26 November 2010

Mr Chris Pattas
General Manager
Network Regulation South Branch
Australian Energy Regulator

By email: qldsagas@aer.gov.au

Dear Mr Pattas,

RE: ENVESTRA SOUTH AUSTRALIAN GAS ACCESS ARRANGEMENT

As a leading gas retailer in South Australia and Queensland, Origin appreciates the opportunity to provide comment to the Australian Energy Regulator (AER) on the proposed Access Arrangement for Envestra in South Australia.

Origin's comments are split between the Access Arrangement and Access Arrangement Information, and the Terms and Conditions.

Access Arrangement and Access Arrangement Information

1. Demand forecasts

Origin notes Envestra's observation that average consumption per domestic connection in South Australia has fallen over the period. Origin also notes Envestra's statement that actual volumes have been persistently lower than the forecasts approved by the regulator in its last determination.

The data provided in Graph 3.4, illustrating projected and actual volumes since 1999, is unhelpful, because it does not provide a complete picture. Rather than showing approved and actual volumes, the graph shows only the *difference* between approved and actual volumes – and this for domestic customers only. At a minimum, it would be helpful to show approved volumes next to actual volumes, for both domestic and non-domestic users.

Envestra states that "new customers continue to use less gas than existing customers, with both new and existing customers continuing to use less gas over time".[1] Once again, it appears that this observation is limited to domestic customers, although this is not always explicitly stated. Greater clarity on use in the non-domestic sector would be helpful.

The implication of each new domestic customer using less gas on average is that the average unit price for existing customers will continue to increase. Normally, as new customers are added to a network, the unit price should fall through greater economies

1 Envestra SA Access Arrangement Information, p.28

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of scale. A fall in unit cost is a primary justification for adding new customers to a network. However, in Envestra's case, the reverse is occurring.

Given the fall in consumption per domestic customer has been a consistent trend, Origin would question whether adding new users to Envestra's network in South Australia is still meeting the National Gas Objective, which requires investment "for the long term interests of consumers of natural gas with respect to price". It may be that Envestra needs to review the threshold gas volume below which it requires new customers to make a contribution towards their connection. This would allow new users with very low volume requirements to make a greater contribution to the fixed cost of their connection, instead of spreading this cost across the existing customer base. As long as new connections continue to increase the average unit price, adding these customers will not be serving the interests of existing gas customers.

Envestra could also consider focusing more on increasing usage among existing customers, instead of growing low-volume connections.[2] While it is undesirable from an environmental point of view that fewer new houses in South Australia should be connected to gas, it would be of greater concern if gas was to become prohibitively expensive for all existing users.

In this context, Origin notes that the Network Management Fee proposed to be paid by Envestra to APA includes "an incentive payment to conduct the business in a way which would increase Envestra's total revenue, for example by expanding the networks".[3] Expanding the network through adding customers with declining consumption may serve to increase Envestra's total revenue in the short term, but will not serve the National Gas Objective. The incentives provided to APA should be considered in this light.

2. *Expenditure on network development and marketing*

Origin notes that Envestra has proposed "increased research and development expenditure to create new uses of natural gas that will offset the persistent decline in average consumption."[4] Origin questions the value of this increased expenditure.

Spending fell from over $6 million in 2006/07 to around $1 million in 2008/09, before returning to over $6 million in 2010/11. Yet in this five year period domestic customer numbers have grown steadily, above the forecasts approved by the Regulator in the last determination. In other words, changes in spending on market development have arguably had little or no impact on customer growth (which has continued to increase) or on average consumption per customer (which has continued to fall). If a lack of marketing was a factor in customer numbers and consumption, it would be reasonable to expect changes in marketing spending to be reflected in consumption and customer growth numbers.

Envestra explains that the long term decline in average consumption is driven by fundamentals, such as changes in climate and increased penetration of solar water heating. In light of this, Envestra could better explain how the development projects it is

2 Envestra's Graph 13.4 on p. 189 of the Access Arrangement Information document shows that houses built in later years typically use less gas.

3 Envestra, SA Access Arrangement Information, p.57

4 Envestra, SA Access Arrangement Information, p.22

contemplating for the coming period will differ from its current projects, to justify the increased cost of these projects.[5]

Origin notes also Envestra's comments at the AER forum[6] that it foresees a turnaround in the decline in average consumption, but not in the next five year regulatory period. It would be helpful if Envestra could describe the drivers of gas demand beyond 2016 that it foresees will deliver this reversal in consumption, in light of its marketing plans and plans for expansion of the network. It would be valuable to understand which gas appliances or technologies Envestra is targeting that will increase gas consumption in those houses likely to have below average consumption. From Origin's perspective there do not appear to be any new gas technologies in the medium term. In any event, in relation to network development, it is not apparent to Origin that the gas distributor is best placed to develop or market the relevant technologies. Customers will pay for these marketing efforts through their network tariffs, so they should be appropriate to the role of a distributor.

3. Mains replacement

Origin notes the concern of the Technical Regulator that the level of mains replacement on the South Australian gas network has been insufficient to reverse increasing levels of leakage, as well as the decision by the Essential Services Commission of South Australia (ESCOSA) to amend the South Australian Gas Distribution Code such that Envestra will have a regulatory obligation to carry out its planned mains replacement as set out in the Mains Replacement Plan.

Origin notes that Envestra has underspent on mains replacement in recent years and that a significant portion of the capital expenditure programme over the coming regulatory period seeks to address the issue of leaky pipes and to ensure compliance with the new obligation.

Proposed spending on mains replacement is to increase dramatically in the coming period, as shown in Table 1, below (which includes the spending estimates for the most recent financial years, for comparison).

Table 1. Mains replacement capital expenditure forecast
$m (real 09/10)

Forecast for current period →		Proposed expenditure in next period →				
2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
8.56	15.12	19.8	50.2	51.5	52.3	52.7

Source: Envestra South Australian Access Arrangement Information p.35,92

As shown in Table 1, this is a dramatic increase in activity, more than fivefold in three years. Origin seeks assurance from Envestra that Envestra and its contractor are capable

5 Origin notes that Envestra refers readers on p.80 to Appendix 6-5 as evidence that its network development programs generate positive net present value, yet this Appendix is not made publicly available.

6 Held in Adelaide on 29 October

of ramping up activity on Envestra's network in order to execute mains replacement on the scale contemplated.

In relation to the proposed mains replacement programme - and in relation to capital expenditure more broadly - Origin urges the AER to apply careful scrutiny to the proposals, in particular to examine whether they appear feasible. As would be familiar to the AER, there is an asymmetry in the allocation of capital expenditure under the revenue model. If capital expenditure is under allocated, but profitable opportunities exist to invest beyond the allocation, then under normal circumstances Envestra can borrow to invest and have the capital added to the regulated asset base at the end of the period. However, if the allocation for capital expenditure is too high and is underspent, then this expenditure is lost to customers. While no return on capital is earned on the unspent allocation, the funds themselves are never returned to the customer. In light of this asymmetry, it seems prudent to err on the side of caution when approving capital projects.

4. Subdivision of Volume customers

Envestra proposes to maintain the division of Volume customers between domestic and commercial customers. Origin does not think this division is effective in South Australia and so would propose that it be removed.

Business to business (B2B) systems currently divide customers between Demand and Volume only in South Australia. This limits the capacity for the customers to be identified and limits any price impact of the sub-division.

There are also complications in how Envestra assesses whether a site is more or less than the 50 percent threshold of domestic use in order to qualify for the domestic tariff.

Origin proposes that Envestra remove this separate sub-category of Volume customer in South Australia.

5. New daily threshold for large customers

Origin notes that Envestra proposes a new daily threshold of 50 gigajoules above which customers will be classified as Demand customers, even if their annual consumption is below the industry standard of 10 terajoules (TJ).

It is unclear whether these customers will be moved onto interval metering and, if they are, whether network users will be able to pass on the cost of the new meter. Furthermore, for the purpose of internal systems and business to business (B2B) interfaces, customers under the 10 TJ threshold will continue to be classed as Volume customers, which will mean the customers cannot easily be identified in the systems, making it difficult to bill them separately according to Envestra's proposed change.

Origin is not convinced there is a sufficient benefit in cost reflective pricing to justify this change, for a very small group of customers.

Proposed Terms and Conditions

6. Daily Overrun Charges

Origin notes that Envestra is proposing to continue charging daily overrun charges on Demand delivery points in South Australia. This practice creates considerable administrative burden and challenges for Origin, since:

- Details of daily overrun charges are not made available at the same time as the primary invoice for the customer in question. This means that the charges need to be administered manually, out of the charging cycle, adding to cost.
- In some cases, in between the arrival of the main invoice and notice of the daily overrun charges for the same delivery point, the customer will have moved to a new retailer, meaning Origin is unable to recover these charges from the customer, and
- Origin is unable to pass on overrun charges to customers on non-market contracts, even though Origin must pay these charges on behalf of the relevant customers.

As a result, Origin would prefer it if the extra cost of customers who overrun their MDQ could be captured through the Maximum Daily Quantity (MDQ) ratchet mechanisms at 5.4 and 5.5.

7. Reduction in MDQ

Origin notes that Envestra proposes that before a demand customer can request a reduction of their MDQ, they must (among other things):

- have experienced a permanent, material reduction in its requirements for gas of at least 10%, and
- not have taken delivery of a quantity of gas equal to or in excess of 90% of MDQ in the last twelve months.[7]

The requirement to have reduced demand for twelve months prior to requesting a reduction in MDQ seems excessive and should be removed. A permanent reduction in demand could take place over a matter of days - as a result of a one off reduction in plant capacity, for example. There is already a requirement that the customer must provide evidence to Envestra's satisfaction that the reduction is permanent. In many cases, it will be immediately evident that the reduction is permanent. Where it is not immediately evident, Envestra could require that usage be monitored for a period of 6 months, for example, prior to accepting the request.

8. Off-specification gas

Envestra proposes to require the network user to inform Envestra as soon as practicable if there is a possibility that gas in the Network does not meet the specification ('off-spec' gas) may be delivered into the Network by or for the account of the network user.[8] Origin sees that there should be a reciprocal obligation on Envestra to notify the network user if they believe that gas in the network does not comply, since network users will face similar obligations in standard large customer contracts. Furthermore, given that it will sometimes be the network that causes the gas to become off-spec (for example through impurities, odorant, the introduction of water or other contaminants in the mains) it

[7] Envestra South Australian Access Arrangement Terms and Conditions, cl.7.1
[8] Envestra QLD Access Arrangement Terms and Conditions cl.12.4

seems reasonable that a party that introduces the impurity should be responsible for alerting the other party.

9. Delivery pressure

Clause 14.1 obliges Envestra to ensure that gas delivered at each delivery point is at pressure within the range of pressures prescribed by law and, to the extent permitted by law, at a pressure agreed. However, clause 14.2 excuses Envestra from this obligation where a failure to comply is due to “the technical, practical and physical limitations of the network whether or not Envestra knew or ought to have known about the limitations in question”. The clause also excuses Envestra when the failure to comply is due to other parties introducing insufficient gas or gas at the wrong pressure.

This exclusion in relation to technical, practical and physical limitations is so broad that it is hard to see under which circumstances Envestra could be held to its obligation to deliver at pressures within the required range. Origin proposes that the exclusion should be limited to when the pressure falls out of the range as a result of insufficient gas being delivered into the network by third parties, or gas being delivered into the network by a third party at pressures outside the required limits. Envestra should take the physical and practical limitations of the network into account when it agrees the range of pressures with network users.

10. Liabilities and indemnities

The liabilities and indemnities in the Terms and Conditions as proposed are unequally weighted towards Envestra’s interests, with no apparent justification.

For example, Envestra is proposing that all network users provide an uncapped indemnity against any loss Envestra experiences flowing from a breach of the agreement in relation to warranties and titles to gas.[9] This liability should be capped and/or it should exclude indirect and consequential loss. Origin notes that Envestra has capped its own liability (in clause 27.7) and has excluded economic and consequential loss from its own liabilities (at clause 27.6).

Origin can see no reason why Envestra’s liabilities should be capped and restricted in their scope while the network users’ should not – other than that Envestra drafted the contract to prefer its own interests. Clause 31 is particularly onerous for network users, since it makes them liable to an uncapped amount for the actions of third parties over which the network user has no control. Origin would propose that in place of the network users’ indemnities in clause 31, clause 27 should be reciprocal and cover both parties’ liability.

Clause 27.5 seeks to limit Envestra’s liability in respect of any claim unless that claim is made known by the network user to Envestra, *in its full particulars*, within three months after that claim becomes known to the network user. This puts network users at a serious disadvantage, given that in the absence of this clause both parties would be entitled to a statutory limitation period of 6 years. Origin would request that this clause be deleted. It can take a long time to put together the full particulars of a claim, so this would rarely if ever be completed within three months.

[9] Envestra SA Access Arrangement Terms and Conditions cl.16.3

Clause 28.2 refers to the *Trade Practices Act (1974)*. These will need to be updated to reflect changes to the Act that come into effect on 1 January 2011.

Origin would stress that in those cases where this imbalance in liability is already in place under the current Arrangement the AER should not take this as grounds for continuing to accept this. The manifest inequality in liability in these distribution contracts increases risk, for no reason, which in turn increases the cost of gas to the end customer. The five year review is the only opportunity to redress these imbalances – where in a non-monopoly environment imbalances like these would be addressed through the pressure of competitive market forces.

11. Other services

Origin notes that Envestra is proposing to include a new category of service "Other Services"[10] - which are separate from ancillary services. Origin does not understand the justification for this. At a minimum, the prices for these services should be transparent and so subject to publication.

12. Force majeure

Clause 29.4 on force majeure is at odds with the well accepted concept of force majeure, which is an event that occurs that prevents the performance of obligations by the parties. It does not make sense that certain obligations of the network user still have to be performed even if there is an event of force majeure. Origin proposes that this clause should be deleted, or modified to a reasonable endeavours basis.

13. Invoicing and payment of charges for reference services

Origin notes that Envestra proposes to continue invoicing in advance for distribution services.[11] Origin does not support Envestra invoicing in advance and requests the AER to remove this term, on the basis it does not serve the National Gas Objective, since it does not serve efficient operation of gas services with respect to price.

Origin understands that the prepayment arrangement was put in place to provide Envestra with working capital during the initial months of its establishment. There is no further need for this arrangement to be in place. Working capital requirements should be included as part of Envestra's overall costing in its arrangement proposal. The on-going justification for this term is unclear, in light of the administrative burden it creates.

The administrative burden comes about in part because for each month of charges two estimates are made and two corrections required. Assuming an invoice arriving in February, the elements of the invoice are:

- A correction to actual charges for January, corrected from an estimate of January charges that was made in January;
- A correction to a revised estimate of February's charges, corrected from an initial estimate of February's charges made in January; and
- An initial estimate of March's charges.

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10 Envestra SA Access Arrangement Terms and Conditions cl.19

11 Envestra SA Access Arrangement Terms and Conditions cl.20.3

This means that for each month's charges funds must move between the parties three times. This contrasts with a distribution business that charges accurately for services in arrears, where only one payment is required.

Administering three payments instead of one involves a cost. Each provisional payment creates a further risk that there will be errors in the calculations (errors other than the estimate itself being inaccurate). Furthermore, it creates exposure for Origin in relation to customers who change retailer and from whom Origin cannot therefore recover the charges from.

Origin can see no countervailing benefit to justify this arrangement and strongly encourages the AER to remove this term in the coming regulatory period.

Lastly, Envestra has inserted new words in clause 20.2 that deals with the First Payment, to the effect that the network user may be required to make its first payment under the agreement prior to the agreement being executed. Origin cannot see why network users would make a payment under an agreement that was yet to be executed. The Queensland Competition Authority removed advance invoicing in Queensland on the basis it was no longer required and there was no justification for it.

14. Correction of billing errors

Envestra proposes that it not be obliged to correct billing errors more than 11 months after they have occurred.[12] Origin notes that this has been revised, from 12 months in the current Access Arrangement. Origin would argue that there should be an exception to this rule, in the event that Origin is required by law to pursue a claim by on behalf of a customer; there being no such limitation on how far back a customer can pursue a claim.

15. Methods of payment

Origin notes that Envestra proposes to remove electronic funds transfer (EFT) as a means of payment, instead requiring payment by "telegraphic transfer". Origin does not support the removal of EFT and an explanation of "telegraphic transfer".

16. Termination

Clause 26 does not allow either party to terminate the agreement unless one party breaches the agreement or becomes externally-administered. A clause should be included whereby a network user can terminate the agreement with notice to Envestra, in the absence of a breach. A network user should also be able to terminate the agreement if Envestra becomes an externally-administered body corporate, becomes insolvent or the pipeline becomes uncovered (as Envestra is permitted to terminate the agreement in all these circumstances).

Origin is unclear under which circumstances clause 26.8 Holding Over would operate and seeks clarification of this. The clause requires that the agreement will continue after the expiry of its term, unless the agreement is terminated. Since the term as defined can only end at termination, this clause seems meaningless.

17. Network user to assist

12 Envestra SA Access Arrangement Terms and Conditions cl.21

Envestra proposes to require that the network user be obliged to provide Envestra with whatever information Envestra might reasonably require from time to time in connection with the Agreement. Envestra also proposes to require that the network user be obliged to provide Envestra with whatever assistance Envestra might reasonably require from time to time in connection with the Agreement.[13]

Origin does not oppose these clauses in principal, but sees there should be an equivalent requirement on both parties. Envestra and the network users are all businesses seeking to control costs – if Envestra is to charge for ad-hoc requests, then Origin should not have an open obligation to assist Envestra under all circumstances, or else Origin should be allowed to charge for these requests.

Separately, clause 30.3 in the Terms and Conditions provides that Envestra "may" provide assistance to Upstream Operators with information required to operate transmission pipelines. Since the network user's obligation to assist is a firm obligation ("the Network User will…") Origin sees no reason why Envestra's obligation to assist should not also be a firm obligation.

18. Confidentiality

Origin sees that the obligations on the network user in clause 34 to keep certain information confidential should apply equally to Envestra. Origin proposes that this clause be made reciprocal in its effect.

If you have any queries in relation to this submission, please contact me in the first instance, on (03) 8665 7155.

Yours sincerely

[SIGNED]

Steven Macmillan
Regulatory Pricing and Policy Manager

[13] Envestra SA Access Arrangement Terms and Conditions cl.30