9 May 2002

Ms Kanwaljit Kaur
General Manager
Regulatory Affairs – Gas
Australian Competition and Consumer Commission
PO Box 1199
Dickson ACT 2602
victoriangasreview@accc.gov.au

Dear, Ms Kaur,

RE: Applications for revision lodged by
GasNet Australia (Operations) Pty Limited and
Victorian Energy Networks Corporation (VENCorp)

Thank you for providing the opportunity to input into the ACCC's consideration of the applications above. As you may be aware, ENERGEX Retail has been Victoria's only active non incumbent Retailer in the Victorian gas market and we have now had considerable experience operating within the numerous access arrangements underpinning that State's unique reform environment.

As a general statement of our preferred approach to the two access regimes being considered, we are of the view that there is a greater need for uniformity of approach between GasNet and VENCorp. Moreover, we maintain that there is also a need to coordinate ACCC's views on crucial transmission pipeline matters with the Essential Services Commission's current deliberations in respect of Victoria's distribution businesses' applications for new access regimes during the same period.

In respect of the number of access applications being consider by multiple regulators currently for the Victorian market, ENERGEX Retail is concerned at the potential magnitude of increased delivery costs faced by Retailers should the proposals from the various regulated entities be successful. In addition to the proposals currently before the jurisdictional and federal regulators, ENERGEX Retail is also mindful of its own additional costs that it must incur to facilitate the imminent FRC market in Victoria. Whilst in a normal commercial market, these additional costs simply translate to an increased price offer to the end consumer, Victoria's price cap legislation and the dynamic that preceded the government's decision in the electricity FRC market is a salutary reminder of the "California" style risk faced by Retailers operating in that State (and elsewhere).

Notwithstanding that ENERGEX Retail is not an incumbent Retailer in Victoria, the use of Government's reserve pricing powers in the manner experienced earlier this year will be fundamental in defining the markets for 2nd tier Retailers. Our fear is that the Victorian Government will not recognise and allow pass through of all regulated price increases thereby stifling the competitive market

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dynamic for gas FRC. Whilst we acknowledge that the ACCC cannot directly influence the Victorian Government's behaviour in this regard, the current disparate processes by regulators operating separately for approval of the various access regimes in the delivery chain result in increasing non recovery risk by retailers (from Government's reserve pricing power). We urge the ACCC to bear this in mind when considering the GasNet application.

In respect of the substantive matters raised in the ACCC's issue paper, ENERGEX Retail makes the observations enclosed in the attachment.

I am available to answer any additional questions regarding ENERGEX Retail's position. Please contact this office should this be required.

Yours Sincerely

Don Vigilante
Energy Regulation Manager

Applications for revision lodged by GasNet Australia (operations) Pty Limited and Victorian Energy Networks Corporation

ENERGEX Retail Submission to ACCC issues Paper

1.5 Broad Issues

Notwithstanding the unique relationship between GasNet (as the owner of the transmission pipeline) and VENCorp (as the operator of that pipeline), we find it difficult to reconcile GasNet's application for tariff approval by the ACCC under the National Access Code without a description of actual reference service. It is our view that the ACCC should request GasNet to properly follow the requirements of the Code (including section 3.9 – trading policy) as part of their application. Moreover, we believe that the suggestion made by GasNet that this unworkable because the Service Envelope Agreement (SEA) (ie the linking document between the separate GP GasNet and VENCorp access arrangements) is not a public document, is unreasonable for end users.

Whilst we have not been able to obtain access to the SEA, ENERGEX Retail understands it is ostensibly a bilateral contract describing the manner in which transmission pipeline assets will be made available for the operator to use. If this understanding is correct, there would appear to be no reason why the contents of the SEA should not form part of the public access application (of both VENCorp and GasNet).

On the matter of how the disparate roles of asset owner and the operator might be accommodated within the auspices of the National Access Code, ENERGEX Retail suggests that GasNet and VENCorp should be compelled by the ACCC to make a joint application and that the ACCC's approval be conditional on each business providing its individual part of the combined service. We maintain that an essential part of this joint application should be the public declaration of the SEA. Continued treatment of the end service delivered to gas customers as two separate access arrangements (ie GasNet separate to VENCorp), ignores the symbiotic (almost parasitic) relationship between the two entities. Regardless of how the two individual businesses choose to treat this matter, the fact remains that neither VENCorp or GasNet's access regimes make sense as a stand-alone service. The transmission network facility is only of value to gas customers as a combined service. A joint application would necessarily be based on the same underpinning assumptions (ie same forecast loads, similar financial circumstances etc). Further, it is our view that the joint application should also include VENCorp's re-authorisation request for the MSOR since this is also fundamental to the holistic mechanisms for user access to the transmission system. This would aid in Retailers' and customers' understanding of the complete service and would provide a consistent foundation for the Regulator's decision.

The commercial environment driving decisions related to prudent discounting of network services will be complex and varied. As a general rule, ENEGEX Retail believes that the costs of such decisions should be the responsibility of the decision-maker (ie GasNet or VENCorp), however we do acknowledge that prevailing circumstances may make this paradigm inequitable. In respect of the three instances where GasNet has specifically asked for discounts, ENERGEX Retail is not convinced that customers generally should finance these discounts. We propose that GasNet be fully accountable for these costs.

We agree with the ACCC that the relative cash flows for the separate entities are such that it is unlikely that VENCorp discounts will be influential on proposals for by pass or alternative fuel. We are also mindful of VENCorp's role as independent clearinghouse for the gas market and we would be concerned if preferential treatment is shown to a particular participant. On this basis, we suggest that the default arrangement be that any prudent discounting should be the responsibility of GasNet.

1.5.4 Differences in demand forecasts

ENERGEX Retail tends to agree with VENCorp's analysis of the alleged "greenhouse effect and urban heat island effect". GasNet's reliance on the metropolitan weather station to substantiate this claim and the fact that urban and rural weather stations were unable to replicate the dynamic appears to question GasNet's claim. In the end, it is our view that even if the reduction suggested by GasNet were true, the effect would be "in the noise" of the other statistical uncertainties underpinning the forecast. On balance therefore, we suggest that the GasNet model provides little value and that energy flows over the period of the access regime should be referenced to VENCorp's annual forecast. Consistent with our earlier proposal for joint application by VENCorp and GasNet, we believe that the underlying assumptions for the treatment of the assets should be the same for both of the two businesses.

2.1.2 Inclusion of the Southwest pipeline.

As indicated in our response to GasNet's previous attempt to roll-in the Southwest Pipeline (SWP) into the general asset base, ENERGEX Retail does not believe that there is sufficient evidence for inclusion of this facility into the regime. It is our view that the SWP has been, is currently and will in the future remain ostensibly an entrepreneurial investment largely benefiting the three incumbent Retailers who use this facility as MDQ support for their retail customer base. Importantly, independent Retailers who have not chosen to accept WUG's offer of $120/MDQ GJ, do not benefit from this facility and as a consequence face increased Uplift Risk in the wholesale market. We are pleased to note that the current proposal separately quarantines the costs of the SWP (as distinct from GasNet's previous attempt to equalise injection charges). However, the proposal allows GasNet to transfer its redundant capital risk to the general users through the "K" factor effect. Notwithstanding the ACCC's previous decision on this facility, ENERGEX Retail's view is that the SWP should not be a "covered" pipeline under the National Access Code.

2.1.3 Regulation of GasNet's Dandenong facility.

Whilst ENERGEX Retail generally prefers the competitive market to provide pricing signals for service provision, we are concerned that market for VENCorp's system security LNG is not sufficiently liquid. In a climate where the Office of Gas Safety has reaffirmed that 3000 tonnes of LNG is required by VENCorp (and has also suggested that an additional 5000 tonnes may be required from another source), and in a market where this commodity can only be sourced from one facility, we maintain that there is a need to continue to regulate prices for this "Reserve Trader" role. This notwithstanding, we do not believe that the ESC should regulate prices for the substantive portion of the LNG facility, which we understand, will be made available to the market through a competitive tender.

2.3 Capital Base

ENERGEX Retail is concerned that GasNet has attempted to re-open its asset base valuation. We agree with the Commission's assertion that the Code does not permit this and we are firmly of the view that GasNet should be compelled to reapply using the ACCC's original determination. In respect of the planned capital works, ENERGEX Retail is not familiar with the supporting arguments for this work. However we are concerned at the size of the planned expenditure given the nature of the PTS and we urge the ACCC to ensure that GasNet's claims do not "gold plate" the forecast CAPEX program.

2.6 Demand forecasts

See previous comments on section 1.5.4.

2.7 Tariffs

ENERGEX Retail is disappointed that GasNet has retained the concept of an "injection charge" albeit based on 10 peak days instead of 5 as at present. GasNet have accepted that the current concept of a "peak withdrawal charge with annual wash-up" should be removed. Instead, GasNet propose to levy a single anytime charge for each tariff sector. ENERGEX Retail has experienced at first hand, the administrative problems related to "an annual wash–up". End use customers are often confused by this process and the administration costs for Retailers are high. The concept is exacerbated in the competitive environment as ENERGEX Retail has often been required to chase-up additional payments from customers who have changed Retailer at the time of wash-up. Whilst we understand the ACCC's desire to provide a form of peak price signal for customer usage, ENERGEX Retail is not convinced that the concept of peak day charges works. Customers and Retailers need to forecast at the beginning of the gas day whether it will be a peak gas day. Given the inherent uncertainty in this process, ENERGEX Retail questions whether customers will be sufficiently motivated to modify usage behaviour. Our preference is for the concept to be removed and for peak injection charges to be based on a simple energy usage principle (as proposed for withdrawal charges).

A major area of concern for ENEGEX Retail in respect of GasNet's application is the sheer magnitude of the increase being sought. An increase of 11% in real terms is frankly unacceptable in a commercial climate where industry, governments and the community is seeking efficiency gains from infrastructure owners. ENERGEX Retail considers that a fair and reasonable return is essential in sustaining asset commitments made by existing investors and in promoting new investments. However, we believe that the returns to the shareholders for these facilities should be consistent with the Regulator's previous decisions for the PTS. We maintain that this approach is proper as this most likely determined the shareholders' valuation of the company at the time of public float. To do otherwise provides a windfall gain to existing shareholders. Notwithstanding the arguments mounted by GasNet in their application (which appear to be ambit claims), it is difficult to understand why users of the PTS over the next five years should pay an additional 11% in real terms. Gas reforms are ostensibly about achieving efficiency gains from the industry's sectoral service providers. We believe that this objective would be inconsistent with the ACCC's approval of GasNet application.

On the general issue of tariff charges, ENERGEX Retail notes GasNet's proposal for "Pass Through Events" (see section 6 of the access arrangement). As proposed, GasNet may request the ACCC to determine if the "pass through event" has occurred and if no notice is given within the proposed 20 Business Day period, such an event will have deemed to have occurred. GasNet is then entitled to charge customers for any costs incurred without the need for consultation or industry input. Under the definition these events include changes to the MSOR or actions taken by VENCorp. ENERGEX is concerned that customer charges can potentially increase without the due regulatory process being undertaken and more importantly without the opportunity for Retailer input. We urge the ACCC to make this clause more consultative and to enable those affected by the proposal to have input to the ACCC's decision making process.

2.9 Extensions

ENERGEX Retail does not agree that GasNet should have unilateral rights to determine whether future extensions should be covered. Clearly this is a matter that warrants independent review, regulatory oversight and comment from affected industry participants. The National Access Code and the ACCC's processes have firmly established the agree methodology for these decisions. We suggest that decisions related to extensions to the PTS should follow these established processes.

2.10 Information

ENERGEX Retail believes that it is not possible for the users to understand the relationship between GasNet (as the asset owner) and VENCorp (as the operator) without access to the Service Envelope Agreement. Given the nature of this document, we can see no reason why the SEA should not be made public as part of the applications made by both VENCorp and GasNet. Likewise, given that a large component of GasNet's application is roll-in of the Western Transmission System, we request that the non financial aspects of the arrangements between GasNet and the incumbent Retailers for this facility be made public so that participants may be more informed as to the benefits that will result from the inclusion of this facility into the general asset base. Whilst we acknowledge that certain commercial aspects of this agreement should remain confidential, we are concerned that very little information about this contract has been made available in the public consultation process. We also agree with the Commission's observations regarding the lack of detail that GasNet have made available in respect of historic operations and maintenance costs. It is difficult, if not impossible for participants to make cogent assessment of the veracity of the substantive proposals for price increases without this information.

VENCorp Access Arrangement

3.2 Reference Tariffs

ENERGEX Retail notes that the Essential Services Commission has recently released the access arrangement proposals for the three incumbent Distributors in Victoria. The application made by TXU Networks introduces a new tariff (called Tariff M) which replaces their existing Tariff "D" for some customers. This proposal if accepted by the Essential Services Commission will conflict with the application made by VENCorp for the commodity charges.

As discussed previously, ENERGEX Retail is concerned that VENCorp's negotiating position in respect of the their discussions with GasNet for the system reserve amount (3000 tonnes) is problematic given the monopoly nature of the LNG facility. We urge the Commission to satisfy itself that the price finally agreed for this activity is fair and reasonable. In this regard, we prefer that the system security service be regulated for as long as it is a monopoly activity.

In respect of the overall structure and magnitude of VENCorp's charges, ENERGEX Retail is comfortable that the application is consistent with the ACCC's previous decisions and industry's expectations of cost. We would point out that whilst much debate has occurred in industry press regarding the costs of Victoria's market carriage regime, VENCorp charges make-up approximately only 1% of our customer's final bill.

3.3 Approval and Reporting process

Whist ENERGEX Retail agrees with VENCorp's proposal for greater price certainty through a five-year price path, we remained concerned at the loss of participant's ability to participate effectively in decisions made on yearly budget allocations. VENCorp's response to our concerns during their public consultation phase was to argue that its operations are "very transparent" and "very accountable". We agree that VENCorp's ex-post reporting mechanisms for expenditures incurred, and that their pre-budget consultation processes are satisfactory. However, notwithstanding these facilities, ENERGEX Retail is not convinced that the ability of participants to influence actual decisions is effective. ENERGEX Retail does not share VENCorp's assumptions that industry representations at Board level, as the mechanism for mitigating this risk is adequate. As we understand, Industry makes-up 30% of the current VENCorp Board membership and independent Retailers are not separately represented. We are also not convinced by VENCorp's analysis of the historic decision dynamic regarding changes recommended by GMCC as we are of the view that in an FRC market, the interests of incumbent and independent Retailers will increasingly diverge. As a result, we anticipate an even more compelling need for independent Retailers to have a separate and direct voice on the VENCorp Board.

3.4 Demand Assumptions

As indicated in previous responses to the issue of forecast volumes, ENERGEX Retail believes that an essential component of the ACCC's approval is for the same volume calculations to be used in both GasNet's and VENCorp's applications. On balance, given that ENERGEX Retail is not convinced by GasNet's arguments regarding the "global warming" effect and while we acknowledge that there is substantial consistency between the two models, our preference is to adopt VENCorp's forecast proposal. We note that the forecasts being used by Victorian Distributors for their new access proposals are more consistent with the GasNet approach and we urge the ACCC to ensure uniformity with the jurisdictional regulator in this matter.

3.8 Services Policy

Notwithstanding our general agreement to the scope of services provided by VENCorp, ENERGEX retail is disappointed that VENCorp has not accepted BHP Billington Petroleum, ENERGEX Retail, and Pulse Energy suggestion regarding VENCorp's future role in the FRC market. During VENCorp's own consultation process, we identified the FRC market as being the single most profound change confronting the gas industry during the period of application of the access regime. ENERGEX Retail (and other industry participants) suggested that VENCorp's functions in facilitating FRC (now enshrined in the Gas Industry Act) should be recognised and included as part of VENCorp's reference services for access to the principal transmission system. Whilst we acknowledge that this activity is retail oriented, we argue that the operation of the FRC market is fundamental to the way participants obtain access to the transmission pipeline and that the paradigms for metering the domestic market are inextricably linked to the mechanisms for determining imbalance costs in the wholesale market. We conclude therefore that there is a compelling case for inclusion of FRC services as a reference service.