



alintaenergy

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### **Draft Decision on Proposed Revisions to the Mid-West and South-West Gas Distribution Systems Access Arrangement for 2020 to 2024**

Alinta Sales Pty Ltd (**Alinta Energy**) is pleased to provide comment on the *Draft Decision on Proposed Revisions to the Mid-West and South-West Gas Distribution Systems Access Arrangement for 2020 to 2024 (Draft Decision)* released by the Economic Regulation Authority (**ERA**) in response to the proposed Access Arrangement submitted by ATCO Gas Australia (**ATCO**) for the five-year period from 1 January 2020 to 31 December 2024 (**AA5**).

The Draft Decision requires ATCO to make 37 amendments to the Access Arrangement before the ERA will accept it.

Following the release of the Draft Decision, ATCO published its *2020-24 Revised Plan<sup>1</sup> (Revised Plan)*, in which it accepted 24 of the amendments required by the ERA.

Alinta Energy has reviewed the ERA's Draft Decision in conjunction with ATCO's Revised Plan and will limit its comments to the specific matters below.

#### **1 B3 Customer Demand Forecasts**

We note the ERA considers<sup>2</sup> ATCO's proposed AA5 greenfields and brownfields growth capital expenditure does not meet the incremental revenue test under rule 79(2)(b) of the National Gas Rules and has therefore reduced all B2 and B3 greenfields and brownfields connections forecasts and associated gas usage to zero<sup>3</sup>.

Additionally, the ERA has adjusted ATCO's B2 and B3 connection numbers by using the average number of opening and closing connections rather than the number of closing connections only each year<sup>4</sup>.

However, the ERA has accepted<sup>5</sup> ATCO's forecast of usage per B2 and B3 connections per year over AA5. **ATCO's average forecast demand for B3 customer connections therefore remains significantly lower than Alinta Energy's forecast demand**, as highlighted in Table 1 and Figure 1 below.

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<sup>1</sup> 2020-24 Revised Plan: Access Arrangement Information for ATCO's Mid-West and South-West Gas Distribution System, ATCO Gas Australia, public, 12 June 2019

<sup>2</sup> Par. 76, Draft Decision

<sup>3</sup> Par. 95, Draft Decision

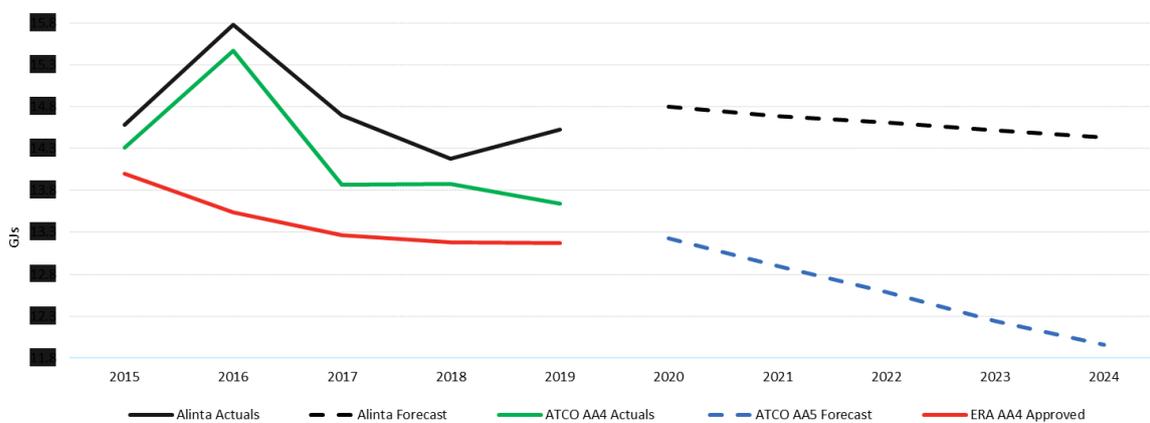
<sup>4</sup> Par. 95, Draft Decision

<sup>5</sup> Par. 96, Draft Decision

**Table 1: Comparison of average demand for B3 customer connections over AA4 and AA5**

	AA4 Actual						AA5 Forecast				
	2014	2015	2016	2017	2018	2019 <sup>6</sup>	2020	2021	2022	2023	2024
<b>ATCO<sup>7</sup> (GJ)</b>	7.79 <sup>8</sup>	14.26	15.41	13.82	13.83	13.59	13.18	12.84	12.54	12.19	11.91
<b>Alinta Energy<sup>9</sup> (GJ)</b>											

**Figure 1: Comparison of average demand for B3 customer connections over AA4 and AA5**



ATCO notes that *historical demand is one of the factors considered in the AA5 demand forecast*<sup>10</sup>. However, as illustrated in Figure 1, ATCO's AA5 forecast demand for B3 customer connections decreases at a much steeper rate than ATCO's actual demand over AA4 anticipates. The year-on-year change in ATCO's AA5 forecast demand is compared with that of Alinta Energy in the table below:

**Table 2: Change in average B3 forecast demand over AA5**

	2021	2022	2023	2024
<b>ATCO (%)</b>	(2.6)	(2.3)	(2.8)	(2.3)
<b>Alinta Energy (%)</b>	(0.7)	(0.6)	(0.6)	(0.6)

<sup>6</sup> Forecast ATCO and Alinta Energy

<sup>7</sup> Derived from Tables 7.6 & 7.7, Revised Plan

<sup>8</sup> Jul – Dec 2014 half year only

<sup>9</sup> Alinta Energy's base forecast has been adjusted for the number of connection points so a direct comparison can be made with ATCO's forecast.

<sup>10</sup> Sec. 7.5, Revised Plan

Alinta Energy's weather-based demand forecast shows a relatively stable forecast for the AA5 period, as highlighted in Figure 2 below. We would expect ATCO's normalisation of the effect of weather on demand would result in a stable load forecast into the future, rather than the average 2.6% year-on-year decrease that is forecast.

**Figure 2: Alinta Energy weather-based demand forecast**

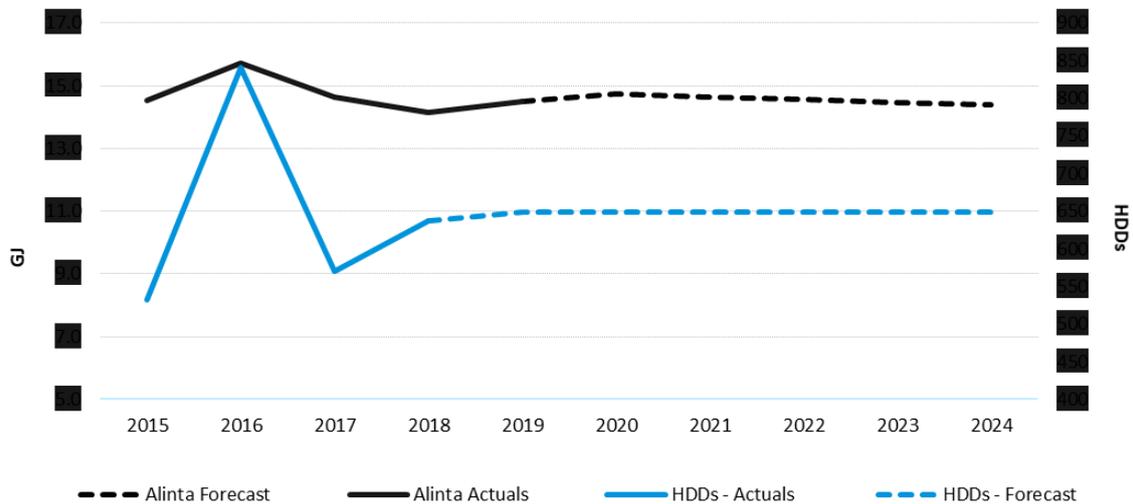


Figure 2 illustrates that over the AA4 period, average consumption within Alinta Energy's portfolio has remained relatively stable even with variation due to weather (with a slight reduction in the average per customer volume being driven by a lower average size for new connections).

We would expect the increase in gas retail market competition and the higher number of customers on discount offers to contribute to increased price elasticity in terms of preferring gas usage over electricity. We also note that lower prices tend to lead to higher demand; the greater the discount, the more a customer is likely to consume as they become less concerned about the amount they will be billed.

Considering all the above, **Alinta Energy does not agree with the significant decline in average demand per B3 customer connection suggested by ATCO over the AA5 period.**

Because of its role in determining the reference tariffs that will be paid by residential customers over the next 5-year period, it is essential that the B3 demand forecast is as accurate as possible. This will be highlighted in the following section.

## 2 B3 Reference Tariffs and Revenue Over-Recovery

Forecast demand plays a significant role in determining reference tariffs; under forecasting customer demand can lead to unnecessary tariff increases, which in turn can result in the over-recovery of revenue.

ATCO has signalled that B3 gas usage reference tariffs will increase from 1 January 2020 for the middle consumption tier and considerably so for the top consumption tier:

**Table 3: Comparison of ATCO B3 gas usage reference tariffs**

	Actual at 1 Jan 2019 <sup>11</sup> (\$)	Proposed at 1 Jan 2020 <sup>12</sup> (\$ nominal)	Uplift
First 1.825 GJ	-	-	0%
Vol >1.825, <9.855 GJ	4.89	7.25	148%
Vol >9.855 GJ	2.11	5.18	245%

Using the proposed B3 gas usage tariffs in Table 3 and the demand forecasts in Table 1, we have calculated (Table 4) that **ATCO would, over the AA5 period, recover up to \$43m more by using the ATCO demand forecast when compared with using the Alinta Energy demand forecast**. This revenue over-recovery would be generated entirely from the top B3 consumption tier.

**Table 4: AA5 revenue over-recovery using ATCO demand forecast when compared with using Alinta Energy demand forecast**

	2020	2021	2022	2023	2024	Total
Alinta Energy demand (GJ/connection)						
ATCO demand (GJ/connection)	13.18	12.84	12.54	12.19	11.91	
Additional demand (GJ/connection)						
Additional revenue (\$/connection) (@ \$5.18/GJ)						
Total B3 customer connections <sup>13</sup>	741,392	750,024	760,302	771,444	782,696	
Over-recovery (\$m nominal)	6.0	7.2	8.5	10.1	11.6	43.4

A similar comparison (Table 5) using ATCO's actual demand and the ERA-approved<sup>14</sup> demand forecast for AA4 indicates ATCO may have over-recovered some \$14m over AA4, again, entirely from the B3 top consumption tier.

<sup>11</sup> 2019 Reference Tariffs – from 1 January 2019, ATCO

<sup>12</sup> Table 17.7, Revised Plan

<sup>13</sup> Table 7.7, Revised Plan

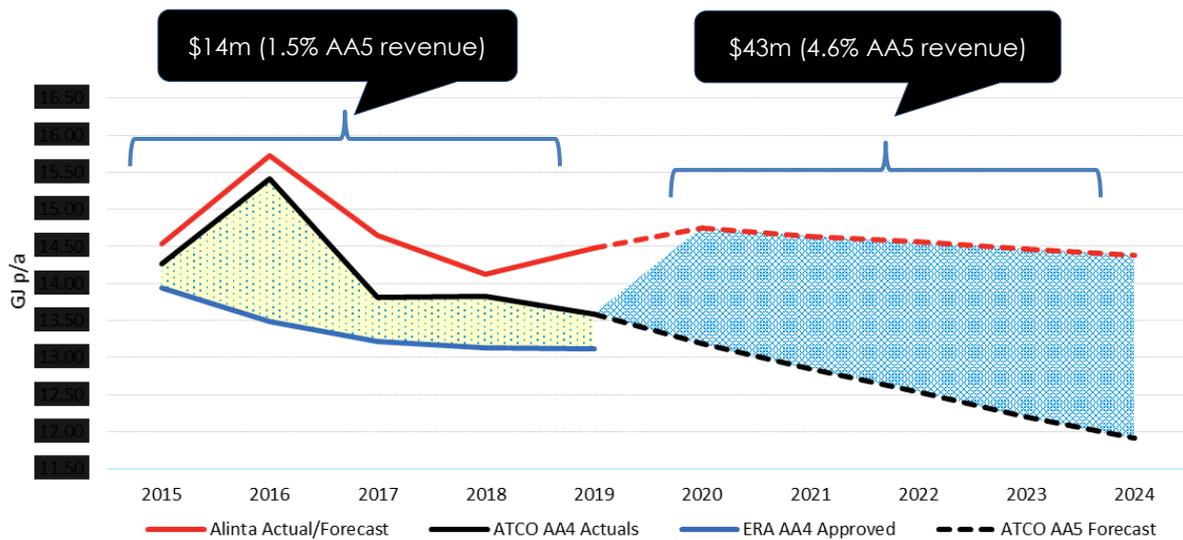
<sup>14</sup> Derived from Tables 13 & 14, Access Arrangement Information for the Mid-West and South-West Gas Distribution Systems – Revised by reason of and pursuant to orders of the Australian Competition Tribunal made on 13 July 2016, Economic Regulation Authority, 25 October 2016 (**AA4 Revised**)

**Table 5: AA4 revenue over-recovery using ATCO actual demand when compared with using ERA-approved demand forecast**

	2015	2016	2017	2018	2019	Total
<b>ERA approved demand (GJ/connection)</b>	13.95	13.49	13.21	13.13	13.12	
<b>ATCO actual demand (GJ/connection)</b>	14.26	15.41	13.82	13.83	13.59	
<b>Additional demand (GJ/connection)</b>	0.32	1.92	0.60	0.70	0.89	
<b>B3 reference tariff (\$/GJ)<sup>15</sup> (vol &gt;9.855 GJ)</b>	6.68	5.66	4.40	3.19	2.11	
<b>Additional revenue/connection (\$)</b>	2.12	10.88	2.66	2.24	1.88	
<b>Total B3 customer connections<sup>16</sup></b>	686,911	705,513	718,911	728,627	735,085	
<b>Over-recovery (\$m nominal)</b>	<b>1.5</b>	<b>7.7</b>	<b>1.9</b>	<b>1.6</b>	<b>1.4</b>	<b>14.1</b>

This over-recovery is demonstrated in the figure below and highlights the importance of ensuring that forecast demand is not understated.

**Figure 3: Estimated revenue over-recovery AA4 and AA5 (\$ nominal)**



Note: The % AA5 revenue is calculated on ATCO's proposed revised revenue<sup>17</sup> of \$931.4m.

Alinta Energy considers that ATCO can generate its B3 revenue requirement over AA5 by using a higher demand forecast that is more reflective of the consumption average over the AA4 period and takes into account the impact of new connections consuming less than the established portfolio, combined with a smaller initial reference tariff uplift, as will be demonstrated in the following section.

<sup>15</sup> Derived from Table 21, AA4 Revised

<sup>16</sup> Table 7.7, Revised Plan

<sup>17</sup> Table 16.2, Revised Plan

### 3 Adjustment of B3 Customer Demand Forecasts and Reference Tariffs

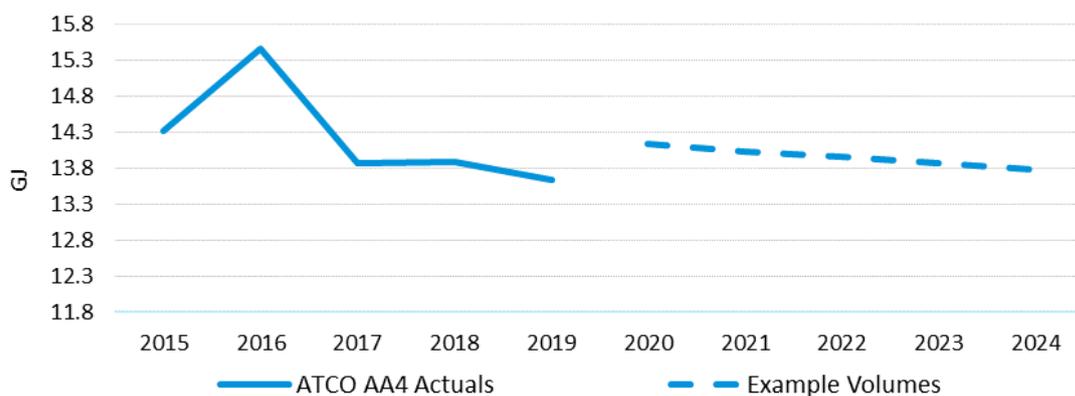
In this section, we will demonstrate how ATCO's B3 revenue requirement for AA5 can be met with a smaller reference tariff uplift than that proposed in the Revised Plan.

In the example below, we have started by adjusting ATCO's B3 customer demand forecast for 2020 to more closely reflect ATCO's actual average B3 demand over AA4 and then applied a year-on-year decline (due to the impact of new customers consuming less on average) similar to that forecast by Alinta Energy for AA5:

**Table 6: Example adjusted average demand for B3 customer connections over AA5**

	2020	2021	2022	2023	2024
<b>ATCO (GJ/connection)</b>	13.18	12.84	12.54	12.19	11.91
<b>Year-on-year change (%)</b>		(2.6)	(2.3)	(2.8)	(2.3)
<b>Alinta Energy (GJ/connection)</b>					
<b>Year-on-year change %</b>		(0.7)	(0.6)	(0.6)	(0.6)
<b>Example Adjusted (GJ/connection)</b>	14.08	13.98	13.90	13.82	13.74
<b>Year-on-year change %</b>		(0.7)	(0.6)	(0.6)	(0.6)

**Figure 4: Example adjusted average demand for B3 customer connections over AA5 compared with ATCO AA4 actual demand**



We have then adjusted the B3 gas usage tariffs shown in Table 3 so the overall uplift is spread equally between the middle and top consumption tiers, significantly reducing ATCO's proposed uplift for the top consumption tier:

**Table 7: Example adjusted B3 gas usage reference tariffs**

	Actual at 1 Jan 2019 (\$/GJ)	Proposed at 1 Jan 2020 (\$/GJ nominal)	Uplift	Example Adjusted 2020 (\$/GJ nominal)	Uplift
<b>First 1.825 GJ</b>	-	-	0%	-	0%
<b>Vol &gt;1.825, &lt;9.855 GJ</b>	4.89	7.25	148%	7.36	151%
<b>Vol &gt;9.855 GJ</b>	2.11	5.18	245%	3.18	151%

Using the adjusted B3 demand forecast together with the adjusted gas usage reference tariffs, ATCO can obtain their required revenue but with no over-recovery. Whilst there may be some under-recovery during the first 3 years, the overall revenue position for the five-year period is in line with ATCO's revised revenue position, as shown in the table below:

**Table 8: AA5 revenue using adjusted B3 demand forecast and adjusted reference tariffs**

	2020	2021	2022	2023	2024	Total
<b>Additional demand (GJ/connection)</b>	0.90	1.13	1.36	1.63	1.83	
<b>Additional revenue/connection (\$)</b>	(2.93)	(1.56)	(0.19)	1.51	2.96	
<b>Total B3 customer connections</b>	741,392	750,024	760,302	771,444	782,696	
<b>Over-recovery (\$m nominal)</b>	<b>(2.2)</b>	<b>(1.2)</b>	<b>(0.1)</b>	<b>1.2</b>	<b>2.3</b>	<b>0</b>



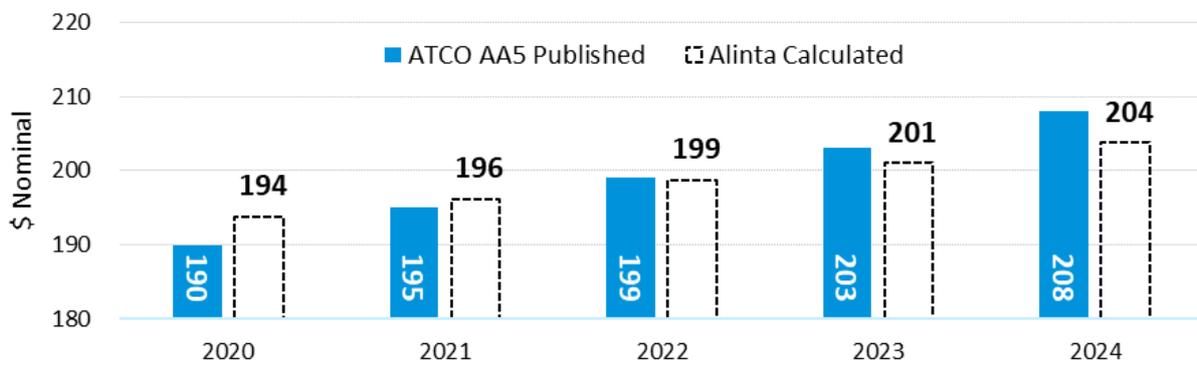
#### 4 B3 Customer Price Path

Using ATCO's forecast demand (Table 1) and proposed reference tariffs<sup>18</sup>, the price path for B3 customers over AA5 can be determined. We note we have been unable to fully reconcile our calculations with the price path presented by ATCO:

**Table 10: Calculation of B3 customer price path for AA5 (\$ nominal) – ATCO forecast demand and proposed reference tariffs**

	2020	2021	2022	2023	2024
ATCO demand (GJ/connection)	13.18	12.84	12.54	12.19	11.91
Standing charge (\$/year)	118.33	119.84	121.38	122.93	124.50
First 1.825 GJ (\$/GJ)	-	-	-	-	-
Vol >1.825 <9.855 GJ (\$/GJ)	7.25	7.51	7.78	8.06	8.35
Vol >9.855 GJ (\$/GJ)	5.18	5.36	5.56	5.75	5.97
Calculated rate (\$/connection)	<b>194</b>	<b>196</b>	<b>199</b>	<b>201</b>	<b>204</b>
ATCO published rate (\$/connection)	<b>190</b>	<b>195</b>	<b>199</b>	<b>203</b>	<b>208</b>
Variance (\$/connection)	<b>4</b>	<b>1</b>	<b>0</b>	<b>(2)</b>	<b>(4)</b>

**Figure 5: B3 customer price path for AA5**



<sup>18</sup> Table 17.7, Revised Plan

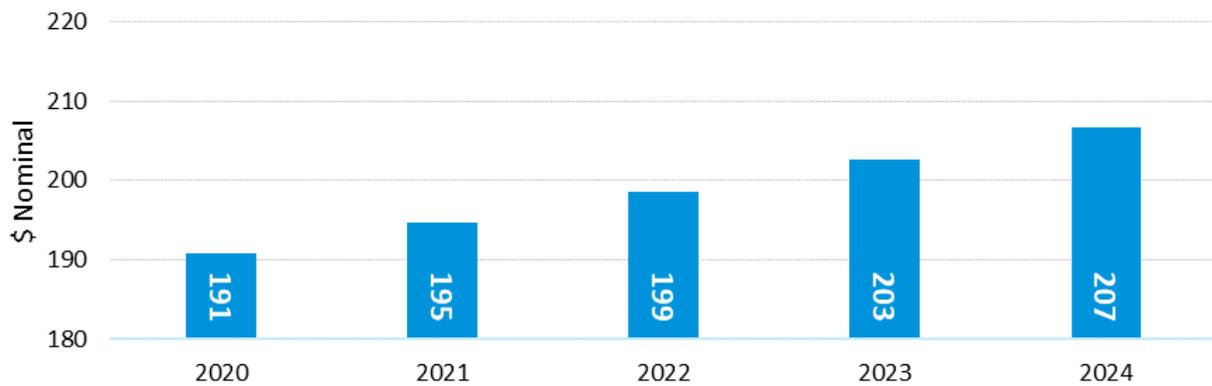
By substituting Alinta Energy's forecast demand (Table 1) for ATCO's, the price path for B3 customers increases significantly and revenue may be over-recovered:

**Figure 6: B3 customer price path using Alinta Energy forecast demand**

(Figure 6 redacted)

However, if the adjusted forecast demand and adjusted reference tariffs from the example in section 3 are used, the price path for B3 customers becomes aligned with ATCO's target price path, as shown in Figure 7 below.

**Figure 7: B3 customer price path using adjusted forecast demand and reference tariffs**



## 5 Summary

Alinta Energy requests the ERA closely reviews ATCO's Revised Plan for AA5. In particular, Alinta Energy considers:

- ATCO's average forecast demand for B3 customers over AA5 is too low. Alinta Energy does not agree with the significant year-on-year decline of 2.6% in average demand suggested by ATCO. Because of its role in determining reference tariffs, it is essential that the B3 demand forecast is as accurate as possible;
- ATCO could over-recover as much as \$43m, approximately \$11 per customer each year, over the AA5 period if the actual B3 customer demand is closer to that forecast by Alinta Energy. This revenue over-recovery would be generated entirely from the top B3 consumption tier;
- Some \$14m may have been over-recovered over the AA4 period due to actual demand being higher than the ERA-approved forecast demand;
- ATCO's B3 revenue requirement for AA5 could be met with a smaller reference tariff uplift by adjusting the demand forecast and spreading the tariff uplift equally between the middle and top consumption tiers, thereby significantly reducing ATCO's proposed uplift for the top consumption tier and providing a much smoother price path for customers over the Access Arrangement period;
- Significant network price increases will ultimately impact residential customers when retailers seek to moderate their discounted retail offers to accommodate the increases; and
- We agree with the magnitude of the ERA's draft revenue determination of \$880.7m and consider it appropriate for a regulated gas network business of ATCO's size and customer base.