



21 May 2001

Mr John Hall  
Queensland Competition Authority  
Level 19, 12 Creek Street  
GPO Box 2257  
BRISBANE QLD 4001

Ref: R-01-081

Dear Mr Hall

**QUEENSLAND GAS DISTRIBUTION NETWORKS - ACCESS ARRANGEMENTS  
DRAFT DECISION**

We refer to the Queensland Competition Authority's ("QCA") Draft Decision in relation to the "Proposed Access Arrangements for Gas Distribution Networks: Allgas Energy Limited and Investra Limited", which was released for public consultation on 22 March 2001.

Ergon Energy Gas Pty Ltd ("Ergon Energy") welcomes the QCA's Draft Decision and supports the outcome it provides to the Queensland gas market. We consider that it delivers a fair and reasonable result for both the network operators and by seeking to unwind the cross-subsidy between the different customer classes, moves the market towards cost reflectivity which is essential for the introduction of retail competition.

The attached submission provides additional comment from Ergon Energy in relation to some of the issues which arise out of the Draft Decision and responds to matters where the QCA has specifically called for further comment.

If you wish to discuss any of the issues raised within our submission, please do not hesitate to contact Ms Rebecca Myers on (07) 3228 8134 or myself on (07) 3228 8116.

Yours sincerely

**Darren Barlow**  
Manager Regulation  
Strategic Business Development Group

ERGON ENERGY GAS PTY LTD



**SUBMISSION TO QUEENSLAND COMPETITION AUTHORITY  
ON THE DRAFT DECISION: ACCESS ARRANGEMENTS FOR  
QUEENSLAND GAS DISTRIBUTION NETWORKS**

## **1.0 INTRODUCTION**

The Queensland Competition Authority (“QCA”) released its Draft Decision in relation to the “Proposed Access Arrangements for Gas Distribution Networks: Allgas Energy Limited and Envestra Limited” on 22 March 2001.

The Draft Decision makes a number of key recommendations and requires the network operators to revise and resubmit their access arrangements to reflect the draft regulatory determinations. Following the submission of these revised access arrangements and the consideration of comments from interested parties, the QCA is expected to release its Final Decision on 17 June 2001. Ergon Energy Gas Pty Ltd (“Ergon Energy”) welcomes this opportunity to comment as part of the public consultation process and would be pleased to discuss this submission with the QCA if requested.

## **2.0 GENERAL COMMENT**

Ergon Energy welcomes the QCA’s Draft Decision and considers that it delivers a fair and reasonable network access and tariff regime which will facilitate the introduction of retail competition over the medium to long term.

By way of general comment, we consider that the key issues to be addressed in the QCA’s Final Decision will be:

- Reviewing the reference tariffs resulting from the revised revenue requirements to ensure that:
  - no customer pays an unreasonable network charge as a result of their customer class, consumption level or location; and
  - the price paths are achieved and do not result in unacceptable price shocks to any customer class or individual customers, whilst moving as quickly as possible towards cost reflectivity.
- Reviewing the costs and benefits of determining different pricing frameworks between the two network operators (ie MHQ v MDQ based pricing).

## **3.0 DISCUSSION**

### **3.1 Reference Tariff Structures**

It is understood that both Envestra Limited (“Envestra”) and Allgas Energy Limited (“Allgas”) will be submitting revised Access Arrangements, including revised reference tariffs, prior to the QCA’s Final Decision. Ergon Energy is strongly supportive of reaching cost reflectivity as soon as possible in order to facilitate the introduction of retail competition. However, we also recognise that customers must be protected from adverse price shocks and therefore note the QCA’s decision to achieve full cost reflectivity for all customer classes over two Access Arrangement periods (ie 10 years approximately) and the use of side constraints on small customer price increases.

In relation to the QCA's examination of the revised tariff structures, we make the following points:

- There may be individual large customers, particularly those located away from major transmission pipelines, who incur price increases under the new tariff structures, despite both the Envestra and Allgas large customer classes receiving an overall price reduction. Ergon Energy believes there may be a need for price increase side constraints to be applied to major customers in order to limit price shocks to these large customer groups or to prevent them considering uneconomic bypass options.
- We query whether the energy component of the small customer regulated gas supply tariff is also due to increase in order to achieve cost reflectivity in advance of full retail competition. If the energy component is to be increased by the Gas Regulator (within the Department of Treasury), in addition to the network component increase, the result of simultaneous increases could be a very significant total retail tariff increase, causing price shocks for customers.

Ergon Energy believes that discussions are required as a matter of urgency between the QCA and the Gas Regulator to determine the price increases necessary to achieve cost reflectivity of both the energy and network components of the small customer retail tariff. Once a complete understanding of price increase requirements is achieved, appropriate glidepaths can be implemented for both the energy price and the network price which, when combined to form the retail tariff, will not deliver unacceptable price shocks to customers.

- Electricity market research overseas indicates that customers tend to require a reduction of 10% to their delivered cost of energy to encourage them to switch to a contestable contract. With the introduction of Full Retail Competition ("FRC") in gas in Queensland expected in 2003, we believe it is important that the decision of a customer to enter the contestable market should not be influenced by ongoing network tariff increases. That is, a customer may not see the benefits of competition because of network price increases, and therefore develop a misapprehension about the benefits of competition.

We believe the QCA should consider the impact that such customer perceptions may have on the success of retail competition when setting the glidepath increases. On this basis, we see benefit in the QCA front-end loading the small customer price path increases, in order that tariffs closer to cost-reflectivity are achieved prior to FRC and network charge increases have less impact on customer decisions in later years.

### 3.2 Daily v Hourly Pricing

- Whilst Ergon Energy understands that Allgas' Toowoomba network may be constrained during peak demand periods, we do not consider that the application of a Maximum Hourly Quantity ("MHQ") pricing regime across all of their network is justified. The use of this style of pricing regime creates additional risk for retailers as overruns are more easily incurred and data requirements are more significant (hourly compared to daily metering) and this adds costs and complexity to systems and the operational environment. This regime is more appropriately applied to heavily constrained systems where time of use signals are required to drive demand behaviour and to send clear

network investment signals. In systems that do not suffer from regular constraints, we consider a Maximum Daily Quantity (“MDQ”) regime is more appropriate.

If one of Allgas’ networks is considered heavily constrained in the long-term, then we agree that a MHQ regime may be required in this specific network. That is, prices applied to customers within the constrained network might be based upon MHQ, whereas elsewhere in the Allgas network we do not consider it necessary to apply a MHQ regime. Further, it is unclear whether network upgrade programs under CAPEX are scheduled to address any existing constraints in the short term and whether a MHQ regime is proposed on the basis of a short-term problem in one minor network. Ergon Energy considers further examination is required to determine whether there are network upgrades currently identified/scheduled to remove the constraints and the effect this would have upon the suggested requirement for MHQ based network pricing in Toowoomba.

- Ergon Energy believes that a uniform basis for transportation pricing, ie MDQ, should be introduced across all Queensland networks in order to minimise complexity, risks and costs for both customers and retailers operating across different networks. Ergon Energy is supportive of the work currently being undertaken by Queensland and the other jurisdictions to seek convergence of gas market frameworks and considers that a uniform MDQ based regime should be implemented across all networks in Queensland, in line with the other jurisdictions.

### 3.3 Asset Valuations – Brown and Root Reports

In their review of the Depreciated Optimised Replacement Cost (“DORC”) of the Envestra natural gas distribution network, Brown & Root Services Asia Pacific Pty Ltd (“Brown and Root”) supported the 75 year estimated useful life (“EUL”) adopted for polyethylene pipe.

Ergon Energy questions the validity of this decision on the following basis:

- In the 1997 Envestra Prospectus, Envestra adopted a 50 year EUL for plastic mains and inlets (ie. PE/PVC). This EUL was confirmed by an Independent Accounting Report prepared by Price Waterhouse<sup>1</sup>. The inclusion of 75 years as the EUL in the Envestra Access Arrangement Information represents a 50% increase in the estimated useful life of the assets from the original figure. Setting a higher EUL effectively reduces the rate of depreciation and therefore increases the DORC valuation of the network. In general terms (when the higher return on capital is combined with the lower depreciation) the total impact is an increase in the revenue cap.
- We believe that there should be no discrepancy between the EUL used in a regulatory determination and that which has already been used by Envestra for the network in their accounting reports.
- Table 1.0 confirms the estimated useful lives adopted by various Australian regulatory bodies for interstate distribution networks. It should be noted that SAIPAR’s draft determination assigned a 60 year EUL for polyethylene pipe in Envestra’s South Australian network as

---

<sup>1</sup> Source: Page 73 of the *1997 Envestra Prospectus*

opposed to the 70 year EUL stated in Table 5.3 of Brown & Root's review. From Table 1.0, it is evident that a range of 50-60 years has been adopted for polyethylene pipe by Australian regulatory authorities.

**Table 1.0**

	AGL NSW	Victoria	GSE Wagga	AGC Albury	AGL ACT	Alinta Gas WA	Envestra SA	Envestra Qld	Allgas Qld
PE	50	60	50	60	50	60	60	75	80

*Source: Page 45 of SAIPAR's draft determination for the South Australian distribution network.*

- Brown and Root have similarly accepted the 80 year asset life for polyethylene pipe used by Allgas in their DORC valuation. Again, Ergon Energy believes this figure to be excessive and draws the QCA's attention to Table 1.0 above, which shows recent regulatory decisions to have determined an asset life for polyethylene pipes in the range 50-60 years.
- Ergon Energy considers that the Brown & Root DORC valuations of both the Envestra and Allgas networks incorporate plastic mains with excessive estimated useful lives. This has the effect of reducing the asset depreciation factored into the DORC valuations. We recommend that the asset lives used for the Allgas and Envestra networks are revised downwards by the QCA and both DORC valuations revised accordingly in the Final Decision.

### 3.4 Current Average Domestic Retail Tariff - Envestra

Ergon Energy has obtained the Origin Energy published tariff schedules. From this data Ergon Energy has examined the tariffs for domestic customers with stove and hot water appliances in metropolitan Brisbane, Gladstone and Rockhampton. Table 2.0 outlines the current tariffs (for a 90 day billing period, exclusive of GST) that have been applicable to domestic customers since 1 July 2000:

**Table 2.0**

Tariff 102 - Brisbane		Tariff 650 - Gladstone		Tariff 514 - Rockhampton	
Tranche (MJ)	c/MJ	Tranche (MJ)	c/MJ	Tranche (MJ)	c/MJ
First 1710 MJ	2.4000	First 1735 MJ	2.4805	First 1735 MJ	2.4710
Next 1710 MJ	1.5930	Next 1735 MJ	1.8666	Next 1735 MJ	1.8517
Above 3420 MJ	1.2920	Above 3470 MJ	1.5609	Above 3470 MJ	1.5558

Based on the average load of domestic customers in the Envestra distribution network of 10.5 GJ/year in 1999/2000<sup>2</sup> (Envestra in their Access Arrangement Information reported 10.7 GJ/year<sup>3</sup>), Table 2.1 provides our modelled result of the current retail gas prices after applying the above tariff schedules:

<sup>2</sup> Source: McLennan Magasanik Associates Pty Ltd (February 2001) *Demand Forecasts for Envestra*, Page 22.

<sup>3</sup> Source: Envestra: *Access Arrangement Information for the Queensland Distribution Network*, Page 7 of Appendix B.

Table 2.1

Tariff 102 - Brisbane	Tariff 650 - Gladstone	Tariff 514 - Rockhampton
\$21.30 /GJ	\$22.81 /GJ	\$22.73 /GJ

Table 18.7 of the QCA Draft Determination states that the average current retail tariff for domestic customers within Envestra's distribution network is \$19.80/GJ. This differs significantly from the figures outlined in Table 2.1 above.

This discrepancy should warrant further analysis by the QCA as a higher current domestic retail tariff implies a higher current domestic distribution tariff. As a result, the CPI – X factor applied by the QCA in their Draft Determination (CPI – 4.4%) to the small customer class (to remove the current cross-subsidy and achieve cost reflectivity) should be revised downwards (assuming our modelling is correct and the discrepancy in figures is real). Without this revision, we would expect Envestra to benefit from an over-recovery of revenue during the first two access arrangement periods that are subject to the transitional price path.

Further, whilst Ergon Energy has focussed on the domestic customer tariffs, we believe the QCA should also undertake a similar re-examination of the average current retail tariffs for all customers classes.

### 3.5 Queuing Policy

Ergon Energy notes that the QCA has allowed both Envestra and Allgas discretion in determining the order of applicants in the event of system augmentation. The QCA recognises in the Draft Decision that this may lead to discrimination towards the incumbent gas retailers, particularly noting the common ownership of Allgas and Energex Retail Pty Ltd. The QCA also notes that any party can use the dispute resolution mechanisms in the Code<sup>4</sup> to pursue any discrimination they feel they have encountered.

Ergon Energy views the lack of clear queuing practices as resulting in an increased potential for parties seeking access to have to pursue dispute resolution processes, and face the costs and risks that this involves. In brief, the Code<sup>5</sup> dispute resolution process requires the party discriminated against to cover the costs of a potentially long-running dispute and manage the risks of information asymmetry involved in pursuing the matter against the network operator. Ergon Energy believes that some parties who have genuinely been discriminated against would not pursue the matter because of the costs and timeframes involved in the Code<sup>6</sup> dispute resolution process.

Ergon Energy therefore believes that the QCA should ensure that queuing policies positively prevent discrimination. To do this we encourage the creation of a QCA approved queuing policy that provides for non-discrimination and a cost-effective dispute resolution mechanism, where determinations can be made within short timeframes and where costs can be recovered by the disputing party from the network operator if discrimination is found to have occurred.

---

<sup>4</sup> National Third Party Access Code for Natural Gas Pipeline Systems

<sup>5</sup> National Third Party Access Code for Natural Gas Pipeline Systems

<sup>6</sup> National Third Party Access Code for Natural Gas Pipeline Systems

## 4.0 CONCLUSIONS

Ergon Energy is supportive of the QCA Draft Decision, and considers that it delivers a positive outcome for retailers and major customers who have been seeking cost reflective network tariffs.

In summarising the comments above, Ergon Energy believes that the QCA should incorporate the following key actions in the Final Decision:

- a) Provide protection to major customers who may be exposed to price shocks by requiring price increase side constraints;
- b) Work in conjunction with the Gas Regulator to factor both network and energy price increases into a retail tariff glide path in order to achieve cost reflectivity, yet mitigate price shocks;
- c) Implement front-end loading of the glidepath to deliver cost reflectivity, to the maximum extent possible, at the commencement of FRC;
- d) Determine that a MDQ based pricing approach is applied to both the Allgas and Envestra networks, unless implementation of a long-term MHQ regime can be justified for application to specific reticulation networks (ie on an individual city network basis), and in this instance require periodic approval by the QCA for continued use of MHQ;
- e) Adjust the estimated useful life of the Envestra and Allgas plastic mains to 50 – 60 years and reassess both of the DORC valuations accordingly;
- f) Review the calculations of Envestra's current average retail tariffs (domestic, business etc), in light of the McLennan Magasanik average domestic gas consumption figures; and
- g) Prevent the inclusion of potentially discriminatory clauses in the Queuing policies of both Envestra and Allgas by implementing a QCA approved policy which incorporates cost-effective dispute resolution.

Ergon Energy would be pleased to discuss any of the issues raised in this submission with the QCA at its convenience.