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2006 Review of Envestra's Gas Distribution Access Arrangement – Response to Issues Paper

I write in response to your request for comment on the above paper.

Introduction

Envestra have historically taken the position of attaching the terms and conditions to the Access Arrangement. When Retailers seek access, the regulatory process has previously reviewed the terms and conditions, so to the extent that Retailers can be confident the review has been thorough, Envestra cannot use differentials to the terms and conditions to create a barrier to entry. This is a positive feature and should be encouraged to continue.

In major contrast to this approach, an issue that arose out of Retailers seeking to conclude the AGLGN access arrangements in NSW was that the full terms and conditions were not included in the Access Arrangement and in our view there were some provisions in that agreement that would be considered unreasonable by any independent regulator. However in order to gain access within a reasonable time it is necessary to accept terms as they were. This is not consistent with principles of access.

Following on from the above, the Commission should provide guidance as to the general tests for reasonableness, such as Guidance on the apportionment of liability. The compelling logic is that risk (and liabilities) sit where it is best managed, but there are some inconsistencies (especially in the linear relationship) between this principle and the

Access Arrangement. Clarity provides further certainty for both the access provider and access seeker.

2006 review of Envestra's Gas Distribution Access Arrangement - Key issues

Measurement and Metering

For the obvious impact that it can have on Swing Services in the SA market, "measurement and metering" remains a key issue for retailers. The Issues paper comments on FRC costs being repaid to Envestra by the SA Govt, but clearly states that the "cost" of telemetry will be covered separately.[1] Our recollection is that only some 40 of the 170 sites had in fact been upgraded to Interval Metering/Telemetry by FRC and market start in 2004. The Commission should seek full clarification of when all required Interval Meters would be installed and how they are to be paid for.

Please also note the words under 2.2.2 Service standards and quality - "Under its Distribution Licence in South Australia, Envestra is required to, among other things, meet certain key performance indicators such as average percentage metering errors and number of outages per year per 1000 customers." Bad data is a commercial concern to all Market Users, especially as metering data includes the measurements at the Gate Points. Gate points are not "owned" by Envestra, they are owned by the pipeline operators, and there is a risk that an "all care but no responsibility" approach may prevail where this data is received to the GRMBS.

Finally, Users are paying for a metering service for two purposes:

1. The purpose of Retailing, and;
2. Daily balancing for every Gas Day of the year.

If this data is realistic, the cost of Swing Services and extent to which it occurs is of minor consequence. However our experience is that this data is not entirely accurate or reliable and it follows that the commercial risk remains unacceptable.

Congestion

On page 10 ESCOSA writes "Each haulage reference service consists of accepting gas into the network at a receipt point and delivering an equivalent quantity of gas to a delivery point in the network after allowance has been made for unaccounted for gas (UAFG)."

The Distribution System, commonly referred to as the Main Adelaide Subnetwork, was designed to be fed by three City Gates off the main MAPS transmission pipeline. With the introduction of SEAGas and the Cavan Gate Point the overall dynamics of the Envestra system has changed. At the time of the drafting of the RMR's Origin held a monopoly over the three MAPS Gates. It is worth noting that this City Gate monopoly

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[1] "The current Access Arrangement provides for all demand delivery points consuming greater that 10 TJ per annum to have telemetry (interval metering) installed." Page 11, Issues Paper

situation expires in December 2005, and we expect that the dynamics of MAPS carriage will then change, and that this will occur prior to the new Access Arrangements being finalised. We encourage the Commission to consult again on this impact closer to the date.

Tariff Zones

There are currently four distribution pricing zones on the MAPS, North West, North, Central and Southern. The North and North West zones are adjacent geographically, however the North West zone appears to be disproportionate. If there is a cross subsidy within the current tariffs should this continue?

Reference services

Haulage reference services:

The access arrangement (Sect 2.2) provides for services that include:

- Odorisation of gas, and;
- Meter reading on a quarterly basis for domestic and commercial delivery points and on a monthly basis demand delivery points.

Each of these raises specific issues for Retailers.

1. The odorisation of gas is an obligation that should indemnify retailers from their responsibilities to supply gas safety and to a technical standard where Envestra fail to meet this obligation to appropriate standards (risk sits where it is best managed), and;
2. The obligations to poll and read interval meters under the Gas Retail Market Rules need to be explicit in the haulage reference services.

Negotiated services:

Where a delivery point has unique requirements, services may be negotiated, with tariffs reflecting the cost of providing the individual service. However a common charging mechanism must be established, either as a protocol or a formula, to ensure that Envestra cannot use price differentials to create a barrier to entry.

Description of Standards of Services:

We agree that the Service Standards and terms and conditions must be sufficiently detailed and complete if a network user is to determine the value represented by the reference service at the reference tariff. However this is not just limited to “determining value”, but understanding and having enforceable agreements that the user and the service provider (Envestra) can use to determine the threshold of unacceptable standards. These can then be cooperatively amended or escalated as necessary. The parties should also be subject to sanction or penalty by the regulator following formal review. It follows that any Services Policy should only be approved if it specifies the service levels to be delivered referenced to the services.

Building Block
TXU supports the building block methodology for determining regulated revenues. Our support for this methodology is on the basis of both its widespread application in other jurisdictions and its historical integrity.

Regulated Asset Base (RAB)
TXU supports RAB valuation methodology presently applied in the Gas Code and the requirement to ensure that all new facilities investment passes the economic feasibility test (Sect 8.16b(1)) of the Gas Code. We support the subtraction of depreciation and redundant capital form the RAB, and the revaluation of the RAB at 5-year periods consistent with DORC values.

WACC
We reject SAIPAR's method of not revealing the parameters of the WACC to determine pre-tax WACC on the basis that this is not transparent. In any case we support WACC parameters on the lower side of the plausible ranges on the basis that this is consistent with outcomes of a purer economic paradigm.

Expenditure Forecasts
Opex
We would question the need for Envestra to have marketing costs included in its Opex forecasts. Where the promotion of natural gas is a public policy initiative, funding for that purpose should be clearly identified for each discrete project, and its allocation explicit.

Given the information asymmetry between regulator and service provider we support the regulator's use of benchmarking as a tool for determining efficient Opex.

Capex
We support the principle that capex spent during regulatory term should only be included in the RAB if it has passed the economic feasibility test under sect. 8.16 of the Gas Code. The Commission has identified the work done by the ACCC in its treatment of Capex and SAIPAR has previously used this as a guide. We support the ACCC's ex-ante approach to setting capex, however we reject its approach to:

(i) Excluded projects and;
(ii) Off ramps,

on the basis that these distort the incentive qualities of the regulatory regime.

Off Ramps
Off ramps are simply re-opening provisions that allow pass through given certain trigger events. We reject these on the basis that they are:

(i) asymmetric, and;

(ii) more consistent with rate of return regulation.

Tariffs

We acknowledge the appeal of the "tariff basket" approach that provides a theoretical basis for:

(i) Economically efficient outcomes, and;
(ii) Allowing distributors more pricing flexibility in tariffs.

However in our view this debate cannot be isolated to the theoretical efficiency of distributors, where it is often an opportunity for gaming, and needs to included in the broader paradigm of consumer outcomes.

Regulators are historically convinced by the economic argument of cost reflectivity advanced by network providers whilst they simultaneously advance in retail markets the breaking down of information asymmetry, and regulating requirements for inclining block tariffs, uniform price disclosures and simplistic price comparisons.

This is generally inconsistent again with any assessment of workable competition at a retail level where the focus is should be upon ensuring barriers to entry (for consumers) are low, choices are available, and competing new retail entrants can accommodate consumer preferences.

In our broader experience of retail energy markets, the information asymmetry (customer to retailer) this attempts to address by regulation is a function of market convention built upon two foundations:

(i) A variety of Retail Tariffs and their complex proliferation of varying inclining and declining consumption blocks and thresholds, and;
(ii) The underlying, substantially different and increasingly complex Network Tariffs and price thresholds encouraged under the regulatory regime including the “tariff basket”.

Whatever their purpose, this proliferation of network tariffs is historically unrelated to consumer preferences.

Combined, these make it difficult to accurately represent any retailer offer in a standardised price format for comparison – often leading to further regulatory intervention such as that experienced recently in Victoria.

If the benefits of competition accrue from the availability of choice of retailer, and not from the proliferation of a distributors or local retailers tariff suite, then we encourage ESCOSA to limit the tariff and pricing flexibility of Envestra to ensure that barriers to entry remain low. Any net benefit test must consider the total cost to the market and broader consumer outcomes, not just the theoretical efficiencies or isolated benefits that may accrue to distributor.

Price path, cost of service, reference tariff control or trigger adjustment?

TXU supports the pure price path approach subject to:

(i) Sect 3.4 pass through of Gov taxes and charges, and;
(ii) Sect. 3.3.2 trigger events limited to new interconnection and FRC costs.

Incentive mechanisms

Our earlier comment on the treatment of Capex is also be relevant to the incentive properties of the regulatory regime applied. TXU would support a regulatory regime that redistributes Opex and Capex gains back to consumers on the basis of the actual gains and a 70:30 redistribution.

SAIPAR have previously supported an incentive regime that carries over a proportion of gains to consumers in the next regulatory period. The ACCC has also previously determined that under the Gas Code that service providers can carry over negative losses for Opex at the end of a regulatory period. This approach is more symmetrical.

We would support a negative carry over on Opex on the basis it makes the incentive mechanism symmetrical.

Further Information

Please contact myself on 03 8628 1156 if you have any queries on the matters raised in this correspondence.

Yours sincerely,

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TXU