

GN26 Energy Regulatory Advisory Panel (ERAP)



Meeting #3 Summary | Session 1: Friday 12 April 2024, 9.30am – 11.45am via MS Teams

Attendees

ERAP members Dr Andrew Nance (Chair), Louise Benjamin, Wendy Russell, Katherine Lowe, Gavin Duffy

Evoenergy John Knox (CEO), Peter Billing (General Manager Evoenergy), Megan Willcox (General Manager Economic Regulation), Gillian Symmans (Group Manager Regulatory Reviews & Policy), Bruce Hansen (Group Manager Gas Networks), Chloe Alexander (A/g Communications & Engagement Manager), Leah Ross (Economic Regulatory Manager), Yolanda Mchao (Regulatory Engagement & Project Manager), Ashlyn Napier (Principal Regulatory Economist), Lev Yulin (Group Manager Regulatory Pricing & Finance)

AER Network Pricing Team (observers) Anita Bryant (Assistant Director), Nickolas Innes (Analyst)

Agenda

- Options to manage risk and uncertainty:
 - Consideration of available options: Tariff Variation Mechanism (TVM), tariff structure, reference services
 - Framing and language for engagement on these topics

Outcome sought:

- Explain and explore options to manage risk and uncertainty with ERAP feedback given in relation to:
 - The National Gas Objective (NGO) 'long term interests of consumers'
 - Framing and language for engaging with consumers and the community

1. Welcome

- The chair opened the meeting with an Acknowledgement of Country.
- No conflict of interest declared, and the ERAP noted the overview of the agenda and meeting outcomes sought.

2. Safety share

- Evoenergy's safety share was about the importance of using the right communication channels in safety situations for faster responses, using recent examples of time-critical safety incidents being reported via ministerial emails and media contact information instead of faults and emergency contacts.

3. ERAP workplan: overview to December 2024

- The ERAP **noted** the workplan presented by Evoenergy which consists of interrelated matters for consideration along the journey to submitting the Reference Service Proposal (RSP) in June 2024 and the access arrangement (AA) proposal in June 2025 and beyond, with a primary focus on the 2026–31 period. The workplan starts with context setting (policy and regulatory) and outlining the challenge and how Evoenergy will engage, moving to the RSP topics of the tariff variation mechanism (TVM) and tariff structures then onto the other regulatory elements including expenditure and recovery of the regulated asset base. The ERAP noted within the workplan there is a degree of flexibility to revisit topics before submitting the AA as decisions will need to be considered holistically.

4. Introducing managing risk and uncertainty

- The ERAP **noted** the presentation by Evoenergy which discussed that there is considerable uncertainty about how fast and when the net zero target will be met. While the TVM challenge is a five-year issue with implications for the future, it is primarily about managing and sharing the risk associated with demand uncertainty over the 2026–31 period. The ACT policy context and recent AER reviews and decision making have changed the landscape for the form of control. Under a price cap, there is an incentive to connect customers, which in turn means that costs are shared across a large customer base (this is no longer an option in the ACT) and network businesses, including Evoenergy have historically outperformed demand forecasts. In recognising this shift, the AER undertook a series of reviews into regulating gas distribution business in uncertainty (2021) and the TVM and tariff structures (2023). In October 2023, the AER made a decision that requires network businesses to propose the TVM and tariff structures as part of the RSP. These elements are non-binding and Evoenergy intends to propose placeholder positions that will be reviewed, refined and revisited through the engagement process (including through the access arrangement submission and revision periods).

GN26 Energy Regulatory Advisory Panel (ERAP)



Meeting #3 Summary | Session 1: Friday 12 April 2024, 9.30am – 11.45am via MS Teams

4. Options to manage risk and uncertainty

Tariff Variation Mechanism

- The ERAP **noted** the presentation by Evoenergy on the following regulatory factors regarding the TVM:
 - The TVM is just one way of managing and sharing demand uncertainty as the energy transition progresses.
 - Evoenergy's TVM position is under consideration and will be reviewed, refined and revisited as we continue to engage with our stakeholders and community.
 - The TVM is set for five years and will be reassessed in future regulatory periods.
 - Ultimately the TVM does not mitigate the long-term risk of recovering efficient investment costs over a declining customer base without significant price increases.
 - Evoenergy is reassessing the TVM because (a) it is an AER requirement; and (b) we are exposed to increasing uncertainty as the energy transition progresses.
 - There is a great level of flexibility in the NGR regarding the design and implementation of TVM options and what combination of options network businesses can utilize (e.g. revenue cap, price cap, weighted average price cap, revenue yield or hybrid).
 - The NGR require that proposed TVMs must be rationalised with a range of relevant considerations e.g., efficient tariff structures, administration costs and risk sharing arrangements.
- The ERAP **noted** the presentation by Evoenergy on its consideration of alternative TVM options. The ERAP offered the following observations:
 - Evoenergy should consider the TVM and revenue risk, and long-term risk of a declining customer base in the ACT, when setting different tariff structures under a price or revenue cap to neither escalate or defer demand.
 - The TVM position outlined in the RSP should be considered preliminary and non-binding. Further, any feedback from the community should also be considered preliminary, as it is challenging to engage with the community on the TVM without presenting revenue requirements and resulting bill impacts over the next five years. The ERAP encouraged Evoenergy to consider not proposing a TVM in its RSP.
 - When engaging on and proposing a TVM, Evoenergy should consider the differences in customer preferences, price stability and impacts on emissions reductions. Evoenergy should also recognise the design of different TVMs could have intergenerational implications, as well as social equity implications.
 - While GN26 is focused on the 2026–31 period, decisions made in this regulatory period will have consequences for later regulatory periods. It is therefore crucial to ensure the TVM or any regulatory setting does not create incentives for, or influence customers to leave the network sooner than they otherwise would have.
 - Evoenergy may need to reconsider its TVM proposal as its demand forecasts become available.
 - Evoenergy could consider a price cap where over recovery of revenue is 'banked' for future costs of decommissioning or regulatory asset base (RAB) recovery.
 - Evoenergy should consider engaging with the community on a hybrid TVM approach in addition to price and revenue caps.
 - The ACT Government's consultation report on the Integrated Energy Plan (IEP) indicates some community sentiment that a customer led approach is not the most effective. Evoenergy should ensure alignment with the IEP set of principles.

GN26 Energy Regulatory Advisory Panel (ERAP)



Meeting #3 Summary | Session 1: Friday 12 April 2024, 9.30am – 11.45am via MS Teams

4. Options to manage risk and uncertainty

Tariff Variation Mechanism (cont.)

- The ERAP **noted** Evoenergy's proposed approach to engaging on the TVM with the community using the *Pattie's Burgers* analogy. The ERAP provided the following observations:
 - Framing of the analogy should show that risk allocation is worn by other customers. It is therefore important to demonstrate through the analogy people's ability or agency to manage the additional risk that other consumers leaving would place on them.
 - Before introducing the analogy, Evoenergy should explain why the business costs are fixed.
 - Evoenergy should remove the references to 'winners' and 'losers' in the analogy.
 - At this early stage of engagement, it will be difficult to illicit consumer preferences. It will be important to focus on exploring community views and concerns about the different options and how they align with their expectations. It will also be important to ensure diversity of views (e.g. Evoenergy's Energy Consumer Reference Council highlighted there will be different views between residential and business customers).
 - The burger analogy implies a level of choice and agency for customers that does not exist for some gas customers. It will be important when using the analogy to introduce the personas and lead discussions about complimentary measures regarding how those who are left behind or are vulnerable and how these cohorts can be assisted during the transition.
 - The burger analogy is a good starting point for conversations with the community but may oversimplify the situation. Evoenergy should consider replacing the analogy and using the gas network as an example.
 - The TVM discussion should consider pricing impacts beyond the five-year regulatory period and be put into the context of the overall revenue requirement for the five-year period and beyond.
- The ERAP **noted** Evoenergy's presentation that the gas connections scenarios shown were developed in consultation with the ERAP and are guided by the IEP – fast transition represents gas numbers hit the mid point of the IEP band in 2030, moderate represents the upper bound and the slow case represents a two-year lag from the target. The scenarios are based on very preliminary modelling using illustrative demand scenarios (+/- 10% dependent on the deviation between actual and forecast demand), taking into account bill impacts under different TVM options. The ERAP suggested the following:
 - Consider the temporal nature of the transition i.e., declining customer numbers, accelerated depreciation and the implications for the next regulatory period.
 - Outline all assumptions used to develop TVM scenarios including future demand and RAB recovery.
 - IEP consultation report outlines community concerns about affordability and equity and emphasised the connection between gas and electricity and the need for the energy transition to be considered holistically.
 - Emphasise the role of the government in delivering the IEP.
 - Describe different elements of the cost stack and discuss tariff cost allocations between fixed and variable, and glide paths and side constraints.
 - Consider the impacts on different personas in the illustration in terms of consumption and to contextualise the diverse customer base.

GN26 Energy Regulatory Advisory Panel (ERAP)



Meeting #3 Summary | Session 1: Friday 12 April 2024, 9.30am – 11.45am via MS Teams

Tariff structures

The ERAP **noted** Evoenergy's presentation on the following regulatory factors regarding tariff structures:

- While the TVM has clearly defined book ends to frame discussions, tariffs have an open-ended range of options that Evoenergy could potentially explore e.g., introducing new tariffs or varying existing tariffs.
- As part of Evoenergy's principles-based review of existing tariff structures it will consider increased demand uncertainty, fairness and equity considerations (including the ability for customers to respond to tariffs, and the recognition that equity has different meaning to different people), as well as the need for stable and efficient cost recovery and the cost of emissions reductions.
- It is important to recognise that any change to the tariff structures (e.g. rebalancing tariffs between customers) will have implications for customers.
- Evoenergy has a declining block structure due to the high fixed cost of operating the network. Application of the principle of economic efficiency would result in a very high fixed charge and a very low usage charge. This approach has affordability implications particularly for smaller customers. To balance affordability and equity, Evoenergy's declining block structure seeks to include some of the fixed costs in the Block 1 usage charge. This approach also provides greater bill certainty for smaller customers in the winter months e.g., if a customer doubles their gas consumption in winter, their gas bill will be less than double.
- The majority of Evoenergy customers (residential and small/medium businesses) are on the volume individual tariff with a declining structure.
- Evoenergy's tariffs are simple and are passed through by retailers. Evoenergy recognises in some jurisdictions, particularly Victoria, networks offer a range of tariffs (summer, winter, regional), however there is a trade-off between simplicity and cost reflectivity and the simpler tariffs are more likely to be passed through by retailers.

The ERAP provided the following observations:

- Consider introducing a NSW tariff to reflect the growing customer numbers, and the decline in the ACT.
- Evoenergy should consider how tariff structures deal with large users (customer numbers will not fall as much as demand falls).
- Avoidance of price shocks (inter and intra-regulatory periods) is an important criteria and should be considered as part of the review.
- Evoenergy should develop a retail bill illustration for a wholistic perspective.
- Evoenergy's current tariffs are simple both for customers to understand and to administer.
- The more complex the tariff structure, the less likely retailers will pass through those tariffs and the more costly it is to administer.
- Tariffs should be designed to be enduring, provide price stability and consider the intergenerational and long-term implications on the customer and the business.
- When engaging with customers, Evoenergy should consider presenting the counterfactual to the proposed principles (i.e., complex tariffs, costly to administer and hard to respond to because the tariff is not passed through).
- Evoenergy should provide working assumptions for community forum sessions to keep discussions on focus e.g., bio renewables are not an option in the ACT, consideration of dividing the ACT and NSW network as there is a social license element to navigate etc.

Reference services: The ERAP agreed to provide feedback on the option to consider specifying two reference services: transport and metering; and ancillary services in Evoenergy's RSP out of session by 19 April 2024.