



January 15th, 2001

Ms Jennifer Hocking  
Queensland Competition Authority  
Level 19  
12 Creek Street  
GPO Box 2257  
BRISBANE QLD 4001

Dear Ms Hocking,

**Re: Invitation for comment on consultation document: *Access Arrangements for Queensland Gas Distribution Networks, Issues Paper (November 2000)***

Origin Energy welcomes the opportunity to submit the following comments to the Queensland Competition Authority for its consideration of the access arrangements proposed by the Envestra and Allgas networks.

Given that our comments reference retail price controls under the Gas Act 1965, in addition to the proposed contestability arrangements for the reticulated natural gas market, we will send a copy of this submission to the Department of Mines and Energy for their joint consideration of particular common issues.

If you wish to discuss any aspect of our submission, please feel free to contact myself on (03)9652-5902.

Regards,

Scott Maves  
National Manager, Regulatory Affairs and Compliance  
Origin Energy Retail



**Submission to the Queensland Competition Authority  
on the Proposed Access Arrangements  
for the Queensland Distribution Networks**

### **Executive Summary**

- The Queensland natural gas industry is currently faced with a material issue of revenue under-recovery in the retail sector, combined with the introduction of network access arrangements which will result in significant price increases for all customers. The tariffs proposed by both Envestra and Allgas in their proposed Access Arrangements will imply a substantial price shock for particular customer segments; it is estimated that even excluding allowance for a retail margin, the price shock for domestic customers on the Envestra network is 50%, and for those on the Allgas network, 48%. Origin Energy does not consider such price increases initially feasible upon commencement of the access arrangements; it is recognised that a transitional period will be needed to accommodate requisite network and retail price re-basing. This may have implications for the contestability timetable.
- Cross-subsidies are a significant issue affecting the ongoing financial viability of natural gas retail activities in Queensland. Origin Energy has concern that historical price movements have not addressed the cross-subsidy issue. Current regulated prices are not cost-reflective, do not provide for a commercial return, and are therefore fundamentally inconsistent with the requirements of a competitive market. To achieve a sustainable retail business, and to avoid adverse financial implications from final network access arrangements, retailers will need to manage customer prices so that they are fully cost reflective, and are therefore consistent with regulated network access prices. Without cost-reflective retail pricing, in order to accommodate the proposed network tariffs, the ongoing supply of natural gas to small customers will require a continuing cross-subsidy from larger customers. If these larger customers become contestable before retail pricing is cost reflective, these cross subsidies cannot be maintained; given a large proportion of small customers, such would impose a very large portfolio penalty cost upon incumbent retailers, a cost that would not be faced by new retailers, and which would prevent equitable and efficient competition. At the limit, this may force retailers out of the domestic market, or encourage mass market energy conversions to alternative energies.
- Origin Energy has been a strong supporter of contestable energy markets in all jurisdictions; while this position is maintained in Queensland, Origin Energy recognises that the Queensland gas industry is especially sensitive to the transitional impacts of the move to retail competition. It is noted that the industry's ability to sustain network access pricing will be dependent on the ability of the competitive market to manage retail pricing over time, and upon the rate and extent with which contestability is introduced into the retail market. Origin Energy recognises that the imposition of retail price controls post market contestability can stifle competition and can threaten the financial viability of retailers operating in the market; moreover, to the extent that the retail market is regulated, and that this regulation is inconsistent with the prevailing network regulation, such has the potential to challenge ongoing network utilisation, with implications for the value of network assets and future investment in the growth of the industry.
- Experience in other jurisdictions has shown that arrangements to support contestability can have significant cost implications for both retailers and network operators. Depending on the extent of government funding, and upon the services

that network operators are expected to provide, such could require substantial revision to the proposed network access pricing arrangements. Origin Energy is concerned that the industry has not yet addressed the requirements for contestability in Queensland, thereby attaching considerable uncertainty to the adequacy of the proposed access arrangements.

- The benefits of contestability need to be assessed with reference to the associated schedule for its introduction; Origin Energy has concern that without careful transition planning, full retail competition may not provide a net benefit for consumers in the Queensland gas market. While it is acknowledged that the government is currently undertaking such an assessment, it is stressed that consideration must be given to the need for consistency between retail reforms and network regulation.
- Both Envestra and Allgas refer to MHQ based over-run charges. The Allgas tariff structure has dependencies on customer MHQ's. Origin Energy do not agree that MHQ based charges or tariffs are necessary or appropriate in Queensland. It is recommended that Allgas and Envestra be required to demonstrate a material risk associated with MHQ exceedence, therefore justifying the need and basis for such a charge, and the conditions upon which the MHQ values will be set.
- It is the view of Origin Energy that a strict 'cost of service' approach to network price regulation transfers network pricing risk to network users. Origin Energy has concern that ongoing network utilisation may be challenged by increasingly elastic demand at long-run pricing levels which may encourage both retailers and customers to switch to alternative energies, thereby affecting the ongoing viability of a reticulated natural gas market. If this happens, networks will find it increasingly difficult to maintain network investment without increasing network charges, thereby further encouraging the switch to alternative energies. Accordingly, Origin Energy maintains that both Envestra and Allgas should be provided incentive to increase network utilisation. Origin Energy therefore supports a mixed approach to network access regulation, with a bias towards the 'price path' approach. Regardless of approach, ultimate network tariffs must be bearable by end-consumers, and competitive with alternative energies.
- The indemnities required of network users by both Allgas and Envestra do not appear to provide for an appropriate or fair distribution of risk between the networks and network users. Origin Energy maintains that such indemnities would only be appropriate should the networks similarly accept liability for breach of obligations as defined by the access arrangement.
- The approaches adopted by both Envestra and Allgas for determining their total revenue requirements are very similar, and in many respects, are consistent with regulator determinations in other jurisdictions. While Origin Energy generally supports the common approach taken by the two networks, it recognises that in the case of asset valuation models, variations in what may appear to be reasonable input assumptions can produce surprising variations in output values. For this reason it is recommended that particular care be exercised in the review of modelling assumptions used by both network operators.

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## BACKGROUND

As a retailer with a significant history of serving customers in Queensland, Origin Energy has approached its review of the proposed access arrangements with reference to various observations of the Queensland gas market; such observations have implication for network third party access, and retail contestability. Specifically:

### 1. Small, mature market, large network, small loads

The economics of supplying natural gas to consumers in Queensland are distinct from those of other Australian markets; features specific to Queensland that have a commercial implication for gas delivery include the following:

- Few customers and a relatively large supply infrastructure necessary for the ongoing delivery of natural gas.
- Different consumption patterns for smaller customers due primarily to climactic differences.
- High delivered costs of gas given low aggregate consumption and large distances from upstream gas fields.
- Greater long-run price elasticity of commodity demand, affecting appliance purchases and increasing sensitivity of network growth to retail price variations.

***As a result, traditional metrics such as revenue per customer and revenue per GJ are distorted, thereby complicating comparisons with utilities in other states; moreover, customers will be sensitive to changes in network pricing to the extent that these alter the structure and value of retail prices.***

### 2. Historical under-recovery of network assets

Historically, regulated price increases have been infrequent, and insufficient to maintain an acceptable commercial return on the costs and assets employed to deliver gas to end consumers. Consequently, current prices are not a guide to the efficient cost of providing such services in the future, and are at a level that will not sustain the natural gas industry in Queensland over the longer term. ***Any increases in network charges must be recoverable by retailers from end consumers.***

Table 1 provides an estimate of gross margin available to cover both network and retail costs for sub 100TJ customers in the Envestra network area for 2000/01; such estimates assume total gas sales revenue from current regulated prices, and show that the margin available is insufficient to provide a normal commercial return on network assets, let alone any return on retail services.

***Origin Energy has concern that in order to maintain ongoing retail services in these regions of Queensland, retail prices will need to increase significantly to accommodate network tariff increases.***

TABLE 1: Margin Available to Cover Retail and Network Costs in the Envestra Network Areas (sub 100TJ customers)

2000/01 Estimates (GST Inclusive)	\$m
Total gas sales revenue from under 100TJ customers <i>This includes all natural gas sales &lt;100TJ, exclusive of appliance sales, other work revenue and appliance subsidies.</i>	\$39
Cost of Gas and Transmission for under 100 TJ customers <i>This includes all natural gas sales &lt;100TJ, exclusive of appliance costs, cost of charge work and System Use Gas. Benchmark Cost of Gas Estimates are used.</i>	(\$14)
<b>Margin available to cover both retail and network costs</b>	<b>\$25</b>
Envestra Access Arrangement (Total Revenue Requirement) <i>Sub 100TJ Component</i>	\$32

### 3. Move to cost-reflective pricing

The National Third Party Access Code for Natural Gas Pipelines (the Code) sets out the pricing principles used to set reference tariffs for third party access to natural gas pipelines. While regulators are provided a level of flexibility given the specific needs of each pipeline, the overarching principle is that prices should be based on the efficient costs of supply. In this context, the Code provides that prices should:

- Replicate the outcome of a competitive market
- Ensure safe and reliable pipeline operation
- Not distort investment decisions in pipeline or upstream and downstream industries
- Provide efficiency in reference tariff levels and structures; and
- Provide incentives for the service provider to reduce costs and develop its market.

The principle that prices must reflect the efficient costs of supply operates beyond just the total revenue level; while total revenue should reflect total costs, individual service prices should also reflect the efficient cost of that particular service. To the extent that some network services are defined over different customer segments, the principle must hold for each customer segment.

***To achieve cost-reflective pricing, both network and retail prices will need to be adjusted; retailers must be able to determine retail pricing policies to best accommodate changes in network prices.***

### 4. Loss-making retail tariffs

The current regulatory regime in Queensland has controlled the retail prices of Origin Energy. Regulated price increases over the past ten years have been infrequent and insufficient to maintain viable commercial returns. Origin Energy has concern that historical price movements have not addressed the cross-subsidy issue. ***Current regulated prices are not cost-reflective, do not provide for a commercial return, and are therefore fundamentally inconsistent with the requirements of a competitive market. To achieve a sustainable retail business, and to avoid adverse financial implications from final network access arrangements, retailers will need to manage customer prices so that they are fully cost reflective, and are therefore consistent with regulated network access prices. Given the inability of host retailers to absorb further retail losses in Queensland, retail prices will need to increase irrespective of retail competition; in the event of contestability, retail prices will then need***

***further adjustment to achieve full cost reflectivity, and to recover any additional costs imposed by contestability. In managing the transition to contestable pricing, both retailers and networks will need to reference the markets capability of adjusting to new pricing structures in the contestable environment.***

**PROPOSED ENVESTRA AND ALLGAS ACCESS ARRANGEMENTS:**

**General Comments**

These general comments apply to the Consultation Paper as a whole, though they are not to prejudice comments on specific issues in the Paper.

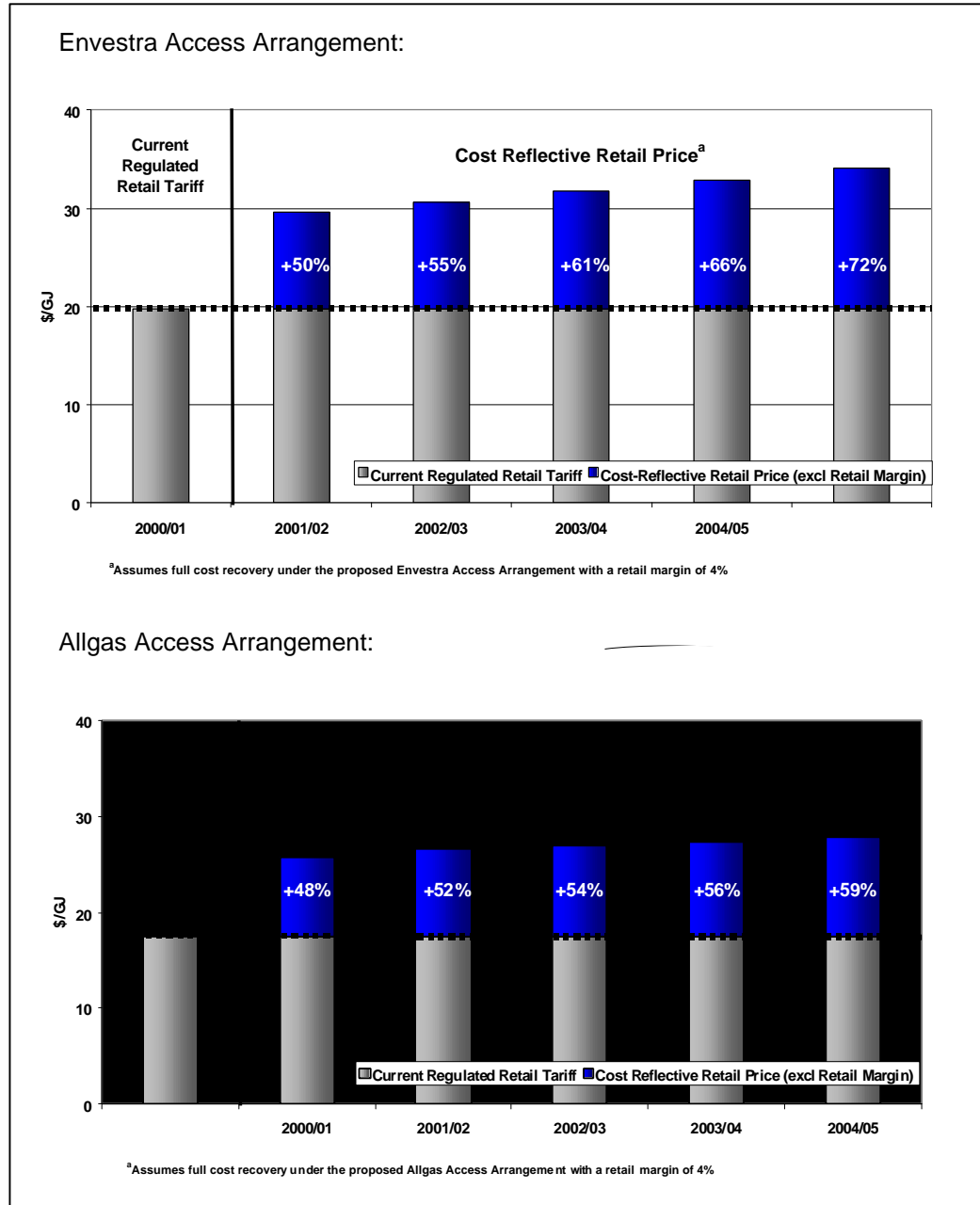
- **Impact on Retailers**

Assuming the move to full retail competition, and given difficulties in realising requisite retail price increases, Origin Energy has concluded that the proposed access arrangements have the potential to further threaten the ongoing viability of natural gas retail activities in Queensland; specifically:

- Cost reflective network pricing would imply a domestic price shock of over 50%  
Current regulated prices are not cost-reflective, do not provide for a commercial return, and are therefore inherently inconsistent with the requirements of a contestable market. The infrequency and insufficiency of historical retail price increases have exhausted Origin Energy's returns from cost reductions and productivity gains and has resulted in domestic and smaller customers becoming loss-making, thereby requiring significant retail price increments to ensure the viability of ongoing supply. ***Origin Energy has determined that the impact of the proposed Envestra Access Arrangements, even excluding allowance for a retail margin, would imply an immediate and requisite price shock of +50 percent for domestic customers upon commencement of competition;*** such a price increase reflects full cost recovery of network and retail costs; this is shown in table 2. ***A similar calculation for retailers that operate in the Allgas network area suggest an implied price shock of 48 percent.***

Origin Energy recognises that such a price shock may not be commercially feasible upon introduction of the proposed access arrangements, and notes concern that in such an instance, incumbent retailers would face material portfolio revenue distortions that will require ongoing cross-subsidies from larger customers, thereby increasing the risk of cherry-picking by new retailers; such would distort the competitive environment between incumbent and new retailers, with implications for the extent and nature of competition faced by customers. ***This may ultimately require a review of the benefits provided by contestability for specific customer segments with a reassessment of the extent and rate with which competition is introduced into the consumer market.***

TABLE 2: Price shock for the average domestic consumer implied by the proposed access arrangement tariffs and cost reflective retail prices –excluding allowance for a retail margin (assumes 12GJ pa Metro household & incl GST)



o Price pressure from alternative fuels will impact retail price adjustment

The sale of natural gas to consumers in Queensland faces competition from alternative fuels such as bottled LPG and from electricity. Table 3 compares the delivered price of natural gas with that of electricity. Although short run switching incentives are challenged by equipment change-over or modification costs, particularly in the case of electricity where customers may require new appliances, it is evident that natural gas faces competition from both LPG and electricity (especially wrt off-peak hot water). While bottled LPG was also considered, it was found that delivered prices can vary considerably depending on locality and movements in world prices; in some regions however, the delivered price of bottled LPG is below that for reticulated natural gas.

Origin Energy notes that price pressure from alternative energies will likely impact the rate and extent of price adjustment possible for retail prices. This suggests that network prices will need to be set with a view to the impact on customers and retailers, and in a manner that is consistent with the government's retail reform agenda. To set network prices otherwise may directly challenge ongoing network utilisation. ***While this emphasises the need for careful transition planning, ultimately network utilisation is a problem that the networks will need to manage; given that retail costs structures are variable, networks bear the ultimate risk that network pricing is not sustainable in the market –it may be the case that in such an instance, networks must discount approved prices to encourage appropriate rates of growth in network utilisation.***

TABLE 3: Competition from Competing Energies (delivered costs)

Average domestic customer 2000/01 (includes GST)	
Delivered Cost of Energy (EXCLUDES COST TO SERVE AND RETAILER MARGIN)	
	\$/GJ
• Natural Gas (Envestra Network) <sup>a</sup>	\$24
• Natural Gas (Allgas Network)	\$20
• Electricity (Off-Peak Hotwater)	\$7
• Electricity (Peak)	\$37
• Electricity (Bundled) <sup>b</sup>	\$13 (80%HW, 20%Cooking)
• Bottled LPG	Large variation in price, depending on locality and the world prices; in some areas significantly cheaper than natural gas.

*a Assumes proposed AA tariffs and benchmark COG estimates*

*b Assumes the effective electricity price paid by customers to run electric hot-water and cooking appliances that have been converted to electricity from natural gas.*

- Competition at the large end of the market would stop cross-subsidies for smaller customers.

Cross-subsidies are a significant issue affecting the ongoing financial viability of retail activities in Queensland. Without the introduction of cost-reflective retail pricing, in order to accommodate the proposed network tariffs, the ongoing supply of natural gas to domestic customers will require a continuing cross-subsidy from larger customers. Origin Energy recognises a material risk for incumbent retailers to the extent that they support customer portfolios with a large proportion of small volume, and therefore unprofitable customers; while under the proposed network access arrangements many medium-large volume customers may be profitable in their own right, incumbent retailers will require this surplus to offset some of the aggregate losses incurred by supplying smaller customers. To the extent therefore that these individually profitable medium to large volume customers become contestable, incumbent retailers will not be able to maintain cross-subsidies, thereby threatening ongoing supply to domestic and smaller customers. ***In this respect, incumbent retailers would face a very large portfolio penalty cost not faced by new retailers, thereby preventing equitable and efficient competition; at the limit, this may force retailers out of the domestic market, or encourage mass market energy conversions to alternative energies.***

- Risk that without careful transition planning, a competitive market may not prove sustainable over time

The Queensland natural gas market is currently faced with a material issue of unsustainable retail margins, and networks seeking to significantly change access prices. Such places the industry in a position where it is particularly vulnerable to the transitional impact of the contestability timetable upon both customers and industry participants; accordingly, Origin Energy recognises that benefits from contestability are sensitive to the degree of consistency between network prices, the ability of the competitive market to determine retail prices, and the rate and extent with which contestability is introduced to the consumer market. Origin Energy has been a strong supporter of contestable energy markets in all jurisdictions, and maintains such a position in Queensland; it does however recognise that the Queensland market will be particularly sensitive to the process adopted for introducing retail competition. It is also noted that such will have a direct and significant implication for networks via associated influences on network utilisation, and the ability to accommodate network price variations over time.

The large proportion of unprofitable domestic customers presents considerable difficulty for the rapid introduction of competition across the retail market given the need for substantial price increases to achieve cost-reflective network and retail pricing. Without such price increases, competition would be limited to the larger and profitable customers. Moreover, an absence of cost reflective pricing will require the maintenance of existing cross-subsidies, thereby distorting the ability of incumbent and new retailers to compete on fair and equitable terms; the need for ongoing cross-subsidies exposes incumbent retailers to material cherry-picking risks that to manage, will diminish available cross-subsidies, thereby preventing the means for offsetting financial losses incurred by the unprofitable smaller customers.

While it is unlikely that a retailer could be expected to continue to supply customers without receiving a sufficient commercial return on such activities, there is a risk that without careful transition planning with respect to network price re-basing and the introduction of retail competition, impacts on the retail market may result in substantial and sudden changes to costs, thereby encouraging switching behaviour to alternative energies, resulting in a snow-balling process of lower network utilisation, loss of customers and increasing network costs.

***It is recommended that the government provide the industry with information defining the intended approach for introducing contestability, and for ending retail price regulation. Such information should be referenced to ensure the ability of the market to accommodate final network tariffs.***

- **Regulatory uncertainty pursuant to retail contestability**

It is acknowledged that the Gas Pipelines Access (Queensland) Act 1998 (the Act), together with the Code, provides a basis for the progressive introduction of contestability for gas consumers in Queensland. Accordingly, a network access arrangement, as required by the Code, allows retail competition by providing facility for multiple retailers to compete for gas consumers within a network area.

In an environment where customers are free to choose between competing retailers, given what can be significant initial costs for retailers to acquire and maintain customers, the retailer-customer relationship will increasingly need to be defined via negotiated contracts. Such contracts will frequently have a multi-year term, and accordingly, require full knowledge of finalised industry rules and related contestability cost-structures. Accordingly, two co-dependent and important precursors to competition are (1) fully defined systems and arrangements to facilitate contestability, and (2) finalised access arrangements for relevant transmission and network areas. Both impact the prices, terms and conditions extended to customers via negotiated supply and service contracts.

Having actively participated in the development of contestability arrangements for most other jurisdictions within Australia, Origin Energy has become aware that such arrangements can infer responsibilities on network operators, with what may be substantial and varied cost and service implications. Such may include developing and managing systems for network balancing, for load profiling, data warehousing and for customer churn systems. Moreover, such systems, depending on those customers that are contestable at a point in time, may be either manual or automated by operation, and depending on government funding, can have significant cost implications for networks and retailers alike.

Accordingly, Origin Energy notes that given the absence of process to develop industry arrangements for contestability in Queensland, retailers are faced with significant uncertainty with respect to the rules, systems and industry costs specific to competition in the Queensland gas market. To the extent that these arrangements infer obligation and cost on network operators, it is therefore noted that ***the proposed access arrangements will need to be reviewed prior to the commencement of contestability in Queensland. While the proposed arrangements provide***

***indicative network costs, present uncertainty with respect to ultimate systems and arrangements will limit retailers from being able to contract existing customers on the basis of the proposed access arrangements.***

- **Need for consistency between network access regulation and retail price controls**

Origin Energy is concerned that a clear process is yet to be developed that deals with retail price control reviews under the Gas Act, and their relationship with the QCA's access pricing responsibilities under the Code. Given the insufficiency and infrequency of past regulated price increases, customers are not currently prepared for the price shocks implied by the proposed access arrangements. Origin Energy therefore has concern that customers may not be able to sustain the immediate and requisite price increases of up to 50% implied by the proposed Envestra access arrangement. It is therefore acknowledged that the Minister may impose transitional retail price controls with implications for the introduction of network access pricing. Origin Energy recognises that it faces the untenable position of cost reflective network access pricing, and insufficient accommodation of such via retail price increases. ***It is therefore recommended that in its consideration of the proposed Allgas and Envestra Access Arrangements, the QCA consider the ability of current retailers and customers to accommodate the price impact of such arrangements, and further, that consideration be given to the associated impacts on competitive equity between incumbent and new participants in the evolving market.***

- **Envestra and Allgas do not offer an Interruptible Service**

Origin Energy has a number of customers with very large "interruptible" components to their loads. Typically these components are normally 0 TJ/day but occasionally step up to between 1.0 and 3.0 TJ/day for a period of 1 to 20 days for a total duration of no more than about 30 days per year. These loads cannot afford to pay for "firm" network service and can only be justified if there is "Interruptible" Network Service available with 1 to 7 days notice when there is sufficient capacity available. Envestra and Allgas should have a reference tariff for at least one Interruptible Service.

- **Special Circumstances at Dinmore**

There is at least one customer at Dinmore that is supplied by pipes from both Envestra and Allgas. In this instance it would appear that this customer would pay a combined tariff.

Envestra has advised that the Dinmore Lateral, which is involved in supplying this customer, is shown on the map in Annexure A of its Access Arrangement and therefore is included within its definition of "network". There is nothing in writing to substantiate this and the pipeline cannot be distinguished on the map.

It is not clear whether the Dinmore Lateral is a covered pipeline: (i) it was constructed under Pipeline License No. 19 of the Petroleum Act (PL19), (ii) it operates at transmission pressure and (iii) all of it is upstream of a gate station (Dinmore Gate). Envestra appears to be relying on Clause 2.3 of the Code which allows the Service Provider to apply to the regulator for any of its pipelines that are not "covered" to be "covered". If this is the case, there should be a special note to that effect in the Envestra Access Arrangement.

It is not clear from the map provided in Figure 6 of the Allgas Access Arrangement Information whether the pipe that supplies this customer is considered part of the Allgas network. Advice to this effect should be included as a special note in the text of this document.

## Specific Comment

### Part A: Non-Pricing Issues

- **Services Policy**
  - **Ancillary and Utility Services**
    - Origin Energy recognises that in a contestable environment, ancillary or utility services such as special meter reading can influence the cost of acquiring customers, and therefore can affect the extent and nature of competition specific to particular customer segments. Origin Energy has concern that given limited expected competition for these services, pricing structures offered by networks may challenge the extent with which retailers will be able to compete in the market. In the case of special meter reading, it is noted that while Envestra include it as a regulated service, Allgas do not. ***It is therefore recommended that Allgas includes special meter reading as a regulated service (and includes it in its total revenue assumptions).***
    - Given the current timetable for introducing contestability, Origin Energy has concern that neither Envestra nor Allgas include gas balancing and apportionment in their reference services. Having participated in the development of such arrangements in other jurisdictions, Origin Energy recognises that such may infer material and costly obligations on network operators; expected costs in other jurisdictions for these services have clearly exceeded the total revenue requirements contained in both the Envestra and Allgas access arrangements. Given relatively few customers in Queensland, knowledge of the cost recovery arrangements for such services are imperative for preparing for competition. ***Origin Energy notes that without defined costs and arrangements for gas balancing and apportionment, it is presented with significant uncertainty that affects its preparation for forthcoming competition.***

- **Terms and Conditions**

- **Allgas**

- Clause 3.1 – Origin Energy do not agree that MHQ based over-run charges are necessary or appropriate in Queensland. It is recommended that Allgas (and Envestra) be required to demonstrate a material risk associated with such events, therefore justifying the need for such a charge.

- Clause 3.2 - In the case of over-runs, Allgas (and Envestra) propose that Receipt-Point MHQ and MDQ be automatically “ratcheted” up, but do not propose provisions for a commensurate decrease. As a consequence, customers generally will pay higher tariffs and the Service Provider will become obligated to augment the system regardless of whether the higher loadings which caused the increase are permanent. A customer that has a “slow year” does not lose entitlement to MHQ; thus the aggregate MDQ for each delivery point can never be less than it was at the start and the whole system will tend to be over-sized and over capitalised.

- MHQ and MDQ should be determined preferably by mutual agreement. If there must be a formula then it should allow for adjustments both up and down and should provide some element of mathematical “smoothing” eg 12 month rolling average or a formula which ignores (say) the 3 highest MDQ days for each month. This would help avoid over-capitalising the network.***

- Clause 3.5 – Allgas do not define how UAFG will be measured or benchmarked to provide an appropriate incentive for Allgas to lower the amount, or even against which customer segments can be levied. Allgas should define the basis upon which UAFG will be measured and benchmarked. Allgas should also explain how such will benefit users.

- Clause 12.3 - The priority schedule for interruptions or curtailments must not disproportionately disadvantage any particular retailer or customer.

- Appropriate ring-fencing arrangements must be ensured if retailers are to provide Allgas with information identifying interruption agreements with particular customers.

- Clause 14.1 - Origin Energy does not consider it appropriate for Allgas to limit liability to this full extent; Allgas must accept responsibility for operational negligence under the access arrangement, and accept liability accordingly.

Clause 14.6 - The indemnities required of network users do not appear to provide for an appropriate or fair distribution of risk between Allgas and network users. Origin Energy maintains that such indemnities would only be appropriate should Allgas similarly accept liability for breach of obligations as defined by the access arrangement.

- **Envestra**

Section 6&7 - Origin Energy do not agree that MHQ based over-run charges are necessary or appropriate in Queensland. It is recommended that Envestra (and Allgas) be required to demonstrate a material risk associated with such events, therefore justifying the need for such a charge.

- In the case of over-runs, Envestra (and Allgas) propose that Receipt-Point MHQ and MDQ be automatically “ratcheted” up, but do not propose provisions for a commensurate decrease. As a consequence, customers generally will pay higher tariffs and the Service Provider will become obligated to augment the system regardless of whether the higher loadings which caused the increase are permanent. A customer that has a “slow year” does not lose entitlement to MHQ; thus the aggregate MDQ for each delivery point can never be less than it was at the start and the whole system will tend to be over-sized and over capitalised.

***MHQ and MDQ should be determined preferably by mutual agreement. If there must be a formula then it should allow for adjustments both up and down and should provide some element of mathematical “smoothing” eg 12 month rolling average or a formula which ignores (say) the 3 highest MDQ days for each month. This would help avoid over-capitalising the network.***

Clause 16.3 - The priority schedule for interruptions or curtailments must not disproportionately disadvantage any particular retailer or customer.

Clause 21.4 - The methodology adopted for estimating meter reads should be defined and agreed between Envestra and network users.

Clause 29.1 - The indemnities required of network users do not appear to provide for an appropriate or fair distribution of risk between Envestra and network users. Origin Energy maintains that such indemnities would only be appropriate should Envestra similarly accept liability for breach of obligations as defined by the access arrangement.

- **Capacity Management Policy**
  - Origin Energy do not agree that MHQ based over-run charges are necessary or appropriate in Queensland. ***It is recommended that Allgas be required to demonstrate a material risk associated with such events, therefore justifying the need and basis for such a charge, and the conditions upon which the MHQ values will be set.***
  - Allgas should negotiate with network users an agreed basis upon which network loads are estimated. Origin Energy does not agree that any network operator should be provided full discretion to determine the basis for estimating or apportioning loads. ***Network users require advance understanding of such methodologies to facilitate appropriate risk management activities.***
  - Refer to our comment on the over-run policies of Envestra and Allgas, detailed on the previous page.
  
- **Trading Policy**
  - Origin Energy is satisfied with the Trading Policies offered by both Envestra and Allgas.
  
- **Queuing Policy**
  - Origin Energy is satisfied with the Queuing Policies offered by both Envestra and Allgas.
  
- **Extensions/Expansions Policy**
  - Origin Energy is satisfied with the Extensions/Expansions Policies offered by Envestra.
  - In the event that network extensions do not meet the economic feasibility test defined in the Code, Allgas reserves the right to determine and levy a Capital Contribution or Surcharge. ***Origin Energy notes that the Allgas Access Arrangement does not provide detail on the methodology with which such levies will be determined. Origin Energy therefore recommends Allgas provide such information for the consideration of the QCA, and of current market participants.***

- **Review Date**
  - Origin Energy is satisfied with the review dates proposed by both Allgas and Envestra.
  - Origin Energy has concern that the proposed access arrangements provide for the introduction of retail market competition, without the industry having defined the arrangements to facilitate such competition. Experience in other jurisdictions has shown that such arrangements can infer material cost and service obligations on network providers. Retailers need to be aware of associated network services and charges in order to develop internal systems, and to prepare for contestability. While it is appropriate therefore that both Envestra and Allgas allow review triggers for such developments, finalisation of access arrangements in the interim would not provide retailers with sufficient certainty to appropriately prepare for the competitive environment.
  - ***The QCA is referred to our general comment earlier on this issue (p12).***

## Part B: Pricing Issues

- **Form of Regulation**
  - Origin Energy does not support the strict application of a 'cost of service' approach to network price regulation. It is the view of Origin Energy that such an approach, by transferring network pricing risk upon network users, provides network operators with insufficient incentive to reduce risk, or the potential cost of that risk. As described earlier in this submission, Origin Energy has concern that ongoing network utilisation may be challenged by increasingly elastic demand at long-run pricing levels which may encourage both retailers and customers to switch to alternative energies, thereby further compromising the viability of a reticulated natural gas market. Accordingly, ***Origin Energy maintains that both Envestra and Allgas should be provided incentive to increase network utilisation. Origin Energy therefore supports a mixed approach to network access regulation, with a bias towards the 'price path' approach.***
- **Determination of Total Revenue**
  - Origin Energy notes that other jurisdictions have successfully applied the cost of service approach in determining total revenue. It is also noted that this approach has been adopted by both Allgas and Envestra in their proposed access arrangements.

Origin Energy supports the cost of service approach as a reference for determining total revenue, but notes that that such assumes the market is capable of bearing final prices. Applying such an assumption in Queensland should be considered with caution given implications for significant price shock, for either retailers or customers depending on the retail price-controls in effect at the commencement of the access arrangement. ***Origin Energy recognises that the immediate introduction of cost reflective pricing may not be commercially feasible, thereby providing support for transitional network and retail pricing combined with a review***

***considering the extent with which contestability can be introduced into the Queensland market.***

- **Determination of Initial Capital Base**

While Origin Energy supports the DORC asset valuation methodology for natural gas pipelines, it recognises that all asset valuation models can produce outcomes which may vary significantly given initial assumptions of what may appear to be reasonable input variables and parameters. For this reason ***it is recommended that the application of such models be carefully reviewed.***

It is further noted that the asset valuation models specified presuppose a viable reticulated natural gas industry. It could be argued that in the event that network access regulation in Queensland is not consistent with prevailing retail price controls and the competition reform schedule, that the application of such asset valuation models may produce prices which challenge ongoing network utilisation, and therefore the viability of the industry (refer to page 11)

- **Rolling Forward the Capital Base**

- Origin Energy has not carried out a thorough analysis of the assumptions and approaches adopted by both Allgas and Envestra with respect to new facilities investment, redundant capital and depreciation. A cursory review however, has not yielded any issues of material concern.

- **Rate of Return**

- In previous comment on page 19, Origin Energy explained a preference for a mixed/price-path approach to regulation. Such provides networks with the appropriate incentive to manage ongoing network utilisation. Further, on page 8, it was stressed that any changes in price must be bearable by end consumers. Accordingly therefore, although Origin Energy is broadly satisfied with the approach and assumptions adopted by both Allgas and Envestra in determining an appropriate rate of return, such must ensure ongoing network growth, and the capacity of customers to accommodate network price variations.
- It is noted that in many respects, assumptions are in line with treatment in other jurisdictions.

- **Allocation of Revenue and Costs**

- **Cost Allocation, Cross-Subsidies and Proposed Tariff Structures**

Both Allgas and Envestra allocate costs on a stand-alone basis to large customers and incremental costs to smaller customers. This is achieved by a combination of fixed and variable charges for specific customer segments. This approach is broadly consistent with that taken in other jurisdictions.

It is noted that in industries with natural monopoly characteristics it is difficult to allocate costs on a fully incremental basis because many costs cannot be directly attributable to individual users, resulting in a revenue under-recovery risk. Accordingly, such industries may need to allocate some costs on a fixed basis, implying distributional equity issues between specific customer

segments. Although Origin Energy is satisfied with the adoption of this approach by both Allgas and Envestra, it must be stressed that the segment based assumptions used by each network should be reviewed to ensure consistency between networks, and competitive equity between customer segments.

Origin Energy has not been able to determine the extent with which Allgas cost allocations infer cross-subsidies between market segments; Allgas should be requested to provide more information to facilitate greater understanding of their cost allocation.

Envestra have stated that the proposed cost allocation approach applies a cross-subsidy favouring volume customers. Envestra is seeking to resolve this under-recovery over a ten year period.

Despite Envestra's claim that proposed tariffs contain a cross-subsidy that favours smaller customers, both Allgas and Energex have proposed prices that imply significant price-shock for domestic customers. Table 2 on page 9 shows the extent of price shock for an average domestic customer in the Allgas and Envestra network areas. It is the view of Origin Energy that such a price increases could not immediately be achieved, and would have negative political and commercial implications for the industry and government.

It is accepted in a competitive market that cost reflective network and retail pricing is essential. Particularly in the case of Queensland, networks must deal with the issue of both bypass and maintaining network utilisation which together limit the extent of cross subsidisation possible between large and small customers. Retailers must manage the consistency of regulated network prices, with what can be charged in the retail market; the latter may be capped via Ministerial price controls, provided under the Gas Act, or via competition in the multi-energy retail market.

Allgas has defined a tariff structure that references customer MHQ. Origin Energy considers this unnecessarily complex and recommends Allgas be requested to justify the need for MHQ based tariffs.

Neither Allgas nor Envestra propose an interruptible service; the absence of such disadvantages those customers with large interruptible components to their loads.

Origin Energy has identified the following issues in Queensland that impact on the recommendations of the proposed tariff structures; greater detail is provided in our general comments earlier in this submission:

- The Queensland natural gas market is currently faced with a material issue of unsustainable retail margins, and networks seeking to significantly change access prices; irrespective of contestability, retail prices will need to increase to provide a normal commercial return.

- Regulated retail price increases have been infrequent and have not prepared customers for a move to cost reflective network and retail pricing, as required in a competitive market. Prior to contestability, retail prices will need to be have been re-based.
- Origin Energy recognises political and commercial risk should retail prices for small customer immediately increase by the extent required under the proposed access arrangements.
- As an incumbent retailer that has had to operate in a market with regulated prices that are insufficient to cover costs, Origin Energy has exhausted returns from cost reductions and productivity gains; as a result, there is no scope for Origin Energy to absorb the small-customer price shock implied by the proposed Access Arrangements.
- The delivered price for electricity and bottled LPG is at a level that may encourage customers and retailers to switch energies over-time, thereby imposing a threat to ongoing network utilisation.

Consequently, Origin Energy has concern that the proposed tariff structures inherently conflict with current regulated retail prices and the proposed contestability timetable. Origin Energy therefore recommends the QCA and the Queensland government jointly consider the following recommendations:

- Network tariff rebalancing will be required to address current cross-subsidies between large and small customers.
- Retail price rebalancing is required, which must be consistent with network pricing, and managed carefully with appropriate limitations on the introduction of contestability. Origin Energy notes that incumbent retailers have large portfolio biases towards currently unprofitable smaller customers; associated losses are significant, and are currently partially offset by larger customers. If these larger customers become contestable before retail pricing is cost reflective, these cross subsidies cannot be maintained, thereby distorting the competitive environment between incumbent and new retailers, and threatening ongoing supply for smaller customers.
- The network revenue under-recovery issue will need to be addressed with reference to retail price flexibility, and the competitive inequity that would result should retail price cross-subsidies be maintained while introducing contestability.
- The benefits of contestability need to be assessed; Origin Energy has concern that full retail competition may not provide net benefits for customers in Queensland; commercial pressure from competing energies may encourage both retailers and customers to switch energies, thereby encouraging a process of accelerating decline in network utilisation or substantial discounting of network tariffs. This suggests that the process of introducing competition needs to be fully considered in light of the government's pending cost/benefit analysis.