



**Supplementary Submission
to
Queensland Competition Authority (QCA)**

**Access Arrangements
for
Queensland Gas Distribution Networks**

**by
Allgas Energy Ltd**

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1. Introduction

Allgas Energy Ltd (Allgas) provides the following information in response to a submission made by Ergon Energy Pty Ltd (Ergon) on the Access Arrangements proposed by Allgas.

In general, Allgas welcomes submissions made by market participants regarding the Allgas access arrangements, since these submissions assist the Queensland Competition Authority (QCA) in developing a balanced view of the various issues in the market. The consultation process adopted by the QCA is a reasonable and appropriate process. However, Allgas has some particular concerns about the Ergon submission and these are detailed below.

Allgas is disappointed with the lack of rigour in the Ergon submission and the significant number of errors of fact and conclusions based on so-called “widely accepted” opinions.

Allgas considers that public submissions should be factually correct, otherwise they can present a misleading picture. It is our view that the Ergon submission presents arguments based on errors of fact and that these need to be corrected.

It is the intention of this Allgas submission to address the most significant errors of fact and redress a number of ill informed statements and unsubstantiated opinions expressed in the document. It is not the intention of this submission to comment on all the issues raised as a number of these issues were already the subject of review by the Queensland Competition Authority.

2. Capacity Management

Ergon states Section 3.4 -

Ergon Energy believes that the use of MHQ as a price setting mechanism is an unnecessary complexity and that Agreed Demand should be based on a Maximum Daily Quantity ('MDQ') basis rather than hourly.

In Allgas' case, in general terms, the network has ample spare capacity and this is an unnecessary step.

It is not correct that the Allgas network has ample spare capacity. This statement is not based on any evidence. Parts of the network are constrained during periods of peak demand. A true assessment of spare capacity should be made through an analysis of the network as has been carried out as part of the Depreciated Optimised Replacement Cost (DORC) valuation. Gutteridge Haskins & Davey Pty Ltd have carried out such a valuation for Allgas. This valuation was reported in the Access Arrangement and is currently being reviewed by the QCA.

Pricing on Maximum Hourly Quantity (MHQ) is an appropriate and efficient approach to pricing for a distribution network. As clarified in the Allgas submission in response to the Issues Paper, a network is designed with capacity to meet the maximum demand. The Allgas network has been optimally designed to meet its customer demand, however it should be noted that such demand can be peaky in nature and maximum demand may not be sustained for long periods.

Unlike a transmission pipeline where Maximum Daily Quantity (MDQ) is used as the price setting mechanism, a distribution network has minimal linepack. MHQ is a capacity measurement while MDQ, for the purposes of a distribution network with significant short-term peak demand, is more closely associated with volume through the network (due to the long period of integration). Some parts of the Allgas network are constrained due to peak demands imposed on the network for short periods. MDQ does not adequately account for these short-term demands. Volume signals as provided by MDQ are not appropriate in a network which exhibits a low diversity of load such as the Allgas network. In many interstate networks where the diversity of load is much higher, MDQ may well be a reasonable indicator of demand.

MHQ delivers the most efficient price signals to end users of a distribution network and provides appropriate information for the efficient management of the network. Pricing on MHQ is important in ensuring optimal usage of the assets. Current technology facilitates continuous monitoring of usage and provides this appropriate information for decision making.

3. Extensions/expansions Policy

Section 3.7 states -

It would appear that the Allgas expansion program is very expensive per additional customer connected to the network.

And later in Section 3.13 -

Over the life of the Access Arrangement, Allgas suggests it will spend between \$4700 and \$6600 per new customer they secure. This is much higher than the benchmark spent by other distributors of around \$2000 per new customer.

The statement on expenditure per new customer is incorrect. Using projections of new customer connections, Allgas will spend less than \$4000 per new connection over the term of the Access Arrangement.

It is inappropriate for Ergon to make the above comparison, firstly without ensuring that the data are comparable and, secondly, without qualifying the comparison by noting that networks differ in their density of customers. The Queensland networks have a greater spread of customers per line of main than many interstate networks and naturally would exhibit higher capital costs per new customer.

4. Capital Base

4.1 Value of the Capital Base

Section 3.13 states -

The initial capital base proposed by Allgas reflects the underlying purchase price paid by Energex for the assets and does not reflect the true value of the asset in terms of replacement cost or market value.

This statement is also incorrect. The initial capital base proposed by Allgas is based on an independent valuation of the DORC of the network undertaken by Gutteridge Haskins & Davey Pty Ltd. This is clearly stated in the Access Arrangement.

The Ergon analysis concludes that if ENERGEX paid \$250 million for the network and ascribes a network replacement value of \$245 million then \$5 million is the value that ENERGEX ascribes to the non-asset aspects of the business. This is incorrect. The \$245 million quoted from the Access Arrangement is clearly stated as the replacement value of the network. To carry out such an analysis a comparison must be made between purchase price and **written down** value. The analysis should also take into account the other assets acquired as part of the purchase and not the subject of the Access Arrangement.

Allgas engaged an independent consultant to address the requirements for the determination of the asset base outlined in the *National Third Party Access Code for Natural Gas Pipeline Systems*. This detailed report has been submitted to the QCA on a confidential basis and examines the relationship between purchase price and the capital base proposed for the purposes of the Access Arrangement. This analysis ignores the premium that ENERGEX paid over alternative offers.

The Ergon analysis is incorrect and is lacking in substance. It demonstrates a lack of understanding of the business drivers involved in the decisions for ENERGEX to purchase Allgas. It has also used incorrect information to draw invalid conclusions.

4.2 Asset Lives

In the case of cast iron mains, Allgas has assumed a remaining life of 80 years compared to the total life of 50 years in the case of AGL in NSW. This is a trend in the manner in which Allgas has chosen to propose extended lifespans for its assets.

This statement is incorrect. Allgas has not assumed a remaining life of 80 years for cast iron mains but rather a **total** life of 80 years and this is comparable to expected lives approved in valuations of other networks. The Sinclair Knight Merz review of the Victorian gas assets recommended a range of 50-120 years as the economic life of cast iron mains.

5. Network Efficiency

Further in Section 3.13 Ergon states -

It would be reasonable to assume that, given the apparently high valuation of the Allgas network, the network would function efficiently. This is not the case relative to other gas distribution networks.

Ergon bases this statement on the level of unaccounted for gas (UAG) associated with the Allgas network. Unaccounted for gas is only one aspect of the operation of a network and, while levels may be relatively high in small pockets because of the age of the network, this does not naturally infer inefficiency in total. Ergon failed to note that significant reductions in UAG have been factored into the revenue requirement for future years.

It is incorrect to imply that the Allgas network does not function efficiently using one selective partial indicator. Benchmarking data were provided in the Access Arrangement which indicated that Allgas compares favourably on a number of indicators given the scale differences of networks.

The Independent Pricing and Regulatory Tribunal (IPART) also conducted an analysis in which Allgas compared very favourably with other Australian distributors. It was found that Allgas was an efficient network given its scale of operations.

The Access Arrangement has outlined further improvements in operations and maintenance expenditure with aggressive reductions in real costs forecast by Allgas.

Ergon also suggests that the Allgas customer base will pay for the UAG a number of times

The Allgas customer base will pay for this lost gas a number of times. Firstly for the gas itself, secondly because an above market price was paid for a network that does not operate efficiently and thirdly in the form of the accelerated asset replacement and augmentation program to bring the network up to appropriate standards.

This statement is incorrect. First, as stated above, the capital base is determined by an independent assessment of the DORC of the network, which is currently the subject of review by the QCA. Secondly, Ergon failed to note that, as stated in the Access Arrangement, significant reductions in UAG have been forecast over the term of the Arrangement as a result of the renewal program. Customers will directly benefit by reduced costs from lower UAG.

Customers do not pay for UAG a number of times; they pay for it once as part of the access prices.

6. Pricing

The Ergon comments on the Allgas pricing regime are confusing and demonstrably incorrect. While it is difficult to decipher what Ergon is inferring on this issue, Allgas confirms that the modelled revenue in the Access Arrangement represents total required revenue as determined by the building block approach outlined in the Access Arrangement Information document. Ergon states -

The average tariff implied by the Allgas revenue requirement is \$3.13 per GJ in 2001 whereas Ergon Energy estimate the required average tariff across Brisbane, Gold Coast and Toowoomba networks would need to be around \$4.12 per GJ in 2001.

The figure of \$4.12 is incorrect. Allgas prices support the revenue as modelled in the Access Arrangement and Ergon's modelling of this figure is unsound.

Also Ergon states-

Ergon Energy is concerned that the tariffs and associated revenue requirements set by Allgas in their Access Arrangement are much lower than that which Ergon Energy has estimated they require in order to cover their costs. This may suggest that the implied Allgas tariff reflects the net revenue requirement and not the total revenue requirement.

Any suggestion of a "net" revenue is wrong. The QCA is currently reviewing the proposed tariffs to ensure that the Allgas pricing regime delivers the target revenue.

6.1 Comparison with other Networks

Section 3.29 of the Ergon submission provides an analysis of the access tariffs in Queensland compared to networks in other states, but seems to confine comments to the Allgas network. Ergon notes that -

Distribution tariffs (ie DUOS charges) in Queensland are amongst the highest in Australia; and later when comparing with Westar states -

Westar region was chosen as it is a sizeable network in terms of geographic area and customer numbers and its charges are broadly between the extremes of those in existence in the Victorian market.

Ergon has failed to note that the Westar network delivers 8 times the volume of gas delivered by the Allgas network and delivers gas to over 400,000 customers compared to the Allgas network that services 59,000 customers. Naturally the average price per GJ of gas would be higher in the Queensland networks because of the lower average consumption in Queensland and the smaller number of customer numbers compared to networks such as Westar.

However, despite the scale disadvantages incurred by Allgas, for larger customers Allgas prices are below many other interstate networks. For example, when compared to the Westar network, Allgas tariffs are considerably below Westar tariffs for customers with annual consumption above 100TJ.

Ergon then states -

The proposed Allgas charges indicate that the customer would pay almost \$15.00 DUOS per GJ, an increase of 36 per cent.

The Allgas Access Arrangement document shows a clearly detailed price calculation example for a typical residential customer consuming 12.994GJ per annum. Ergon has chosen to ignore the resulting price of \$13.08/GJ and has somehow determined a higher incorrect price of \$15/GJ. The inference from this price is that residential customer prices will need to rise by 36 per cent. Again this is incorrect – Allgas has carried out analysis demonstrating that significant price rises will not be required. This has been supplied to the QCA.

7. CONCLUSIONS

Allgas always welcomes well-informed submissions from market participants and the ensuing debate that arises on various issues. This is appropriate as part of the consultative process associated with QCA's determination regarding the access arrangements.

However, Allgas objects to the incorrect assertions made in the Ergon submission and rejects many of the conclusions since they are based on incorrect or misleading analysis.

Allgas submits that QCA should ignore comments made in the Ergon submission due to the absence of analytical rigour and conclusions formed from incorrect unsubstantiated information.