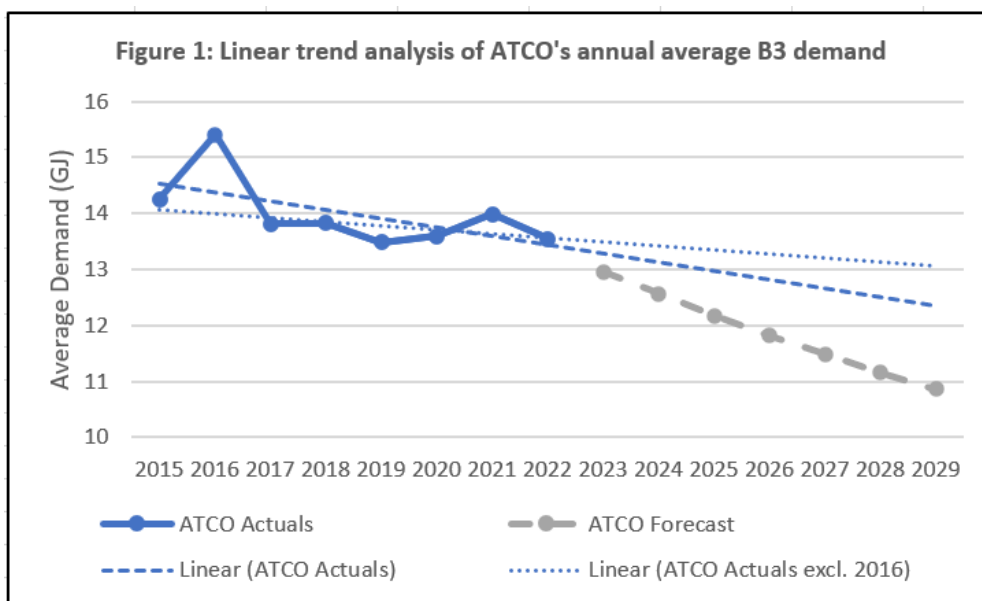
Having considered the current and proposed changes in some key contributors to the demand forecast for natural gas, we do not foresee a pronounced decrease in the short-term. This is consistent with our own forecast of gas demand for the Alinta Energy B3 customer base. As shown in Table 1, we anticipate only a marginal decline in B3 demand over AA6, in comparison with ATCO's forecast average year-on-year decrease of around 3%.

⁶ Incorporating an emissions reduction objective into the national energy objectives - Proposed legislative package to give effect to an emissions reduction objective in the National Electricity Law, the National Gas Law and the National Energy Retail Law - Consultation Paper, Energy Ministers, December 2022, p. 5

Table 1: Comparison of forecast average residential (B3) customer demand over AA6

| | 2025 | 2026 | 2027 | 2028 | 2029 | Average |
|--------------------|--------|--------|--------|--------|--------|---------|
| ATCO (GJ) | 12.17 | 11.82 | 11.48 | 11.16 | 10.86 | 11.50 |
| Alinta Energy (GJ) | ██████ | ██████ | ██████ | ██████ | ██████ | ██████ |

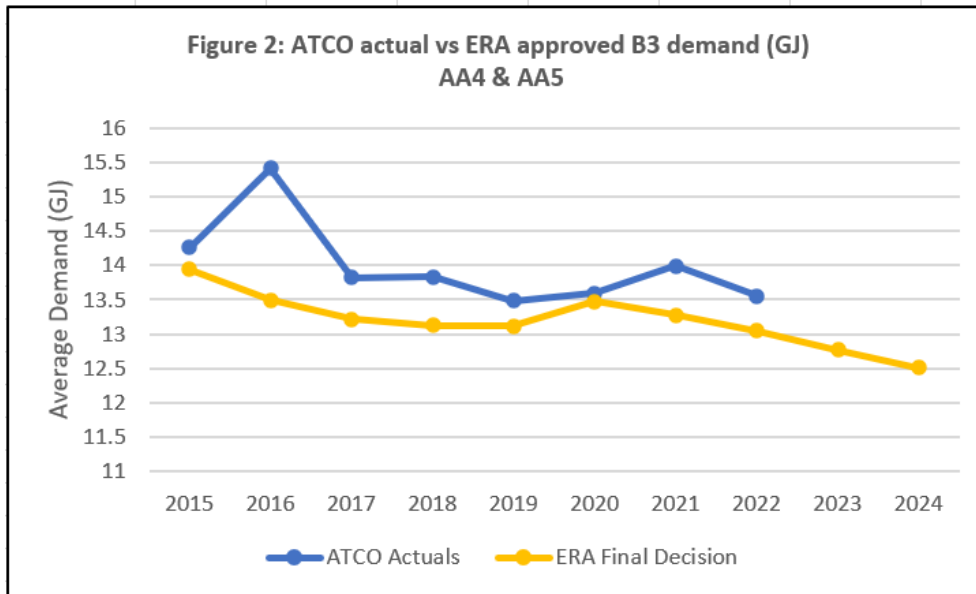
Further concern with the rate of decrease forecast by ATCO is raised by Figure 1. Applying a linear trend to ATCO's actual volumes over AA4 and AA5 shows that a continuation of this trend, which Alinta Energy considers to be overly pessimistic, would be well above demand levels forecast by ATCO in AA6. The divergence from the historical trend is even greater if 2016 is excluded from the trend analysis, which we consider to be a reasonable approach given the abnormally cold weather that year.⁷



Ensuring forecast demand is as accurate as possible is of the utmost importance, given its key role in calculating reference haulage tariffs. The Australian Energy Regulator (**AER**) recently commented that 'gas distributors have, over the last 10 years, consistently earned more revenue than our determinations have targeted because actual gas volumes have been higher than the forecasts we have used to determine haulage tariffs.'⁸ Figure 2 shows that this is precisely what has occurred with respect to ATCO's approved forecasts for both AA4 and AA5, returning a significantly greater revenue to ATCO over these access arrangement periods.

⁷ Over 2014 – 2018 there was an average of 614 HDDs, with a high of 830 HDDs in 2016.

⁸ Review of gas distribution network reference tariff variation mechanism and declining block tariffs – Final decision, Australian Energy Regulator, October 2023, p. 5



We draw the ERA's attention to NGR 65(1) and the asymmetrical risk applying to ATCO and consumers, whereby ATCO may apply to the ERA to vary an approved access arrangement:

A service provider may submit for the AER's approval a proposal for variation of the applicable access arrangement (an access arrangement variation proposal).

The AER considers that a 'driver of an access arrangement reopener application could be actual gas volumes being lower than the forecasts we used to determine a distributor's target revenues'.⁹ Customers, on the other hand, are not provided with an opportunity to request a reduction in haulage tariffs if actual volumes are higher than forecast.

Below we discuss some of the key factors likely to have the highest effect on demand for natural gas in WA and our views on how these factors are likely to develop in the short-term.

3.1.1 Population growth

Population growth in WA will be a contributor to higher consumption of natural gas in the short-term. Data from the Australian Bureau of Statistics has confirmed WA has the nation's highest population growth rate, at 2.3%, compared to a national average of 1.9%. Between the 2016 and 2021 Census, WA gained approximately 20,000 more residents than previously estimated. Overall, approximately 50,000 more people are living in WA than forecast and current data shows the number of people who moved to the state during the COVID period was higher than previously estimated.¹⁰ The inferences that can be drawn from these developments are that WA's population is growing larger than forecast and that growth is happening quickly. This factor will support gas consumption in the short-term.

3.1.2 Industrial activity

The WA Government has forecast real Gross State Product (**GSP**) will grow 1.0% in 2023-24, 1.75% in 2024-25 and 2.25% in 2025-26. Goods-producing industries (including mining, construction and manufacturing) accounted for 60% of GSP in 2021-22.¹¹ On this basis, we can

⁹ Review of gas distribution network reference tariff variation mechanism and declining block tariffs – Final decision, Australian Energy Regulator, October 2023, p. 7

¹⁰ UWA (The University of Western Australia), July 2023 [Growing pains are real: new data reveals WA's population is bigger than we thought \(uwa.edu.au\)](https://www.uwa.edu.au/news/growing-pains-are-real-new-data-reveals-wa-s-population-is-bigger-than-we-thought)

¹¹ JTSI (Department of Jobs, Tourism, Science and Innovation, Government of Western Australia), *Western Australia Economic Profile*, January 2023, p.1 <https://www.wa.gov.au/system/files/2023-02/WA%20Economic%20Profile%20-%20January%202023.docx>

expect an increasing trend in industrial activity in WA over the next few years and a need for more natural gas for industrial purposes.

An assessment of WA's domestic gas market by the Australian Energy Market Operator (AEMO) for the 10-year period 2023 to 2032 indicates 'a tight supply demand balance between 2023 and 2029' with an average annual growth rate of 1.7%. Whilst customers supplied through ATCO's network account for only 7% of the total domestic gas demand, AEMO anticipates a growth in residential and small business connections at an average annual rate of 0.8%.¹²

3.1.3 Government policy

State government policy towards natural gas is more favourable in WA than other Australian states and territories. ATCO has itself acknowledged this, expressing:

*'In WA, the gas distribution network continues to be supported by the government and by other stakeholders and customers in part due to the lower cost of gas compared to other states. We note that the recent analysis by the Grattan Institute demonstrates the price competitiveness of gas in WA. Their report states "Some West Australian homes may pay more in an all-electric home – since gas is so cheap in that state".'*¹³

A prime example of a policy favourable to gas in WA is WA's Domestic Gas Policy (referred to as 'DomGas'), in place since 2006, which seeks to make gas equivalent to 15% of exports available for WA consumers. There is no similar protection for in-state consumption in other Australian states and territories. This policy has had significant consequences for wholesale gas pricing in WA in recent years following geopolitical instability in Europe from early 2022 which constrained the supply outlook for gas internationally, with wholesale gas prices rapidly increased globally.

Recent policy developments around Australia have also indicated a more supportive policy environment for natural gas in WA than elsewhere. Whilst the governments of Victoria and the ACT have made announcements regarding the phasing out of natural gas, the WA Government has confirmed it will not impose a ban on new homes connecting to the gas network.^{14,15,16}

3.1.4 WA consumer sentiment

ATCO's own research across its operations has identified favourable attitudes towards gas among its current customers and communities in which it operates. ATCO has found, for example, that:

*'Consumers are keen to continue to use gas as part of the energy system due to its relative affordability. Majority of customers surveyed (79%) believe the price they pay for natural gas is not beyond their means.'*¹⁷

Such a finding supports our views outlined previously on the favourable pricing of gas in WA.

Further, ATCO has also found that:

'In a recent survey... more than half of ATCO's end-users surveyed (53%) consider access to gas as "extremely important" in their household and up to 97% of our end-

¹² 2022 Western Australia Gas Statement of Opportunities, AEMO, December 2022, p. 3, 5, 25, 29

¹³ ATCO Gas 2025-29 Plan, p. 174

¹⁴ Victoria State Government, [New Victorian homes to go all electric from 2024](#) (media release), July 2023 [New Victorian Homes To Go All Electric From 2024 | Premier of Victoria](#)

¹⁵ ACT Government, [Australian first partnership helps Canberrans make their next choice electric](#) (media release), April 2023 [Australian first partnership helps Canberrans make their next choice electric - Chief Minister, Treasury and Economic Development Directorate \(act.gov.au\)](#)

¹⁶ [WA premier confirms gas in the mix for residential energy in his state](#), August 2023

¹⁷ Attachment 03.004A: Renewable Gas Delivery Strategy, ATCO Gas 2025-29 Plan, p. 30

users surveyed believe gas to be important. The response to the survey was even more positive towards gas when considering our regional end-users.¹⁸

3.2 Comments on ATCO's gas forecast methodology

ATCO has used a range of historical data in its demand forecast, including weather, disconnection numbers and demand per connection. In its approach, ATCO has also taken all access arrangement draft and final decisions, future network reach/penetration, retailers' plans and other third-party data sets into account to adjust its forecasts. It is also evident that ATCO normalises the historical actual demand using weather impact based on AEMO's EDD (Estimated Degree Day) forecasting guidelines.¹⁹

We agree that using historical data to forecast future gas demand is an appropriate approach. Historical data reflects ultimate demand responses to market dynamics, seasonal fluctuation and business cycles, policy and regulatory changes and any other shocks affecting demand for natural gas. These variations are all important in shaping future demand for gas, including for the AA6 period.

3.2.1 Popular approaches in forecasting

Whilst historical data is crucial for demand forecasting purposes, some further considerations should be taken into account regarding upcoming uncertainties in the market. This does not eliminate the importance of historical data in the forecasting models. The uncertainties, which could be mostly around the renewable transition, policy and regulatory changes and weather conditions, could be addressed through various approaches. Some popular approaches that are currently practised in Australia are included below.

Developing multiple scenarios

Developing multiple scenarios that consider different future conditions, such as economic dynamics, policy and regulatory changes, advancements in renewable technology, or the progress of the renewable transition, helps in understanding potential outcomes and associated risks. The outcomes could be consulted on with stakeholders to then arrive at the best-case scenario covering upcoming uncertainties. This is a popular approach in regulatory pricing in Australia. For instance, for its 2023 water price review in Victoria, the Essential Services Commission asked water businesses to make available evidence that a range of supply and demand scenarios were modelled in their submissions. This included low, normal and high water inflow scenarios and consideration of a range of low to high population growth assumptions.²⁰

Monte Carlo simulation

Conducting Monte Carlo simulations to model possible future scenarios by introducing random variations in key parameters helps in assessing the range of potential outcomes and associated probabilities. Monte Carlo simulation is popular in demand forecasts and regulatory pricing in Australia. For instance, in setting up seasonal peak demand and annual energy forecasts for the regional demand profiles for the Queensland Competition Authority, Acil Allen used a number of years of historical load data, together with the P10, P50 and P90 seasonal peak load and energy forecasts from the AEMO neutral scenario, to produce multiple simulated representations of the hourly load profile for the given determination year using a Monte Carlo analysis. These multiple simulations include a mix of mild and extreme

¹⁸ Attachment 03.004A: Renewable Gas Delivery Strategy, ATCO Gas 2025-29 Plan, p. 30

¹⁹ Attachment 07.001: CORE Energy – Gas Demand Forecast, ATCO Gas 2025-29 Plan

²⁰ Essential Services Commission, 2023 water price review – Guidance Paper, p. 49-50, [2023 water price review \(esc.vic.gov.au\)](https://esc.vic.gov.au)

representations of demand – reflecting different annual weather conditions (such as mild, normal and hot summers).²¹

4 Cost recovery for disconnections

Alinta Energy supports ATCO's proposal to require up-front payment directly from customers requesting the permanent disconnection ancillary reference service. From a retailer's perspective, we do not foresee a significant increase in the uptake of this service over the AA6 period and therefore do not consider it appropriate to socialise the costs of providing this service across the broader customer base at this time.

Of greater concern is the absence of any key performance indicators and accountability related to disconnections, noting the \$27.1m contributed by ancillary reference services – including applying a meter lock and disconnecting a delivery point – to the proposed AA6 operating expenditure.

When a retailer requests ATCO to disconnect a delivery point under the Retail Market Procedures, then ATCO is obliged to complete that service order request.²² However, we have found all too frequently that, if ATCO is unable to perform a disconnection at the first attempt then the service order, having been paid for by the retailer, is simply closed out and no further action is taken.

When a retailer requests and pays for a disconnection, there is a reasonable expectation and a regulatory obligation that ATCO will complete that disconnection, even if it means finding an alternative solution. If disconnection is not practicable then, as a last resort, any on-going consumption costs incurred at the delivery point should be borne by ATCO or shared, as agreed, with the retailer.

5 Network tariff structures

Alinta Energy supports the removal of the first tariff band for residential (B3) customers, which currently provides 1.825 GJ of gas at no charge, but on the proviso that the supply charge for these customers is equivalently reduced. The ERA will need to be satisfied that ATCO's proposed \$19 reduction in the standing charge for each customer is sufficient.

We note ATCO's comment that, despite the zero-charge tariff band being in place for nearly 10 years, 'retail tariffs were not adjusted in response to the free B3 tariff band'.²³ This reflects that the regulated gas tariff caps for these customers, including the consumption tariff bands, are set by the Gas Tariffs Regulations.

In markets in which standard gas tariffs are not set by regulations, retail tariffs are generally structured to reflect the underlying network tariff structures. Any changes to network tariff structures aimed at achieving specific emissions reductions objectives under the NGO, as it applies in WA, would be best served by the removal of retail price regulation. In the absence of this reform, any movement from ATCO's current declining block tariff structure to a flat or inclining structure would not serve any purpose at this time and could further exacerbate the misalignment between the network and retail tariffs.

²¹ Acil Allen, *Estimated energy costs – For use by the Queensland Competition Authority in its Draft Determination of 2022-23 retail electricity tariffs*, February 2022, p.12, [Report \(qca.org.au\)](https://www.qca.org.au)

²² *Retail Market Procedures (WA)*, version 8, Australian Energy Market Operator, August 2020, cl. 105

²³ *ATCO Gas 2025-29 Plan*, p. 230

6 Investment in renewable gases

As discussed in section 2 of this submission, we agree with the ERA's position of applying the gas regulatory framework as it stands at the time of making each of its decisions (draft and final). Irrespective of changes to the legislative and regulatory frameworks, we consider that ATCO's investments in renewable gases:

- Are not consistent with the NGO and will not be consistent with the revised NGO when this takes effect in WA; and
- Do not satisfy the current criteria applying to capital and operating expenditure under the NGR. These criteria will be unchanged under the amendments to the NGR currently pending implementation and, therefore, ATCO's investments in renewable gases would not satisfy these criteria even if the changes to the regulatory framework take effect.

Additionally, we do not consider that ATCO's proposed investments in renewable gases are in the long-term interests of consumers:

- The risk profile of renewable gases is currently such that there isn't a reasonably probable expectation of attaining suitably high benefits for consumers (i.e., benefits that would justify the risks incurred) in terms of price, quality, safety, reliability, security of supply or emissions reduction; and
- We do not believe that ATCO has made the case that its proposed investments in renewable gases would provide benefits to consumers in terms of expanding their option set of cost-effective, lower emissions energy sources. Other renewable energy choices currently offer greater benefits relative to their costs and are more efficient choices for investment; the future competitiveness of renewable gases is highly uncertain and particularly so in the case of hydrogen.

ATCO itself has acknowledged the risks associated with renewable gas technologies, including biomethane and renewable hydrogen. By requesting that its expenditure for renewable gases investments is included in its total revenue, ATCO is effectively proposing that consumers assume the immense risks of these investments. For this to be acceptable under the NGO, a reasonably probable expectation of attaining suitably high benefits for consumers from these investments must exist at the time the investment is made. We don't consider that this the case.

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

For much the same reasoning, we do not consider that ATCO's proposed investments in renewable gases satisfy the criteria for new capital expenditure (**capex**) and operating expenditure (**opex**) under NGR 79(1) and NGR 91(1) respectively, which include that capital and operating expenditure (emphasis added):

*...must be such as would be incurred by a **prudent service provider acting efficiently**, in accordance with accepted good industry practice, to achieve the **lowest sustainable cost**...*

Whilst ATCO considers, with regards to its renewable gas program capex, that the 'planned expenditure conforms to NGR 79(1) as it aligns to government climate objectives and is in line with good industry practice for reducing emissions', it is not clear to us that a prudent service provider, acting efficiently, would undertake these same investments given the high degree of risk they entail. ATCO also considers this capex is justifiable as it 'delivers overall positive economic value' as required by NGR 79(2).²⁴

When considering ATCO's proposed investment in renewable gases, we advocate that the ERA considers the risk allocation that ATCO's proposed access arrangement creates in the aggregate. By including these investments in the total revenue, consumers will essentially be underwriting a life extension option for the network and de-risking the investment. Whilst the NGR provides that networks are to be allowed a 'reasonable opportunity' for recovery of their efficient costs, we consider that by including the investments in renewable gases in total revenue, an unacceptable quantum of risk will be shifted from ATCO to the consumer, without any corresponding benefit that would justify that reallocation.

If and when the expected benefits of renewable gas technologies become more likely and significant, the ERA could consider including investments in renewable gases as part of ATCO's total revenue. Currently however, including these investments should not be accepted. One option could be to include these investments in a speculative capital expenditure account per NGR 84 until such time as the risk profile of renewable gases materially changes.

7 Accelerated depreciation

Alinta Energy is opposed to the introduction of accelerated depreciation of ATCO's gas network assets for AA6. ATCO has proposed an accelerated depreciation profile which will, if approved, front-load cost recovery for ATCO and mitigate some degree of the risk ATCO currently bears of not recovering their investment in the network.

Accelerated depreciation is one of a range of mechanisms which could be applied to alleviate stranded asset risk in a situation of declining gas demand. However, it may not be the 'best' instrument in such a situation and it may not be an appropriate mechanism to address other gas market risks. The AER has emphasised the need for a case-by-case approach to stranded asset risk and has stated that it 'will carefully consider the surrounding circumstances of a regulated business to determine the materiality of the demand risk it faces and assess the efficiency and prudence of the measures it proposes to mitigate pricing risks'.²⁵ We consider this is the correct approach to take in considering ATCO's proposal for accelerated depreciation.

Accelerated depreciation may have merit regarding intergenerational equity, where this is measured in terms of the imposition of gas prices to cover the cost of supply. On the other hand, it may conflict with equity measured by other terms. In addition, its impact on consumers should be considered in the context of other changes to gas prices.

A main contention is that the direction and magnitude of demand risk is not yet proven and the role of gas in energy transition is not yet clear. Therefore, it is too early to determine an appropriate mechanism to manage future demand uncertainty. Introducing a mechanism too early may result in adverse and/or unintended consequences. In the case of accelerated depreciation, it may also result in inefficient capex currently – for example, it is not logical to

²⁴ ATCO Gas 2025-29 Plan, p. 163

²⁵ [AER Information Paper - Regulating gas pipelines under uncertainty - 15 November 2021.pdf](#), p. x

'gold plate' a network with additional capex while seeking at the same time to accelerate its depreciation.

While ATCO's case for accelerated depreciation is based on an eventual decline in natural gas demand, in contrast, ATCO is suggesting a potential increase in demand for renewable gases. Indeed, it appears that ATCO is aiming to be compensated for several types of risk at once and is not willing to accept the reasonable risks associated with owning regulated gas infrastructure, including stranded asset, changes in demand and inflation, even though these risks either cannot, or are unlikely to, coincide.

Alinta Energy considers that consumers should not be required to hedge ATCO from all and competing risks, including that of both increasing and decreasing demand. The NGL's revenue and pricing principles (NGL 24) state that a service provider should be provided with a 'reasonable opportunity to recover at least the efficient costs' of its service provision, not a guarantee or complete insulation from the risks of their business.

We do not agree with ATCO's method of establishing its 'future of gas' scenarios, nor using those scenarios to determine an accelerated depreciation schedule. These should be established independently, in the WA context and in consultation with a wide range of stakeholders. Further, it is critical to attach probabilities or likelihoods to scenarios, otherwise their choice and application is arbitrary. The need for stakeholder consultation on this aspect is supported by the AER's position that 'Consumer views are also important to us in understanding their expectations of future energy needs and the particular challenges that captive customers may face in this energy transition'.²⁶

Whilst accelerated depreciation has been approved for application elsewhere, that does not make the case to apply it to the ATCO distribution network, which has a range of different characteristics that distinguishes it from networks in other jurisdictions. Different decarbonisation policies, targets and electrification objectives also apply in WA compared to the eastern states. Finally, there has been no consultation with stakeholders on this issue.

7.1 Future of gas scenarios

Alinta Energy considers it unreasonable to use the proposed 'future of gas' scenarios as a starting point for discussion as they have not been prepared independently, are not relevant to the WA context, do not provide a complete set of possibilities and are unweighted, making their selection and application arbitrary.²⁷ We consider:

- It does not make sense to recommend accelerated depreciation to manage risk stemming from decreasing demand when three of four scenarios have gas demand increasing;
- The choice of a 50-year assessment period is questionable given the long-term life of gas network assets; and
- It is unclear whether a terminal value for the gas network has been included under all scenarios; including an appropriate terminal value would ensure the total cost of the network does not need to be 'earned' during the 50-year period. Corporate finance best practice supports the inclusion of a terminal value representing the residual, recoverable value of the network assets at the end of life. In the case of some assets, this may be a salvage or scrap value. However, ATCO is also proposing to make investments in capital assets which would begin to prepare the network to accept and distribute renewable gases e.g., injection gate stations, blending control systems and meters suitable for hydrogen blending. Should those investments be

²⁶ [AER Information Paper – Regulating gas pipelines under uncertainty – 15 November 2021.pdf](#), p. 47

²⁷ Attachment 03.002: Future of Gas Report, ATCO Gas 2025-29 Plan, p. 9

included in the regulatory asset base, we consider any terminal value of the network would be far higher, as value could be derived from its alternate use.

To demonstrate stranded asset risk, the AER expects a regulated business 'provide plausible future energy scenarios that covers a spectrum of outlooks from the most pessimistic to the most optimistic for their networks, and to estimate the likelihood (probability) of each scenario'.²⁸ In view of this, Alinta Energy considers that, with respect to AA6, ATCO has not provided a full spectrum of scenarios and recommends:

- Consideration of a 'status quo' scenario, where growth and volumes continue at current rates (and therefore there is no accelerated depreciation);
- A 'gas increases' scenario, where gas-intensive industry moves to WA and the network continues to expand, resulting in lower marginal costs and higher consumption;
- The Hydrogen Future scenario should be dismissed until regulations allow for hydrogen as a fuel and there is clear policy and intent; and
- Scenario probabilities should be provided and applied, rather than using a midpoint method.

Where accelerated depreciation is adopted, we would recommend either of the following approaches as a reasonable estimation methodology:

- Using the accelerated depreciation amount from the most likely scenario; or
- Using a weighted average of the plausible scenarios (meaning all plausible scenarios need to be defined and weighted according to their probability).

Essentially, in our view it is necessary and in line with AER principles to account for probabilities of scenarios. In accordance with this view, we do not consider the following to be reasonable:

- Using the scenario with the highest accelerated depreciation amount – this is a random assignment that ignores the likelihood of the scenario (including if the scenario is plausible as assessed more broadly) and ignores all other reasonable scenarios. This approach may result in artificially high prices that are inefficient and produce unintended consequences;
- Taking the midpoint – this results in a contrived and unweighted amount of accelerated depreciation that does not align to any of the scenarios. Further, it is related only to the 'bookend scenarios' which are of their nature outliers, and ignores all other reasonable scenarios and likelihoods.

7.2 ATCO's accelerated depreciation proposal

Alinta Energy considers that ATCO should not be entitled to receive accelerated depreciation during AA6 for the following reasons:

1. Customer impact does not appear to have been well considered. The significantly higher weighted average cost of capital (**WACC**) in AA6 (7.33%) compared to AA5 (4.16%) results in a material increase in gas prices in AA6, which would be compounded by accelerated depreciation;
2. Implementing accelerated depreciation is not a logical outcome based on forecasts of increasing new connections (ATCO is expecting to install 68,000 new B2 and B3 customer connections over AA6) and stable consumption (as we have

²⁸ Draft Decision, APA Victorian Transmission System (VTS) Access Arrangement 2023 to 2027 (1 January 2023 to 31 December 2027), Overview, Australian Energy Regulator, June 2022, p. 20 [*Report template \(aer.gov.au\)](#)

outlined in section 3 of this submission);²⁹

3. The AER notes that 'some form of accelerated depreciation would be appropriate if there is sufficient evidence to demonstrate and quantify the pricing risk and stranded asset risk arising from demand uncertainty.'³⁰ Alinta Energy considers this a high evidentiary benchmark and believes ATCO's evidence falls significantly short. Accelerating depreciation is not the only method of mitigating risk and other options have not been suitably explored;³¹
4. The implementation of accelerated depreciation in east coast networks is in response to substantiated policy (such as Victoria's Gas Substitution Roadmap) rather than generic 'uncertainty', as noted in ATCO's proposal;³²
5. The WA gas market is markedly different to the east coast gas market:
 - a. WA is not at the same stage of energy reform and currently does not plan to implement the same reforms;
 - b. WA has a comparative advantage in gas and its use is different to other states; and
 - c. WA has mechanisms such as the DomGas reservation policy (discussed in section 3 of this submission) and electricity market capacity mechanisms that provide support for the supply and consumption of gas in WA. It is anticipated that gas will play an important role in the transition away from coal; and
6. ATCO has not proposed to change its capex investment strategy to reduce the life of installed assets. Arguably, if there are so few users of gas in the future that accelerated depreciation is required, then it is questionable whether use of those assets towards the end of their current life is efficient.

7.3 General comments

7.3.1 Straight line depreciation

Alinta Energy's view is that, unless ATCO can demonstrate and substantiate specific and legitimate risks, the existing method of depreciation (straight line) should be retained.

The concept of uncertainty, broadly, is not necessarily a sufficient reason to introduce a new instrument or mechanism. Accelerated depreciation may be a suitable instrument to apply for a specific type of uncertainty – namely, declining demand, where the uncertainty is around the rate of change and the likelihood of stranded assets – but the case for this is not yet established.

Further, there are other mechanisms to consider depending on the nature of the uncertainty, such as disconnection fees, tariff structures and the capital investment framework. Accelerated depreciation may have adverse consequences if it is applied to address a situation that does not eventuate or manifests itself differently.

7.3.2 Intergenerational inequity

Accelerated depreciation may be one of a range of tools that could (and should) be considered to address the risk of stranded assets and inadequate return of capital.

²⁹ ATCO Gas 2025-29 Plan, p. 174

³⁰ [AER Information Paper - Regulating gas pipelines under uncertainty - 15 November 2021.pdf](#), p.ix

³¹ [AER Information Paper - Regulating gas pipelines under uncertainty - 15 November 2021.pdf](#), p.44

³² [Victoria's Gas Substitution Roadmap \(energy.vic.gov.au\)](#)

For example, while accelerated depreciation may level out the burden of capex recovery across customers such that the burden per customer per year across the asset life is the same, this is not necessarily the correct price signal to send customers. It may be that such a price signal conflicts with other goals or policies such as energy transition objectives.

We consider:

- Accelerated depreciation has a specific outcome that should be attached to a specific risk that is best addressed by that outcome. That risk case needs to be firmly identified and established;
- A range of alternative mechanisms to address the specific risk should be assessed; and
- The assessment should consider the best outcome for the consumer, where this may include objectives beyond levelised gas pricing.

It is Alinta Energy's view that, in the absence of state government policies on the role of gas in the energy transition, price signals should continue as currently, without further adjustment, such that in the case of increasing gas demand consumers can benefit from lower marginal gas prices. The overall impact on consumers is a critical consideration and the impact of accelerated depreciation should not be disconnected.

7.3.3 Adjusting asset lives

We consider that asset lives should be adjusted where:

- (i) The original life was suitably and efficiently determined;
- (ii) There is reasonable certainty of the impact of changing circumstances; and
- (iii) It is likely that the changed circumstances are permanent.

However, as well as shortening asset lives, this relates to extending asset lives where assets can continue to operate safely and economically beyond their technical life.

The economic lives for greenfield deployments should take account of current and expected future circumstances, where this may produce a different outcome to past methods of assessing asset life. Alinta Energy's view is that the regulatory arrangement for such assets needs further consideration.

7.4 ACIL-Allen "Future of Gas" model

Alinta Energy is concerned with the appropriateness of ATCO adopting the Future of Gas model provided by ACIL Allen for its accelerated depreciation proposal.³³ It would appear that this is the same model as used in the Australian Gas Networks (Victoria and Albury) access arrangement for 2023–2028 but has not been appropriately updated for the ATCO distribution network.³⁴ For example:

- Unlike for Victoria, specific suburb income categories have not been assigned, but rather the medium category has been assigned to all suburbs, thereby understating the gas-to-electricity switching threshold; and
- Appliance consumption assumptions have not been updated, including the "other heating" category. This is significant as, for example, a heat pump hot water system in WA uses less than half the energy it requires in Victoria.

It would also appear that the model provided to ATCO relies upon a Grattan Institute report. The Grattan report notes that, whilst households on the east coast that 'move into a new all-

³³ Attachment 03.002: Future of Gas Report, ATCO Gas 2025-29 Plan

³⁴ [Australian Gas Networks \(Victoria and Albury\) - Access arrangement 2023–28 | Australian Energy Regulator \(AER\)](#)

electric house with efficient appliances will save money compared to an equivalent dual-fuel house', this was not the case in WA for non-gas heated houses: 'A Perth household will be better off using gas for cooking and hot water rather than electricity due to the low retail cost of gas and the lower upfront cost of gas stoves and water heaters than efficient electric appliances'.³⁵

Finally, we have additional concerns on the reliability of the ACIL Allen model on the grounds that:

- The analysis assumes all hot water systems are gas instantaneous. Instead, hot water storage systems should be separately considered given they have a different use and cost profile and generally, unlike instantaneous systems, have no electrical connection, which would likely translate to higher switching costs;
- The time of day that gas appliances are used and thus the potential impact of time-of-use electricity rates on switching, has not been considered;
- Assessing whether to switch every 15 years may be reasonable for owner-occupier households with sufficient capital, but is less likely to be relevant for rental properties or owner-occupiers with capital, space or other practical constraints; and
- Few of the model's data sources are referenced.

8 Rate of return and inflation

ATCO has proposed an average nominal post-tax WACC of 7.33% for the AA6 period. This is a very steep increase from the 4.16% WACC approved for the AA5 period. The impact of the proposed increase in the rate of return (**RoR**) on ATCO's tariffs is substantial, accounting for 38% of the change in revenue between AA5 and AA6.

We acknowledge that the ERA is required to calculate the regulatory RoR as set out in the ERA's gas rate of return instrument (**Instrument**)³⁶, including:

- Adopting fixed values for certain RoR parameters which are stipulated in the Instrument (gearing level, market risk premium, equity beta, debt and equity raising costs); and
- Applying prescribed estimation methods incorporating formulae, estimation techniques, assumptions and proxy instruments for calculating other parameters (risk free rates for debt and equity and the debt risk premium).

The RoR proposed by ATCO is significantly elevated due to the effects of current capital market conditions (high yields), which flow through to the RoR estimate due to the operation of the estimation methods set out in the Instrument. We therefore ask that, in evaluating ATCO's proposed RoR, the ERA consider evidence that the regulatory RoR overstates the efficient RoR for networks, notwithstanding the fact that it may have been calculated in accordance with the Instrument.

The evidence we refer to is the AER's Energy Infrastructure Credit Spread Index (**EICSI**), an index of actual network debt costs based on data collected from privately-owned regulated networks on their debt instruments. The EICSI has generally tracked below the AER's regulatory return on debt for the entirety of the period for which data has been collected (2013 – 2021).³⁷

³⁵ [Flame out: the future of natural gas \(grattan.edu.au\)](https://www.grattan.edu.au), p. 45

³⁶ *2022 final gas rate of return instrument*, Economic Regulation Authority, 16 December 2022, amended 12 September 2023

³⁷ *Overall rate of return, equity and debt omnibus – Final working paper*, Australian Energy Regulator, December 2021, pp. 69-70

That networks' actual costs of debt have been persistently below regulatory returns on debt strongly demonstrates that regulatory RoRs overstate networks' efficient costs of capital. This is clearly detrimental to consumers who, as a consequence, are burdened by regulated tariffs which are bloated by inflated costs of capital. It follows that this outcome is entirely contrary to the NGL.

The AER declined to use the EICSI to directly set the regulatory return on debt under the AER's RoR instrument due to methodological issues concerning the construction of the index that were yet to be resolved and to allow time to compile a longer data series.

We understand that resolution of these issues is part of the high bar for change that the ERA may seek to pass before amending the Instrument to use the EICSI to more directly set the return on debt. Notwithstanding, we consider that the results of the AER's EICSI review demonstrate that regulatory returns on debt, including ATCO's proposed returns, are too high. The need for further scrutiny of regulatory returns on debt is particularly urgent in the context of the steeply rising network tariffs proposed by ATCO and other networks, current capital market volatility and the unfolding cost-of-living crisis, the interplay of which raises the risk of serious adverse outcomes for consumers.³⁸

One inference that could be drawn from the EICSI is that networks' actual financing practices are different from the debt financing strategy assumed by the Instrument. The method for calculating the return on debt set by the Instrument applies several assumptions, including that networks undertake a staggered refinancing of their debt portfolio over time, refinancing 10% of their total debt each year. Networks are not, however, bound to follow this strategy. Rather, the assumptions embedded in the Instrument's methodology for calculating the return on debt comprise a benchmark debt strategy which forms a point of reference for estimating an efficient network's cost of debt financing.

In practice, and as would be suggested by the EICSI, networks' actual debt financing strategies can and do differ from the benchmark debt strategy embedded in the Instrument. It has been suggested that businesses defer debt issuance when credit spreads are very high and reciprocally concentrate their debt issuance during periods when spreads are low. Such practice would be consistent with a profit-maximising firm acting rationally and efficiently in respect of its financing. Logically, this would yield a lower overall cost of debt than the regulatory return on debt and could be one reason for the deviation between the EICSI and the regulatory returns on debt. As the AER has itself observed, the EICSI may be 'reflective of an active debt management strategy' which presumably the networks pursue to maximise their profits.³⁹

NGL 30D sets out the principles the ERA must adhere to in making a rate of return instrument:

30D [ERA] to make rate of return instrument

- (1) *This section applies if a rate of return on capital or the value of imputation credits is required for performing or exercising an [ERA] economic regulatory function or power.*
- (2) *The [ERA] must make an instrument (a rate of return instrument) stating—*
 - (a) *for a rate of return on capital—the way to calculate the rate; and*
 - (b) *for the value of imputation credits—the value or the way to calculate the value.*
- (3) *The [ERA] may make an instrument only if satisfied the instrument will, or is most likely to, contribute to the achievement of the national gas objective to the greatest degree.*

³⁸ We appreciate that the AER sets its regulatory RoR according to its own Rate of Return Instrument however, the methods for calculating the return on debt component of the regulatory RoR under both the AER's and the ERA's RoR instruments are materially the same. We therefore consider that our discussion of the EICSI and its implications for estimated regulatory returns on debt are equally applicable to WA energy networks, including ATCO's network.

³⁹ *Energy Network Debt Data - Final working paper*, Australian Energy Regulator, November 2020, p. 32

- (4) *Subject to subsection (3), the way to calculate a rate of return on capital must include a weighted average of an allowed return on equity and an allowed return on debt.*
- (5) *In making an Instrument, the [ERA] must have regard to -*
 - (a) *the revenue and pricing principles; and*
 - (b) *other information the [ERA] considers appropriate.*

We consider that the regulatory RoR should reflect the cost of capital of a network that is financing itself efficiently. This interpretation is the most consistent with the NGO and the revenue and pricing principles which the ERA must have regard to in making the Instrument and which the ERA must therefore have regard to in estimating regulated RoRs. The EICSI is an available measure of networks' efficient costs of debt and therefore the deviation between the EICSI and regulated returns on debt indicates that regulated returns on debt are above efficient rates of return, contrary to the mandates of the NGL, NGO and revenue and pricing principles.

We appreciate that, in regulatory practice, benchmarks need to be adopted as proxies for efficient costs where accurate revealed efficient costs are not available. However, the EICSI is now available as a source of revealed efficient cost for networks' debt financing. Further, and as the AER has acknowledged, actual industry data is also used in setting other relevant parameters of regulatory RoRs such as beta, so the use of the EICSI as a reference point for evaluating the regulatory return on debt could also be valid. To date, the EICSI has demonstrated that the actual efficient costs of debt finance for networks are below regulated returns on debt and, as such, we would support the ERA taking this into account when evaluating ATCO's proposed rate of return.

Further to the above, the AER has acknowledged that adopting the EICSI in whole or part for determining the regulatory return on debt is not contrary to the objectives of incentive-based regulation. The AER has expressed that 'A regulated return on debt set using the EICSI (in whole or in part) would still be a benchmark approach, because the EICSI reflects costs across all networks rather than any network individually' and that 'the desirable properties of the incentive regime are preserved. That is, networks have an incentive to pursue efficiency gains across time, and consumers benefit in the long term when these efficient costs are revealed.'⁴⁰

Moreover, in our view, adopting the EICSI as a reference point for evaluating or setting the regulatory return on debt, either on its own or in combination with other methods, is also more consistent with good corporate finance and valuation practice than the current estimation method. For example, in determining the market values of financial instruments held on their books, financial institutions apply a hierarchy of estimation methods which preferences values observed directly in the market (where available) over modelled or estimated values. Observed values bypass the estimation error contained in values determined using models or other estimation methods which apply assumptions and inputs which themselves are prone to error and mismeasurement. Extending this logic, the networks' costs of debt as measured by the EICSI are strong evidence that regulatory returns on debt are overstated.

In summation, we consider that the evidence we have outlined above strongly suggests that regulatory rates of return on debt are above efficient rates. By inference, ATCO's proposed rate of return on debt and proposed WACC are also above efficient rates. We ask that the ERA consider the evidence we have outlined in evaluating ATCO's proposed rate of return.

⁴⁰ *Energy Network Debt Data - Final working paper, Australian Energy Regulator, November 2020, p. 32.*

9 Revenue and price paths

Whilst Alinta Energy supports ATCO's proposal to retain the existing tariff classes and, for the most part, its tariff structures, we have concerns regarding the magnitude of the proposed step increase of \$78 at the commencement of AA6 for an average residential (B3) customer.

Alinta Energy considers long-term price stability to be in the long-term interest of consumers and considers this can be achieved by applying a smaller step increase in 2025, followed by a smoother year-on-year increase over the remainder of AA6.

As noted earlier in this submission, it is important for forecast demand to be as accurate as possible given its role in calculating haulage tariffs, as under-forecasting demand can lead to unnecessary tariff increases and the over-recovery of revenue. Table 2 shows that by using ATCO's average B3 forecast demand of 11.50 GJ, ATCO would recover over █████ in additional revenue from B3 tariff customers over AA6 compared with what would be recovered using Alinta Energy's average B3 forecast demand of █████ GJ. This revenue over-recovery would be generated entirely from the top consumption block.

Table 2: Estimate of ATCO over-recovery of B3 revenue (\$m)

| | | 2025 | 2026 | 2027 | 2028 | 2029 | Total |
|---------------------------|------------|---------|---------|---------|---------|---------|-------|
| Δ B3 demand ⁴¹ | GJ | █████ | █████ | █████ | █████ | █████ | |
| Band 2: vol >9.855 GJ | \$/GJ | \$7.26 | \$7.45 | \$7.65 | \$7.86 | \$8.07 | |
| Additional revenue | \$/cust | █████ | █████ | █████ | █████ | █████ | |
| Total B3 customers | No. | 786,470 | 794,293 | 803,215 | 812,819 | 822,736 | |
| Over-recovery | \$m | █████ | █████ | █████ | █████ | █████ | █████ |

Figure 3 shows that by using Alinta Energy's average B3 forecast demand, the network tariff price path for B3 customers is almost █████ higher than if ATCO's average is used. Of significance is the █████ step increase from \$199 in 2024 to █████ in 2025, which is considerably more than the \$78 quoted by ATCO.

(Figure 3 redacted)

⁴¹ This is the difference between Alinta Energy's and ATCO's average B3 forecast demand over AA6.

Regulation 7(1) of WA's local gas access provisions sets out that the ERA must consider the impact on customers and retailers when making or approving an access arrangement:

When exercising a discretion in approving or making an access arrangement for a distribution pipeline the ERA must take into account the possible impact of the proposed reference tariffs, the method of determining the tariffs and the reference tariff variation mechanisms on —

- (a) users to whom gas is or might be delivered by means of a small delivery service provided for in the access arrangement; and*
- (b) small use customers to whom gas is or might be delivered by those users.⁴²*

We therefore urge the ERA to consider whether the steep step increase proposed by ATCO is in the best interests of either customers or retailers.

10 Opex and capex

10.1 Opex

ATCO has proposed \$455.9m of opex for AA6. This is significantly higher than its approved and expected actual opex of \$377.9m and \$355.9m respectively for AA5.

ATCO has outlined justifications for its proposed AA6 opex forecast, linking the components of its proposed opex spend captured within its base-step-trend (**BST**) opex forecast to the criteria governing opex set out under NGR 91(1).

Assessment of the individual items comprising ATCO's proposed AA6 opex, both in terms of justification and costing, requires knowledge of network operation and industry practice. We trust the ERA will apply suitable knowledge in evaluating all of ATCO's proposed opex items, including ensuring that network opex allocated to reference and non-reference services is fairly allocated as required under NGR 91(2).

Our comments on specific aspects of ATCO's AA6 opex forecast are outlined below.

10.1.1 AA5 opex variance

ATCO's forecast opex spend for AA5 is expected to be \$22m less than the ERA's opex forecast per its AA5 Final Decision, equivalent to a variance of 6%. We ask that the ERA consider whether this underspend may be indicative of systematic over-forecasting, which may warrant application of a general downwards adjustment to ATCO's proposed AA6 opex.

10.1.2 Selection of the base year

As part of ATCO's application of the BST method for forecasting opex, ATCO has used 2022 as its base year because it is 'the most recent year of actual expenditure'.⁴³ This is not what the NGR require, nor what the BST method logically requires. Rather, the most efficient year should be selected as the base year, balanced also against consideration of selecting a year that is likely to be reflective of future costs. In Alinta Energy's view, this is the lowest cost year selected at a granular cost level where compliant operations occurred. This means different years could be selected for different costs.

Further to this, we do not consider COVID-19 to be a relevant reason for disregarding any of the years in AA5 as potential base years, given the regulatory and safety obligations applying to ATCO did not change due to the pandemic.

⁴² National Gas Access (WA) (Local Provisions) Regulations 2009

⁴³ ATCO Gas 2025-29 Plan, p. 112

10.1.3 Adjustments for efficiencies in opex in AA6

Noting ATCO's anticipated AA5 opex actual/forecast underspend, we have the following comments:

- ATCO's cited reasons for its network opex underspend include a tight labour market, which has left several positions in its organisation vacant, increased efficiency of pipeline surveys and internalisation of reinstatement activities for a portion of its network activities. We ask the ERA to consider whether these efficiencies may persist into AA6 and whether ATCO's BST forecast has been adjusted appropriately for these efficiencies. For example, if the internalisation of reinstatement activities took place in 2023, the efficiencies gained from this change would not be reflected in ATCO's forecast, which used 2022 as the base year. ATCO has also described several opex improvement initiatives it undertook in AA5, including the introduction of vehicle telematics which improved operational efficiency, and we ask the ERA to consider whether these initiatives may yield opex efficiencies in AA6 that should be reflected in the opex forecast; and
- ATCO has stated that the main driver for its unaccounted for gas (**UAFG**) underspend was that its gas loss rate has improved due to the impact of its UAFG management initiatives such as leak repair. ATCO has stated that it has taken into account the improvements it achieved in its UAFG performance in AA5 in setting its UAFG targets for AA6. We trust the ERA will consider whether ATCO's AA6 UAFG targets appropriately reflect ATCO's efficiency gains in terms of UAFG loss achieved during AA5.

10.1.4 Opex for investments in renewable gases

We have outlined our views on ATCO's proposed investments in renewable gases, including proposed opex, in section 6 of this submission. As outlined, irrespective of changes to the legislative and regulatory framework, we consider that ATCO's proposed investments are not, and will not be, consistent with the NGO or satisfy the criteria governing opex under the NGR.

10.2 Capex

Our most significant concern related to ATCO's proposed capex is the consistency of the composition of its capex spend with ATCO's proposal to apply accelerated depreciation. ATCO has grouped its proposed capex for AA6 under four investment drivers, being network sustaining, network growth, information technology, and structures and equipment. ATCO's reasoning for applying accelerated depreciation is the risk of asset stranding of ATCO's network due to uncertainty of the future of gas and use of its network. This reasoning seems inconsistent with the magnitude of ATCO's proposed 'network growth' capex for AA6 of \$157.4m, equivalent to approximately 34% of ATCO's total proposed AA6 capex of \$465.8m, and the proposed network growth capex for AA5, equivalent to approximately 35% of ATCO's total AA5 capex.

ATCO has classified all of its AA6 network growth capex as 'Customer Initiated'. ATCO describes network growth investments as 'Network expansion projects will install new services, mains extensions, and meter installation for more than 68,000 new domestic and commercial customers'.⁴⁴ Further, ATCO states, 'Most of our growth capex forecast is focused on the cost of connecting customers in new subdivisions bordering existing areas of our network'.⁴⁵ ATCO has undertaken Net Present Value (**NPV**) analyses of the incremental revenue and costs for its expected new connections in greenfields (B2 and B3) and commercial brownfields (B2) (a total of 63,324 connections of the approximately 68,000 expected new B2 and B3 connections in AA6) and found that the NPV for this growth capex is positive under a range of scenarios.

⁴⁴ ATCO Gas 2025-29 Plan, p. 151

⁴⁵ ATCO Gas 2025-29 Plan, p. 174

While we appreciate that network demand and the claim for accelerated depreciation must be assessed on a whole-of-network basis, the fact remains that there is still opportunity for profitable expansion of the network, which in our view casts doubt on the claim for accelerated depreciation.

Consideration of whether the magnitude of ATCO's proposed network growth capex for AA5 and AA6 is inconsistent with ATCO's reasoning for applying accelerated depreciation also needs to take into account changes to ATCO's classification of what constitutes network growth capex. ATCO states that:

*'Reinforcement projects have historically been classified as Growth, Demand Capex and this was the case in the AA5 FD. However, on review of the drivers for projects of this nature, from 2023, these are classified as Sustaining, Performance capex. This is being done as the key driver for these projects is safety risk reduction.'*⁴⁶

Presumably then, ATCO's network growth capex, as measured following this reclassification, would be smaller than it would be if measured using the previous classification. We request that the ERA considers whether ATCO's reasoning for this reclassification of some part of its capex is sound and whether the proposed network growth capex might in fact be higher than stated in its proposal.

10.2.1 Capital investments in renewable gases

We have outlined our views on ATCO's proposed investments in renewable gases in section 6 of this submission. Irrespective of changes to the legislative and regulatory framework, based on available information we consider that ATCO's proposed investments in renewable gases are not, and will not be, consistent with the NGR nor satisfy the criteria for conforming capex under the NGR.

10.2.2 Other capital expenditure items

ATCO has outlined justifications for its proposed capex items, linking these to the new capital expenditure criteria set out under NGR 79. Based on the information publicly available, ATCO's justifications for much of the capex, particularly the proposed network sustaining, IT, and structures and equipment capex, is that it will be incurred either to ensure the safety and/or integrity of services, to comply with regulatory obligations or requirements, to meet existing demand, or a combination of these reasons.⁴⁷ As is often the case for capex, justification requires a degree of engineering assessment and we trust the ERA will apply suitable knowledge and assessment in evaluating the reasoning for and costing of all the proposed capex line items against the new capital expenditure criteria and other relevant requirements of the NGL and NGR.

11 Summary

We request the ERA closely reviews ATCO's AA6 proposal, particularly with respect to the following:

- ATCO's Voice of the Customer research does not appear to support its proposed additional expenditure over AA6, particularly with respect to its investment in renewable gases. Despite customer bill size being overwhelmingly the largest influence in ATCO's Choice Model, with customers being very responsive to a small shift in change, ATCO has proposed a significant increase of \$78, or 39%, for an average residential (B3) customer at the start of AA6, representing an increase of 12% on an annual retail gas bill at the gazetted price;

⁴⁶ ATCO Gas 2025-29 Plan, p. 70

⁴⁷ These are acceptable justifications for capex under NGR 79(2)(c)(i) - 79(2)(c)(iv)

- We support the ERA's position of applying the relevant regulatory framework from a 'point in time' perspective, whereby it does not seek to apply amended regulations and legislation in advance of those amendments being adopted. This point-in-time application plays an important role in considering ATCO's proposed investment in renewable gases;
- Unlike other jurisdictions, the WA Government has confirmed it will not be imposing a ban on new homes connecting to the gas network. As such, we consider ATCO's average forecast demand of 11.50 GJ for B3 customers over the AA6 period is too low and the year-on-year decline of 3% is too steep. Because of its role in determining reference tariffs, it is essential that the demand forecast is as accurate as possible, particularly in light of recent revelations by the AER that gas distributors have, over the last 10 years, consistently earned more revenue because actual volumes have been higher than forecast. If ATCO's B3 forecast demand is accepted, ATCO could over-recover as much as █████ over the AA6 period if the actual B3 customer demand is closer to that forecast by Alinta Energy;
- There is an absence of any key performance indicators and accountability related to ATCO completing ancillary reference services requested by retailers, despite these services forming part of ATCO's total tariff revenue;
- If the first B3 tariff band, which currently provides 1.825 GJ of gas free-of-charge, is to be removed, the supply charge should be equivalently reduced. We do not consider it appropriate to move from the current declining tariff block structure in the absence of tariff reform that would provide specific emissions reductions price signals to customers;
- ATCO's proposed investments in renewable gases are not consistent with either the current or proposed legislative frameworks in WA and do not meet the criteria for capex and opex under the NGR. The future competitiveness of renewable gases is highly uncertain and we do not believe that ATCO's proposed investments would provide benefits to consumers in terms of providing cost-effective, lower emissions energy sources;
- We do not agree with ATCO's method of establishing its 'future of gas' scenarios or using those scenarios to determine an accelerated depreciation schedule and consider the existing straight-line method of depreciation should be retained;
- Consumers should not be required to hedge ATCO from all and competing risks, including those of both increasing demand (investment in renewable gases) and decreasing demand (accelerated depreciation);
- Due to current market conditions, the impact of the proposed RoR on ATCO's tariffs is substantial. We encourage the ERA to consider evidence that the regulatory RoR overstates the efficient RoR for networks, as demonstrated by the AER's EICSI review;
- As required by regulation 7(1) of WA's local gas access provisions, the impact of ATCO's proposed AA6 on both customers and retailers should carefully considered; and
- Careful assessment of the individual items comprising ATCO's proposed AA6 opex and capex is required, both in terms of justification and costing. The selection of 2022 as the base year for opex should be examined to determine whether it is the most efficient year or one that is most likely to be reflective of future costs.