

13 July 2007

Chief Executive Officer
Queensland Competition Authority
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Brisbane Qld 4001

Email: gas@qca.org.au

Dear Sir/Madam

ORIGIN ENERGY SUBMISSION - APT ALLGAS ENERGY PTY LTD APPLICATION FOR COST PASS THROUGH PREPARING FOR FULL RETAIL COMPETITION

Origin Energy (Origin) welcomes the opportunity to submit comments to the Queensland Competition Authority (QCA) regarding APT Allgas Energy Pty Ltd's (APT) application for pass through of its costs as a distributor in preparing for Full Retail Competition (FRC) in the Queensland (QLD) natural gas market.

Origin, as a major participant in the retail market, supports the introduction of FRC in Queensland and is keen to see this market grow. Having actively participated in the design and development of the gas FRC program from the commencement of government consultations to involvement with the Energy Competition Committee (ECC), Origin's intent has always been to achieve the lowest cost gas FRC solution (automated) for QLD. In order to fully capture the benefits of gas FRC it is vitally important that any additional costs be limited as far as practical due to the relatively small number of gas customers.

FRC requires significant capital investment in systems for distributors and in order to limit APT's costs Origin supported the use of the Victorian gas market rules as the basis for the Queensland rules and the appointment of VENCORP as the gas market operator for QLD. While it is understood that at the time APT did not have an association with a network operating under the Victorian rules, it did allow for the option to source existing systems from providers which have Victorian market capability. It is therefore rather disturbing that APT is seeking to pass through \$20.3 million (present value) to customers supplied off the APT Energy distribution system. From an individual customer perspective it appears that volume based customers will be charged an additional \$119 year 1 (\$141 year 2) and demand based customers \$6,899 (\$7,495 year 2) over the next 2 years. Individual cost recovery rates in years 3 and 4 are significantly less, but Origin is concerned that this financial relief will be too late as the gas market will be severely stressed by that time.

Origin believes that these additional FRC charges to individual customers are substantial, particularly for volume based residential customers - for instance, the \$119 pa FRC charge would result in an increase of some 28%¹ in residential customer bills, while the

¹ Based on recently published AGL small customer tariffs.

\$6,899 pa charge would result in around 5%² increase in bills for demand customers in the lower range of consumption.

Furthermore, as the APA Group, the parent company of APT, has recently purchased a significant holding in the Envestra network and the entire Origin Energy Asset Management business, APT has also become the operator of the Envestra gas distribution system in QLD. This arrangement surely suggests that the determination for FRC costs for both networks requires a reassessment with particular emphasis on the synergies in operating costs that can be achieved with a single operator for both networks, going forward. Given there is no urgency to finalise the QCA's FRC cost determination since both Envestra and Allgas have been allocated an allowance of \$2.8m in their tariffs for the 2007/08 year, it would appear reasonable to request APT to resubmit their FRC operating costs for the future based on being a single operator of both networks.

In any event Origin accepts the necessity for distributors to receive a fair recovery of the costs of FRC at a rate of return in line with their Access Determination. However, given the extent of the impact on customers and the potential impact on gas demand in general in QLD, Origin believes it is essential that the QCA undertake a very comprehensive review of these costs, the rate of proposed recovery of cost and the period of recovery to ensure every option is explored consistent with a fair recovery.

Specific Comments related to the APT Application

1. Regulatory Environment

It is acknowledged that the limited lead time for the introduction of gas FRC in QLD together with the sale process of the APT network was not an ideal arrangement for the planning and implementation of a capital project of this scope. However, the impact of this was somewhat offset by the early participation of APT representatives in the industry retail rule development processes and the selection of VENCORP as the market operator. Also, gas FRC had been introduced successfully in several other jurisdictions, so this was not a totally new project. Therefore, the "rapid assembly" of the APT project team should not have adversely affected the APT cost implications to the same extent had it occurred some years earlier. There is a broad understanding of FRC systems and requirements in the market that could have been readily sourced.

2. FRC Capital Costs

For the assessment of eligible FRC capital costs it is important to ensure that these costs have not been recovered under an alternative criteria or that the costs don't relate to general process improvements.

In their submission APT makes reference to an allocated cost of \$4.2 million for the PEACE system. Origin understands that this PEACE system was for a billing system that could cater for multiple retailers under new market rules. It is implied in the APT proposed Access Arrangements and the ECG consultancy that, as FRC was coming with new market rules, APT could not rely on a combined customer billing engine with a single

² Based on a 15 TJ customer

retailer. Therefore, Origin urges the QCA to ensure that this capital already recovered is accounted for appropriately in any FRC cost allocation.

Similarly, in section 5.3 of the APT submission it is mentioned that APT already had remotely read interval meters and systems for its large customers, >100TJ, but that this system was unsuitable for FRC. Origin believes this process enhancement is a business decision and not a cost as a result of FRC. Even if this cost is to be recognised by the QCA, Origin would expect the previously approved increase in DUOS to large customers to be removed once the new FRC cost is imposed?

Origin also queries whether the GIS investment decision appears to be a normal business decision unrelated to FRC. As mentioned in the APT submission:

“GIS is increasingly being used in network or distribution electricity, gas and water companies as the “database of record for the core assets and their network connectivity”

The inclusion of a portion of the capital costs of this system for FRC purposes is not substantiated. The management of APT's assets in street addresses is a normal operational requirement for any prudent distribution company and does not constitute a specific cost for new FRC related obligations.

2.1 Cost Recovery Period

It is unclear in APT's submission why they have proposed an accelerated cost recovery over the initial two years. In most other jurisdictions FRC costs have been recovered over a period of 4- 5 years in a smoothed allocation. It is particularly pertinent in the QLD gas market where gas loads are relatively small and the number of customers that must bear these costs is also quite small. The proposed APT accelerated cost recovery over the initial 2 years will accentuate the price shock for customers. Consideration should be given to recovering the costs over, say, five years at a more equal rate, as has occurred in other jurisdictions.

3. Operating and Maintenance Expenditure

Operation and Maintenance costs are predicted to be an additional \$4 million per annum for 2006/07 reducing to about \$2.2 million per annum by 2010/11. When assessing additional FRC activities and costs it is important to understand what is normal (existed prior to FRC) distributor operational activities and how the new FRC automated systems have impacted on some of the former manual processes which existed prior to FRC.

3.1 Proposed new FRC structure

APT plans to initially allocate an extra 19 staff to operate the FRC operations in this network. Origin urges the QCA to review the additional staff requirements proposed by APT to ensure they reflect additional activities related specifically to FRC. For instance:

- Appendix B11 of the APT submission notes that 3.5 additional staff have been allocated to new connections. The function of new connections existed prior to FRC and therefore with the exception of making an allowance for less staff due to automated B2B transactions there should not be any increased FRC staff requirement for this function; and

- two new staff have been allocated to the function of exception management. While it is agreed automated transactions will result in exceptions, they are the preferred industry method for managing such processes due to the efficiencies they deliver and similar problems/exceptions would have occurred with their previous systems.

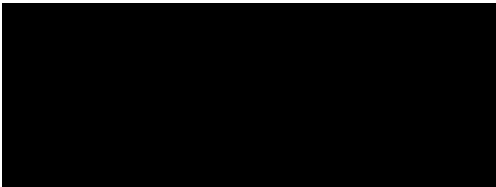
3.2 Ombudsman Scheme

APT has made an allowance for the Ombudsman scheme in their operational FRC costs. APT already incurs similar costs from the Energy Consumer Protection Office (ECPO) to manage disputes and it is unclear how these costs have been separately accounted for in the existing distribution use of system charges. Origin also questions why these additional costs have been allocated to the 2006/7 period, when the Ombudsman scheme only commenced on 1 July 2007.

In summary, it is difficult for Origin to determine the full extent of how APT has utilised their capital expenditure on systems etc. due to the limited information provided in the submission. Therefore, we can only reiterate our concerns with regard to the size of the capital and operational expenditure and the impact that it will have on the limited number of customers in QLD. We support a fulsome review of these costs by the QCA and an amendment of the proposed cost recovery method which we believe is not sustainable in the QLD gas market.

Should you require further information on this submission please do not hesitate to contact Randall Brown on 03 9652 5880.

Yours sincerely



For

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Retail