

Access Arrangement  
for the  
South Australian Distribution System

RESPONSE TO  
ESCOSA DISCUSSION PAPER  
BY

ENVESTRA LIMITED



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## 1. INTRODUCTION

Envestra is pleased to provide these comments to assist ESCOSA in forming its preliminary views on issues ahead of the submission of the Access Arrangement and Access Arrangement Information on 1 October 2005.

Envestra is conscious that it is about to submit an Access Arrangement that will have a term concurrent with the largest restructuring of energy regulation in Australia since 1994, by the Ministerial Council of Energy (MCE). A significant reform deliverable for the MCE is the development of a national framework for distribution and retailing (D&R Framework) - with the stated goals of streamlining and improving the quality of economic regulation across energy markets, lowering the cost and complexity of regulation facing investors, enhancing regulatory certainty and lowering barriers to competition.

In August 2004, the MCE initiated consultation on the D&R Framework through the release of an Issues Paper. The Issues Paper was widely criticised for focusing on the harmonisation of existing regulatory instruments (and their content) without strategic context. A further Options Paper is scheduled for release for consultation in July 2005, with the aim of the Australian Energy Regulator assuming responsibility of the D&R Framework, from late 2006.

As a consequence, by January 2007 Envestra expects that the form and structure of distribution regulation in Australia will have changed significantly, that the Gas Code will have been rewritten, that electricity distribution regulation will be much more consistent with gas regulation and that the various Codes underpinning the South Australian access regime will have been repealed.

These are major changes which will impact Envestra, which makes almost all of its revenues from regulated returns. These changes will also impact on the willingness of potential investors to invest in network infrastructure equities. Envestra will have no certainty, at the time that the Access Arrangement is approved, in relation to:

- Amendments to the National Gas Code and the associated alteration of rights and responsibilities for network users and owners consequent to this;
- how network owners like Envestra will transition from the current arrangements to the proposed new arrangements, and whether the AER will be able to re-open ESCOSA's decision and under what conditions;
- what residual responsibilities will remain with ESCOSA and the South Australian Government, and what responsibilities will lie with the Ministerial Council of Energy and the Australian Energy Regulator – it is possible that regulatory duplication could incur costs that are not eligible for pass-through for Envestra;
- how the AEMC/AER will develop further the detail of the new regulatory arrangements through rules and statements of requirements. It is unclear:
  - if the new arrangements will impact on Envestra's current and proposed new investments over the second Access Arrangement Period;
  - what rules and regulations will apply at both the national and the State level;
  - what control or influence Envestra will have in the development of the new regime that will apply to it.
- the range of legislative changes required in South Australia to facilitate the proposed arrangements, including repeal of legislation. It is possible that legislative amendments will impose costs and may impact on other rights and obligations currently held by Envestra; and

- whether South Australia's existing distribution licences and codes would be repealed, and replaced with new arrangements to be developed by the AEMC/AER. If this Access Arrangement is drafted to meet existing instruments, Envestra and network users face the risk of ambiguity when the underlying instruments are repealed.

While Envestra recognises that ESCOSA's decision must take into account the existing regulatory regime, and understands that as a consequence ESCOSA intends to ignore the national amendments to the regulatory regime, Envestra doubts whether in a practical sense this is possible. The magnitude of the changes that are being proposed, the time over which they will be implemented, and the 'twists in the tail' anticipated while the detail is being agreed by the jurisdictions, introduces a significant degree of regulatory and commercial risk to Envestra given the timing of the Access Arrangement submission.

Envestra has not yet considered how it will seek to mitigate this risk. As discussed later in this submission, one possibility that Envestra is considering is the use of fixed principles to mitigate some of this risk.

The above issue aside, this response has been drafted to address each of ESCOSA's preliminary views in the discussion paper.

## 2. SERVICES POLICY

### *Issue 1*

*Whether additional services are warranted in the second AA period is a matter for Envestra to propose after consultation with network users*

Envestra supports ESCOSA's preliminary view on this issue. Envestra considers that its existing services continue to meet the requirements of users and are appropriate for the second access arrangement period. It does not intend to propose additional services as part of its Access Arrangement submission.

### *Issue 2*

*Provided that Envestra documents such consultations, ESCOSA is unlikely to nominate reference services additional to those proposed by Envestra*

Envestra is currently in the process of consulting with network users. Consultation to date has reinforced Envestra's position not to amend its reference services.

### *Issue 3*

*A description of services that sufficiently identifies each service and distinguishes it from other services is necessary*

Envestra agrees with ESCOSA's preliminary view on this issue.

Envestra believes it has identified all services required by the market, and is in the process of seeking feedback from retailers on this issue. Envestra will provide a full description of its services as part of its Access Arrangement.

### 3. REFERENCE TARIFFS: RATE OF RETURN

**Issue 4**

*Only after the AA is submitted can ESCOSA assess whether the rate of return submitted by Envestra meets the Code*

Envestra agrees with ESCOSA's preliminary view on this issue.

**Issue 5**

*The plausible range of rate of return values is likely to be quite narrow, provided prevailing conditions in the market for funds and the risk involved are appropriately assessed*

Envestra has not formed a view at this stage on the range of appropriate WACC parameters.

**Issue 6**

*Any decision by ESCOSA that the rate of return is not commensurate with prevailing market conditions and the risk involved, and outside the choices reasonably open to Envestra must be clearly articulated and supported with evidence*

Envestra welcomes the acknowledgement by ESCOSA that it must clearly articulate its reasoning and justification for deciding the appropriateness of the rate of return submitted by Envestra.

**Issue 6**

*Where appropriate, ESCOSA will seek to determine whether the rate of return proposed by Envestra is determined in a manner consistent with the ETSA decision and other interstate regulators*

Envestra notes that there are two different ways of interpreting ESCOSA's preliminary view on this issue. The first relates to the manner of the calculation of the rate of return. The second relates to the numeric parameters adopted by ESCOSA.

In relation to the first, Envestra intends to use the capital asset pricing model which is consistent with the Code. This is also a method for calculating the rate of return that is well established. Envestra agrees with ESCOSA that using well established methods for determining the rate of return eases the assessment process for ESCOSA and aids understanding of the Access Arrangement by users.

In relation to the second possible interpretation of ESCOSA's preliminary view, Envestra does not believe that ESCOSA should value or target consistency in WACC parameters (such as asset beta) across jurisdictions or industries unless it believes that such parameters are appropriate for use in relation to Envestra's assets. Envestra will be proposing values for key parameters that it believes are commensurate with prevailing market returns and risks for Envestra's SA business.

#### 4. REFERENCE TARIFFS: CAPITAL BASE ISSUES

##### *Issue 7*

*Where it assesses forecasts of new facilities investment, and with the possible exception of any new facilities investment provided to Envestra via its contractual arrangements with OEAM, it expects to use a variance against trends approach. The onus is on Envestra to show why its forecasts of NFI should depart from the continuation of a trend based upon (normalised) past spending levels*

Envestra:

- Supports, in-principle, a variance against trend approach for assessing the forecasts of new facilities investment;
- notes that there will be areas within Envestra's new facilities investment forecasts where forecast expenditure will be greater than past levels of expenditure. Envestra understands that, where this occurs, it will need to justify forecasts of such expenditure; and
- fails to see the relevance of Envestra's ongoing contract with OEAM in determining the efficient level of new facilities investment. This contract is merely a means of delivering elements of Envestra's services.

##### *Issue 8*

*Envestra will need to provide evidence or argument that any forecast new facilities investment to be provided by OEAM meets the Code's prudence test*

Envestra will provide justification of all proposed new facilities investment as part of the Access Arrangement Information.

##### *Issue 9*

*Continuation of a straight line basis for forecast depreciation is consistent with the requirements of the Code*

Envestra agrees with ESCOSA's preliminary view on this issue. It intends to continue to use a straight line basis for forecasting depreciation on the asset base.

##### *Issue 10*

*Use of up to date asset lives as a basis for depreciation is also important, with any changes in asset lives proposed by Envestra to be carefully considered*

Envestra agrees that up to date asset lives are important as a basis for depreciation and can understand ESCOSA's concerns in relation to this issue. At this stage, however, Envestra can see little basis for changing the lives of assets in the upcoming access arrangement period.

***Issue 11***

*Both regulatory and market incentives exist for efficient capital expenditure*

Envestra agrees with ESCOSA's preliminary view on this issue.

***Issue 12***

*It is appropriate for all actual spending on approved projects (including FRC projects) undertaken during the first AA period to be rolled-in to the capital base*

Envestra strongly supports ESCOSA's preliminary view that all actual capital expenditure incurred in the current access arrangement should be rolled into the asset base for the commencement of the second access arrangement period.

Such an approach is consistent with financial capital maintenance theory and ensures that Envestra has security to invest on the basis of need rather than being constrained by the approved benchmarks for new facilities expenditure determined at the commencement of the first access arrangement period.

***Issue 13***

*ESCOSA will adjust the capital base for the proceeds of disposals, rather than regulatory book value*

Envestra does not support ESCOSA's preliminary view on this issue.

Envestra accepts that it should only be able to earn a return on, and of, assets that it uses to provide services to end customers and accordingly it should not earn revenue on assets that have been disposed of during the regulatory period. However, Envestra has not disposed of any assets over the current access arrangement period. This issue is therefore immaterial for the upcoming access arrangement review.

***Issue 14***

*Actual annual values of past capital contributions are required for the roll-forward of the capital base*

Envestra agrees with ESCOSA's preliminary view on this issue.

***Issue 15***

*Envestra's capital base during the first Access Arrangement Period should be rolled forward on the basis of the 'headline' measure of inflation over the period, minus the estimated impact of the GST 'spike'.*

Envestra does not agree with ESCOSA's preliminary view in relation to the treatment of the GST spike.

Envestra considers that the GST spike in inflation should be included within CPI for the purposes of the Access Arrangement submission because:

- to do otherwise would be inconsistent with the financial capital maintenance principle, and with Envestra's legitimate business interests under the Code; and
- there is considerable regulatory precedent for inclusion of the GST spike.

Envestra will address this issue in detail in its submission to ESCOSA with the Access Arrangement.

*Issue 16*

*ESCOSA will not adjust Envestra's asset base to take account of redundant assets*

Envestra agrees with ESCOSA's preliminary view on this issue.

**5. REFERENCE TARIFFS: NON-CAPITAL COSTS**

*Issue 17*

*ESCOSA will use a trend analysis for all non-capital costs except for marketing costs and the OEAM contract*

Envestra:

- Generally supports a variance against trend approach;
- notes that there will be areas within Envestra's non-capital cost forecasts where expenditure will be higher than past levels of expenditure. Envestra understands that it will need to justify the need for higher expenditure rigorously.

*Issue 18*

*ESCOSA will undertake a zero based budgeting assessment of network marketing and asset management*

Envestra acknowledges ESCOSA's preliminary view to undertake a zero based budgeting assessment in relation to network marketing. For its part, Envestra will ensure it provides sufficient information to ESCOSA to ensure that this assessment is informed.

In relation to asset management, Envestra fails to see the relevance of Envestra's outsourcing contract in determining the efficient level of non-capital costs. This contract is merely a means of delivering elements of Envestra's services. ESCOSA's assessment should be limited to ensuring that the costs proposed by Envestra are consistent with those that would be incurred by a prudent Service Provider, acting efficiently in accordance with accepted and good industry practice to achieve the lowest sustainable cost of delivering the Reference Service.

6. REFERENCE TARIFFS: TOTAL REVENUE

*Issue 19*

*ESCOSA must strictly apply the section 8.1 criteria as currently worded, without anticipating future changes*

While Envestra agrees with ESCOSA's preliminary view on this issue, it notes that ESCOSA will need to weight the objectives of section 8.1 against the requirements of section 2.24 of the Code, particularly in relation to the upcoming changes to the national regulatory regime.

*Issue 20*

*Each of the 8.1 criteria are equal in the sense that none hold precedence over any of the others*

Envestra agrees with ESCOSA's preliminary view on this issue.

*Issue 21*

*Section 8.1(b) requires consistency with the types of competitive pricing outcomes observable in relevant or similar contemporary markets where extensive rivalry exists between producers of the same or similar products to the acknowledged long term benefit of consumers of these products*

Envestra does not believe that this approach is possible for the upcoming access arrangement process because:

- It is not aware of a relevant similar contemporary market where extensive rivalry exists between producers of the same or similar products; and
- It would need to be satisfied that if ESCOSA found such a market, that the pricing outcomes observable were sustainable and were to the acknowledged long-term benefit of consumers.

While 8.1(b) of the Code does require ESCOSA to ensure that reference tariffs achieve the outcome of a competitive market, Envestra agrees with the approach taken by the Productivity Commission which highlights the absurdity of a Regulator estimating a tariff and then seeking to replicate it in a market in which clearly no competition exists.

Envestra considers that ESCOSA would be better placed adopting this criterion as a check once it has satisfied other sub-sections of 8.1.

*Issue 22*

*Only after Envestra's AA revisions are submitted is it appropriate for ESCOSA to assess whether there are any tensions between Envestra's reference tariff policy and section 8.1. – page 52*

Envestra agrees with ESCOSA's preliminary view on this issue.

**Issue 23**

*Any subsequent decision by ESCOSA that the principles of section 8.1 of the Code conflict with Envestra's reference tariffs and reference tariff policy must be clearly articulated, reasonable and supported with evidence*

Envestra agrees with ESCOSA's preliminary view on this issue.

**Issue 24**

*Any range of values attributed to Total Revenue must be assessed against any of the section 8.1 range and each of the factors specified in section 2.24a to 2.24g one by one, distinguishing between criteria and factors warranting adoption of a value at the lower end of the range of criteria and factors which may warrant adoption of a value at the higher end*

Envestra agrees with ESCOSA's preliminary view on this issue. Envestra is particularly concerned that its legitimate business interests will be impacted by the inter-relationship between the access arrangement decision and the new national regulatory regime which will apply from 2007, and will welcome ESCOSA's attention to this matter.

**Issue 25**

*ESCOSA will need to arrive at its assessment of any single Total Revenue requirement proposed by Envestra based upon balancing the various values consistent with all the criteria and factors and in terms of its judgement as to how best these values can be reconciled in view of the objectives stated in the Code.*

Envestra agrees with ESCOSA's preliminary view on this issue.

**Issue 26**

*Where appropriate, ESCOSA will seek to reconcile objectives and arrive at single values in a manner consistent with the ETSA decision and other interstate regulators*

Envestra notes that there are two different ways of interpreting ESCOSA's preliminary view. The first relates to the manner by which ESCOSA will reconcile and arrive at single values. The second relates to the single values that ESCOSA arrives at.

In relation to the first, Envestra agrees with ESCOSA that using well established methods for assessing arguments, weighing the alternatives and setting them out in the decision document aids understanding of the Access Arrangement approval process for Envestra.

In relation to the second possible interpretation of ESCOSA's preliminary view, Envestra does not believe that ESCOSA should value or target single values that are the same or consistent with Regulatory decisions by ESCOSA or by other Regulators unless it believes that such values are appropriate for use in relation to Envestra's assets.

7. REFERENCE TARIFFS: AVERAGE PRICES

*Issue 27*

*Any proposed Access Arrangement Revisions that fail to somehow allow for the revenue requirement of ancillary reference services and non-reference services as well as haulage reference services is not likely to satisfy the requirements of the Code. Assuming revenues from non-reference services cover both the marginal cost of such services and a reasonable share of all overheads and fixed capital costs would seem to be a reasonable starting point*

Envestra has no objections to ESCOSA's preliminary view on this issue. The Access Arrangement will involve a fair and reasonable cost allocation between revenue requirements of haulage reference services, ancillary reference services and non-reference services.

*Issue 28*

*The balance of the ex-gratia payment should be determined in accordance with ESCOSA's earlier advice in conjunction with the 2004 FRC determination. This balance should then be allocated to customers across each of the first three years in the second AA period in proportion to the annual FRC revenue requirement for those years as published as part of the 2004 FRC determination*

Envestra agrees that there is a need to determine how the balance of the ex-gratia payment will be allocated to customers across each of the first three years of the second Access Arrangement period and is developing a proposal for consideration by ESCOSA.

*Issue 29*

*When preparing its forecasts of sales (and peak load), Envestra should take into account the forecasts of natural gas sale and demand to be published by the Commission before June 2005*

Envestra will take these forecasts into account when they are published before finalising its demand forecasts for the second regulatory period.

*Issue 30*

*When assessing the forecasts prepared for the 2nd AA period, ESCOSA will take into account the forecasts separately endorsed by ESCOSA at the retail level, with a view to ensuring consistency between retail and distribution forecasts*

Envestra accepts that ESCOSA will have regard for the forecasts separately endorsed by ESCOSA at the retail level when it assesses Envestra's forecasts for the second access arrangement period. However, in evaluating Envestra's forecasts, ESCOSA must make its assessment according to the criteria in the Code, including the need for forecasts to represent best estimates arrived at on a reasonable basis (Clause 8.2).

8. REFERENCE TARIFFS: PRICE STRUCTURE ISSUES

*Issue 31*

*If Envestra proposed adoption of a tariff basket similar to that applying in Victoria, ESCOSA is prepared to consider leaving the assessment of the compliance of individual reference tariffs with the requirements of section 8.38 – 8.42 of the Code to the incentive structure recognised to be generally inherent in a tariff basket approach.*

Envestra supports ESCOSA's preliminary view on this issue.

Envestra has not yet decided whether it will submit an access arrangement on the basis of a price path approach or a tariff basket similar to that applying in Victoria.

*Issue 32*

*If an alternative approach is proposed, ESCOSA would expect to undertake a detailed assessment as to whether the level and structure of each reference tariff satisfies the requirements of section 8.38*

Envestra understands ESCOSA's desire to conduct a detailed assessment into the level and structure of each reference tariff. Envestra has not yet decided whether it will submit an access arrangement on the basis of a price path approach or a tariff basket similar to that applying in Victoria.

9. REFERENCE TARIFFS: ANNUAL VARIATION METHOD

*Issue 33*

*The calculation of X and Po factors by methods other than setting the NPV of allowed revenue over the 2nd AA period equal to the NPV of that portion of total revenue applicable to the associated reference service is unlikely to satisfy the requirements of the Code. To satisfy the requirements of the Code, a proposed trigger event mechanism should endeavour to be symmetrical in its application.*

Envestra does not object to ESCOSA using an NPV approach to determining the X factors, provided that the total revenue approved by ESCOSA is sufficient for Envestra to deliver its forecast service levels on the basis of forecast capital and non-capital expenditure.

10. REFERENCE TARIFFS: INCENTIVE MECHANISM

*Issue 34*

*ESCOSA will be cautious in exercising the power it has under the first period's incentive mechanism to consider 'reasonable foreseeable' costs to be something other than the forecasts underlying the first period's reference tariffs, as exercising this power would generally be contrary to regulatory precedent. ESCOSA will only consider exercising this power if relevant data from Envestra reveals extraordinary unforecast efficiency gains*

Envestra is not anticipating any extraordinary unforecast efficiency gains. Envestra therefore expects that ESCOSA will not need to consider this issue further.

**Issue 35**

*The detailed method for preserving the first period's efficiency gains requires ESCOSA to specify the carry-over mechanism that best gives effect to the spirit of SAIPARS's incentive mechanism. The mechanism that best meets SAIPAR's requirements is a glide path mechanism which glides out the gains over the second period, includes both revenue and cost gains, does not carryover any negative amounts (presumably losses), and excludes capex savings.*

Envestra has not yet determined a mechanism that best meets the needs of SAIPAR's requirements for efficiency sharing.

**Issue 36**

*ESCOSA considers that passing on reasonably foreseeable efficiency gains to network users is an essential requirement of the Code. Benefit sharing should only apply to unforecast efficiency gains.*

Envestra agrees with ESCOSA's preliminary view that future efficiency gains are difficult to estimate. We also note that in designing an Incentive Mechanism, ESCOSA should have regard to section 8.46 of the Code which requires the regulator to balance the need to pass on gains from increased efficiency gains to consumers with the need to provide an incentive for the Service Provider to improve efficiency. If there is uncertainty over the size of future efficiency gains, ESCOSA should be cautious in requiring Envestra to pass efficiency gains on to consumers before they are realised.

**Issue 37**

*The detailed method for preserving the second period's efficiency gains is a matter for the ESCOSA to determine in light of the objectives of the Code.*

Envestra agrees with ESCOSA's preliminary view on this issue.

**Issue 38**

*The detailed efficiency carry-over mechanism that best achieves the objectives of the Code would involve (1) a five year rolling carryover mechanism, whereby the gains made in the second period are to be retained by Envestra for five years following the year in which they were achieved, (2) both efficiency gains and losses in each year being considered in the carryover, (3) any negative carryover amount at the end (of) the second period not being carried over into the third period (except where) this is consistent with the overall incentive characteristics targeted for the Access Arrangement, and (4) inclusion of revenue based efficiency gains only where this is consistent with the treatment of costs (such as marketing costs) associated with Envestra's efforts to increase usage*

Envestra supports the inclusion of an incentive mechanism in the second access arrangement period however it does not support the mechanism designed by ESCOSA because:

- The five year timeframe for retention of efficiency gains by Envestra is inappropriate. Ten years is a more appropriate timeframe as it provides for a fairer sharing of efficiency gains between customers and Envestra; and
- Efficiency losses should not be included in the carryover each year. Clause 8.44(a) of the Code restricts the application of an incentive mechanism during an Access Arrangement Period to returns that are in excess of those expected (not less than those expected);
- There should be no carryover of negative efficiency gains at the end of the second access arrangement period as this is inconsistent with the Code obligation to set Reference Tariffs in an Access Arrangement Period to earn a stream of revenue that reflects the costs incurred in delivering Reference Services (Clause 8.38).
- Envestra does not believe that revenue gains should be included within the efficiency mechanism, as this weakens the incentive powers inherent in both a price path approach and a tariff basket mechanism. Envestra believes that it should be able to retain the benefits of delivering service at lower than benchmark costs, where this can be achieved without lowering service quality, yet retain the upside revenue from additional tariff revenue.

## 11. REFERENCE TARIFFS: INFORMATION DISCLOSURE

### *Issue 39*

*Irrespective of whether such information is confidential or commercially sensitive, unless Envestra provides all the information that ESCOSA requires to understand how each of the proposed elements of the AA will apply in the 2nd AA period, ESCOSA will be unable to conclude that the AA satisfies the Code.*

*Before approving the proposed AAI, ESCOSA will need to be satisfied that the document discloses sufficient information to enable network users to understand how each of the elements of AA are derived. An AAI document should be able to meet such requirements without disclosing information that would unduly harm the legitimate interests of the service provider or network users*

Envestra will provide sufficient information in order for ESCOSA to adequately assess how each of the proposed elements of the Access Arrangement will apply in the second Access Arrangement period.

Envestra agrees with ESCOSA's preliminary view that the Access Arrangement Information should contain sufficient information to enable network users to understand how the Access Arrangement has been derived, without disclosing information that would unduly harm Envestra's legitimate interests.

Where ESCOSA seeks additional information from Envestra, in order to assure itself or clarify issues in relation to the Access Arrangement or Access Arrangement Information, this information may be commercial in confidence to Envestra, its contractors or suppliers. Where information is commercial in confidence, Envestra will seek this information to be excluded from public release using the provisions of the Code.

### *Issue 40*

*ESCOSA will consider approving proposed AA revisions subject to periodic reporting during the second AA period capable of providing reassurance of compliance with the approved AA.*

Envestra will comply fully with regulatory reporting requirements set out by ESCOSA in accordance with Code requirements.

## 12. TERMS AND CONDITIONS

### *Issue 41*

*To be assessed as reasonable, proposed standard terms and conditions need to be comprehensive, clear and unambiguous, practical and workable and generally consistent in their application across jurisdictions*

Envestra agrees that standard terms and conditions should, and currently do, meet the criteria of clarity, lack of ambiguity, practicality and workability.

Envestra sees little merit in achieving a goal of jurisdictional consistency in the standard terms and conditions because:

- Terms and conditions are contractual arrangements between retailers and distributors, and accordingly are drafted to fit within the legislative and regulatory frameworks of the states in which the pipelines are situated ; and
- The terms and conditions in South Australia have been developed over time, and on consultation with network users, to a stage where they reflect the SA market, retailer mix and customer base.
- It would be inappropriate to use terms and conditions from another state in South Australia as they are unlikely to be suitable for the South Australian market. For example, the Victorian terms and conditions set out in the 2002 ESC process were drafted to be consistent with the Victorian electricity default Use of System Agreements and the gas Distribution Tariff Agreements<sup>1</sup>, which suited the requirements of the particular market in Victoria – not the South Australian market.

### *Issue 42*

*ESCOSA proposes to convene a Terms and Conditions Working Group soon after Envestra submits its proposed Access Arrangement Revisions, comprising representatives of Envestra, network users and the Commission to help it consider Envestra's proposed terms and conditions*

Envestra acknowledges ESCOSA's preliminary view on this issue.

### *Issue 43*

*To avoid doubt about whether any terms and conditions are standard or specific, Envestra should clarify the criteria it uses to distinguish specific terms and conditions that are agreed between Envestra and each network user in their access agreement from the standard Terms and Conditions approved as part of the Access Arrangement*

ESCOSA seems concerned that Envestra may have specific terms and conditions for some retailers but not reflect these into the standard terms and conditions under the Access Arrangement.

The process of agreeing a haulage agreement with a retailer commences with the standard terms and conditions under the Access Arrangement, with the exception of specific issues such as the name, address and notice details for the user concerned, the contract start date, the term of contract and identification of the relevant receipt points and delivery points.

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<sup>1</sup> See ESC Final Decision, 2002, page 21

As negotiations progress, the agreed haulage agreements can end up including additional specific terms which:

- reflect negotiated services requested by the retailer and not covered by the standard terms and conditions;
- reflect other amendments to the terms and conditions requested by retailers ; and
- update the terms and conditions, eg to account for the Retail Market Rules.

These contracts will, prima facie, differ from the terms and conditions than that approved by the Regulator, however this reflects nothing more than the outcomes of commercial negotiations and both parties taking the opportunity to update the terms and conditions for their specific commercial and practical needs.

**Issue 44**

*The exclusion of a general condition that specifies how the quality of supply to be provided over the second AA relates to that provided over the first five years of the first period would be unlikely to satisfy the test of reasonableness required by the Code*

Envestra understands ESCOSA's focus on service standards, particularly the relationship between the quality of service provided to customers and the reference tariff. It has always endeavoured to make this relationship understandable to network users and to ESCOSA.

Envestra does not support the inclusion of a general condition in the terms and conditions of the Access Arrangement in which Envestra would undertake to continue to provide a quality of service consistent with that provided over the five years of the first Access Arrangement. It does not support this because:

- While it seems intuitively simple to warrant that future quality of service will be consistent with past service quality, it is not simple. Quality of service encompasses a very broad range of activities conducted by Envestra, as well as measures specified in the Distribution Code and other instruments. There may be varying views amongst users and ESCOSA of which aspects of service quality are important; and
- The actual performance provided to individual retailers or customers may differ between customers and retailers within an area, and between areas.

**13. CAPACITY MANAGEMENT, TRADING AND QUEUING POLICIES**

**Issue 45**

*ESCOSA considers that 'use it or lose it' rules may not be possible under the Code in its present form*

Envestra agrees with ESCOSA's preliminary view on this issue.

Envestra notes, however, that ESCOSA seems to be concerned that customer churn is somehow being inhibited by the existing terms and conditions, in particular that contracting full capacity might be being used by retailers to prevent competition. Envestra does not believe that this is possible under the existing terms and conditions.

Envestra contracts with retailers to deliver gas to specific customers – ie it does not sell blanket capacity to retailers. Retailers cannot, for example, buy all of the capacity in a section of the network in order to

block new entrants. When an existing customer supplied from the Envestra network transfers to a new retailer, that new retailer is then able to contract with Envestra for the capacity allocated to that customer. Accordingly, Envestra cannot see any way that a retailer could somehow 'hold onto' the capacity for a lost customer and thereby stop customers transferring.

**Issue 46**

*Until congestion becomes an issue or unless necessitated by FRC, the retail market rules or transmission market developments, a Queuing Policy is not required for the SA distribution network – page 94*

Envestra agrees with ESCOSA's preliminary view on this issue.

**14. EXTENSIONS/EXPANSIONS POLICY**

**Issue 47**

*ESCOSA will not require a change in the AA provision that states that ESCOSA's approval must be obtained to exclude an extension prior to the extension entering into service.*

*On the coverage of any expansion to the existing system, such expansions of covered pipelines should be covered by default in the Access Arrangement.*

*As the pricing of extensions is covered in ESCOSA's gas distribution code, ESCOSA will continue to rely on that Code unless network users can identify reasons why the associated provisions are not reasonable.*

*The pricing of expansions should generally be charged to affected network users on an incremental cost basis*

Envestra agrees with ESCOSA's preliminary views on these issues.

**15. DURATION OF ACCESS ARRANGEMENT**

**Issue 48**

*A five year access arrangement is appropriate at this time*

Envestra agrees with ESCOSA's preliminary view on this issue.

**Issue 49**

*In the current circumstances, it would be difficult for any proposal for a fixed principle to satisfy the requirements of the Code*

Envestra does not agree with ESCOSA's preliminary view on this issue.

The regulatory system is about to undergo its most comprehensive review and restructure since it was first established. Envestra understands that the Gas Code and Electricity Codes are to be amended substantially, and that the Australian Energy Market Commission will commence writing new rules for regulation from January 2006 which will replace the existing instruments that guide jurisdictional regulators. 2006/07 will be a period of profound uncertainty for Envestra, as it will not know the future regulatory arrangements for natural gas until the rules are written.

ESCOSA's view is that it cannot agree to fixed principles which anticipate possible changes to the regulatory regime and its administration. Envestra believes that this is the purpose of a fixed principle, to provide certainty to the service provider and to users and prospective users (in the face of either market, regulatory or legislative uncertainty).