



28 April 2010

Mike Buckley
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Dear Mr Buckley,

ACCESS ARRANGEMENT DRAFT DECISION: JEMENA'S NSW GAS NETWORKS

Origin appreciates the opportunity to comment on the Australian Energy Regulator's (AER) *Draft Decision* covering Jemena Gas Networks (JGN) for the period 2010-15 ("Draft decision").

At the outset Origin would like to acknowledge that Origin found the AER's two roundtable sessions constructive.

Origin supports the bulk of the AER's findings in the Draft Decision, and it is a disappointment that many of the AER's required amendments are not adopted in JGN's Revised Proposal.

1. Revenue requirements and price path

Origin supports the scrutiny that the AER has applied to JGN's capital expenditure proposals, as it is of concern to Origin that JGN has forecast such significant increases in capital expenditure based on falling consumption.

In relation to price paths, Origin's submission on JGN's Initial Proposal noted that it would be helpful if the X factor for each year of the five year access arrangement period was clearly labelled.¹ In its Draft Response, the AER acknowledged this, and Amendment 10.1 requires a clear expression of JGN's X factors for all five years and for all three reference services.²

¹ Origin notes also that the AER has adopted as standard practice across gas and electricity determinations not to use the term P0 and instead to refer to X factors in all five years including the first. This simplified approach is helpful.

² AER, *Draft Decision JGN Access arrangement proposal for the NSW gas Networks 1 July 2010 - 30 June 2015 February*, Amendment 10.1, Table 10.3, p.xxv.



However, Origin notes that JGN has not complied with Amendment 10.1 in its Revised Proposal. Four of the five X factors are provided in Section 3 of the Revised Proposal, and a price path for average cost is provided at Table 12-2 of the revised Access Arrangement Information document. However, this does not comply with Amendment 10.1 in Origin's view.

Origin cannot understand why JGN has not provided X factors in all five years, as required by the AER. The X factor in the first year is particularly important, since JGN's Initial Proposal included a significant increase in the first year of the five year period. The way the AER has laid out the X factors in Table 10.3 of its Draft Response makes very clear the X factors for the Haulage Reference Service, the Ancillary Fees and the Meter Data Service. For the sake of clarity, Origin requests that JGN make Amendment 10.1 as directed.

2. *Charging framework*

Renaming maximum daily quantity

Having had the opportunity to review the proposed Chargeable Demand framework in the context of JGN's input at the AER's roundtable session on 27 November³ Origin is of the view that the term "Maximum Daily Quantity" ("MDQ") is not the most appropriate term for contractual capacity in the new framework. The term MDQ has become less relevant because JGN is moving from an overruns framework to a Chargeable Demand framework.

MDQ is not the maximum daily quantity a customer can or will use or be charged for in all circumstances and so is not a "maximum" in any real sense. While MDQ may be the maximum quantity JGN can be obliged to deliver, it is also the "minimum" a customer can expect from JGN if required. JGN will deliver more under certain circumstances and will automatically charge the customer for that use.

As a result, the term MDQ is likely to confuse customers. Confusion was apparent at the AER's Roundtable on terms and conditions, where experts in the regulation of gas distribution struggled to understand the link between MDQ, capacity and Chargeable Demand. Many non-experts must also use the Access Arrangement in coming years.

In light of this, Origin sees that "Daily Capacity Entitlement" would be a more appropriate term than "Maximum Daily Quantity". "Capacity Entitlement" is already defined in JGN's proposed Reference Service Agreement as equal to the MDQ specified in the relevant customer list. "Daily Capacity Entitlement" could therefore be the daily entitlement specified for that customer in the customer list. The term "Daily Capacity Entitlement" would:

- better convey the significance of the entitlement record in the customer list, in relation to capacity management, prioritising requests and queuing;
- better convey the idea of an entitlement to gas that is the maximum obligation of the provider and minimum expectation of the customer;
- avoid confusion associated with the term MDQ, which arises because MDQ is not the maximum quantity consumed or the maximum quantity JGN will charge for under the Chargeable Demand framework.

³ Held on 27 November at the ACCC in Sydney.



Origin recognises that MDQ is a well established term, but as JGN is significantly altering arrangements in relation to chargeable demand, this creates an opportunity to simplify terminology that has become less relevant. To Origin's knowledge there is no requirement in the National Gas Law or Rules that requires the AER to defer to existing practice.

Origin also recognises that MDQ is used in a number of other networks and in gas markets outside NSW; however, the precise meaning of the term differs depending on its context, according to the terms of the particular access arrangement and market, so MDQ is not equivalent across all.

Systems and terminology that are unnecessarily difficult to understand inhibit efficient markets for the supply of natural gas. This is inconsistent with the National Gas Objective, in Origin's view. In the interests of clarity and consistency, Origin would support the AER requiring that MDQ and MHQ be renamed "Daily Capacity Entitlement" and "Hourly Capacity Entitlement", respectively.

Renaming large and small customers

Origin supports JGN's decision to no longer use "Non Tariff" and "Tariff" to describe large and small customers, since the terms are not descriptive. JGN has chosen "Demand" and "Volume", instead. While these are established terms, they are not readily descriptive, either.

Regulated charging frameworks are inherently complex, so the terms chosen should reflect their actual meaning wherever possible. "Large" and "Small" are both simpler and more accurate.

Setting Chargeable Demand when customer does not exceed MDQ

The Reference Service Agreement as drafted says that Chargeable Demand must be greater than both MDQ and ten times MHQ (cl.4.5), and states that Chargeable Demand can increase when a customer uses more than their MDQ (cl.4.6), but it doesn't say what Chargeable Demand will be when a customer has not exceeded their MDQ.

Based on JGN's comments at the AER's Roundtable on Terms and Conditions, in the event that a customer does not exceed their capacity entitlement, their chargeable demand will *equal* the larger of their MDQ or 10 times their MHQ. JGN acknowledged this at the Roundtable, where it was noted that "Firstly, the contract states the requirement of chargeable demand being the greater of MDQ/MHQ". Presumably then, in light of these comments, this is the *intention* of clause 4.5(c), however this is *not* what is drafted. 4.5(c) currently reads:

Subject to clause 4.5(d), the Chargeable Demand for a Demand Customer Delivery Point for any Day must be greater than the larger of:

- (i) the MDQ for that Delivery Point; and*
- (ii) ten times the MHQ for that Delivery Point.*

This should be redrafted to reflect JGN's stated intention, thus:

Subject to clauses 4.5(d) and 4.6, the Chargeable Demand for a Demand Customer Delivery Point for any Day must be equal to the greater of:

- (i) the MDQ for that Delivery Point; and*



(ii) *ten times the MHQ for that Delivery Point.*

Clause 4.6 then deals with the circumstances when Chargeable Demand can be increased above MDQ or ten times their MHQ, that is, when a customer uses more than their contracted daily quantity.

Origin cannot see any purpose that is served by leaving 4.5(c) as it is currently drafted, particularly as it does not accurately represent JGN's stated intention. The drafting error effectively means that even a customer that contracts for a certain quantity and never exceeds that quantity can be charged based on an unspecified quantity in excess of their actual use. This error leaves the price for a regulated gas service uncapped, which is inconsistent with the National Gas Objective.

3. *Unauthorised Overruns and flow control*

Origin notes JGN initially proposed that, after an unauthorised overrun has occurred for a large customer, JGN should have the discretion to install a flow control mechanism at the customer's premise and at the customer's expense, to ensure compliance with the AA and system security.

Origin notes that the AER did not approve JGN's right to install flow control mechanisms as a way to enforce compliance with the AA. The AER determined that the customer should at a minimum have an opportunity to rectify the situation before JGN should be permitted to install a flow control mechanism unilaterally and at the customer's cost.

Origin supports the AER's decision not to allow JGN to install flow control as a way to enforce compliance with the AA, since there are mechanisms in the proposed AA to cover disputes and enforcement, as well as tariff arrangements that cover unauthorised overruns. Origin notes that JGN has accepted the AER's decision in this regard and has removed this part of the clause.

The AER did, however, support JGN's right to install flow control mechanism to ensure the network's safe and reliable operation. Origin questions whether this is necessary, for the following reasons:

- JGN is not obliged to supply a customer if it would be unsafe to do so: Division 2 Part 12 of the National Gas Rules allows for JGN to issue a safety of operation notification, which lays out why it would be unsafe to provide a requested pipeline service (in the event that refusal to supply the service in question has led to a dispute). This is adequate protection for JGN against having to provide services that are unsafe.
- The chargeable demand framework sends a strong price signal to customers not to allow unauthorised overruns. Once nine overruns have occurred, the cost of the ninth highest is maintained for a period of twelve months.

Where there are no immediate security concerns, but where measuring equipment for a given site allows access to a quantity of gas significantly in excess of the capacity entitlement and unauthorised overruns are regularly occurring, then if JGN feels its own charging framework is not providing adequate compensation or this is creating systemic issues JGN can negotiate with the customer to increase MDQ and/or reduce flow capacity. This will give the customer an opportunity to re-assess their use and to re-



consider the impact of unauthorised overruns on final charges. Since this type of negotiation would not relate to immediate system security, it would not require pre-emptive rights for JGN to install a flow control mechanism.

4. *Repair of basic metering equipment*

Origin notes that under the Reference Service Agreement (RSA), as proposed, JGN will be required to repair basic metering equipment “within a reasonable time of becoming aware of the need to do so”.

Origin cannot see why JGN could not meet a timeline of two business days since basic metering equipment will be readily available in stock. JGN has depots across its distribution area that it could use to supply replacement metering equipment within a two business day timeframe.⁴

If deemed necessary by the AER, JGN could have a separate requirement for specific areas of the reticulation system, for instance 4 business days in an outer gas supply region. This is a preferable approach (and common regulatory practice) to deal with specific regional issues.

In Origin’s experience, a maximum timeframe is likely to be of much greater meaning and value to a final customer than a commitment to completing a task in a “reasonable timeframe”.

5. *Invoice frequency*

In its initial submission Origin noted that, under JGN’s proposal, JGN will have absolute discretion on the frequency with which it invoices retailers. Origin and a number of other retailers requested that JGN should be required to insert a commitment on the regularity of its invoices, with a limit on the maximum frequency with which invoices can be issued.

The AER determined in its Draft Decision that no amendments were necessary in this respect, as JGN’s proposal was consistent with the National Gas Objective and represented a continuation of current commercial arrangements. Origin cannot concur with this.

Firstly, the National Gas Objective includes as a goal the efficient operation of natural gas services. If JGN changes its invoice frequency on a regular basis, at its absolute discretion, the retailer will be unable to plan its cash flows, since network costs account for a significant portion of retailer revenue. This cannot promote the efficient operation of natural gas services.

Secondly, the current clauses are not a continuation of current commercial arrangements. Under current arrangements, JGN is committed to issuing invoices at a regular frequency, no less frequently than once monthly. The commitment to a regular frequency is important. It may be that JGN intends to continue to issue invoices on a regular basis, even though it will no longer be required to do so. If this is the case, then JGN has no need for “absolute discretion”. “Absolute discretion” implies that JGN’s requirements are likely to change at short notice and in unpredictable ways, when in

⁴ Origin notes that in Victoria the Gas Interface Protocol allows for a period of 24 hours for a situation where no gas is passing to a premise (see AEMO Victorian *Gas Interface Protocol, Participant Build Pack 1*, Job Enquiry Code: SPN, priority E.



reality the services JGN will be invoicing for will be highly regular and predictable, by the nature of the contracts in place. Absolute discretion is not current commercial practice and is also unnecessary, in Origin's view.

In relation to the question of current commercial practice more generally, Origin appreciates that current commercial practice can give some indication of the importance of existing barriers to entry. However, given that NSW is a significant and important market for gas and JGN is the monopoly owner of the primary gas distribution infrastructure in that state, retailers are likely to shoulder an allocation of risk that may be sub-optimal. The result of a sub-optimal allocation of risk can be that customers pay more than they otherwise would, which clearly does not serve the National Gas Objective. A new AA period provides the regulator with an opportunity to review and correct any imbalance in risk between network and retailer and Origin would urge the AER to examine each clause outside the context of the current AA.

6. *Gas balancing*

Origin is not convinced that JGN requires a right to enforce an alternative gas balancing regime, as proposed in clause 7.4 of the RSA. The new Short Term Trading Market (STTM) allows for gas contingency arrangements, whereby JGN will have a number of options in the event that it finds gas in the network to be insufficient to meet demand. These include the Capacity First Response tariff arrangements and load shedding, within the context of the STTM. Origin proposes that clause 7.4 of the RSA be removed.

7. *Unaccounted for Gas*

Unaccounted for Gas (UAG) in the network is the difference between the total volume of gas received into the distribution network and the total quantity delivered to customers. JGN is required to make up any forecast difference between aggregate receipts and deliveries to consumers by purchase of replacement gas, which is currently done through competitive tender.

UAG is made up of a number of different components; such as leakage, operational losses and metering error. In its 2004-2009 access arrangement, JGN was allowed to pass through on average 2.1 per cent of total gas volumes as UAG, although the actual volumes it purchased over the 5 year access arrangement period turned out to be 2.34 per cent on average, leading to a considerable additional cost to JGN.

An important consideration for NSW gas market participants going forward is that where JGN purchases too little gas to replace UAG the residual is physically made up by participants themselves, which is reflected in their Reconciliation Account Balances (RAB). This has been confirmed by analysis recently undertaken by the AEMO. The RAB for each participant reflects the difference between their actual and forecast withdrawals over time, which in aggregate, should oscillate closely around zero (since one person's over-injection relative to its forecast must be balanced by another injecting less to ensure pressure in the distribution pipeline is kept within appropriate bounds). AEMO has found that the aggregate RAB diverges from zero primarily because JGN either over or under-injects replacement gas for UAG into the network.

In this context, Origin is concerned that with the UAG cost overruns experienced by JGN to date (ostensibly due to their under-forecasting actual UAG requirements over last



access arrangement period)), that this may create a perverse incentive for JGN to do precisely the opposite under the next access arrangement period. That is, JGN may have an incentive to systematically under-purchase gas in the knowledge that participants will physically make up the remainder in the event that UAG is greater than forecast. In this way JGN can ensure that their actual UAG costs remain below that forecast to avoid the cost overruns of the past. Under the existing incentive mechanism of the access arrangements, if such costs remain are below the target set, JGN gets to retain the difference.

Origin's considers this perverse incentive could lead to an ever increasing positive RAB imbalance for market participants. AEMO is currently consulting on a methodology to settle out any residual RAB amounts in order to transition existing gas market arrangements to the STTM in June. Analysis performed by AEMO and ourselves in respect of this consultation has revealed that there is likely to be a very substantial positive aggregate RAB imbalance at commencement of the STTM. This suggests that there is already a pattern forming of significant under-injection by JGN.

As a consequence of this net imbalance being primarily due to under-injection by JGN, participants have no way of off-setting individual imbalances between themselves. In other words, participants are unable to recover the cost of providing this gas on JGN's behalf, or the means to compel its on-going return under current arrangements.

In effect this means that in the first year of the new access arrangement that market participants will be paying twice for UAG, first through the settlement process described above, and second, through the amount JGN is able to pass-through in its next access arrangement. Origin suggests that the AER consult with AEMO, and if applicable, make adjustments to JGN's UAG allowance at least in the next year to account for participants calculated contributions to UAG. We also consider that incentive arrangements could be improved to avoid the potential for ongoing market distortions.

Improving the UAG incentives in the access arrangement

In the first instance, the RAB settlement exposures determined above for individual participants could be recovered through adjustment to the UAG pass-through amounts (subtracted from overall forecast UAG volumes used in the pass-through methodology) set by the AER in the first year of the next access arrangement. AEMO is currently working with participants to determine the precise volumes this would entail, and we consider such an adjustment would be consistent with normal legal principles of natural justice and procedural fairness.

However, over the longer term we believe the access arrangements should be amended to avoid any systematic bias for under-injection by JGN. Given AEMO's finding that differences between the replacement gas purchased for UAG and actual UAG are the primary driver for aggregate RAB imbalances, we believe that a more sophisticated UAG incentive could be implemented. Such an incentive would involve imposing a financial penalty (some component of the UAG pass-through amount) on JGN if the aggregate RAB imbalance moves outside a certain range over a given time period (monthly, quarterly, or annually for example).

This would provide an incentive for JGN to purchase replacement gas to more closely match "actual" UAG requirements, since systematically purchasing below this level would lead to a growing positive aggregate RAB imbalance over time and subsequent exposure to a financial penalties (if it moves outside the agreed range). Importantly, the current



incentive in the access arrangement to reduce “actual” UAG costs (below the target set by the AER) should not be affected, provided any such reductions in UAG costs are genuine.

AEMO has the capability to monitor and track aggregate RAB imbalances post STTM, which would form a necessary element of a workable and appropriately targeted incentive framework.

In taking on such a role AEMO would increase the level of transparency surrounding the causes of aggregate RAB imbalances, how they relate to UAG, and how they can be appropriately managed over time. We consider this to be critical, in fact, for ensuring the integrity and viability of the STTM.

Origin would be keen to explore these issues further with the AER and AEMO with the ultimate objective of achieving a more effective integration between the NSW access arrangements and the gas retail and wholesale markets in NSW.

If you have any queries about this submission please contact Steven Macmillan on (03) 8665 7155 in the first instance.

Yours sincerely,

A handwritten signature in blue ink, appearing to read "Randall Brown".

Randall Brown
Manager Regulatory Development