



## Jemena Gas Networks (NSW) Ltd

### Revised 2020-25 Access Arrangement Proposal

#### Attachment 2.1

Response to the AER's draft decision - bd infrastructure report on asset lives workshop



**JEMENA GAS NETWORKS (NSW)  
ACCESS ARRANGEMENT 2020-2025**

# Asset Lives Workshop

Outcome Report – 14 October 2019

# Contents

|   |           |
|---|-----------|
| <b>Summary</b>                            | <b>3</b>  |
| Background                                | 3         |
| Workshop details                          | 3         |
| Conclusion                                | 3         |
| <b>Introduction and background</b>        | <b>4</b>  |
| Jemena's access arrangement proposal      | 4         |
| Asset depreciation challenges             | 4         |
| Workshop planning and agenda              | 5         |
| <b>Findings</b>                           | <b>6</b>  |
| The regulatory framework                  | 6         |
| Risk and risk transfer                    | 6         |
| Investment and market uncertainty         | 7         |
| Customer engagement and advocate feedback | 8         |
| <b>Conclusion</b>                         | <b>9</b>  |
| <b>Appendix A – agenda</b>                | <b>10</b> |

# Summary

## Background

In June 2019, Jemena Gas Networks (NSW) Ltd submitted an access arrangement proposal for 2020-2025 to the Australian Energy Regulator (AER). In it, Jemena proposed to shorten the period over which it recovers the cost of new gas assets (along with some existing asset categories). This accelerated depreciation is proposed to mitigate against the risk of declining gas demand which threatens to reduce the size of the customer base from which Jemena can recover the cost of its investments.

This proposal was tested with residential customers during a comprehensive engagement process which indicated consumer support for accelerated depreciation. Nonetheless, consumer advocates and the AER's Consumer Challenge Panel (CCP) have challenged whether this proposal is really in their long-term interests. These challenges were outlined in submissions to the AER on the Jemena proposal, and at a public forum on the proposal held by the AER on 7 August 2019.

## Workshop details

On Monday 14 October, Jemena hosted a workshop at its offices in North Sydney, to explore the issue of asset lives further and seek a possible alignment with consumer advocates. This workshop was attended by representatives from the Public Interest Advocacy Centre (PIAC); Energy Consumers Australia (ECA); the AER CCP and Jemena. The AER attended as observers. It was facilitated by Rachel Fox from bd infrastructure. The agenda was structured around the following discussion topics:

- The regulatory framework
- Risk and risk transfer
- Investment versus market uncertainty
- Customer engagement and advocate feedback

## Conclusion

The workshop was successful in improving a mutual understanding between Jemena and advocates on respective opinions regarding asset lives. Participants enjoyed the workshop and felt it was a worthwhile discussion.

There appears to be greater understanding on why Jemena believes there is a material risk to Jemena's gas network and advocates gained a better insight to Jemena's sentiment on this trend. Advocates also reported an improved understanding of Jemena's rationale for investment, despite this risk.

However, alignment was not achieved on the need to act over the next five years within the parameters of the regulatory framework to address market uncertainty; whether accelerated depreciation is the most appropriate regulatory tool to use; or on whether reduced asset lives passes risk onto customers.

# Introduction and background

## Jemena’s access arrangement proposal

In June 2019, Jemena Gas Networks (NSW) Ltd submitted an access arrangement proposal for 2020-2025 to the Australian Energy Regulator (AER). The proposal was developed over a period of 21 months in close consultation with residential and business customers.

The proposal contained a number of initiatives to continue providing customers with an affordable and reliable gas service at a time when the future of the gas market is uncertain. This uncertainty is being driven by the growing renewables market, which is prompting some customers to choose renewably-generated, low-carbon electricity as a sole energy source. This trend threatens to replace gas as a fuel of choice over time, reducing the size of the network customer base from which Jemena might hope to recover the cost of its investments.

In response, Jemena is proposing to shorten the period over which it recovers the capital cost of new gas assets. In this way, Jemena hopes to reduce the risk of ‘stranded assets’.

This proposal was tested with residential customers during three deliberative forums held in five locations across NSW during 2018. It was also confirmed at a final forum held in March 2019 where Jemena asked customers whether it had correctly understood and applied their feedback.

Jemena’s findings on customer views on this topic of accelerated asset depreciation – as described in its access arrangement proposal - is outlined below.

| Topic we engaged on   | What customers said  | How we are responding  |
|---|--|--|
| <b>Whether to change the profile of cost recovery of future investments to strike a fair balance between current and future customers</b> | <ul style="list-style-type: none"> <li>— Customers want us to take a proactive approach to managing future uncertainty and to minimise any negative customer consequences, such as future bill increases</li> <li>— Changing the recovery period for new, medium pressure mains and services assets was seen as a low risk or ‘no regrets’ approach</li> </ul> | <ul style="list-style-type: none"> <li>— We have incorporated customer preferences on the profile of cost recovery into our 2020 Plan. We tested the 2020 Plan as a whole with customers, enabling them to see the impact of cost recovery changes in the context of the overall plan and they confirmed their support for this change at our March 2019 forums</li> <li>— We are proposing to expense corporate overheads which will reduce capital expenditure in the long term and help improve the cost-competitiveness of gas over the long term</li> </ul> |

## Asset depreciation challenges

The approach to asset depreciation is far from straightforward. Fundamentally, in the case of Jemena, it has required delicate assessment of: risk (how real is the threat to the gas market?); timing (should we act now or wait?); and fairness (is Jemena’s risk being transferred to customers?).

It is this complexity that has prompted challenge from the Public Interest Advocacy Centre (PIAC); Energy Consumers Australia (ECA); and the AER’s Consumer Challenge Panel (CCP). These challenges were outlined in submissions to the AER on the Jemena proposal, and at a public forum on the proposal held on 7 August 2019

At that forum, the suggestion of a further workshop on asset lives was made as a means of furthering understanding between Jemena and consumer advocates on their respective positions. Rachel Fox from bd

infrastructure was invited to facilitate the workshop. Rachel facilitated deliberative residential forums and a large customer forum during the development of the Jemena proposal while working for RPS (Straight Talk).

The workshop took place on Monday 14 October 2019 at Jemena's offices in North Sydney. Representatives from PIAC, ECA, the CCP and Jemena attended as participants. The AER attended as observers. An agenda and full attendee list are included in Appendix A.

## Workshop planning and agenda

In advance of the workshop, Rachel spoke to representatives from the CCP, ECA and PIAC to understand their hopes and objectives for the session. Their comments, along with the issues raised in consumer advocates submissions on the Jemena proposal, informed the format and discussion topics for the workshop.

Stakeholders consulted in advance of the workshop were:

- Chris Fitz-Nead, AER Consumer Challenge Panel
- Shelley Ashe, Energy Consumers Australia
- Miyuru Ediriweera, Public Interest Advocacy Centre.

From these conversations, it was clear consumer advocates were keen to hear more from Jemena on the subject of risk: why it felt the risk to the future gas market was real and material, with a specific request to see Jemena's risk assessment analysis; what risk assessment it had undertaken to arrive at this conclusion; and why it was necessary to act now to mitigate.

In addition, advocates remained concerned that accelerated depreciation was Jemena's response to its own risk – a response that consumers shouldn't have to manage. Advocates were keen for Jemena to provide more information to support its case for why asset depreciation was in the long-term interests of customers.

Finally advocates wanted to receive more context on why Jemena proposed to continue investing in gas infrastructure while, at the same time, stating that its future was uncertain. Specifically requesting to see Jemena's risk assessment analysis.

Prior discussions with Jemena suggested there could be merit in using the workshop to outline its understanding and interpretation of the regulatory framework to show how that had led to its proposals around asset depreciation. Jemena was also keen to explore how it should balance the advice of advocates with the views garnered directly from consumer feedback.

Based on these prior discussions, the agenda was structured around the following discussion topics:

- The regulatory framework
- Risk and risk transfer
- Investment versus market uncertainty
- Customer engagement and advocate feedback

The format comprised presentations by members of the Jemena team, followed by a facilitated round-table discussion structured on key questions.

# Findings

## The regulatory framework

### Presentation

Jeff Balchin from Incenta provided an overview of the regulatory framework on behalf of Jemena. The purpose of this session was to confirm whether each party's approach to the issue of asset lives was based on the same sets of assumptions. Jemena has assumed that the regulatory framework provides the opportunity to recover efficient costs and that there are limited regulatory tools to do this.

### Discussion

Attendees felt that Jemena needed to establish the materiality of the market risk before proper consideration could be given to regulatory responses. As such, the discussion focused on how Jemena had assessed the risk to warrant regulatory action now. Advocates asked whether, if Jemena felt the risk was sufficiently severe to accelerate depreciation of new assets, the same approach would be taken for all assets during the next price review. Jemena responded that this was a real possibility. It also confirmed that if the risk reduced then asset lives could be changed back, and that this was the premise of their consumer engagement. When asked by attendees if Jemena's consultation with consumers covered the idea that accelerated depreciation could be applied to all assets in future – rather than limited to new assets – Jemena's response was that it did not.

Alternatives to accelerated depreciation were also suggested, for example introducing capacity and other tariff charges or altering the rate of return. Jemena reiterated that it was taking a range of actions to address uncertainty in the gas market but that shortening asset lives was the only regulatory tool open to it. Jemena also noted that it is bound by the rate of return guideline and cannot propose a Weighted Average Cost of Capital (WACC) to compensate for asset stranding. Moreover, tariffs will not mitigate the risk of declining use if people disconnect.

### Outcomes

- Advocates feel the materiality of risk needs to be established before considering regulatory tools to mitigate.
- Advocates would like Jemena to explore alternatives to accelerated depreciation that could have a lower customer impact.
- Jemena is taking a range of actions to address market uncertainty but feels that accelerated depreciation is the only regulatory tool at its disposal.

## Risk and risk transfer

### Presentation

Gabrielle Sycamore, General Manager Strategy and Commercial, Gas Distribution; and Peter Marcus, General Manager Asset Management, Gas Distribution, outlined that Jemena faced the potential of between \$1bn and \$3.5bn of stranded assets in the network should demand for gas fall as NSW moves towards decarbonisation. Even if demand remains stable, by 2050 Jemena could face a potential \$2.8bn of stranded assets. Under Jemena's corporate risk framework, the consequence of this risk was assessed as *catastrophic*.

Gabby and Peter also outlined that the likelihood of market decline is at least *possible* (greater than 25%). Only recently, the NSW Premier stated that her Government's net zero target for carbon was no longer aspirational. Irrespective of Government policy, the private sector is already acting. Jemena frequently encounters larger customers and developers who believe that renewably-generated electricity is the only low-carbon energy option open to them.

Finally, Jemena argued that changing asset lives for new investments does not constitute a transfer of risk. That is because the investments being made now will deliver benefits to customers that exceed the costs before 2050.

## Discussion

Advocates acknowledged that the presentation provided useful information on how Government policy and market trends were presenting threats to gas usage. They were keen to follow up with Jemena's Government contacts to understand the latest shift in policy. The catastrophic consequence of market decline to Jemena, in terms of the value of the potentially stranded assets, was also acknowledged. However, advocate participants wanted to consider the information provided in more detail before providing a view on the materiality of the risk; and still felt unconvinced on why the need to act was now.

### Outcomes

- Advocates have a better understanding of Jemena's logic in assessing market risk and noted the changed Government and private sector stances in relation to net zero targets.
- Advocates noted the additional information provided by Jemena but wanted more information on the proposal to accelerate depreciation versus stopping investment now.

## Investment and market uncertainty

### Presentation

Gabrielle Sycamore and Peter Harcus provided an overview of Jemena's rationale for investment in gas infrastructure. They explained that investment in national projects – for example the Northern Gas Pipeline – was subject to different terms and conditions designed for the contracted load. This was generally recovered via bilateral agreements over a period of typically 20 years. Investment to serve growth areas, for example the Aerotropolis, will deliver benefits to customers before 2050, although Jemena may not recover its costs.

### Discussion

Information on the rationale and background to investment was noted and appreciated. Advocates noted Jemena's concerns; but still had their own concerns about the precedent that could be set by shortening asset lives, and about the level of evidence that supported this move. Advocates could see the case that the economic life of assets is now different and that it is a difficult time to make investments. However, they were reluctant to support a move that would increase prices. Government compensation was suggested here as another alternative to asset depreciation that Jemena could explore.

Advocates also argued that the financial impact on customers of delaying a decision on asset lives did not seem to be that significant, and that the potential benefits could outweigh the additional costs.

### Outcomes

- Advocates have a better understanding of Jemena's rationale for investing while the market is uncertain.
- Advocates appreciated the case that the economic life of assets is now different and that it is a difficult time to make investments. However, they are reluctant to support a change that could increase prices or create precedent for other businesses.
- Questions remained on whether the increased contribution to customer bills caused by accelerated recovery could stymie demand for gas.

## Customer engagement and advocate feedback

### Discussion

Jemena then asked for guidance from participants on how it should balance the feedback it receives from direct customer engagement with that it receives from customer advocate groups.

Jemena's engagement process was widely acknowledged to be robust, comprehensive and trending towards best-practice. It was noted that there may not always be 100% consensus between customers and customer advocates, as different groups think about issues in different ways. Additionally, customer advocates are more informed than consumers who may not be aware of precedent issues and other interactions, but this doesn't mean that customers are wrong or should be ignored either. ECA aims to provide their views based on the evidence base available.

### Outcomes

- Jemena is acknowledged for undertaking a comprehensive engagement process in support of the 2020-2025 proposal. This workshop is further proof of that.
- Good engagement does not necessarily require consensus. Advocates seek to understand the evidence for proposals and will continue to challenge on those grounds.

# Conclusion

The workshop was successful in improving a mutual understanding between Jemena and advocates on respective opinions regarding asset lives. Participants enjoyed the workshop and felt it was a worthwhile discussion.

There appears to be greater understanding on Jemena's views on the claim of a material risk to the gas market and advocates gained a better insight to Jemena's sentiment on this trend. Advocates also reported an improved understanding of Jemena's rationale for investment.

However, alignment was not achieved on the need to act over the next five years within the parameters of the regulatory framework to address market uncertainty; whether accelerated depreciation is the most appropriate regulatory tool to use; or on whether reduced asset lives passes risk onto customers.

# Appendix A – agenda

## Meeting Agenda

JGN 2020-25 Access Arrangement Review – Asset lives workshop  
Monday, 14 October 2019, 13:00-17:00



|                         |   |                  |                 |
|-------------------------|---|------------------|-----------------|
| <b>Meeting Title:</b>   | JGN 2020-25 Access Arrangement Review – Asset lives workshop  |                  |                 |
| <b>Date:</b>            | Monday, 14 October 2019   | <b>Time:</b>     | 13:00-17:00     |
| <b>Location:</b>        | Meet at L14, 99 Walker St, North Sydney   | <b>Security:</b> | Choose an item. |
| <b>Dial In Details:</b> | 03 9173 7444<br>08 8445 3210<br>02 9867 7444<br><br>Participant PIN: 37683  |                  |                 |
| <b>Attendees:</b>       | Facilitator - Rachel Fox (bd infrastructure)<br>Shelley Ashe (ECA), Anthony Cribb (Trac Partners), Miyuru Ediriweera (PIAC)<br>Christine Xue (AER), Aidan Coulahan-Davy (AER), Albert Tong (AER)<br>Jeff Balchin (Incenta)<br>Gabby Sycamore, Peter Harcus, James Turnley, Sandeep Kumar, Jerrie Li, Stephanie Oesterheld, Ana Dijanosic (Jemena) |                  |                 |

### DISCUSSION ITEMS

| Item  | Responsibility  | Time         |
|---|---|--------------|
| 1. Welcome  | Rachel Fox  | 13:00        |
| 2. The Regulatory Framework<br>Presentation and discussion          | Jeff Balchin  | 13:10        |
| 3. Risk and risk transfer<br>Presentation and discussion            | Gabrielle Sycamore,<br>Peter Harcus,<br>Ana Dijanosic | 14:20        |
| <b>Break</b>  |   | <b>15:20</b> |
| 4. Investment vs market uncertainty<br>Presentation and discussion  | Gabrielle Sycamore,<br>Peter Harcus                   | 15:30        |
| 5. Customer engagement and stakeholder advocacy input<br>Discussion | Rachel Fox  | 16:30        |
| 6. Final reflections  | All   | 16:50        |
| 7. Close  |   | 17:00        |