

23 June 2023

Dale Johanssen
Australian Energy Regulator

Submitted by email

Dear Dale

Review of gas distribution network reference tariff variation mechanism and declining block tariffs

PIAC welcomes the opportunity to respond further to the 'Review of gas distribution network tariff variation mechanism and declining block tariffs Issues Paper' (the Paper). We note our presentation to the public forum held on 8th June¹ and request its content also be regarded as a formal submission to this process.

We understand the context in which the Paper has been initiated and agree the prevailing circumstances, developments in policy and regulation and the progressing energy system transformation warrant examination of national gas laws, regulations and policy. Gas is a fossil fuel and meeting emissions targets will involve electrification and the decommissioning of gas networks. Regardless of the pace of this change, it involves risks which must be managed and mitigated to ensure consumers are not unreasonably impacted.

We agree that the existing regulations of gas businesses (including the tariff variation mechanism and tariff structures) are not consistent with jurisdictional policies, climate change policies and a contemporary understanding of what will be required to efficiently transition and decarbonise the energy system. However, isolated changes to the tariff structures and tariff variation mechanisms are unlikely to deliver the impact intended. There are also risks that making isolated changes to these mechanisms will have significant unintended consequences, some of which we detailed in our presentation to the public forum on 8th June.

PIAC contends changes to gas law, regulation and policy must be more considered holistically, in conjunction with retail pricing and practices, in order to determine the most effective and consistent set of reforms to better manage risks and costs for gas networks and consumers, supporting a rapid, managed energy system transition. In that context provide further recommendations regarding the changes under consideration.

Tarif variation mechanisms

PIAC does not support change to a revenue cap tariff variation mechanism and

¹ PIAC have provided the slides and speaking notes from this presentation as an attachment to this submission.

recommend retaining a robust cap on prices to protect consumers. However, we agree the current application of weighted average price caps provides some incentive for businesses to under-estimate their demand forecasts and then 'over perform'.

The AER should consider opportunities to amend the weighted average price cap approach to improve the incentive for businesses to increase the accuracy of their demand forecasts and better manage to meet that demand. The AER should also consider changes to other aspects of the reporting and regulatory frameworks to ensure they are aligned with consistently reducing gas demand (where they currently actively assume or encourage ongoing demand growth).

Tariff structures

PIAC agree that it is possible to regard flat or inclining block network tariffs, in isolation, as compatible with measures to encourage reduced gas demand. However, we contend there are a range of factors related to the variation in gas network tariffs and the nature of their interaction with retail tariffs which mean the intent of switching to flat or inclining structures is unlikely to be delivered and may result in unintended negative impacts on consumers. We provided examples of common retail practices and their interactions with network tariffs in our presentation to the public forum on 8 June.

Given the variation within and between gas network businesses and their circumstances, rather than make a prescriptive change to tariff structure, it may be more effective for the AER to provide binding principles for how tariffs structures should be formulated to support efficient demand reduction, and more efficient cost recovery for higher levels of demand. PIAC recommend these principles include:

- Blocks for 'higher gas consumption' (which could have a relative definition provided by the AER) should include the long run marginal cost (LRMC), reflecting any costs of future augmentation that can be avoided by reducing demand, and some residual costs in line with historical levels.
- Tariffs should differentiate between residential and large commercial and industrial users.
- Fixed charges for residential consumers should be as low as possible.
- Gas network business should be required to assess retail pricing and practices as part of customer impact modelling work required in the development of their tariffs.

More comprehensive and effective ways to reduce gas use and address the risks and impacts of electrification

The AER should look to undertake a more comprehensive review of gas regulation to identify the full suite of legal, regulatory and policy changes required to ensure gas businesses manage their risks more effectively on behalf of consumers. As part of this review the AER should seek to implement or advocate for measures including:

- Remove incentives for gas network businesses to increase new gas connections and replace gas appliances. This should include changes to monitoring and performance frameworks which focus on increasing gas demand and usage.
- Clearly signal to gas businesses that future new investments (such as network conversions and augmentations to accommodate distributed hydrogen to households) are at their own risk and cost.
- Implement reforms to allow businesses to refuse new gas connections.

- Commit to protections for consumers to shield them from gas network asset risk they cannot manage.
- Encourage or require gas businesses to identify areas of declining demand or 'inefficient' network utilisation as a basis for managed network retreat with sufficient signals to consumers and governments.
- Implement strong standards regarding the advertising and marketing of gas and gas appliances, requiring them to be accurate (particularly in relation to relative cost, efficiency and emissions intensity). This should also include central provision of consistent information on the cost, emissions and health impacts of gas appliances.
- More robust, accelerated reforms of building and appliance efficiency standards and programs to support efficiency improvements.
- Enabling and providing targeted assistance to consumers experiencing vulnerability. This should include encouraging gas businesses to direct budgets for innovation, marketing (such as those currently used to subsidise new gas appliances) and demand management, towards supporting those consumers to efficiently disconnect from gas.
- Consider measures to support the right down gas network business assets.

We welcome the opportunity to discuss these matters further with the AER and other stakeholders.

Yours sincerely

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