



22 March 2007

Chief Executive Officer
Queensland Competition Authority
GPO Box 2257
Brisbane Qld 4001

Email: gas@qca.org.au

Dear Sir/Madam

ORIGIN ENERGY SUBMISSION - ENVESTRA LIMITED'S APPLICATION FOR COSTS RELATING TO FULL RETAIL COMPETITION

Origin Energy (Origin) appreciates the opportunity to provide comments to the QCA regarding Envestra's application for costs relating to Full Retail Competition (FRC) in Queensland.

The introduction of gas FRC into Queensland on 1 July 2007 is welcomed by Origin as it will support the development of this market which has previously been constrained by the former regulatory and policy regime.

Origin has 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) and our 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.

Industry has always been aware of the significant costs that FRC can impose onto network companies and in order to limit Envestra's costs, Origin has supported the use of the Victorian Gas Market Retail Rules as the basis for the Queensland rules and the appointment of VENCORP as the gas market operator for Queensland. It is somewhat disturbing that despite these initiatives Envestra is still seeking to pass through total FRC costs of \$20.9m to QLD gas customers. The period of cost recovery appears to be four years although Origin believes that recovery should be over five years as has been the case in other jurisdictions. It is also unclear as to how FRC costs will be reflected under the next access arrangement period. Envestra indicates that from an individual customer perspective these costs result in volume and demand customers being charged FRC tariffs of \$54 and \$17,600 per annum respectively.

Origin believes that these additional FRC charges to individual customers are relatively high - for instance, the \$54 FRC charge would result in an increase of some 18% in residential customer bills, while the \$17,600 charge would result in around 10% increase in bills for demand customers in the lower range of consumption (10-15TJ). As these

latter customers are already contestable, the advent of FRC provides little additional benefit to them but at a high cost.

Origin accepts the necessity of distributors receiving a fair recovery of the costs of FRC at 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 the State, Origin believes it is essential that the QCA undertake a very comprehensive review of these costs and that every option for reducing these costs consistent with a fair recovery to Envestra (including rationalisation of systems across networks) is fully explored.

It is regrettable for instance, that the relatively late decisions with respect to the introduction of FRC in the gas market and the form of market rules has exacerbated the costs of implementation of FRC and minimised the time available to the QCA to undertake such a detailed review.

Origin is, therefore, open to the QCA considering an interim allowance to Envestra for FRC costs, followed by a pass through of legitimate costs (and true-up if necessary) in subsequent years. This might, for instance, allow for a 5 year recovery period in which the first year (2007/08) includes interim costs.

We also urge all parties involved to consider whether other options are available to mitigate the gas FRC costs and their potential impact on the growth in the gas market. As part of this, we highlight that underlying gas prices in Queensland are themselves in need of reform, with significant price distortions as demonstrated in various reports to the Queensland Government and to the QCA¹.

Specific Comments related to the Envestra Application

1. *Summary*

In the summary Envestra refers to a key assumption that it has used to progress the development of its FRC systems - "*Extension of the current "greater than 1TJ customer market solution to cover less than 1TJ customers, for initial market operation on 1 July 2007"*". Origin is unsure what is meant by this statement as it is our understanding that while the market rules for the greater than 1 TJ customer segment were developed some time ago the market solution was never built due to the announcement of FRC to occur on 1 July 2007. This statement appears to indicate that Envestra may not have an automated FRC system ready for 1 July 2007. Origin would be interested to understand how Envestra will operate in the competitive market until their FRC system is in place and what affect this will have on retailers.

The table on page 2 outlining the forecast capital and operating expenditure does not appear to be correct as there are various errors in the calculations. Clarity is sought on whether this is simply a typographical error or a change in the annual allocation of capital and operating costs.

Preferred Solutions

¹For example, McLennan Magasanik Associates, *Demand Forecasts for Envestra, November 2005*. This report was prepared by MMA as part of the QCA determination of Envestra's access charges. The paper also indicated that given gas price elasticity, price increases are likely to reduce demand, an outcome that is contrary to government policy.

Origin is unable to comment on the particular solution options or the costs of these options discussed in this section except to say that the assumptions seem reasonable. Further analysis of the system selected and costs needs to be undertaken by an independent party with greater access to all information. It is important as part of this to clarify what costs are associated with an interim solution compared to the permanent solution and what costs are associated with an accelerated implementation plan (compared to the standard 9 months).

FRC Operations Staff

Envestra is proposing that an additional seven operational staff are required post FRC to cover new FRC functions. Surely with the inclusion of new FRC systems many functions are now automated and some man hour savings can be achieved. For instance network billing was a network function prior to FRC. Special meter reads for customer transfers will be separately charged to retailers if they are requested. Therefore, this should not be cause for additional operational staff. Origin suggests that more detail is required from Envestra in this section to assess if man hour savings have also been allowed for with the introduction of the new FRC systems.

2. FRC Telemetry

It is acknowledged that the QLD Retail Gas Market Rules have prescribed the installation of interval metering to all sites greater than 10 TJ per annum and with the addition of telemetry this equipment will assist the whole market to ensure that all parties are attributed their true costs of supply. It will also provide participants and customers with sufficient information to adequately manage their risks in the market and it will reduce the opportunity for any "free riding" of pipeline capacity.

However, the proposed allocation of an FRC Tariff of \$17,600 to each demand site is unsustainable. Every opportunity needs to be investigated to reduce this cost and/or to investigate alternatives for meter data collection and management (see below).

Envestra states that the new QLD Retail Gas Market Rules require gas distributors to deliver metering and gate station data daily to the Gas Retail Market Operator (GRMO) and that this is required for network balancing, estimations and substitutions. It is not clear to Origin if all of the functionalities costed under "The Central System" are for the exclusive purpose of managing individual demand customer data. Should this functionality also be used for network monitoring and control or custody transfer meters it may be appropriate that a portion of these costs be allocated to the volume based customer segment particularly as there are only 74 demand customers. Moreover, this expenditure should be carefully reviewed to ensure it has not at least in part previously been included in the approved capital expenditure under the 2005/06 Access Arrangement determination.

Estimated Capital and Operational Expenditure

Origin is unable to comment on the capital costs of the central system or the cost per interval metering site apart to seek clarification of what the "other cost" of \$1200 per site relates to.

The total operating expenditure for FRC telemetry is \$3.6M and Origin believes that there may be opportunities to significantly reduce this cost as follows:

- The process of interrogating interval meters and managing interval meter data is undertaken by contractors in other jurisdictions and this option should be investigated. The relative small number of demand meters in Queensland limits any economies of scale for the network to undertake this efficiently as opposed to a contractor that may also undertake similar functions for other entities; and
- The installation, maintenance and administration costs may also benefit from some form of outsourcing.

If a review of the FRC telemetry costs (operating and capital) by the QCA fails to identify cost reductions for individual demand customers the industry should be further consulted to consider alternative arrangements for this market segment.

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

Yours sincerely

A handwritten signature in blue ink, appearing to read "Neville Joyce".

Neville Joyce
National Manager Regulatory and Analysis
Retail