



26 November 2010

Warwick Anderson
General Manager
Network Regulation North Branch
Australian Energy Regulator

By email: qldsagas@aer.gov.au

Dear Mr Anderson,

RE: ENVESTRA(QLD) AND APT ALLGAS ACCESS ARRANGEMENT PROPOSALS

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

Origin's comments are split between the Access Arrangement and Access Arrangement Information (comments on Envestra only), and the Terms and Conditions (comments on both Envestra and APT Allgas).

Access Arrangement Information

1. *Demand forecasts*

Origin notes Envestra's observation that average consumption per domestic connection in Queensland 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 2000, 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 customers.

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 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 Queensland 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.¹ While it is undesirable from an environmental point of view that fewer new houses in Queensland 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”.² 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.”³ Origin questions the value of this increased expenditure.

Spending on Network Development has been around \$1 million annually over the period 2006/07 to 2010/11.⁴ Envestra is proposing annual expenditure of around \$1.7 million in the coming period. This would represent an increase in excess of 60 percent over the five year period. In the current five year period domestic customer numbers have grown steadily, above the forecasts approved by the Regulator, so arguably spending has been effective in this regard. But network development spending has had little apparent impact on declining volumes. 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.

If the network development spending is designed merely to add customer numbers, than arguably \$1 million a year has already proven sufficient. If the objective of the spending is to lead to higher consumption per connection, then Origin seeks detail on how the development projects Envestra is contemplating for the coming period will differ from its current projects, justifying a significant increase in spending.⁵

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

¹ Envestra’s Graph 13.5 on p. 178 of the Access Arrangement Information document shows that houses built in later years typically use less gas.

² Envestra, QLD Access Arrangement Information, p.56

³ Envestra, QLD Access Arrangement Information, p.22

⁴ Envestra, QLD Access Arrangement Information, Table 3.3

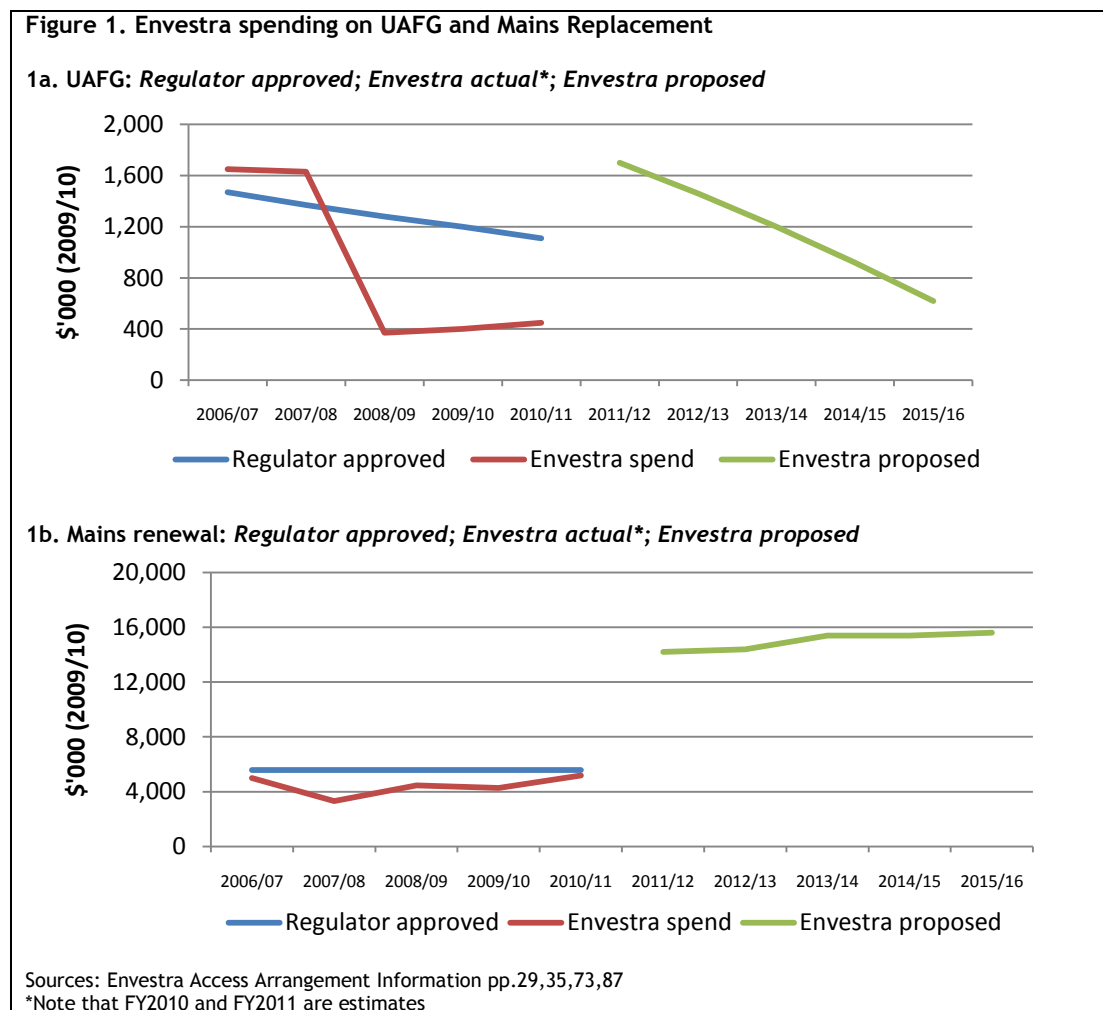
⁵ Origin notes that Envestra refers readers on p.79 to Attachment 6-5 as evidence that its network development programs generate positive net present value, yet this Appendix is not made publicly available.

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. *Unaccounted for gas*

Origin has some concerns about apparent inconsistencies between actual and proposed spending on unaccounted for gas (UAFG).

Expenditure on UAFG and on Mains Renewal is illustrated in Figure 1, below.



As shown in Figure 1a, Envestra has underspent its allocation for UAFG considerably. Envestra's UAFG costs are based on actual volumes of gas lost in the system - and payments made to the party that provides UAFG. As such, these payments are not discretionary in nature, so this reduction indicates that gas losses from the system have been much lower than expected.

As outlined in Figure 1b, the dramatic reduction in UAFG occurred against a moderate increase in spending on mains renewal. Envestra has noted that "some reduction in UAFG is attributed to the mains replacement program in Queensland, however it is believed that the majority of this step change cannot be associated with physical alteration of the

network, and as such is presumed to be the result of other unidentified and potentially temporary factors related to gas volume accounting.” Origin is concerned that Envestra reported at the AER’s public forum that Envestra’s UAFG numbers were “unreliable, and most likely incorrect”.⁶ Given that it is the primary business of a distribution network to transport gas securely it is of considerable concern that the operator of these monopoly assets cannot identify what may have caused this issue. Origin would be concerned if an operational issue was causing an apparent reduction in UAFG (for example, if gas was flowing into the Queensland system from another system) and Envestra was entirely unaware of this.

Given that Envestra cannot even confirm whether the reduction in UAFG is a temporary or permanent phenomenon, it is of concern that Envestra proposes to jump from \$450,000 for UAFG in the last year of the current regulatory period, to \$1.7 million on UAFG in 2011/12. This 380% increase in spending on UAFG is particularly strange given Envestra is also proposing a more than threefold increase in spending on mains renewal in the same year, which ought to reduce UAFG further rather than increasing it.⁷

Origin would propose that either Envestra resolve the issue with UAFG and identify the source of surplus gas as soon as practical, or else it revises its opex forecast for UAFG to be more in line with spending in recent years. Origin would also question whether the magnitude of the proposed increase in spending on mains renewal program is justified or prudent.

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 bring the division of Volume customers between domestic and commercial customers. Origin does not think this division is effective in South Australia and so would oppose the introduction of this division in Queensland, for the following reasons:

- The business to business systems currently divide customers between Demand and Volume only - even in South Australia - so this limits the capacity for the customers to be identified and limits any price impact of the tariff;
- The system framework in Queensland is based on the Victorian model and so is less amenable to schema changes to allow for a subdivision of Volume customers;
- The customer base in Queensland is a lot smaller and hence the cost of the any system change is borne by a smaller group of customers;

⁶ Andrew Staniford speaking at the forum held in Brisbane on 28 October

⁷ Envestra says in the Access Arrangement Information that its Mains Replacement Plan sets out in detail the basis for forecasting UAFG over the forecast period. This document has not been made has been unable to consider this.



- It is unclear exactly how Envestra proposes to assess whether a site is more or less than the 50 percent threshold of domestic use in order to qualify for domestic.

Origin would propose that Envestra does not introduce this separate sub-category of Volume customer in Queensland.

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.

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, particularly in the Queensland market.

Proposed Terms and Conditions

6. *Daily Overrun Charges*

Origin notes that Envestra is proposing to adopt charging daily overrun charges on Demand delivery points in Queensland. 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 timing 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 all 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 clauses 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 their 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.⁸

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 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.⁹ 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 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 a 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.

The 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 against those of the network user.

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

⁸ Envestra QLD Access Arrangement Terms and Conditions, cl.7.1

⁹ Envestra QLD Access Arrangement Terms and Conditions cl.12.4

to warranties and titles to gas.¹⁰ This liability should be capped, 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 be completed within three months.

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 the imbalances in liability are already in place the AER should not take this as grounds for continuing to accept this arrangement. 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. *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.

12. *Other services*

Origin notes that Envestra is proposing to include a new category of service "Other Services"¹¹ - 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 subject to publication.

¹⁰ Envestra QLD Access Arrangement Terms and Conditions cl.16.3

¹¹ Envestra SA Access Arrangement Terms and Conditions cl.19



13. *Correction of billing errors*

Envestra proposes that it not be obliged to correct billing errors more than 11 months after they have occurred. 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 on behalf of a customer; there being no such limitation on how far back a customer can pursue a claim relating to over-charging.¹²

14. *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.

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 requests an explanation of "telegraphic transfer".

16. *Network user to assist*

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.

¹² Envestra QLD Access Arrangement Terms and Conditions cl.21

¹³ Envestra QLD Access Arrangement Terms and Conditions cl.30

17. *Insurance*

In Origin's view some of the proposed insurance clauses are unworkable in practice.

Clause 32.5 on claims enforcement implies that the network user must maintain insurance specific to its agreement with Envestra. This is not practical - Origin maintains group insurance policies that cover exposure to a wide range of agreements. This should read "insurance held pursuant to" rather than "insurance held under".

Clause 32.6 actually requires the network user to seek Envestra's consent when it settles a claim under any insurance held pursuant to the Agreement. This is impractical. Origin may have claims on its group insurance in relation to matters unconnected with Envestra. Even if a matter did relate to Envestra, it is unclear why Envestra should have this pre-emptive right to withhold consent to Origin settling a claim with its insurers.

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.

Proposed Terms and Conditions - APT Allgas

19. *Tariff assignment*

Clause 2.2 states the APT Allgas will determine from time to time whether an end user is a volume customer or a demand customer and this determination will be binding on the user.¹⁴ This term should also stipulate that the tariff assignment will be made according to the principles outlined in 2.1.1 and 2.1.2 of the Access Arrangement.

20. *Disputing measured quantities*

APT Allgas makes no allowance for the network user to question the quantity of gas delivered (at clause 3.7) or any opportunity to initiate a meter test (clause 4.1.4 allows for a correction, but not a test initiated by the network user). Normally, gas distributors would provide a mechanism whereby a network user could query the quantities of gas being delivered and the accuracy of meters. Origin requests that such a mechanism be included.

21. *Delivery pressure*

Clause 5.2.1 obliges APT Allgas to ensure that gas delivered at each delivery point is at pressure within the range of pressures reasonably nominated by APT Allgas. However, clause 5.2.2 excuses APT Allgas from this obligation where a failure to comply is due to "the technical, practical and physical limitations of the network whether or not APT Allgas knew or ought to have known about the limitations in question". The clause also

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APT Allgas Terms and Conditions, cl.2.2



excuses APT Allgas 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 APT Allgas 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. APT Allgas should take the physical and practical limitations of the network into account when it determines (at its sole discretion) the range of pressures within which it will deliver gas.

22. Correction of billing errors

APT Allgas proposes that it not be obliged to correct billing errors more than 12 months after they have occurred. 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 over overcharging on behalf of a customer; there being no such limitation on how far back a customer can pursue a claim of this nature.

23. Information and assistance

APT Allgas proposes that the user will provide APT Allgas whatever information APT Allgas might reasonably require from time to time and whatever assistance or co-operation might reasonably require from time to time.

It is not reasonable to expect network users to make a blanket commitment of this nature that is not reciprocated. This means network users could be obliged to pay the network for any assistance but cannot request payment in return. In Origin's view this clause should be reciprocal or should be removed.

24. Liability and indemnity

Clause 14.1 includes "consequential loss" as a defined term, but it is not defined. This clause also appears to be contradictory, in that it says "Notwithstanding any clause of this Agreement" but also refers to "(except as provided for elsewhere in the Access Arrangement)". The intention appears to be that neither party will be liable for consequential loss arising out of, or in connection with, the agreement unless expressly stated elsewhere in the agreement. This should be clarified.

In Origin's view there is no reason why the indemnities in clause 14.5 should not be wholly reciprocal - that is, the network user's liability should not include consequential loss.

25. Insurance

In Origin's view some of the proposed insurance clauses are unworkable in practice and so should be removed.

Clause 13.1 requires the network user to seek approval from APT Allgas as to the insurers it chooses to use, as well as APT Allgas' approval of the terms of each insurance policy. This is entirely unrealistic. The terms of Origin's insurance agreements are commercially confidential and timing would prevent this in any event. Origin's insurance programme is



approved by the Board of Origin, rather than APT Allgas. If APT Allgas was to consider the converse proposition (that Origin must approve all the terms of the insurance agreements of APT Allgas) it should become evident that this obligation is unrealistic and cannot be honoured. As such, it should be removed.

Clause 13.2 requires the network user to inform APT Allgas about any claim that arises under an insurance policy if the network user holds this insurance in part pursuant to its agreement with APT Allgas. It is unrealistic that the network user should need to consult with APT Allgas about settling a claim that does not relate to APT Allgas - indeed it is unrealistic to require the network user to consult with APT Allgas prior to settling a claim even when that claim does relate to APT Allgas, since the terms of the settlement will be commercial in confidence.

26. Confidentiality

Joint obligations on confidentiality (as expressed at clauses 15.1 and 15.3) should outlive the agreement, in the interests of both parties. This should be an exception to clause 18.3, which relates to obligations after termination.

27. Termination

At clause 18.4 APT Allgas proposes to treat costs associated with termination brought about by default of one of the parties -- and subsequent termination of the agreement -- as liquidated debt payable by the User. Evidently, this should only apply if the default is caused by the user. This should be stated.

Clause 18.5 specifies that rights in relation to termination set out in clause 18 do not limit other rights or remedies that may be available to APT Allgas, pursuant to the Access Arrangement, at law, in equity, or otherwise. This qualification should be reciprocal and apply to both APT Allgas and its counter parties.

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