10 August 2015

Warwick Anderson
General Manager – Network Finance and Reporting
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

Submitted by email: ActewAGL2015GAAR@aer.gov.au

Dear Mr Anderson

ACTEWAGL DISTRIBUTION 2016-21 ACCESS ARRANGEMENT PROPOSAL FOR ITS AUSTRALIAN CAPITAL TERRITORY, QUEANBEYAN AND PALERANG GAS DISTRIBUTION NETWORK

Origin Energy LPG (Origin) appreciates the opportunity to provide a response to ActewAGL Distribution's proposal in relation to the Access Arrangement (AA) for its Australian Capital Territory, Queanbeyan and Palerang gas distribution network for the 2016-2021 period.

A network's AA is an important factor in a retailer's ability to deliver quality gas services to customers. ActewAGL Distribution's AA therefore needs to support effective operations and set a reasonable revenue allowance and efficient service fees as shortcomings in these areas can impede a retailer's operations and increase customer costs. While ActewAGL Distribution has proposed a forecast revenue allowance that provides an upfront price cut on 1 July 2016 followed by Consumer Price Index increases in each subsequent year, Origin considers there are additional efficiencies that could further improve customer outcomes. As such, this submission focuses on those areas where we see potential for further enhancements or where we consider ActewAGL Distribution's proposal has not been clearly explained or justified.

Should you have any questions on this submission, please contact Lillian Patterson in the first instance on (02) 9503 5375 or lillian.patterson@originenergy.com.au.

Yours sincerely

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Response to ActewAGL Distribution's Proposal for the 2016-2021 Regulatory Control Period for its Australian Capital Territory, Queanbeyan and Palerang Distribution Network

Origin Submission

August 2015

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1 Revenue Components

In its proposed Access Arrangement (AA), ActewAGL Distribution proposes to reduce distribution tariffs by (Consumer Price Index (CPI) – 2.23 per cent) in 2016/17, followed by CPI increases in each remaining year of the next AA period.[1] This is required to support:

- investment of $143.8 million in operating expenditure (opex) and $115.7 million in capital expenditure over the next AA period from 2016-21;[2] and
- a 7.15 per cent rate of return, comprising a return on equity of 9.87 per cent and a return on debt of 5.34 per cent.[3]

Origin's below comments on the revenue components of the AA generally relate to those issues where ActewAGL Distribution's proposal has not been clearly explained or justified and therefore we would appreciate the Australian Energy Regulator (AER) paying particular attention to these issues in its assessment.

1.1 Operating Expenditure Step Changes

ActewAGL Distribution's opex forecast includes $12.1 million for step changes required to meet regulatory obligations and operate in accordance with good industry practice.[4] Origin appreciates that ActewAGL Distribution may incur some costs for regulatory changes. However, we caution that some aspects of these regulatory changes, such as information and data collection and reporting, are a core activity of any business and as such, would not represent material new costs. We ask that the AER carefully examine the justification provided by ActewAGL Distribution to ensure this step change cost is prudent and justified. For example, we ask that the AER pay particular attention to ActewAGL Distribution's proposed $3.23 million step change amount for 2021 AA revision as it is not clear why it will incur material new costs for a process which should be included as recurrent expenditure.[5]

1.2 Rate of Return

ActewAGL has proposed a rate of return of 7.15 per cent. This is higher than the AER's recently approved rates of return of 5.41 per cent for Jemena Gas Networks (JGN) and 6.48 per cent for ActewAGL's electricity distribution network.[6] While ActewAGL Distribution agrees with many of the factors for estimating the rate of return set out in the AER's Rate of Return Guideline (Guideline), it departs from the Guideline in relation to the following issues:

- Return on equity – ActewAGL Distribution proposes: an average of four models to determine return on equity; and expert advice in relation to the different input parameters for each model.[7]
- Return on debt – ActewAGL Distribution proposes: a hybrid approach to transition to the new ten year trailing average of the cost of debt whereby the return on debt should be estimated as the sum of the historical debt risk premium for ten years, the average of one to ten year swap rates, and transaction costs; a credit rating of BBB; and providing the AER the proposed averaging periods used to estimate the return on debt throughout the AA period.[8]

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[1] ActewAGL Distribution, *Proposed 2016-21 Access Arrangement Information*, June 2015, p. 7.
[2] Ibid, p. 54 and 58.
[3] Ibid, p. 63.
[4] Ibid, p. 56.
[5] ActewAGL Distribution, *Proposed 2016-21 Access Arrangement Information Attachment 5: Operating Expnsiture*, June 2015, p. 25.
[6] AER, *Final Decision on 2015-2020 JGN Access Arrangement*, June 2015, p.11; AER, *Final Decision on 2015-2019 ActewAGL Access Arrangement*, April 2015, p.16.
[7] ActewAGL Distribution, *Proposed 2016-21 Access Arrangement Information*, June 2015, p. 62.
[8] Ibid, pp. 61-2.

In Origin's view, the Guideline provides certainty and predictability of outcomes in rate of return issues and a balance between the views of distributors and consumers. A departure from the Guideline should only be approved where there is strong evidence to support the departure. Most of the above departures proposed by ActewAGL Distribution have already been proposed by other networks through their AA processes, assessed by the AER and not accepted.[9] The AER has considered its approach to these elements produces a rate of return that best reflects the rate of return of a benchmark efficient entity.

In its proposal, ActewAGL Distribution has repeated many of the arguments used by other networks with little additional evidence to support its position. We do not consider ActewAGL Distribution has provided any new compelling arguments to suggest reopening the elements that the AER has already considered and not approved for other networks. Maintaining the rate of return approach in the Guideline and applied to other networks ensures that the final approved rate of return for ActewAGL Distribution is consistent with the rates of return across all networks.

Origin notes one new argument proposed by ActewAGL Distribution that has not been proposed in other AAs, namely in relation to the benchmark entity's credit rating. It proposes adopting a BBB credit rating in place of the AER's BBB+ credit rating to calculate the cost of debt on the basis that gas distribution businesses such as itself are more risk exposed that electricity network businesses and gas transmission pipelines. Reasons given for this increased riskiness include: demand risk; sensitivity to other risk factors; fuel of choice risk; wholesale price risk; supply shortfall risk; and asset stranding and depreciation risk.[10]

We acknowledge a gas distribution business faces a different range of risks compared to an electricity network business given the different nature of the gas market compared to the electricity market. However, ActewAGL Distribution would face similar risks to other gas distribution businesses, such as JGN and Australian Gas Networks (AGN). Origin agrees with the AER's position that a BBB+ credit rating is consistent with the position that the credit risk for regulated utilities is likely to be relatively small because the credit profile for Australia's regulated utilities sector is underpinned by a regulatory framework that provides certainty and stability, which reduces their overall business risk. Given this, Origin is not convinced that ActewAGL Distribution's return on debt should depart from the Guideline and the methodologies used by other gas distribution networks through a reduced credit rating.

1.3 Reference Tariffs

ActewAGL Distribution is proposing significant changes to its tariff structure by:

- changing the tariff classes and introducing new tariffs;
- simplifying the charge components by consolidating the three fixed charges into a single fixed charge;
- introducing a tariff assignment process;
- simplifying the process for major customers to seek additional capacity by moving to a chargeable demand-based charge;
- setting more cost reflective ancillary charges and a new decommissioning and meter removal charge.[11]

[9] Examples include the 2014-19/2015-20 Access Arrangements approved by the AER for JGN, ActewAGL electricity, Ausgrid, Endeavour Energy and Essential Energy.
[10] ActewAGL Distribution, *Proposed 2016-21 Access Arrangement Information Appendix 8.01 – Detailed Return on Debt Proposal*, June 2015, pp. 6-9.
[11] Ibid, pp. 76-77.

We understand ActewAGL Distribution's justification for this is to maintain the competitive position of gas relative to other fuels and to continue promoting the efficient use of the network and efficient new connections.

Origin agrees with the intention of ActewAGL Distribution's tariff structures and some of its proposed elements, such as consolidating the three fixed charges into a single fixed charge and setting more cost reflective ancillary charges and a new decommissioning and meter removal charge. However, we consider the proposed tariffs poorly execute ActewAGL Distribution's intention. The intention of the regulated tariff framework is to set tariffs based on efficient prices. We do not consider the proposed tariff structures meet the economic efficiency criteria for pricing. In our view, the tariff structures are unnecessarily complicated and would effectively lead to a duplication of tariffs with limited benefit to customers.

For example, ActewAGL Distribution proposes four residential tariffs that are intended to incentivise efficient gas use. This first of these two tariffs are the residential individually metered (VRI) tariff, which is for customers who have only one gas appliance, and the residential individually metered with gas heating and other gas appliances (VRH) tariff, which is for customers who have more than one gas appliance and hence presumably their gas usage is higher. Origin considers that an efficient tariff structure should be based on a customer's usage volume. It should not matter whether that customer has one or more appliances, particularly given usage depends on a number of factors such as household size and appliance efficiency rather than just the number of appliances. The only criterion that ensures efficient pricing is volume-based charging.

A simpler and more cost-reflective approach would be to maintain a single residential tariff with a higher first block that declines as usage increases and no more than three blocks. This is more likely to effectively support ActewAGL Distribution's intention to maintain the competitive position of gas relative to other fuels and to continue promoting the efficient use of the network and efficient new connections.

ActewAGL Distribution has also indicated it requires evidence to move from the default tariff, for example for residential customers this would be from the VRI tariff to another tariff. In the event the AER approves ActewAGL Distribution's multi-tariff structure, Origin does not support the proposed requirement to provide evidence as it is unclear, onerous and would ultimately lead to additional costs for customers. This is contrary to National Gas Rules 94(2)(b), which requires that a tariff class must be constituted with regard to the need to avoid unnecessary transaction costs.

1.4 Cost Pass Through Events

ActewAGL Distribution proposes a refresh of its cost pass through events as follows:

- remove cost pass through events that are no longer needed, namely the Carbon Pollution Reduction Scheme event, National Energy Customer Framework/National Gas Connections Framework event and specified uncontrollable cost event, as a result of the introduction of an automatic annual adjustment mechanism or because the event would be captured by the regulatory change event or general pass through event;
- amend the definitions of some events to enhance consistency with other AA and address concerns previously stated by the AER; and
- add cost pass through events, which have largely been accepted by the AER in other regulatory decisions, including the insurance cap event, insurer credit risk event, terrorism event, natural disaster event and network user failure event.[12]

[12] AGN, *Proposed 2016-21 Access Arrangement Information*, June 2015, pp. 86-7.

Origin broadly agrees with this approach and the cost pass through events proposed. We do, however, suggest that the Short Term Trading Market (STTM) event be removed as it is no longer necessary. When the STTM was first developed, the National Gas Rules required the Australian Energy Market Operator (AEMO) to examine the potential for the STTM to operate at prospective additional hubs, such Brisbane and the Australian Capital Territory (ACT). At the direction of the Queensland government, a Brisbane hub commenced operation on 1 December 2011. AEMO also undertook a review of STTM operations in 2011-12. This review concluded that in the absence of either a commitment from the relevant jurisdictions for policy reasons or other compelling reasons, AEMO considered it more productive for the STTM reviews to focus on the design and operation of the existing hubs rather than the potential for additional new hubs, for example in the ACT.[13]

Since then, there has been no discussion around an STTM hub in the ACT. Instead, future gas market developments have focused on improving current STTM market design rather than implementing STTM hubs in new locations. There have also been no indications from the ACT government of any appetite for a STTM hub in the ACT. As such, it is highly unlikely that an STTM hub will be established in the ACT and therefore there is no need for the STTM event.

In addition, should the ACT government decide to implement a STTM hub in the ACT, this would require a regulatory change, which would be covered by the regulatory change event definition. ActewAGL Distribution would be able to recover STTM associated costs through this cost pass through event and so would still be able to recover at least its efficient costs in the absence of a specific STTM event.

2 Terms and Conditions

ActewAGL Distribution’s current AA contains general terms and conditions that apply to all services and specific terms and conditions for each reference services. Users must enter into a gas transport service agreement (GTA) before being given access to services. Two GTAs—one for small customers and another for large customers—set out the more detailed terms and conditions for the reference services. These agreements do not form part of the current access arrangement.

ActewAGL Distribution proposes to replace these two GTAs with a single reference service agreement (RSA) that will form part of the AA. The proposed RSA sets out the terms and conditions on which ActewAGL Distribution will offer its haulage reference service to network users and prospective network users. It is modelled on JGN's approved RSA for its 2015-20 AA with further amendments to reflect regulatory and market arrangements specific to ActewAGL Distribution.

Origin supports simplifying and consolidating the two GTAs into one RSA. This will improve the transparency of the terms and conditions on which ActewAGL Distribution provides its reference service. It will also simplify operations for network users as it will be easier to manage one RSA rather than two GTAs. We also support ActewAGL Distribution adopting a similar agreement to JGN as this ensures a more harmonised approach across the ACT and New South Wales.

[13] AEMO, *STTM Operational Review and Demand Hubs Review Final Report, 30 March 2012*, pp. 44-6.

2.1 Bulk Transfer Process

Origin's only substantial comments on the RSA relate to the bulk transfer process. ActewAGL Distribution's bulk transfer process is set out as follows:[14]

> Network users will be able to bulk transfer customers to the RSA as follows:
> - the network user will need to enter into a form of the RSA with ActewAGL Distribution within 2 weeks of 1 July 2016; and
> - within 3 business days of entering a form of the RSA with ActewAGL Distribution, the network user will need to provide ActewAGL Distribution with formal notification to bulk transfer its customers to the RSA.

Origin is of the view that a more efficient and streamlined process would be for the RSA replace the existing GTAs and take automatic effect from 1 July 2016 without the parties explicitly having to sign it. This ensures certainty of implementation and would negate unnecessary delays and associated costs for all parties to the RSA, which represents a fairer approach as neither party is penalised should the other delay signing the RSA.

If the AER deems it necessary, a process could be outlined in the AA whereby should a retailer not agree to the automatic adoption of the RSA, it must advise ActewAGL Distribution of this in writing before 1 July 2016. However, Origin suggests such an eventuality is highly unlikely.

Automatic adoption of the RSA would necessitate a change to the second step of the bulk transfer process which currently requires that within three business days of entering the RSA, the retailer must provide ActewAGL Distribution with formal notification to bulk transfer its customers to the RSA. Origin suggests that in place of this, ActewAGL Distribution should be required to send out a notice to its retailers on 1 July 2016 seeking agreement to bulk transfer its customers. A retailer's signed return of this notice to ActewAGL Distribution would indicate its formal agreement to the bulk transfer.

ActewAGL Distribution's bulk transfer proposal also sets out the following process for tariff assignment as part of the bulk transfer process: [15]

> If the network user requests a different tariff category to the default tariff category and the network user seeks the benefit of the tariff category from 1 July 2016, the network user will need to provide ActewAGL Distribution with:
> - least 3 months' prior to 1 July 2016:
>   - a list of customers to be assigned to a different tariff category to the default tariff category;
>   - the tariff category the network user is requesting for that customer; and
>   - evidence to support that request (where applicable); and
> - at the same time as its formal bulk transfer notification, formal notification of its tariff assignment.

Notwithstanding Origin's earlier comments on the proposed tariff structure and the requirement to provide evidence, we do not support the proposed notice period required to request a different tariff category to the default tariff category to apply from 1 July 2016. The proposal requires retailers to provide a list of customers to be assigned to a different tariff category plus the required evidence at least three months notice prior to 1 July 2016, that is by 1 April 2016. Given the time-consuming process of advising customers of the tariff change and gathering the requisite evidence, retailers would need at least two months to undertake this work. The date by which this work would need to

[14] AGN, *Proposed 2016-21 Access Arrangement Information Attachment 14 – Non-Tariff Components*, June 2015, p. 13.
[15] Ibid, p. 13.

commence, 1 February 2016, is well before the AER would have made a final decision on the AA. As a result, retailers would need to initiate this process before the final tariff structure had been decided. This is not appropriate and could lead to inefficiencies where retailers have to communicate with its customers on changes that have yet to be agreed and then again once the changes have been agreed. Should the AER accept ActewAGL Distribution's proposed tariff structure, Origin asks that it review the process required by retailers to notify ActewAGL Distribution of requests for a different tariff category to ensure it is efficient and fair for ActewAGL Distribution, retailers and ultimately, customers.