Australian Gas Networks

Australian Gas Networks Limited

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Essential Services Commission

Level 37, 2 Lonsdale St
MELBOURNE VIC 3000

Via email: energy.submissions@esc.vic.gov.au

Re: Review of Unaccounted for Gas Benchmarks, Draft Decision - Methodology, May 2017

To Whom It May Concern:

Australian Gas Networks (AGN) welcomes the opportunity to make a submission to the Essential Services Commission's (the Commission's) Draft Decision "*Review of Unaccounted for Gas Benchmarks, Draft Decision - Methodology*" (DD - Methodology). AGN understands that the Commission will review submissions received on the draft decision and publish a final decision on its methodology by the end of July 2017.

AGN is supportive of the Commission's actions in order to clarify the proposed methodology to calculate the Unaccounted for Gas (UAFG) benchmarks for the next (2018 to 2022) Access Arrangement (AA) period. AGN understands that this review is the first stage of a two stage review process by the Commission, with the second stage to set the UAFG benchmarks for the next AA period, which is due to commence in the second half of 2017.

AGN understands the Commission proposes the following methodology to calculate the UAFG benchmarks:

1. The use of the revealed cost approach with a multi-year average, consistent with the approach taken for previous periods;
2. Not to account for possible reductions in UAFG resulting from the distributors' mains replacement programs, due to uncertainty in determining any possible reduction in UAFG;
3. Not to account for possible increases in UAFG caused by continued deterioration of the distributor networks, due to uncertainty in determining any possible increase in UAFG;
4. Consider whether there are any efficiencies that can be achieved by distributors, which may result in an adjustment to the forward benchmarks; and
5. To retain separate UAFG benchmarks for class A and class B customers.

AGN's particular comments in relation to the draft decision are detailed in the remainder of this letter.

Revealed Cost Approach with a Multi-Year Average

AGN supports the Commission's approach to using the revealed cost approach with a multi-year average to calculate the UAFG benchmarks. We note this is consistent with the approach used by the Commission for previous periods, and as such, is a well understood and transparent approach[1].

We also support the Commission's approach of determining the number of years of data to include in the multi-year average based on the particular circumstances of each business. We agree that the best method is to review each distributor's UAFG data and believe it is important to consider each distributor's circumstances when selecting the number of years to include in a multi-year average.

We are currently preparing our UAFG data to submit as part of our benchmark calculation. AGN is working with retailers to ensure 2013, 2014 and 2015 data is capable of being settled by the end of August 2017. To the extent this data has not been settled, AGN believes that it should be used in any event given that it reflects the most recent conditions for the network. AGN supports the Commission's following comments on the challenges of using old data:

> *"…the relevance of the data diminishes as the period used is extended because older data may not reflect the current circumstances faced by the distributors."*[2]

Furthermore, based on our past experience the total UAFG data provided to retailers, does not change. Any agreement with the retailers is instead focused on the amount allocated to each individual retailer and not the total amount of UAFG, which is relevant for setting benchmarks going forward.

On this basis, we consider that the use of data that has not been settled should be used to establish UAFG benchmarks, given the alternative of using older data that may result in unachievable or irrelevant UAFG benchmarks, which would work against the incentive properties of the regime.

Adjustments to the Benchmarks

AGN supports the Commission's approach of not adjusting UAFG benchmarks as a result of each distributor's mains replacement programs. Our mains replacement program objective is to improve safety, with the additional benefit of improving supply reliability to gas consumers by replacing ageing mains and services. Our Final Plan, provided to the Australian Energy Regulator (AER) on 23 December 2016, details that we are on schedule to deliver the approved replacement of 696 kilometres over the current (2013 to 2017) AA period.

The table below summarises progress to date and the forecast for the remaining two years of our current AA period.

Table 1: Current AA Period Mains Replacement Performance (kilometres)[3]

	2013	2014	2015	2016	2017	Total
Allowance	195	172	148	91	90	**696**
Actual/Forecast	195	171	151	94	85	**696**
Annual Variance	0	(1)	3	3	(5)	**0**
Cumulative Variance	**0**	**(1)**	**2**	**5**	**0**	**0**

[1] ESC, *Review of UAFG Benchmarks – Final Decision*, June 2013, page 49.
[2] ESC, *Review of Unaccounted for Gas Benchmarks – Draft Decision – Methodology*, May 2017, page 14.
[3] AGN, *Final Plan Attachment 8.2, Distribution Mains & Services Integrity Plan,* December 2016, page 18.

Our Distribution Mains & Services Integrity Plan (DMSIP), which formed part of our Final Plan to the AER, supports the Commission's view of not adjusting the UAFG benchmark for AGN to account for mains replacement programs. Recent analysis detailed in the DMSIP shows that the trend UAFG on AGN's network has been unresponsive to the mains replacement program over the 2010 to 2015 period, suggesting factors other than leakage are key influences in the level of UAFG in the AGN network.[4]

As part of our submission on the calculation of UAFG benchmarks, we will be providing the Commission with further information on how we have efficiently managed our network to minimise UAFG over the current AA period (i.e. taking into account all relevant factors). We plan to also include in this submission our plans to continue to minimize UAFG in the next AA period (which information is also included in our DMSIP, which we have attached to this submission).

For the purposes of setting benchmarks we also do not oppose the Commission's proposed approach of not accounting for possible increases in UAFG caused by the ongoing deterioration of the distribution network. We support the view that there are many components that contribute to the uncertainty of UAFG and these differ between each distribution network. We believe the setting of any adjustments to UAFG is potentially problematic and already captured through the multi-year revealed cost approach in any event.

Efficiency adjustments to the benchmarks

AGN would like to understand further the basis the Commission may make efficiency adjustments to the forward UAFG benchmarks.

This reflects our support for the Commission's views that:

> *"…there are exogenous factors beyond the distributors' control which partly determine the level of UAFG."*[5]
>
> and
>
> *"….it may not be cost effective for distributors to address all of these causes in an attempt to minimise UAFG"*[6]

Given these collective views on the level of uncertainty relating to the various causes and their impact on UAFG levels, we would like to work collaboratively with the Commission to understand what the adjustment to future UAFG benchmarks would be, if the Commission elects to apply an adjustment in light of the completion of our mains replacement program.

Separate UAFG benchmarks for class A and class B customers

AGN supports the Commission's continued use of two benchmarks for class A and class B customers.

Proposed change to the Gas Distribution System Code

The Gas Distribution System Code (GDSC) clause 2.4 (b) requires the gas distributor to provide written notice to the Australian Energy Market Operator (AEMO) by 30 April each year of the gas withdrawn. AGN requests this clause to be deleted as AEMO is not in a position to provide injections, net system load (NSL) and pricing data to distributors until 118 business days after the end of December.

This process is detailed in AEMO's Wholesale Market Distribution UAFG Procedures (Victoria)[7] and typically equates to the end of June each year. Once distributors receive this data from AEMO they

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4 AGN, *Final Plan Attachment 8.2, Distribution Mains & Services Integrity Plan,* December 2016, pages 39 to 40.
5 ESC, *Review of Unaccounted for Gas Benchmarks – Draft Decision Methodology*, May 2017, page 10.
6 ESC, *Review of Unaccounted for Gas Benchmarks – Draft Decision Methodology*, May 2017, page 9.
7 AEMO, *Wholesale Market Distribution UAFG Procedures (Victoria)*, 1 January 2016.

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need to reconcile this data and basic metered customer data with the retailers following any further data cleansing or validation required.

While it is not our preference to retain the clause, if this clause were to remain we propose it refers the AEMO Procedures only to avoid duplication of requirements and further potential misalignment in the future.

AGN believes that it would be beneficial to delete this clause of the GDSC at the same time the GDSC is amended for the new benchmarks.

Summary

We consider the Commission's two stage approach to setting the UAFG benchmarks to apply over the 2018 to 2022 period reflects good industry practice. The process of establishing the UAFG benchmark methodology first, followed by a process to establish the UAFG benchmarks themselves, will make, and has made to date, for a more focused discussion of the key issues.

In respect of the proposed methodology detailed in the Commission's draft decision, we are supportive of the use of a multi-year average based on a revealed cost approach. We do support using the most recent actual data, noting that this would be consistent with maintaining relevant benchmarks that support the incentive properties that are intended to apply. We also note that the data does not change through the settlement process.

We also do not consider the multi-year revealed cost approach should be adjusted for the impact of mains replacement, ongoing network deterioration and further efficiencies, reflecting that we have delivered our capital program over the current five year period, and the uncertainty and practical difficulty associated with making any such adjustments.

We look forward to further engagement as the UAFG benchmarks are developed over the course of 2017. Please contact either Vicky Knighton (   ) or myself (   ) if you would like to discuss this submission further.

Yours sincerely,

Craig de Laine
General Manager – Strategy and Regulation