



**Allgas Energy Ltd.**  
ACN 009 656 446

**Submission to the  
Queensland Competition Authority  
on the Draft Decision  
for the Access Arrangements  
for Gas Distribution Networks**

21 May 2001

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## 1. INTRODUCTION

Allgas Energy Ltd (Allgas) makes this submission in response to the Draft Decision by the Queensland Competition Authority (QCA) on the proposed access arrangements for gas distribution networks. Allgas acknowledges that in reaching its Draft Decision, the QCA has attempted to balance the interest of the service providers and users to achieve an efficient and equitable outcome. However Allgas is most concerned that the QCA's approach does not provide for an adequate commercial return for the Allgas network or the appropriate incentives for the development of the gas industry in Queensland, contrary to the Queensland and Australian Governments' recently announced energy policies. It is in this context that Allgas has prepared the following comments.

Allgas is prepared to amend the proposed access arrangements in accordance with more than half of the QCA's forty draft amendments. Where Allgas does not support the QCA's other draft amendments, this submission explains Allgas' position on these matters. Given that the QCA consultancies on reviews of capital and non-capital expenditure are still in progress it is impossible to respond fully to the Draft Decision, particularly in regard to the QCA cuts to capital expenditure and unaccounted-for-gas (UAG) and the efficiency gains expected of the network. Allgas is concerned about this process of decision-making and has raised these concerns formally with the QCA. Allgas reserves the right to respond further to the consultancies' reports when they become available.

Nevertheless, Allgas has addressed matters in this submission which are still the subject of review, and provides arguments which substantiate the package of costs proposed in the access arrangement. Given the previous regulatory environment the management decisions by Allgas regarding investment in the network in recent years have been prudent, and have delivered a cost-effective outcome to gas customers of the network. This position is supported by the analysis in Attachment A which has been prepared with the assistance of the Network Economics Consulting Group. In summary, the QCA's Draft Decision regarding the allowed capital expenditure and unaccounted-for-gas penalises Allgas for prudent commercial management.

Allgas submits that the QCA should enable Allgas to make commercial decisions, such as network augmentation and expansion, rather than hinder development through overly prescriptive regulation. If QCA fails to deliver adequate funding for legitimate network investment, new or indeed existing customers may be denied the choice of an environmentally friendly energy source. At best, customers will be denied the choice of modern high input gas appliances.

The following table summarises Allgas' responses to individual draft amendments. Subsequent sections of this submission provide more detail.

**Table 1** QCA's Draft Amendments to Allgas Access Arrangement

No.	Description	Comment
1	Ancillary Services to be included as Reference Services Special meter reading fee not charged for switching retailers, or alternatively, a separate nominal fee for such circumstances nominated by Allgas Prices to be inclusive of GST	See Text See Text  Agree

## Submission on the QCA's Draft Decision for the Access Arrangements for Gas Distribution Networks

No.	Description	Comment
2	Users to be able to obtain a separate tariff for an element of any service as defined in the services policy	Agree
3	Amendments to sections 3.6 and 5.1.1 of terms and Conditions	Agree See Text re 5.1.1
4	Amendment to section 8.1(b) of terms and conditions	Agree
5	Amendment to section 8.1 of terms and conditions	Agree
6	Amendment to section 3.4 and insertion of new clause	Agree
7	Amendment to section 3.2 - overruns	See Text
8	Amendment to section 4.2.1 of terms and conditions - metering to be read at intervals of approximately 90 days.	See Text
9	Amendment to section 12.4 of the terms and conditions - retailers and customers within each priority class to be treated equitably	Agree
10	Amendment to section 18.3 of the terms and conditions - default on obligation	See Text
11	Amendment to section 14 of the terms and conditions - Allgas would be required to make good or pay compensation .....	See Text
12	Amendments to sections 13.1 and 13.2 of the terms and conditions	Agree
13	Amendment to trading policy	Agree
14	Amendment to extensions/expansions policy - Automatic inclusion of all extensions/expansions as part of the covered network	See Text
15	Revisions to extensions/ expansions - Allgas will provide written notice to the Authority of a Surcharge Allgas may seek approval for higher tariff where augmentation has system wide benefits	Agree Agree
16	Amendment to section 1.4 of the access arrangement - access arrangement that is current at the time will continue to apply until such time as the regulator approves any revisions	Agree
17	Amendments to review triggers	See Text
18	Increase or decrease in tariffs from a new impost or change in impost to be approved. Definition of impost to reflect changes in taxation or government policy (costs of full retail contestability)	Agree
19	Reporting on gas demand by no later than 31 August each year	Agree
20	Asset base to be set at DORC valuation of \$179.2 million.	See Text
21	Value of Initial Capital Base	See Text
22	Amendment to forecast capital expenditure	See Text
23	Remove an amount from the capital base so as to share costs associated with redundant capital Assets that have been declared redundant subsequently contribute	See Text Agree
24	Amend depreciation charges	See Text
25	Amendments to capital base calculations	See Text
26	Post-tax nominal WACC	See Text
27	Risk free rate of 5.97 percent to be adopted in determination of WACC	See Text
28	Equity beta to be set at 0.97	Agree
29	Cost of debt for calculating WACC must be set at a debt margin of 160 basis points above the risk free rate	Agree
30	Dividend imputation rate of 0.5 should be assumed in the cash flows	Agree

No.	Description	Comment
31	Allgas must include forecasts of the cost of tax for each year of the regulatory period in the cash flows	See Text
32	Expected inflation to be set at 2.40 percent	Agree
33	Post tax nominal WACC to be set at 9.26 percent.	See Text
34	Amendment to projected non - capital costs Distribution marketing will not include the name of the incumbent retailer or the network service provider	See Text See Text
35	Unaccounted for Gas costs to be amended	See Text
36	Gas demand forecasts to be adjusted to reflect post price impact demand forecasts.	Agree
37	Price path amendments	Agree on some aspects. See Text
38	Revision to reference tariff schedule	Agree
39	Amendment to section 9 of the access arrangement information so to provide more information on the allocation of all relevant costs between services and zones.	Agree
40	Amendment to definition of CPI in Appendix A	Agree

## 2. NON-PRICING ISSUES

### 2.1 Services Policy

#### Allgas draft amendment A1

*In order for the Allgas access arrangement to be approved, the Authority requires Allgas to include the ancillary services identified in its access arrangement as reference services. Charges for ancillary services must be expressed inclusive of GST. The special meter reading charge must note that this is not to be charged to customers when switching retailers, or alternatively, a separate nominal fee for such circumstances may be nominated by Allgas.*

Allgas does not agree to the inclusion of the proposed ancillary services as reference services. Reference services are services required by the majority of the market where there is some certainty of demand so as to provide some reliability of forecasts for the access arrangement period. The reason Allgas proposed these services as ancillary services rather than reference services is precisely that the services do not clearly comply with the Code's definition of a reference service.

Experience shows that disconnection and reconnection services are not required by a significant part of the market. In the case of the special meter reading service, the proposed charge was based on a cost of service basis due to the fact that the forecast demand is very unpredictable. Due to the uncertainty of retail contestability and the nature of the Queensland market the future demand for these services cannot be estimated with any degree of reliability and therefore they are difficult to model as a reference service for which a reference tariff is calculated.

Allgas did not intend that the special meter reading charge act as a barrier to retail competition. Rather, it was identified as a service that will be required in the market and was priced on a cost-of-service basis. The QCA considered this charge to be reasonable.

Allgas submits to the QCA that the issue of applying the special meter reading charge to customers when switching retailers is an issue to be addressed in the market rules for contestability. If the special meter reading charge is viewed as a barrier to the effective introduction of contestability, there are a number of ways in which this can be overcome. One possibility is that in the case of customers switching, the meter will be read at the scheduled meter reading for that end user and a retrospective adjustment is made to that account on an estimate basis. In this circumstance if a special meter read is requested, the charge will apply. This however needs to be further discussed and have the support of the market participants as do the market rules for contestability.

Allgas acknowledges the principle behind this draft amendment. However, Allgas submits that this issue should not be the subject of approval as part of the access arrangement. Rather, it is one of the many issues that need to be further explored when formulating the market rules of contestability.

Allgas submits that the ancillary services proposed in the access arrangement are not reference services as defined in the Code, and therefore Allgas disagrees with the QCA's requirement to include ancillary services as reference services.

Allgas disagrees with the QCA's requirement to note that the special meter reading charge should not be charged to customers when switching retailers. Allgas submits that this is an issue that should be addressed in formulating the market rules for contestability for the gas market.

Allgas agrees to publish charges inclusive of GST.

### Allgas draft amendment A2

*In order for the Allgas access arrangement to be approved, the services policy must be amended to provide for users to be able to obtain a separate tariff for an element of any service as defined in the services policy.*

Allgas agrees to amend the services policy of the access arrangement to provide for users to be able to obtain a separate tariff for an element of any service as defined in the services policy.

## 2.2 Terms and Conditions

### Allgas draft amendment A3

*In order for the Allgas access arrangement to be approved, Allgas should replace the words in sections 3.6 and 5.1.1 of the terms and conditions, "...on whatever basis Allgas considers reasonable..." with "...on a reasonable basis..."*

Allgas agrees to amend section 3.6 of the terms and conditions in accordance with the above. However, Allgas seeks clarification of the amendment to section 5.1.1 of the terms and conditions as the QCA amendment does not appear to apply to this section.

Allgas draft amendment A4

*In order for the Allgas access arrangement to be approved, Allgas must amend section 8.1(b) of the terms and conditions to the following effect:*

*“(b) to demonstrate to the reasonable satisfaction of Allgas the user’s ability to meet all financial obligations under this agreement.”*

Allgas agrees to amend the access arrangement in accordance with the above.

Allgas draft amendment A5

*In order for the Allgas access arrangement to be approved, Allgas must insert a requirement in section 8.1 of the terms and conditions that Allgas will credit users on their regular account with interest on the security held, with the interest rate equal to the quoted rate for 90 day bills for the last day of the previous quarter.*

Allgas agrees to amend the access arrangement in accordance with the above requirement.

Allgas draft amendment A6

*In order for the Allgas access arrangement to be approved, it must:*

- *amend section 3.4 of the terms and conditions so that Allgas will have an obligation to maintain the network in accordance with good engineering and industry practices; and*
- *insert a requirement in the terms and conditions to the effect that Allgas must not connect a new delivery point to the network unless the system has sufficient capacity to sustain that end user.*

Allgas agrees to amend section 3.4 accordingly.

Allgas draft amendment A7

*In order for the Allgas access arrangement to be approved, Allgas must amend section 3.2 of the terms and conditions to the effect that an increase in MHQ will occur should an end user’s actual demand exceed its MHQ on any four days in any period of 30 days or 10 days in any period of 12 months. In addition, section 3.2(c) of the access arrangement, relating to retrospective changes to MHQ, must be deleted.*

Allgas has revised the structure as per section 3.6 of this submission. Therefore, in accordance with this proposed change to tariff structure, Allgas amends clause 3.2 of the terms and conditions regarding overruns to read as follows:

"Where the actual MHQ exceeds the Nominated MHQ for an End User at a Delivery Point within a single billing period, Allgas will make no adjustment to the Nominated MHQ. However, if the actual MHQ exceeds the Nominated MHQ during a second billing period in

the same Contract Year, then the Nominated MHQ for the remainder of the Contract Year will reflect the highest actual recorded MHQ.

Where the actual MDQ exceeds the Nominated MDQ for an End User at a Delivery Point within a single billing period, Allgas will make no adjustment to the Nominated MDQ. However, if the actual MDQ exceeds the Nominated MDQ during a second billing period in the same Contract Year, then the Nominated MDQ for the remainder of the Contract Year will reflect the highest actual recorded MDQ.

Where the metering for an End User at a Delivery Point does not measure the actual MDQ, the actual MDQ for that Delivery Point will be calculated as the average daily quantity of gas delivered to the Delivery Point during the billing period multiplied by a factor of 1.1."

Definitions of the terms Nominated MHQ and MDQ will be clarified in Allgas' Access Arrangement.

In view of the QCA's comments on the proposed Allgas tariff structures, Allgas submits an alternative section 3.2 of the terms and conditions as outlined above. This is consistent with the new tariff structure proposed in section 3.6 of this submission and does not refer to any retrospective changes as noted by the QCA in the Draft Decision.

### Allgas draft amendment A8

*In order for the Allgas access arrangement to be approved, Allgas must amend section 4.2.1 of the terms and conditions to the effect that metering equipment at each delivery point for small customers is read at intervals of approximately 90 days.*

Allgas submits that the QCA should not arbitrarily take such a prescriptive approach on this issue. Allgas considers this to be a management issue and so reserves the right for flexibility. This amendment limits the potential for technical or cost efficiencies in this regard; instead imposing a cost to a group of end users. For example, pre-paid meters never need to be read, or meter readers may have difficulty gaining access to premises within the prescribed period.

The small customer service is comprised of predominantly domestic customers with some small commercial and industrial customers. Allgas should be given the opportunity of delivering this service in a timely and cost effective way according to the customer's requirements. In the case of the small customer class where consumption is relatively stable, it is difficult to see any benefits of such a prescriptive approach as set by the Regulator.

Allgas does not agree to the above draft amendment. Allgas contends there is no benefit delivered to the users or end users of the network by prescribing 90 day meter reads for this customer class.

Allgas draft amendment A9

*In order for the Allgas access arrangement to be approved, it must insert a paragraph in section 12.4 of the terms and conditions to the effect that retailers and customers within each priority class will be treated equitably when considering curtailment.*

Allgas agrees to insert the suggested paragraph in section 12.4 of the terms and conditions in addition to the existing clause 12.4. Allgas wishes to reserve the right to allocate curtailments in accordance with its own internal policy particularly in the event of a high priority curtailment (for example due to safety, health or large property damage issues). This would be exercised against the background of Allgas' position that it will allocate the curtailment proportionately and treat users within each priority class equitably.

Allgas agrees to insert the suggested paragraph in section 12.4 of the terms and conditions in addition to the existing clause 12.4.

Allgas draft amendment A10

*Section 18.2 should also be amended to the effect that "if a user ... does not remedy this default to the reasonable satisfaction of Allgas...".*

*In order for the Allgas access arrangement to be approved, it should amend section 18.3 of the terms and conditions to the effect that the user may terminate the agreement if Allgas defaults on its obligations under the agreement and fails to remedy that breach within 21 days.*

The amendment to section 18.2 gives rise to uncertainty given the nature of the obligations on the user under the terms and conditions.

Allgas does not agree to amend section 18.2 in accordance with the above as Allgas considers that this amendment gives rise to uncertainty regarding the nature of the obligations on the user under the terms and conditions.

Allgas considers there are reasonable grounds to allow for a longer period for remedial action for the network provider than for the customer and submits that there is justification for this difference in treatment.

The nature of the obligations by the user under the terms and conditions could be easily remedied within 21 days. In some instances Allgas may not be in a position to rectify defaults on obligations within 21 days. Network difficulties can be complicated and in some cases require longer than 21 days to rectify, for example, if involving major repair to the infrastructure of the network. Defaults on obligations by customers would not include such instances and could be reasonably remedied within 21 days.

Allgas does not agree to amend section 18.3. Allgas maintains there is justification for the difference in treatment arising from the nature of the obligations of the parties under the terms and conditions.

Allgas draft amendment A11

*In order for the Allgas access arrangement to be approved, it must amend section 14 of the terms and conditions to the effect that:*

- *Allgas would be required to make good or pay compensation to an equivalent value for damage to property caused by Allgas or its agents in installing, reading or servicing equipment used for the purpose of delivering gas; and*
- *neither party will be liable for any indirect or consequential loss arising out of or in connection with the agreement (except as provided for elsewhere in the access arrangement).*

The draft amendment exposes Allgas to uncapped claims for property damage arising from Allgas or its agents installing, reading, or servicing equipment. Allgas submits to the QCA that liability should be restricted to wilful or negligent acts or omissions by Allgas or its agents and capped under clause 14.4. The draft amendment is too onerous on Allgas to the extent that it seeks to impose liability on Allgas for any loss or liability suffered as a result of actions by Allgas that are neither negligent or wilful.

Allgas does not agree to this amendment and submits that it is unreasonable for the QCA to impose on Allgas this increased uncapped risk.

Allgas submits to the QCA that a more reasonable amendment should read that liability should be restricted to wilful or negligent acts or omissions by Allgas or its agents and capped under clause 14.4 of the terms and conditions.

The second point of this amendment removes Allgas' right at general law to recover against a user and specifically for actions in negligence to recover indirect or consequential loss. It is important that Allgas provides a real disincentive to users to act in a way which may cause loss to Allgas as a network provider.

Allgas does not agree to amend section 14 of the terms and conditions , as it is not reasonable for Allgas to accept this limitation on Allgas' ability to recover indirect or consequential loss.

Allgas draft amendment A12

*In order for the Allgas access arrangement to be approved, it must amend sections 13.1 and 13.2 of the terms and conditions to the effect that:*

- *with respect to the approval by Allgas of an insurer, this approval is not to be unreasonably withheld; and*
- *where Allgas requires a user not take any action to settle or compromise a claim without the consent of Allgas, this consent is not to be unreasonably withheld.*

Allgas agrees to amend sections 13.1 and 13.2 in accordance with the above requirements.

## 2.3 Trading Policy

### Allgas draft amendment A13

*In order for the Allgas access arrangement to be approved, the trading policy must be amended to include words to the effect that:*

- *Allgas will reply to any request from a user for Allgas' consent to a transfer (other than a bare transfer) or for a change in receipt point or delivery point, within 14 business days of receiving the request accompanied by information which is reasonably necessary to enable Allgas to consider the request; and*
- *if at the time the request is made the user informs Allgas that due to hardship the user requires an urgent reply to its request, Allgas will use reasonable endeavours to respond to the request within two business days of receiving the request.*

Allgas agrees to amend the access arrangement in accordance with the above.

## 2.4 Extensions/Expansions Policy

### Allgas draft amendment A14

*In order for the Allgas access arrangement to be approved, the extensions/expansions policy should be altered to the effect that that all extensions and expansions of the network will automatically be included as part of the network covered by the access arrangement.*

Allgas does not agree with the above amendment, as there may be some instance where an extension or expansion of the network is primarily for a dedicated new user or group of users. In this case Allgas reserves the right to apply a flexible contract and pricing arrangement for these large dedicated users of the network cognisant of the risk of the enterprise for which the extension was built.

The QCA approach takes away any flexibility for pricing or contract arrangements for these large customers. Allgas noted in the access arrangement that, if it chooses to treat the extension as an excluded network, it must provide written notice to the Regulator prior to the extension entering into Service.

Allgas submits to the QCA that this approach maintains flexibility on this issue but while still ensuring that the pricing of such an extension/expansions comes under the scrutiny of the QCA.

Allgas does not agree to the above amendment and submits that the QCA needs to adopt a more flexible attitude to this issue to ensure that the network is able to recover the costs of such extensions from the appropriate customers for which the investment was made. Allgas submits that the requirement that Allgas needs to present a case to the QCA for exclusion ensures that individual cases will be considered on their merits.

Allgas draft amendment A15

*In order for the Allgas access arrangement to be approved, the extensions/expansions policy (sections 7.1 and 7.2) must be revised to the effect that:*

- *Allgas will provide written notice to the Authority where Allgas elects to recover all or part of an amount that it would not recover at the prevailing reference tariff through a surcharge; and*
- *to the extent that an augmentation has system wide benefits and Allgas believes that these benefits justify the approval of a higher reference tariff for all network users, Allgas may seek the regulator's approval of a higher reference tariff for all network users.*

Allgas agrees to amend the access arrangement in accordance with the above.

## **2.5 Review Date and Review Triggers**

Allgas draft amendment A16

*In order for the Allgas access arrangement to be approved, section 14 must be amended to the effect that the access arrangement that is current at the time will continue to apply until such time as the regulator approves any revisions.*

Allgas agrees to amend the access arrangement in accordance with the above.

Allgas draft amendment A17

*In order for the Allgas access arrangement to be approved:*

- *the trigger for gas demand (sales volume) in a single year differing from that forecast must be revised to 10 per cent, for each customer class;*
- *the trigger referring to total revenue must be deleted;*
- *the trigger event dealing with uncontrollable costs must be deleted;*
- *the trigger event concerning decisions by ministers must be deleted; and*
- *the reference to the regulator being able to trigger a review relating to terms and conditions should be deleted.*

Allgas supports the above draft amendment provided that the trigger for gas demand only triggers a review of prices but not a review of the whole access arrangement.

Allgas draft amendment A18

*In order for the Allgas access arrangement to be approved, it must be amended to the effect that any increase or decrease in reference tariffs as a result of a new impost or change in an impost, must be approved by the regulator. The definition of impost must be adjusted to reflect:*

- *changes in taxation; or*
- *other major changes in government policy (for example, costs associated with the introduction of full retail contestability).*

Allgas agrees to amend the access arrangement in accordance with the above.

Allgas draft amendment A19

*In order for the Allgas access arrangement to be approved, it must be amended so that Allgas will report to the regulator by no later than 31 August of each year on performance against forecasts for the previous financial year of gas demand on an aggregate (whole of covered network) basis and for each customer class.*

Allgas agrees to the above amendment.

### **3. PRICING ISSUES**

#### **3.1 Initial Capital Base**

Allgas draft amendment A20

*In order for the Allgas access arrangement to be approved, the DORC valuation should be amended to be \$179.2 million.*

In the Draft Decision the QCA wrote down the value of the Allgas assets by \$2.2M. Allgas submits that the QCA should not write down an independent valuation.

Allgas draft amendment A21

*In order for the Allgas access arrangement to be approved, the ICB value must be set at the Authority's determined DORC value of \$179.2 million.*

The QCA's determined value of \$179.2 million for the ICB incorrectly excluded the value of Allgas' non-system assets which were provided in Table 4.6 of the access arrangement information.

Allgas wishes to place on record in this response that easements currently owned by Allgas are not listed in the capital base. The reason being that the easements have no material value under the present regulatory approach of valuing easements at historical cost. Allgas submits that the QCA's approach to valuing easements should change to recognise deprival value; in which case the value of the Allgas easements will become material. Allgas reserves the right to include this value in the capital base of the network.

Allgas submits that the value of the ICB must include the \$4.4 million of non-system assets.

#### **3.2 Rolling Forward the Capital Base**

Allgas draft amendment A22

*In order for the Allgas access arrangement to be approved, forecast capital expenditure for the five years of the access arrangement period must be amended in accordance with Table 14.3.*

Allgas does not agree with the arbitrary cutback of the proposed capital expenditure program in the Draft Decision and does not agree to amend the forecast in accordance with Table 14.3. Allgas cannot adequately address this decision, given that the QCA's position on this matter was unclear in the Draft Decision and that a QCA consultancy on this issue commenced only after release of the Draft Decision. Unfortunately, this consultancy will not be finalised in time for comment in this response to the Draft Decision.

In its Draft Decision on the renewals program, the QCA commented that:

*The Authority considers that acceptance of a DORC valuation for the purpose of determining the ICB implicitly assumes that the network in question is in good working order, and therefore should not require accelerated mains replacement.*

Allgas submits that the QCA's position on this issue is not correct. Attachment A is provided in support of this position. This report demonstrates that the capital expenditure program is necessary for augmentation of the network rather than an accelerated mains replacement.

Allgas submits that the capital expenditure proposal has been developed based on appropriate technical and economic drivers. These include an economic viability test (cost reductions including increase in sales exceed capital costs), timing decisions (again based on the optimum reduction in ongoing costs given the capital expenditure), appropriate prioritisation and packaging to provide for efficiency of expenditure. Consideration of the growth strategy for the network is incorporated into the capital expenditure program.

Attachment A also demonstrates that, had the capital expenditure program been undertaken in previous years, the DORC valuation of the network would be higher at present. Hence, the QCA's position on this issue penalises the network for the prudent management decision to defer capital expenditure. The package of capital and non-capital costs proposed for this period delivers the lowest price to customers.

Allgas submits that the capital expenditure program proposed, together with the economic signals created by actual UAG costs create the greatest likelihood that customers will benefit from the future network which is most productively and dynamically efficient. This is consistent with the General Principles of the Reference Tariff Policy (Section 8.1) of the Code. Allgas is committed to providing a network with the lowest feasible price outcome.

Allgas does not agree to amend the forecast capital expenditure for the five years of the access arrangement in accordance with table 14.3 of the draft decision. Attachment A of this submission develops the arguments in support of Allgas position.

### Allgas draft amendment A23

*In order for the Allgas access arrangement to be approved:*

- *the redundant capital policy (section 3.5) must state that Allgas will remove an amount from the capital base so as to share costs associated with a decline in the volume of sales of services provided by means of the covered pipeline between the service provider and users; and*
- *the reference tariff policy must state that if assets that have been declared redundant subsequently contribute, or make an enhanced contribution, to the delivery of services, the*

*assets may be treated as a new facility having new facilities investment (for the purpose of sections 8.16, 8.17, 8.18 and 8.19) equal to the redundant capital value increased annually on a compounded basis by the rate of return from the time the redundant capital value was removed from the capital base.*

Allgas agrees to amend the access arrangement in accordance with the draft amendment above provided that the change in volume is significant.

Allgas draft amendment A24

*In order for the Allgas access arrangement to be approved, depreciation charges for the five years of the access arrangement period must be amended in accordance with table 14.6.*

Allgas agree to amend the depreciation charges based on the correct ICB and forecast capital expenditure.

Allgas draft amendment A25

*In order for the Allgas access arrangement to be approved, the capital base calculation must be adjusted in accordance with table 14.7.*

As stated above in response to amendment 21 Allgas does not agree to adjust the calculation of the capital base in accordance with table 14.7 of the Draft Decision as this calculation does not include full capital expenditure.

Allgas does not agree to the above amendment as table 14.7 of the Draft Decision excludes the value of appropriate capital expenditure.

### **3.3 Rate Of Return**

Allgas draft amendment A26

*In order for the Allgas access arrangement to be approved, the WACC must be expressed in post-tax nominal terms.*

Allgas considers it essential that regulatory decisions for regulated gas and electricity networks be consistent in approach. Methodologies such as asset valuation, WACC principles, revenue calculation, etc, should be equivalent to the maximum extent possible. Consequently Allgas will not oppose the application of a post-tax WACC but does refer QCA to previous submissions by its parent ENERGEX Limited on this issue.

Allgas does not oppose the position of a post-tax WACC in recognition of the importance of consistency in regulatory determinations for gas and electricity.

Allgas draft amendment A27

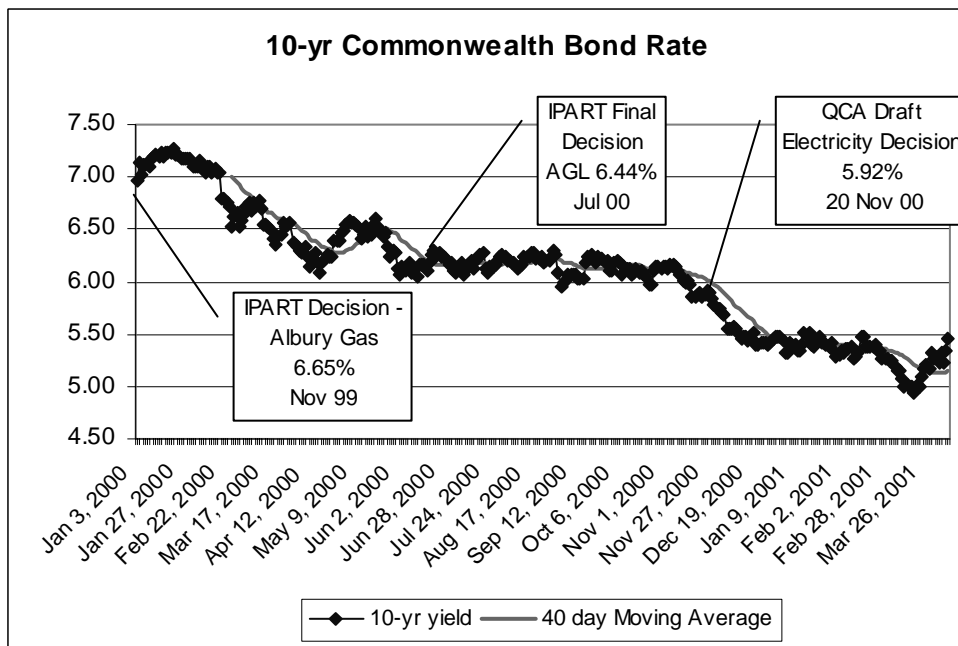
In order for the Allgas access arrangement to be approved, a risk free rate of 5.97 per cent is required to be adopted in the determination of the WACC. This rate will be updated in the Authority’s Final Decision, and may therefore be required to be further amended prior to final lodgement of the service providers’ access arrangements.

Allgas had previously proposed a 40-day average of the 10-year Commonwealth bond rate in order to smooth out daily movements in the bond rate. The QCA proposed the use of a 20-day average of the risk free rate to be applied in the Gas access arrangement. In light of Queensland Treasury Corporation’s comments and given their expertise in financial markets and debt management, Allgas considers that a longer-term average is more appropriate. Longer-term averages smooth interest rate cycles (as opposed to daily movements within a month) and will therefore smooth WACCs determined in future regulatory periods.

The risk of using an ‘on-the-day’ rate or a short-term average is highlighted by the extent to which the 10-year bond yield has moved within a 12 month period.

Figure 1 shows the movement in the 10-year Nominal Bond yield over the period of the most recent gas & electricity regulatory determinations.

**Figure 1 Movements in the 10-year Nominal Bond yield**



The current regulatory determination is occurring at a very low point in the interest rate cycle and has three major impacts:

- Customer price shock

Customers could be subject to a rate shock in the next regulatory period if rates increase, particularly given the low base at which they are. Analysts’ views are that bond yields fell through most of last year and into this year in anticipation of slower economic growth and lower

official cash rates from the Reserve Bank. As the RBA lowers cash rates (the US Federal Reserve has already started doing so), bond yields are likely to rise again, pricing in the next re-acceleration of economic growth.

- Interest Rate Risk / Cost

The bond rate forms the basis of the benchmark cost of debt used in determining the allowable rate of return. Selection of the bond rate at such a low point in the economic cycle will create significant interest rate risk for network owners unless borrowed funds can be locked in for the regulatory period. In addition, there is a potential to incur additional costs as a result of re-financing at the beginning of each regulatory period.

- Regulatory Risk

Regulators are quick to move on downwards adjustments to network owners revenue requirements, however as bond yields rise regulators are less inclined to pass these increases through to customers due to rate shock.

Allgas proposes that QCA adopt a longer-term average to reduce both network owners and customers risks.

### Allgas draft amendment A28

*In order for the Allgas access arrangement to be approved, the equity beta used in calculating the WACC must be set at 0.97.*

Allgas will amend the access arrangement to reflect an equity beta of 0.97.

### Allgas draft amendment A29

*In order for the Allgas access arrangement to be approved, the cost of debt for calculating the WACC must be set at a debt margin of 160 basis points above the risk free rate.*

Allgas will amend the access arrangement to reflect a debt margin of 160 basis points.

### Allgas draft amendment A30

*In order for the Allgas access arrangement to be approved, a dividend imputation rate of 0.5 should be assumed in the cash flows of the business.*

In discussions with the QCA Allgas agreed to incorporate a dividend imputation rate according to the following methodology.

*Imputation Credit = Tax Expense \* gamma*

Allgas considers it essential that regulatory decisions for regulated gas and electricity networks be consistent in approach. Parameters such as gamma should be equivalent unless there are reasons otherwise. Consequently Allgas will not oppose the application of gamma at 0.5 but does refer QCA to previous submissions by its parent ENERGEX Limited on this issue.

Allgas will amend the access arrangement to incorporate a dividend imputation rate of 0.5 into the cash flows.

Allgas draft amendment A31

*In order for the Allgas access arrangement to be approved, Allgas must include forecasts of the cost of tax for each year of the regulatory period in the cash flows.*

Allgas is unable to provide tax forecasts due to their dependence on outcomes of operational and maintenance expenditure, unaccounted-for-gas, depreciation and revenue. However, Allgas has previously provided the QCA with forecasts of permanent and timing differences which will be unaffected by changes in other inputs.

Allgas is not in a position to agree to the above requirements for reasons of circularity explained above.

Allgas draft amendment A32

*In order for the Allgas access arrangement to be approved, expected inflation is to be set at 2.40 percent.*

Allgas supports QCA's approach to the measurement of inflation and consequently will amend the access arrangement to reflect CPI at 2.4%.

Allgas draft amendment A33

*In order for the Allgas access arrangement to be approved, the post-tax nominal WACC is to be set at 9.26 per cent.*

Allgas will amend the access arrangement to reflect a Post Tax Nominal WACC that results from the position taken in respect to the WACC formula and WACC inputs in the Final Decision.

### 3.4 Non Capital Costs

#### Allgas draft amendment A34

*In order for the Allgas access arrangement to be approved, Allgas is required to amend its projected non-capital costs (excluding UAG) to reflect those outlined in table 16.12.*

*The Authority reserves the right to revisit these numbers in light of further analysis prior to issuing its Final Decision.*

*Allgas is also required to include a commitment in its access arrangement that distribution marketing will not include the name of the incumbent retailer or the network service provider.*

QCA's Draft Decision section 16 required Allgas to change its non-capital costs to reflect the revised non-capital costs (excluding UAG) that the QCA calculated. Allgas disagrees with these revisions, for the following reasons:

- The QCA has assumed that non-capital costs increase at only 50% of the volume growth of the system. Allgas submits that the growth factor should be in the range 0.8 to 1.0.
- The draft report from the QCA's own consultants (UMS) indicated that Allgas was some 30% more efficient than study average, and yet QCA has applied an unjustified efficiency factor of 3.5%.
- The UMS report provided no evidence as to why an industry average improvement is 3.5%, or why this is a valid efficiency factor to be applied to the Allgas network when Allgas is already more efficient than the average. Indeed, QCA's efficiency consultants for electricity said explicitly that there was insufficient evidence to justify an industry average efficiency factor for regulatory determinations.
- In any event, the QCA incorrectly applied the factor to non-capital cost figures by simply subtracting 0.5% from the original figures submitted by Allgas.

These arguments are expanded in the following sections.

#### 3.4.1 Growth of Costs

The operational costs of a network change during the regulatory period for a number of reasons including growth in customer numbers and gas throughput. This growth directly affects the network assets and operational costs of the network and it is important for the resulting change in costs to be reflected in the regulated revenue.

The QCA's Draft Decision did not explicitly consider the question of growth of operating and maintenance costs for gas networks. Instead it has arbitrarily set the revised non-capital cost estimates based on a growth factor equivalent to 50% of volume growth, that is, the cost elasticity of volume growth is 0.5.

As with electricity, there is little published evidence about cost elasticities of supply. However, in the case of electricity, the QCA has accepted that the cost elasticity is at least 0.8. The QCA in its Draft Decision used data from electricity as the basis for suggesting parameters for gas. On this basis, the QCA should use a consistent cost elasticity of supply, namely at least 0.8 for the South East Queensland gas networks.

Another problem with the revised non-capital costs is that the QCA has used the independent forecasts of gas sales provided by its consultant to derive the reference tariffs, but did not use these forecasts consistently in escalating non-capital costs.

Allgas submits that the QCA should use a growth factor of 0.8 applied to the same forecasts used elsewhere in the Decision.

### 3.4.2 Efficiency Factor

The QCA commissioned an independent report by consultants UMS Group to assess the efficiency of the non-capital costs (excluding unaccounted for gas) proposed by the service providers. At the time of the publication of the Draft Decision there was a considerable amount of work to be done to finalise this study. However, the QCA applied the findings of the study in the Draft Decision.

The UMS Draft Report concluded that Allgas' relative performance was 33% better than study group average. Similarly, the QCA's own benchmarking of the efficiency of the service providers using partial indicators of non-capital costs (excluding unaccounted for gas) in other jurisdictions also indicated that Allgas was significantly more efficient than average.

Allgas submits that the QCA should not apply an efficiency factor to Allgas that penalises Allgas for past efficiency gains.

### 3.4.3 Industry Average

The QCA extracted from the UMS report the number 3.5% and used this for an efficiency factor. Allgas does not accept this for the following reasons:

- UMS provided no evidence to support why 3.5% is an appropriate estimate of industry average efficiency improvements; and
- there is no justification for applying an average figure to Allgas.

Indeed, QCA's efficiency consultants (Tasman Asia Pacific) for electricity said explicitly that there was insufficient evidence to justify an industry average efficiency factor for regulatory determinations.

*“There is... uncertainty surrounding the estimates of the improvements in efficiency. This is sufficiently high to suggest that it would be inappropriate to incorporate the identified improvements in best practice in any unit cost target set during the current regulatory period.”*

Allgas cannot understand why the QCA would apply the same efficiency factor as for Envestra when Allgas is more efficient than the industry average. This is tantamount to penalising Allgas for delivered efficiencies.

Allgas submits that the QCA should use the same end targets for efficiency levels rather than inappropriately applying the same efficiency factor to all.

#### 3.4.4 QCA Calculation of Revised Operating and Maintenance Costs

Allgas submits that the QCA calculation of the revised non-capital cost figures is in any event erroneous. The QCA seems to have assumed that the operating and maintenance costs submitted in the Access Arrangement already contained efficiency savings of 3.0%. This assumption is incorrect as explained below:

1. The Allgas non-capital cost figures included large reductions based on the impact of the capital renewal program. However the QCA arbitrarily disallowed the renewals but did not add back the savings from the renewals. Then the QCA simply subtracted an additional 0.5% from the non-capital costs.
2. The QCA used non-capital costs in 2000/01 as a basis. However the Allgas submission used 1999/2000 as the basis and the non-capital costs in 2000/01 represented substantial efficiency gains well in excess of 3.5%. Allgas believes these cost reductions from 1999/2000 should be taken into account or a new basis used for 2000/01.
3. The QCA Draft Decision has recommended the use of their consultant's demand forecasts in the Draft Decision calculations. Therefore, simply removing an additional 0.5% from the proposed Allgas non-capital costs using the Allgas energy forecasts is inconsistent. The new non-capital cost figures must be based on the new demand forecast to be consistent with network pricing.

Allgas submits that the QCA should calculate costs correctly.
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#### 3.4.5 Additional Costs

Allgas has identified additional cost items since the submission of the access arrangement. Some of these costs were identified in a letter to QCA on 23 February 2001 but have not been included by the QCA in the draft decision. The additional costs are as follows:

- **Marketing Costs**

In view of the recent decision by the QCA on the ring fencing of marketing staff and the further work that Allgas has completed in this area, Allgas submits that an increased allowance of \$250k for marketing is required for each of the first three years of the access arrangement to be used in targeting areas of potential growth for the network and \$550k for each of the remaining two years of the access arrangement period for more high level advertising as the network develops. These costs are reasonable given the QCA benchmarking.

Justification for this expenditure can be supplied to the QCA on a commercial in confidence basis.

Allgas cannot agree that marketing be free of the name of the network service provider. Allgas submits that any marketing must include the name of the sponsor network, to provide the basic contact details of the network service provider. Allgas agrees that in order to comply with ring fencing requirements joint marketing should not occur exclusively with the associated retailer.

However, Allgas submits that the QCA should allow the network to jointly advertise with all retailers that have a licence for the service provider’s area.

Allgas disagrees with the requirement that the name of the service provider must not be included in any distribution marketing activities. Allgas submits that joint advertising should be allowed with all retailers licensed in the network service provider’s area.

- **Other costs**

Other costs have been advised to the QCA on a confidential basis.

Allgas submits that the QCA should recognise all costs that have been advised to the QCA.

### 3.4.6 Correct Calculation of Non-Capital Costs

Table 2 shows estimates of the non-capital costs required by Allgas using an efficiency factor of 0% and a cost elasticity of volume growth of 0.8.

**Table 2: Allgas Non-Capital Costs**

	00/01	01/02	02/03	03/04	04/05	05/06
O&M (\$M)	7.303					
add Other Costs (to apply from 01/02)	0.450 <sup>1</sup>					
O&M Requirement	7.753	7.914	8.452	9.080	9.746	10.345
add Marketing Costs		0.250	0.250	0.250	0.550	0.550
<b>TOTAL NON-CAPITAL COSTS</b>	<b>7.753</b>	<b>8.164</b>	<b>8.702</b>	<b>9.330</b>	<b>10.296</b>	<b>10.895</b>
CPI Forecast		2.40%	2.40%	2.40%	2.40%	2.40%
MMA Forecast Volume Growth		-0.4%	5.5%	6.3%	6.2%	4.7%
G Factor (80% of Volume Growth)		-0.3%	4.4%	5.0%	4.9%	3.7%
X Factor		0.0%	0.0%	0.0%	0.0%	0.0%
CPI+G-X		2.1%	6.8%	7.4%	7.3%	6.1%

### 3.4.7 Unaccounted-for-Gas

Allgas draft amendment A35

*In order for the Allgas access arrangement to be approved, Allgas is required to amend its unaccounted for gas costs to reflect those outlined in table 16.18.*

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<sup>1</sup> The additional costs of \$450,000 are labour costs that do not apply until 2001/2002. They have been included in the table for 2000/2001 for ease of modelling.

Allgas does not agree with the QCA's position on this issue. The high unaccounted-for-gas (UAG) costs are the result of aging pipes within the Allgas network. This information is obtained in the report on the asset valuation submitted to the QCA to support the access arrangement. The reduction of the unaccounted-for-gas costs forecast in the Allgas access arrangement was completely dependent on the capital expenditure program proposed in the arrangement.

To date, Allgas has made the economic choice of managing the UAG by operating the network at lower pressure rather than spending on capital to renew the network. The position now is that it is not economically prudent to continue with this management approach and it is more efficient to renew the network in order to reduce the costs of maintenance and unaccounted-for-gas as well as augmenting the existing system. Allgas has provided as part of this submission a study which indicates that the package of capital and non-capital costs provided in the access arrangement does indeed represent an optimal outcome to users and a least cost approach to maintaining the integrity of the Allgas network. This study is attached as Attachment A.

Allgas does not agree to amend the unaccounted for gas costs to reflect table 16.18 for reasons outlined above. Allgas submits that the QCA should revise its position on this matter in light of the further information submitted to the QCA on this matter.

### 3.4.8 Regulatory Process

Allgas is concerned about the process used by the QCA, and has previously advised the QCA in writing.

Allgas submits that the QCA should adopt a reasonable process in reaching the final decision on the proposed access arrangements.

## 3.5 Gas Demand Forecasts

### Allgas draft amendment A36

*In order for the Allgas access arrangement to be approved, the gas demand forecasts, and hence the reference tariffs, should be adjusted to reflect the post price impact demand forecasts as outlined in table 17.3.*

Allgas agrees to adjust its gas demand forecasts and hence reference tariffs to reflect the demand forecasts in table 17.3 of the Draft Decision as these forecasts closely reflect the Allgas projections submitted to the QCA.

## 3.6 Reference Tariffs and Tariff Paths

### Allgas draft amendment A37

*In order for the Allgas access arrangement to be approved, the Authority requires that:*

- *the small customer class be subject to an average price constraint of CPI - 1 per cent;*

- *the large customer class be subject to an average price constraint of CPI - 5.1 per cent;*
- *the side constraint on individual prices for end users be set at CPI + 4 per cent;*
- *the total revenue requirements for each customer class be revised to those indicated in table 18.11;*
- *a provision be included to the effect that disconnection and reconnection reference services will be increased on an annual basis by no more than CPI; and*
- *an amendment be inserted requiring that changes to reference tariffs be submitted to the regulator for approval to ensure they are in accordance with the above requirements.*

Firstly, Allgas does not agree to revise its total revenue requirements for each customer class to equate to the QCA's determination as Allgas disagrees with the QCA on the allowed capital and non-capital costs for the network, as described in this submission.

However, Allgas agrees that in the final access arrangement, the small customer class will be subject to reasonable price constraints, such as CPI – 1 per cent. Similarly, Allgas agrees that the large customer class will be subject to a reasonable price constraints, such as CPI – 5.1 per cent per annum. Allgas also agrees to revise the side constraint on prices for individual end users to reasonable levels.

Allgas agrees to include a section in the Access Arrangement that describes the annual price adjustments for the ancillary services as described below.

*"The price for the Ancillary Services shall be adjusted prior to and effective from the commencement of each Contract Year. The rate will be adjusted by the percentage change in CPI for that year."*

Allgas is prepared to insert a commitment in its Access Arrangement that it will submit the annual changes to reference tariffs to the regulator for approval. However, Allgas requests that the QCA officially specify reasonable information requirements, and a reasonable timetable for approval process with sufficient time to enable Allgas to comply.

Allgas agrees to accept reasonable levels for price constraints, subject to final allowed revenue.

Allgas agrees to include a section in the access arrangements describing the adjustment to the price of the Ancillary Services.

Allgas does not agree to revise the total revenue requirements for each customer class to equate with the QCA's draft decision.

Allgas agree to submit annual changes to reference tariffs provided that the QCA's information requirements and timetable are reasonable.

### Allgas draft amendment A38

*In order for the Allgas access arrangement to be approved, the Authority requires that the reference tariff schedule be revised to reflect:*

- *the revised transitional revenue requirements for each year of the regulatory period;*
- *the revised CPI – X targets for each customer class;*
- *the revised CPI + X side constraint for individual customers; and*
- *the inclusion of GST.*

*The Authority is also of the view that the general views on tariff structure expressed above should be considered by Allgas in developing its revised tariff schedule.*

Allgas is prepared to revise its tariff schedule for each customer class, subject to acceptance of revised transitional revenues and revised CPI – X targets. Allgas will adjust the price schedule to include GST on published prices.

In regard to the tariff structure, the QCA suggests that there is a strong argument for the amount of revenue recovered through fixed charges to be relatively high. Accordingly, Allgas is prepared to increase the fixed cost component of the price schedules for End Users of the Small Customer Class. This will require Allgas to adjust the block tariff steps for the Small Customer class. The larger fixed charge will enable Allgas to remove the small block tariff step applying to very small gas users (consumption less than 3 GJ per annum) and allow the other block tariff steps to be distributed more evenly over the whole customer class and provide a smoother price transition.

The QCA also stated their preference for a Maximum Daily Quantity (MDQ) based price structure for the Large Customer Class because it was considered to be a better signal of network capacity than the volume charges. Allgas contends that Maximum Hourly Quantity (MHQ) charges are the best capacity based charges for gas distribution networks. MHQ is the appropriate and efficient approach to pricing for a distribution network as a network is designed with capacity to meet MHQ. MHQ is a capacity measurement while MDQ, for the purposes of a distribution network with significant short-term peak demand, is actually associated with volume through the network.

For example, two customers with the same MDQ may require completely different connection assets and pressures. One customer may utilise their daily quantity of gas within 4 hours while the other may operate over 24 hours. The difference in connection assets and network requirement can only be captured using MHQ charges.

MDQ is predominantly the average daily volume of gas used for the period. As such, the throughput charges for Allgas' Large Customer tariffs closely represent MDQ charges. Accordingly, Allgas is prepared to convert the fixed charge component and stepped throughput charges of the Large Customer prices into MDQ format as suggested by the QCA. Furthermore, with MDQ replacing throughput charges, Allgas is prepared to combine both actual and agreed MHQ charges into a single MHQ charge.

An example of how the resultant price structure will appear for each pricing zone is as follows. It must be noted that these are not actual prices.

**Table 3 Example of price structure**

<b>Large Customer Reference Tariff</b>	
MHQ Demand Charge	\$2.00 per GJ of MHQ per day
<b>MDQ at Delivery Point</b>	<b>Daily charge</b>
50 GJ or less	\$65
Greater than 50 GJ but not greater than 150 GJ	\$65 plus \$0.80 per GJ of MDQ for MDQ over 50 GJ
Greater than 150 GJ but not greater than 300 GJ	\$145 plus \$0.50 per GJ of MDQ for MDQ over 150 GJ
Greater than 300 GJ but not greater than 500 GJ	\$220 plus \$0.20 per GJ of MDQ for MDQ over 300 GJ
Greater than 500 GJ	\$250 plus \$0.10 per GJ of MDQ for MDQ over 500 GJ

The added advantage of this price structure is that it removes the need for separate demand based and volume based network charges as this structure can apply to both situations. Demand metered customers will use actual recorded readings for annual MHQ and MDQ while Nominated MHQ and MDQ figures will be utilised for customers with only volume metering.

In terms of the zonal pricing structure, the QCA has correctly stated that it is a trade-off between achieving prices which are more accurately reflective of costs against establishing a common or postage stamp price which can be applied to all users ie. accuracy versus simplicity. Allgas believes that it must retain a zonal system to reflect the bypass potential due to the transmission pipeline passing close to the Allgas distribution network.

### 3.7 Other

#### Allgas draft amendment A39

*In order for the Allgas access arrangement to be approved, it must amend section 9 of the access arrangement information, so that it provides more information on the allocation of all relevant costs between services and zones.*

Allgas has already provided the QCA, on a confidential basis, with information relating to cost allocation and the reference tariffs in the Access Arrangement including disaggregating the data into the relevant pricing regions.

Allgas agrees to amend Section 9 of the Access Arrangement Information so that it contains a table highlighting the revenue requirements for the Large Customer Class in each region. The data cannot be disaggregated into zones because some zones contain only one major customer and this data then becomes customer specific, which is confidential information. Zonal data has been submitted to the QCA on a confidential basis.

The QCA’s Draft Decision has shown an allocation of revenue between the Small and Large Customer Classes, so Allgas is prepared to include correct information in the final Access Arrangement.

Allgas agrees to amend section 9 of the access arrangement and provide more information on the allocation of costs between services and regions.

Allgas draft amendment A40

*In order for the Allgas access arrangement to be approved, Appendix A must be amended so that 'CPI' means "...the Consumer Price Index (all groups weighted average for the eight capital cities) as published by...".*

Allgas agrees to amend Appendix A in the Access Arrangement to read:

**"CPI"** means the Consumer Price Index (all groups weighted average for the eight capital cities) as published by the Australian Bureau of Statistics or, if publication of that Index ceases, any official replacement index published by the Australian Statistician.