20/12/2023

Mr Nathan Zhivov
Executive Director - Energy
Essential Services Commission
Level 8, 570 Bourke Street
Melbourne VIC 3000

Dear Nathan,

Thank you for the opportunity to respond to the Gas Distribution Code of Practice Review. Please find attached our submission in relation to the draft decision.

We support many of Commission's proposed changes including the removal of overlap in regulatory obligations and the provision of information that will enhance customer awareness of their available options. Additionally, we support proportional and effective customer protections, including the proposal to introduce deemed distribution contracts and consider these contracts have an important place in the gas regulatory framework.

However, we do not consider that the introduction of a large upfront connection charge is warranted at this time. This change to the current economic framework introduces inconsistency into our treatment of new and existing customers. It is inconsistent with the transitional arrangements under the Victorian Government's Gas Substitution Roadmap and the long-term interests of Victorian consumers.

It is our view that a broader conversation needs to be had about how to transition away from gas in a way that considers the regulatory contract between customers, government and gas networks but also manages the transition for those customers that are unable or unwilling to shift. Current policy positions support exit for those that can afford to leave the network sooner (for example the Australian Energy Regulator's (**AER's**) connection abolishment fees at less than economic cost). This results in customers with less options available – such as through vulnerability or lack of choice – paying a greater share for the network into the future. The upfront connection charge increases the burden on those customers who will remain on the network the longest and therefore contribute to the sustainable transition from gas to electricity.

In reviewing the draft decision, we also observed the addition of a substantial number of new civil penalty and other obligations. It is unclear from the draft decision how the costs and benefits of introducing additional regulatory requirements were balanced in the context of the energy transition and how these additional requirements promote efficiency in the delivery of gas distribution services. It is important the costs and benefit of regulation changes are assessed when substantially increasing regulatory burden including an assessment of how risk and cost is allocated, particularly given the decreasing role of gas in our energy mix.

If you have further queries on this submission, please do not hesitate to contact Rebecca Love on [redacted] or via email: [redacted]

Sincerely,

[redacted]

Tom Hallam
General Manager Regulation and Policy (Transmission and Gas)
AusNet Services

Victorian Gas Policy

The latest iteration of the Victorian Government's Gas Substitution Roadmap (**GSR**) confirms a clear policy intent that the decarbonisation of the residential and commercial gas load will be primarily through electrification.[1] This intent has been implemented through a series of complimentary policies including new energy efficiency requirements for new housing, connections ban on new gas reticulation from 1 January 2024 and incentives and programs to encourage appliance switching. Further pro-electrification policies will be assessed during 2024. A renewable gas policy for the hard to abate industrial sector is also being developed. Nonetheless, the Victorian Government has been careful to ensure existing customers or those that intend to become new customers are not restricted in their choices where they have already committed to a gas investment. This concern ensures the disruption caused by these new policies are minimised in the short run while delivering the fundamental changes required in the medium and long term.

As the owner of both electricity and gas networks, AusNet is well placed to ensure this transition is managed well, facilitating the desired policy outcomes while ensuring customers are protected and treated fairly.

It is important the Gas Distribution Code changes reflect both the GSR policy intent and the transitional arrangements to ensure sunk customer decisions are not penalised unfairly. With respect to the proposed changes to connection charges, while on the surface they appear consistent with the desire to disincentivise further connection to gas, in practice they unfairly penalise new customers who have already committed to a gas connection that remains permitted under the existing transition arrangements to a full ban. This is explained in more detail in the sections below.

Incentives for new gas connections

The draft decision stated aim is to address an inefficient incentive to connect, at face value contradicting Government policy, by replacing the current economic feasibility test with upfront charges to cover the full costs of installing a new connection and of any necessary changes to the distribution system to serve that customer.[2]

While we agree the current economic feasibility test requires amendment, and we have proposed changes, it remains the appropriate way to manage both new and existing customer stranding risks. With our proposed changes, the test provides efficient signals for the residual permitted connections and does not impose additional stranding risks on connecting customers or the sunk customer base. Importantly, by providing the flexibility to the distributor, it provides the tools for managing stranding risk with the party most capable of managing that risk.

We consider the proposed mandated upfront charges:

- Are not necessary to align with Government policy and indeed may contradict policy aims to ensure the transition does not penalise customer's sunk decisions and spread benefits and costs fairly;
- May actually increase rather than mitigate stranding risk for the existing customer base, particularly vulnerable customers;

[1] *Victoria's Gas Substitution Roadmap: Update*, December 2023

[2] ESC, *Draft Decision: Gas Distribution Code of Practice Review*, 14 November 2023, p. 5.

- Are inconsistent with electricity connection charging; and
- Result in unfair charging of new customers.

Each of these points are addressed in detail below.

How the policy is being implemented

The gas connections ban sensibly initially targets the planning decision to reticulate new gas mains, it does not target the continued connection of houses to recently laid mains in new residential estates. Nonetheless, new home connections will naturally decrease to zero as no new mains are laid after present planning permits are exhausted. This deliberate implementation approach ensures that recent developer and new homeowner decisions to build and connect are not penalised and a sudden transition that imposes extra costs on new homeowners is avoided.

Stranding risk of new customer assets

We note that the stated concern with the stranding risk to the existing customer base created by building assets to serve new customers. As such, limiting new customers is seen to be reducing stranding risk. In considering stranding risk, the draft decision accepts the Brotherhood of St Laurence (BSL) argument that introducing a connection charge would reduce stranded asset risk.[3]

We consider the analysis presented by BSL is incorrect. It is important to differentiate between new assets and the connection to existing assets. It is also important to give appropriate weight to how the transition is managed for both new and existing customers and how the economic feasibility test already takes these factors into account.

This implementation approach avoids additional stranding risk because allowing customers to connect to the recently laid mains ensures they are paid for by the new customers they were built for rather than the existing customer base. It is reasonable to assume that a new house connected to gas will have a suite of gas appliances with a 10–15-year life and the economic feasibility test ensures that the new connection assets are paid for over that time. If take up rates still fall, then the proposed flexibility in the economic feasibility test can incorporate that assumption and connection charges will rise naturally as customer interest falls.

In contrast, up front charging disincentivises connection to assets that have only recently been added to the asset base. If no new customers then connect, this actually creates rather than mitigates stranding risk for the existing customer base who are left with outstanding cost recovery.

We also note the key investment choice for both new and existing customers under the GSR is not a new additional charge for connection, as this is now banned, but rather the outlay for new appliances influenced by government incentives and standards.

Increased cost and stranding risk for existing customers

Therefore, it is our view that the proposed connections charge will lead to higher average costs for existing customers on the network. Currently, most new connecting customers do not face

[3] ESC, *Draft Decision: Gas Distribution Code of Practice Review*, 14 November 2023, p. 13.

upfront connection charges, because the economic feasibility test determines that they will contribute more to the network in terms of revenue than the costs they are imposing on the network. This test is consistent with the approach used in electricity, however the higher costs of an electricity connection results in some costs that must be paid for upfront because they will not be recovered from tariffs over time.

We note that assets in the gas network generally tend to be long lived assets that are paid down over decades. When a customer connects to a pipeline that has already been reticulated each connection means the costs of those long-lived assets are shared over more customers which reduces per customer costs for all customers on the network.

The phasing out new residential gas connections[4] will result in residential estates no longer being reticulated. However, where network assets already exist, new connections would reasonably be expected to lower the cost to existing gas customers.

We note that the draft decision stated the proposed upfront charging approach will lead to a reduction in revenue from a reduction in demand but will also lead to cost savings for customers that should be passed back[5]. While it is correct that new connections expenditure will decrease, we note that is a relatively small proportion of overall cost to customers. The net impact will be to drive prices higher for existing AusNet customers. AusNet's gas network operates under a price cap. In the short term, a reduction in demand will result in lower revenue to AusNet, simply because we have less customers. However, the price for each existing customer does not reduce. In the longer term (after the next price review determination) the revenue allowance is recovered from a lower level of demand, resulting in higher prices for customers.

The view above is consistent with the recent AER information paper, *Review into regulating gas pipelines under uncertainty*.[6] The AER considered declining demand for gas means that gas prices will increase because there are less customers to share network costs with. As there would be fewer customers in a declining gas future, the customers that remain using gas would have to take on the burden of paying for the long-term asset costs of those customers who left the network before contributing enough revenue to pay off the capital investment incurred on their behalf.

Fundamentally we consider the draft decision position will increase costs for existing customers and ultimately have a larger impact on vulnerable customers, renters, and people without the means to transition quickly. Keeping prices for existing consumers at a reasonable level is important for ensuring equity between those that can afford to transition quickly and those that cannot. It is also important for ensuring the gas network can continue operating through the transition. If consumers who need gas are not able to pay the price to use gas, then the gas network cannot recover the revenue needed to maintain operations safely and securely and ultimately it limits the network's ability to play a role in smoothing the transition for all customers.

Application of the economic feasibility test

Our view is the economic feasibility framework, with our proposed modifications, remains appropriate in the changing policy landscape. Managing the speed of the transition off gas is important – both for ensuring the electricity network has the infrastructure in place to manage

[4] *Victoria's Gas Substitution Roadmap*, September 2023, see: [Victoria's Gas Substitution Roadmap (planning.vic.gov.au)]
[5] ESC, *Draft Decision: Gas Distribution Code of Practice Review*, 14 November 2023, pp. 5-6.
[6] AER, *Regulating gas pipelines under uncertainty: Information paper*, November 2021

the increased load but also ensuring that customers can transition as and when makes sense to them in a way that causes least harm to the remaining customers. The test remains flexible enough to handle policy changes and if input assumptions on connection rates and utilisation of existing infrastructure change the upfront charge will naturally increase without being mandated.

Some stakeholders noted that the current economic feasibility test for calculating connection charges 'does not take into account the expected transition away from residential gas in Victoria and the associated costs of transitioning or decommissioning the network'.[7]

We dispute this premise. Applying the economic feasibility test principally considers how cost is apportioned and ensures the incentives of the network are aligned with managing the cost impact on customers. We would caution against removing this test and applying a blanket upfront charge. That type of approach will have unintended impacts that are detrimental to longer term decarbonisation goals. Further, without a plan for decommissioning the network we consider it is too early for the draft decision to make these sorts of policy calls regarding the speed of transition especially in relation to existing assets, as there is simply not enough planning and consideration being given to aligning the economic impacts in a manner that most effectively manages customer outcomes.

New customer charging considerations

Existing customers received a 'cheap' (often with no upfront charge) connection on the basis that they will pay off the cost of their connection through their tariffs over time. The connection was never 'cheap', simply the customers didn't have to pay the cost upfront. New customers will pay their full cost upfront and, therefore, should not have to pay off the cost of their connection over time. As such, new customers tariffs should be lower only reflecting the ongoing additional costs they impose (largely the additional operational and maintenance costs).

However, under the current tariff arrangements new connecting customers will be effectively paying twice for their connection – the upfront charge and also the ongoing contribution to other people's connections that were calculated under a different regulatory framework.

We therefore consider we would need to introduce a separate tariff for new customers that recognises the different contributions of new and existing customers to capital recovery.

Cost recovery considerations include:

- This new tariff will apply to a small subset of customers. This would likely need to be set up as a new customer class. Further work would need to be done as to which customers this should apply to.
- AusNet would bill retailers the appropriate amount for that customer class. Retailers should then apply this new tariff to the correct customers through their bills – noting retailers are not required to pass this lower network tariff on to the end customer. If retailers cannot apply this different network tariff to the specified customer class, they would effectively be double charging new customers.
- Consideration would need to be given to processes to determine how retailers could differentiate between the different types of customers. This may require billing system changes for retailers.

[7] Renew, *submission to the 'Gas Distribution System Code of Practice review: Issues Paper'*, 4 May 2023, p. 1; Alan Pears, op. cit., 4 May 2023, p. 6

- Timing should be aligned with AER regulatory reset processes –networks cannot introduce new tariffs outside of a regulatory reset.
- As part of that reset process, we would also need to determine and be approved by the AER what the appropriate recovery amount should be for each customer class, assuming the AER agrees to the introduction of a new customer class.
- To ensure customers aren't worse off as a result of this approach Commission will need to be able to monitor to ensure retailers aren't double charging customers.

This new tariff would have an impact on stakeholders – particularly retailers, and we consider the Commission would need to engage further with these stakeholders to understand the impact of its proposed approach and the likely outcomes for customers.

Response to Commission questions

Commission's questions	AusNet Response
Do you agree with the proposed introduction of upfront charges for new gas connections? Are there any implementation costs, advantages or disadvantages to the options considered that we should take into account? Please discuss.	The GSR is clear that the decarbonisation of the residential and commercial gas load will be primarily through electrification. However, the GSR is also careful to ensure that existing customers and those that have committed to new connections are not unfairly penalised. AusNet has a role, as an owner of both electricity and gas networks, to implement the policy intent while ensuring the shift towards electrification and the decreasing role of gas in the energy mix is managed in a way that ensures the energy system remains reliable and affordable for our customers. As discussed previously we consider the draft decision position: • Does not necessarily align with Government policy; • May actually increase rather than mitigate stranding risk for the existing customer base, particularly vulnerable customers; • Is inconsistent with electricity connection charging; and • Results in unfair charging of new customers. In our previous submission to the issues paper, we suggested changes that could be made to the economic feasibility test that could improve efficiencies within the current framework and align assumptions with the distributor access arrangement allowing gas policy changes to be dynamically reflected. We consider the best approach for customers would be for the final decision to work within the existing regulatory framework to improve efficiency.
Should the proposed code be more specific about how distributors calculate the costs of a new connection, as an upfront charge to customers? If so, how?	We consider the proposed wording in the code is generally acceptable. We note there is a risk proposed wording could lead to inequitable outcomes as it does not indicate a view around whether the application of costs is customer specific or an average cost for similar connections, for example, where a customer on one side of the street is paying significantly more than their neighbour across the road. Should the final decision implement this additional large upfront charge we suggest consideration is given to ensuring equity between customers and support is given for averaging of costs as appropriate.

Do you agree with the proposed implementation of new connection charges to begin from 1 January 2025? Please discuss.	The draft decision position will increase costs for existing customers and the impact is inconsistent with the GSR policy intent to reduce the impact of electrification on customers in the short run while delivering the fundamental changes required in the medium and long term. The proposed timing will ultimately have a larger impact on vulnerable customers and increase stranding risk. We have discussed these concerns under our consideration of incentives for new gas connections above. Further, the final decision should give additional weight to managing the speed of transition and the associated impacts on customers. Keeping prices for existing consumers at a reasonable level is essential for ensuring equity between those that can afford to transition and those that cannot. However, in the event this new upfront connection charge is introduced the proposed timing would need to take into account AER processes as we consider we would need to introduce a separate tariff for new customers. This tariff would be required to recognise the different contributions of new and existing customers to capital recovery. In particular, the timing will need to be aligned with the financial year tariff updates and allowed for as part of a GAAR re-opener.
Do you agree with the proposed definitions and processes for disconnection and abolishment? Please discuss.	We agree with defining abolishments and disconnections in the code. In relation to processes we don't consider that customers should be able to directly contact the distributor to organise an abolishment. Retailers have that direct relationship with customers and responsibility for abolishment should be with retailers. Where no retailer/customer relationship exists, the formation of this relationship, prior to abolishment, is a key control in ensuring that the process is undertaken properly. For example, there is a danger if distributors start directly abolishing connections at the request of a landlord that the interest of all parties at the residence are not considered. We note the draft decision did not implement the proposal to allow gas distributors to disconnect or abolish service lines that have been unused for years. We ask this be reconsidered in the final decision. Unused service lines present a real risk to consumer safety and action on this matter should be undertaken as a matter of urgency. This risk is only likely to increase into the future – particularly given changing consumer sentiment towards gas.

Do you agree with the proposed new provision of information obligations for gas distributors? Please discuss.	We, in principle, agree with provision of information requirements, particularly the obligations to provide information to customers about changes in the type of gas provided and our complaint handling processes. We will need a later effective implementation date to implement and report on these matters – particular matters that create new obligations such as unaccounted for gas and abolishments.
Do you agree with our proposed amendments to remove duplication with other regulatory instruments and to streamline the code? Please discuss.	We agree with the removal of duplication with other regulatory instruments. Consistent with this objective the draft decision should be reviewed to limit duplication with existing obligations under the AER framework such as the AER Pipeline Information Disclosure obligations. For example, we are already required to publish our Gas Access Arrangement - which contains our tariff schedule for all regulated services (and is already easily accessible to retailers).
Do you agree with the removal of the overlap of metering requirements between our code and the National Gas Rules? Should we retain the requirements in clause 7 on meter accreditation, certification and testing? Please discuss	We support the removal of overlap of metering obligations and in Part 19 of the National Gas Rules.
Do you have any feedback on our proposed compliance and performance reporting requirements? Please discuss.	It is unclear from the draft decision what weight the draft decision has given to the decreasing role of gas and the cost/benefits of increasing obligations in the current environment.
Do you have any feedback on our proposed variations to gas distribution licences? Please discuss.	We estimate it will take 6-12 months to establish a deemed distribution contract (depending on revisions and Commission approval timeframes). There would be benefits in undertaking consultation with industry and consumers on the nature and scope of these obligations in relation to deemed distribution contracts.

Can you identify any other changes to codes of practice, guidelines, licences or other instruments we may need to make as a consequence of the proposed Gas Distribution Code of Practice?	We have outlined below where we have concerns regarding the proposed variations and consider specific changes should be made.
	
	• **Disconnection, clause 6.1.3**
	    ○ Previous clause included ability for distributor to disconnect a customer for more than a health and safety reason, including in case of emergency, to reduce of damage, etc. We consider this ability should be reinstated in the proposed drafting.
	    ○ New wording may limit our ability to disconnect in these circumstances.
	• **Ongoing distributor obligations, clause 7.7.2**
	    ○ Missing reference to all sub clauses of 7.7.1 – currently it says 7.7.1(a), should be 7.7.1(a-d)
	
	There are also a number of other drafting amendments which may have implications which was are in the process of assessing. AusNet has considerable experience in providing services to meet the needs of our gas and electricity customers. We would appreciate the opportunity to work with the Commission when drafting the Gas Distribution System Code of Practice final determination.

Are there any issues with implementing the proposed Gas Distribution Code of Practice that we should consider?	Implementing many of the changes required in relation to Code Review will not be achievable by 1 May 2024. We request an effective implementation date of 1 January 2025 at the earliest. There are a lot of changes proposed, namely reporting requirements, civil penalty requirements, requirements to publish on our website and additional customer notification requirements.
	
	While we acknowledge and support the objectives of the draft decision, we will need time to ensure we have time to work through the implication of these changes with our business units and have the appropriate systems and structures in place to manage these obligations effectively. Four months (January-April) assuming 1 May 2024 final release date is not sufficient time for us to make these changes and be compliant with the new code.
	
	Specifically, in relation to this concern we note the following examples:
	• **Civil penalty requirements**
	    ○ New clauses with civil penalty requirements that would require new processes to ensure compliance.
	• **Guaranteed service levels, clause 3.2.2**
	    ○ Stipulates timing for payments and stipulates when analysis must be conducted to determine eligibility for payment

	○ Will require assessment of processes for GSL calculations/payment timings • **Unaccounted for gas, clause 3.4.6** ○ Includes stipulations to publish information on website ○ We have not previously reported in this manner on unaccounted for gas. While we have provided information in the past it has been in an ad hoc manner and specific reporting systems will need to be set up. • **Provision of information, clause 4.3.1** ○ Would require effort from multiple teams to gather information, validate it, and publish it to the website ○ Impact assessment will need to be undertaken to determine if this information is available or will require new collection processes to be set up. • **Provision of information on disconnection and abolishment, clauses 6.4.1-6.4.5** ○ Per Schedule 3, Part 2 – requires a new report to on abolishments to be published (new process with civil penalty requirement) ○ For abolishments we consider we should be able to publish these by postcode however will need time to implement as it is not currently data we track in this form. • **Registration of life support equipment, clause 7.3.1(a)** ○ Changed from "within one business day **after** being advised" to "within one business day **from** being advised" • **Distributor's obligation to remedy and report, clauses 9.1.1- 9.1.4** ○ Requires new reporting processes • **Gas type clauses** ○ New obligation – will require assessment to be undertaken.
Do you have other comments, feedback or suggestions about our draft decision or the proposed new code?	We support Commission's suggestion around the future work proposed in relation to decommissioning gas connections in the longer term. We note that it is important decommissioning of gas networks is managed in a way that supports gas networks to exit in an orderly and safe manner, supports customers meet their energy needs in a manner that is accessible, and ensures that energy remains reliable and affordable during the transition.

Promoting the long-term interests of Victorian energy consumers	Commission assessment criteria	AusNet comments
Quality, price and reliability of gas service	Do the proposed code changes provide a clear allocation of roles and responsibilities in relation to the quality and reliability of the supply of gas? Would the proposed code changes have unjustified effects on the price and affordability of gas services?	We consider the proposed code changes would allow for a clear allocation of roles and responsibilities in relation to gas. The final decision should reconsider the proposed changes in the draft decision to determine the effect on the price and affordability of gas services – specifically we raise concerns in relation to the connection framework and the introduction of new charges above the economically efficient cost of connection. This approach incentivises upwards pressure on prices to gas customers, creates additional stranding risk and is counter-intuitive to meeting the quality, price, and reliability of gas service objective.
Incentives for efficiency	Do the proposed code changes promote efficiency in the delivery of gas distribution services? Are the costs and benefits of proposed code changes appropriately allocated between distributors, retailers and consumers?	We disagree that the removal of the economic feasibility test promotes efficiency in the delivery of gas distribution services. Stranded assets are economically inefficient, and we consider the final decision assessment needs to appropriately weight the increased risk of stranded assets from the proposed approach. It is our view the current regulatory framework remains appropriate. The current regulatory approach of assessing the economic feasibility allows the AER and Commission to balance the needs of all Victorian consumers while managing the cost impost on existing customers through the transition more appropriately than the proposed changes in the draft decision. We consider the final decision should give greater consideration to the decreasing role of gas into the future and whether the benefits of additional regulation outweigh the costs.
Appropriate protections for consumers	Do the proposed code changes provide appropriate and effective consumer protections?	We support appropriate and effective consumer protections.
Decarbonisation	Do the proposed code changes support the decarbonisation of the energy market and the achievement of Victoria's climate action targets?	While the proposed changes address some aspects in relation to decarbonisation concerns our view is without a clear transition plan that considers the regulatory contract between customers, government and gas network service providers the proposed approach could lead to increased transition costs and ultimately be detrimental to achieving longer term decarbonisation goals.