Kleenheat

Economic Regulation Authority
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Submitted online at: https://www.erawa.com.au/consultation

24 November 2023

**Kleenheat submission on the proposed revised access arrangement for Mid-West to South-West Gas Distribution Systems**

Dear Sir/Madam,

Thank you for the opportunity to provide feedback on ATCO's 2025 - 2029 Access Arrangement (AA6) for the Mid-West and South-West Gas Distribution Systems (GDS).

Kleenheat is part of the Wesfarmers Limited Group and serves over 220,000 business and residential customers on the GDS. Kleenheat believes that access to the GDS should remain affordable for its customers and the business sector, avoid exacerbating cost of living pressures in the community, while providing reasonable returns for the GDS operator.

Kleenheat notes that AA6 presents significant increases in the reference tariffs, which are driven from accelerated depreciation rates, and a significant amount of operating and capital expenditure which are not in line with historical expenses. Kleenheat is concerned about the proposed reference tariff increases, at a time when cost of living is a significant issue impacting WA households and businesses, and are set at a time when interest rates are expected to be at their peak in the cycle.

In response to this submission, Kleenheat would like to make the following comments on specific areas of the proposal:

## 1. Projected Operating and Capital Expenditure

ATCO is proposing a $78 million increase (over 20 per cent) in the operating expenditure (Opex) in AA6, when compared to the current Access Arrangement (AA5). Kleenheat also notes that ATCO's actual Opex has historically been significantly lower than previous proposed Access Arrangements. The table below outlines the proposed AA6 Opex, ERA's Final Decision and the actual Opex for AA4 and AA5.

| | AA4 | | | | AA5 | | | | AA6 |
|---|---|---|---|---|---|---|---|---|---|
| **$ Million** | **ATCO's Initial Proposal** | **ERA's Final Decision** | **Actual Spend** | **% Difference (Actual vs Initial Proposal)** | **ATCO's Initial Proposal** | **ERA's Final Decision** | **Actual Spend** | **% Difference (Actual vs Initial Proposal)** | **ATCO Draft Plan** |
| OPEX | 448 | 406 | 355 | (21) | 407 | 378 | 356 | (13) | 456 |
| CAPEX | 518 | 497 | 487 | (6) | 516 | 483 | 414 | (20) | 466 |

ATCO has underspent on average 17 per cent in AA4 and AA5 relative to its proposed amount. Given the history of underspending, Kleenheat urges the ERA to evaluate the Opex proposal carefully.

The proposed capital expenditure (Capex) of $466 million is $17 million lower than the AA5 Final Decision, however, it is $52 million higher than the actual spend in AA5. Kleenheat notes that $19 million of Capex is carried over from AA5[1] and encourages the ERA to review the proposed Capex and ensure that ATCO can undertake the level of work proposed.

Kleenheat is concerned that the history of over-estimation of Opex and Capex has resulted in ATCO receiving excessive returns over the previous Access Arrangement as outlined below, which is at the detriment of the customers of the GDS.

| **AA5** | **ERA Final Decision** | **Actual/Forecast*** |
|---|---|---|
| Cost of Service ($million) | 742.12 | 681.26 |
| Total Revenue ($million) | 742.12 | 744.20 |
| Rate of Return (nominal) | 4.16% | 5.37% |
| Rate of Return (real)** | 2.98% | 4.18% |

Note: * based on adjusting the Gas Tariff Model for AA5[2] for the actual/forecast tariff, volume, Opex and Capex indicated by ATCO in the Gas Tariff Model in the AA6 submission[3]

Note: ** Based on the inflation rate of 1.14 per cent as per the AA5 Gas Tariff Model

The National Gas Rules, Rule 77(2) appears to have some mechanism to remove any benefit associated with any difference between estimated and actual expenditure[4]. Kleenheat strongly urges the ERA to ensure any benefit from prior year over estimation is removed, including benefits from timing.

[1] ATCO Gas Australia, Access Arrangement Information, 18 September 2023, p. 144, Table 10.2
[2] ATCO Gas Australia, Revised Access Arrangement Model, 15 November 2019
[3] ATCO Gas Australia, 16.001A - ATCO Gas Tariff Model, 18 September 2023
[4] The National Gas Rules, Rule 77(2), https://energy-rules.aemc.gov.au/ngr/494/304632#9

## 2. Accelerated Depreciation

For AA6, ATCO is proposing accelerated depreciation to bring forward capital recovery, which represents a change from the current straight-line depreciation method. The accelerated depreciation proposed by ATCO is stated to be due to the intergenerational impact of an energy transition on tariffs. Kleenheat acknowledges that the future use of the GDS, and therefore future tariffs, is uncertain due to the energy transition. It is noted that the WA Government have stated clear support for continuing natural gas residential connections, which is unlikely to change in the AA6 period. WA Premier Roger Cook, speaking at a press conference back in August 2023[5], expressed support for green energy but said gas would remain a part of the state's residential energy mix. Accelerating depreciation increases the burden on current customers. Customers that have greater means will be more likely to transition early and as such, this exacerbates the problem that accelerated depreciation is trying to solve. Ultimately, the path cannot be predicted in advance of the transition.

Furthermore, ATCO proposes spending $15.5 million on the 'enabling renewable gas' program[6] to ensure the GDS can accept and distribute renewable gases. Investment in enabling the GDS for renewable gas would prolong the use of the GDS, which is inconsistent with the proposal to accelerate depreciation.

Kleenheat disagrees with the accelerated depreciation proposal and believes pre-empting the outcome of the energy transition risks consumers paying more than necessary ahead of time. Kleenheat believes that continuing straight line depreciation of the GDS in AA6 would not result in the asset being unrecoverable or reduce the incentives for efficient operation of the GDS.

## 3. Demand Forecast

ATCO has flagged a significant decrease in the demand for B3 customers in AA6. On a 'weather-normalised' basis, average demand per connection is forecast to decline from 12.19 GJ per customer in 2025 to 10.86 GJ per customer in 2029 at a rate of 2.8 per cent per annum[7]. This is not consistent with the current trend of Kleenheat active customers' average usage which is declining at around half the rate of that proposed by ATCO.

Kleenheat notes that the total actual volumes have historically been higher than both the Initial Proposal and Final Decision of AA4 and AA5, as shown in the table below. Kleenheat urges the ERA to review the volume forecast proposed by ATCO taking into consideration the under-estimation of the previous Access Arrangements.

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[5] https://www.news.com.au/lifestyle/home/wa-premier-confirms-gas-in-the-mix-for-residential-energy-in-his-state/news-story/6f71c1d5ad1df4841a92380ce426fcb7
[6] ATCO Gas Australia, Access Arrangement Information, 18 September 2023, p. 164, Table 10.12
[7] ATCO Gas Australia, Access Arrangement Information, 18 September 2023, p. 91

| Volume (TJ) | AA4 | AA5 | | | |
|---|---|---|---|---|---|
| **Meter Type** | **Actual** | **ATCO's Initial Proposal** | **ERA's Final Decision** | **Actual** | **% Difference (Actual vs Initial Proposal)** |
| A1 | 51,062 | 47,956 | 57,239 | 60,536 | 26.2 |
| A2 | 9,947 | 7,965 | 8,920 | 9,239 | 16.0 |
| B1 | 10,373 | 10,818 | 10,924 | 10,213 | (5.6) |
| B2 | 7,358 | 7,254 | 7,008 | 6,435 | (11.3) |
| B3 | 55,843 | 48,222 | 49,397 | 50,733 | 5.2 |
| **Total** | **134,582** | **122,215** | **133,488** | **137,156** | **12.2** |

## 4. Proposed Price Path

Kleenheat challenges the proposed price step increase in 2025 followed by constant real prices from 2026 to 2029. ATCO's proposed $78 increase[8] to the annual average distribution network bill for the average residential (B3) customer is a concern given the cost of living pressures in the community. The proposed initial tariff increase is significant (12 per cent of the average annual natural gas bill)[9] and will ultimately impact customers as retailers may moderate discounts to accommodate the increase.

Kleenheat supports a smoothed price increase over the AA6 period, which is consistent with ERA's decision during AA5[10]. This would result in a more modest increase in 2025 and reduce the price shock to customers in the transition between AA5 and AA6.

## 5. Rate of Return

Kleenheat acknowledges that ATCO's proposed rate of return is in line with the methods of the gas rate of return instrument. However, Kleenheat is concerned that the risk-free rate at the time of this decision is set at the high point in the interest rate cycle and is then fixed for the AA6 period. The rate of return is a key driver of the tariff increase, and setting the rate of return of the GDS at the potential peak would result in ATCO achieving significant excess returns, at the cost of consumers. Kleenheat urges the ERA to consider this when setting the rate of return for the GDS, ensuring reasonable return for the operator and affordable access to the GDS.

In summary, the issues raised above align with Kleenheat's primary concern that access to the GDS remains safe and affordable for WA households and businesses.

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

For further information, or to discuss any of the points raised above, please contact Rick Newnham at [redacted].

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[8] ERA, Access Arrangement Issues Paper, 24 October 2023, p. 4
[9] ATCO Gas Australia, Access Arrangement Information, 18 September 2023, p. 235
[10] ERA, Final decision on proposed revised Access Arrangement, 15 November 2019, p. 364

Yours sincerely,

[redacted]

Rick Newnham

Commercial Manager, Kleenheat