Submission on the Draft Decision- GasNet Australia access arrangement revisions for the Principal Transmission System

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Origin Energy

Contents

1. Summary

Origin Energy Ltd. (Origin) welcomes this opportunity to comment on the Draft Decision (GasNet access arrangement revision for the Principal Transmission System [PTS]). As a major user of the PTS, Origin has a strong interest in the outcomes of the Australian Competition and Consumer Commission's (the Commission's) review of gas transmission access arrangements for the forthcoming regulatory period.

Origin notes that the Commission has made a significant number of amendments for GasNet to consider in revising their access arrangement. Issues remaining of concern to Origin are addressed in this submission and summarised below.

New Facilities Investment

Origin considers the inclusion of SWP under a combination of the system-wide benefits test and the economic feasibility test an appropriate outcome for users of the PTS. However, given the inclusion of the SWP, it is assumed that tariffs applied to this pipeline replace existing contractual charges. Currently, tariffs for the use of the SWP are defined in the Transmission Entitlement Deed (TED) and provide GasNet with the economic return required for this pipeline asset. Origin's support of the inclusion of the SWP is conditional upon confirmation from GasNet that these charges terminate on the approval and application of the revised access arrangement for the PTS.

Furthermore, GasNet need to advise of the charges associated with AMDQ rights, applicable following the roll in of the SWP into the asset base.

Revenue Elements: K factor application

In its previous submission[1], Origin raised the issue of increased transfer of risk from the owner of the PTS to users, based upon the proposed K factor approach. GasNet has had a legitimate basis to criticise the operation of the K factor in the first access period, and it has ultimately resulted in additional costs for users in the forthcoming access period (2003-07). However, the solution proposed by GasNet will, by the Commission's own assessment, have the potential to increase volatility in pricing between the years of the second regulatory period.

Reference Tariff and Cost Allocation

Of key concern to Origin is the assessment of cost allocation and tariff design put forward by the Commission. In essence, Origin does not consider the proposal put forward by GasNet to satisfy the principles and requirements of Section 8 of the National Third Party Access Code (the Code), nor for the proposal to be in the interests of the fully competitive gas market in Victoria. Origin contends that some key principles remain unsatisfied in regard to the tariff structure for the forthcoming regulatory period. These issues are addressed in detail in section 4 of this submission. In summary:

- Whilst supporting the elimination of peak-day withdrawal charges on a lottery basis, the retention and expansion of peak-day injection charges on the same lottery approach will result in complex reconciliation and reduced certainty as the market moves to full retail contestability.

- Origin agrees with a tariff setting methodology that is designed to alleviate constraints in the transmission system. Noting the Commission's request for evidence as to whether injection or withdrawal assets are more likely to experience constraint over the regulatory period, Origin is not convinced that

[1] 17 May 2002

GasNet has substantiated the basis for elevated focus on peak injection tariffs in their proposal. Indeed, ongoing addition of new supply injection points should reduce the likelihood of constraints on any one-injection point. GasNet's own argument for reducing the economic life of the Longford to Dandenong pipeline was based upon this expectation.

- Recognising the advanced stage of the Commission's deliberations, Origin does not expect substantial changes to the tariff design and cost allocation approach adopted by GasNet. However, Origin believes that achievable changes to GasNet's proposal are realistic and will greatly reduce additional cost and risk that would otherwise be borne by users of the PTS.

Impact Upon Participant's Systems

Origin would express some concern that the shift from the present zonal approach and the changes brought about by shifting the emphasis of peak injection and withdrawal usage tariffs to ten peak injection days only will generate costs and a degree of risk for retailers using the PTS in 2003 and beyond. These changes are being proposed at a time when retail systems are already subject to upheaval in preparation for the commencement of full retail contestability in October of this year. Origin would ask that the Commission consult further with retail participants in its deliberations, in order to take note of the likely impact of the proposed structure and zonal modifications on the cost to serve end use customers.

Tariff Path

The Commission has commented that it

"would be reluctant to accept any tariff path of the shape proposed by GasNet, that is, a large initial increase followed by a substantial fall over the second access arrangement period"[2]

In addition the Commission has identified that GasNet has placed the most weight on the impact of tariff movements from the end of the second regulatory period to the third, without sufficient attention to the substantial impact that would have occurred in 2003. Origin agrees with this assessment and stated similar concerns with GasNet's proposed approach in its submission to the Commission's Issues Paper.[3]

Whilst supportive of the Commission's view, Origin notes that no specific amendment has been proposed in the Draft Decision. The indicative price path provided by the Commission in Figure 8.2 of the Draft Decision[4] is assumed to furnish GasNet with sufficient guidance to modify their price path and it is further assumed the Commission expects GasNet to comply with the discussion in Section 8.2.5, however it is not clear what parameters a modified price path might assume in the absence of an amendment.

Origin welcomes questions or comments from the Commission on matters raised in this submission.

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[2] ACCC, *Draft Decision- GasNet Australia access arrangement revisions for the Principal Transmission System*, August 2002, page 148.
[3] Origin Energy, *Review of Victorian Natural Gas Transmission Access Arrangements: Response to ACCC Issues Paper*, May 2002, page 8.
[4] ACCC, op. cit., page 149.

2. Capital base recommendations

2.1 New facilities investment: South West Pipeline

Section 4.2.5 of the Draft Decision; proposed amendment 7

Origin supports the decision to roll-in the South West Pipeline (SWP) into the PTS. There is concern however that existing contractual arrangements (specifically the Transportation Entitlement Deed [TED]) requires amendments in order to reflect the tariff recommendation reached by the Commission:

'GasNet must amend its revised access arrangement to include tariffs for the Southwest Pipeline which are approximately 10 per cent higher than those on the Longford to Pakenham Pipeline'[5]

The TED expires during the second access arrangement period. It is anticipated that pricing elements of the TED (for example, transportation charges) will cease at the introduction of the access arrangement, however Origin support of SWP roll in requires confirmation of this from GasNet.

Notwithstanding GasNet's continued deliberations on the appropriate mechanism to reconcile the inclusion of the SWP into the asset base, Origin expresses some concern that GasNet might over recover on the SWP if private contractual arrangements are not reconciled with new access arrangement tariffs. This includes the approach GasNet applies to AMDQ charges for existing AMDQ rights on the SWP.

3. Revenue elements

3.1 K factor for the second access arrangement period

Section 6.2.2 of Draft Decision; proposed amendments 13 & 14

Origin recognises the under-recovery of revenues faced by GasNet over the previous regulatory period (1998-2002). The previous access arrangement generated this outcome by not allowing sufficient recovery of income streams based on variations of actual transported volumes with respect to forecast volumes.

The Commission has recommended that GasNet be allowed to recover this shortfall over the forthcoming access period.[6] Furthermore, the Commission has allowed GasNet to adopt individual tariff K factor correction. Consequently, Origin is concerned that the Commission has conceded:

'[T]he introduction of an allowance for the K factor in individual tariffs would expose users to increased tariff volatility during an access arrangement period'[7]

Origin agrees that avoiding price shocks between regulatory periods is a worthwhile objective, however, GasNet's proposal is considered to have the potential to generate annual price shocks by allowing volatility through the K factor recovery of GasNet's revenue requirement. Given that the large K factor carryover derives from forecast volume errors (particularly in regional pipeline assets such as the Culcairn pipeline), and that this anomaly has now been corrected, Origin questions the need for GasNet to implement a rebalancing approach that may reduce cost reflectivity and increase price volatility for users.

[5] ACCC, op. cit., page 48.
[6] Ibid., page 92.
[7] Ibid., page 93

As the Commission is aware, Victorian gas retailers are subject to maximum uniform tariff control for small users. Therefore, the opportunity to pass through any increases in a tariff due to K factor adjustment is limited in the current regulatory environment. Given the risk that GasNet's proposal conveys to users, Origin would support as an alternative a tariff rebalancing K factor that is constrained (for under-recovery) such that the total increase for an individual tariff is no greater than the consumer price index (CPI), unless the CPI exceeds an agreed benchmark.[8] This would reflect the risk position of major users (such as retailers) who will remain subject to maximum tariff control through at least part of the second regulatory period.

The Commission notes that GasNet could achieve lower than forecast revenues (and volumes) and still be required to pay back to users a K factor adjustment. The Commission's comment was made in response to submissions from BHP Billiton and Origin that the reverse situation might occur under the access arrangement proposed.[9] Origin concedes this is a possibility but questions the likelihood of GasNet finding itself in such a scenario, given the adoption of warming trends and volumes (albeit of a small order) lower than VENCorp's assessment of PTS flows.

4. Reference tariff design and cost allocation

Section 8.1 of the Draft Decision

As noted by the Commission, interested parties put a number of alternative positions in submissions lodged on GasNet's access arrangement revisions consultation in May 2002. To this end, the Commission has not found cause to address the structure and allocation of costs proposed by GasNet. Origin would contend that a number of principles are of key and common importance to users of GasNet's system, and that on this basis the cost allocation and structure of tariffs on the PTS be altered to reflect these principles.

4.1 Zonal Amendments and Complexity Concerns

Page 129 of the Draft Decision

Origin notes the competing objectives identified by the Commission between simplicity in the design of tariffs and allocation of costs and the need to encourage cost reflectivity in tariff design where possible, as per sections 8.38 and 8.42 of the Code.

The proposal to move to 19 zones in the interests of improving cost reflectivity substantially increases the complexity of transmission pricing for customers in the Victorian gas market. GasNet's proposal equates to one zone for approximately 100 kilometres of transmission pipeline (given the GasNet system is ~1900 km in length). This compares to the three distribution networks in Victoria currently proposing six pricing zones in distributed over substantially longer pipelines.

The impact of the changed specification of zonal amendments upon retail billing systems is anticipated but not fully assessed by Origin at this time. The operation of a number of billing and wholesale systems will require modification to accommodate the proposed changes. Even if GasNet were to more clearly demonstrate that the introduction of 19 zones would promote greater cost reflectivity, Origin questions whether this benefit (which is difficult to estimate and

[8] A benchmark cap would recognise the potential that CPI itself may far exceed the decreased revenues experienced by GasNet, who would in effect face no constraint in such a scenario.
[9] ACCC, op. cit., page 93.

currently unmeasured) would exceed the costs of billing software redesign (already subject to alteration in preparation for full retail contestability in Victoria). Origin would argue that improved cost reflectivity is best achieved through the pricing signals provided by the net pool for gas within the market carriage model, rather than be anticipated through an access arrangement developed by a monopoly service provider. At the current time, VENCorp as the independent system operator and users of the PTS have not identified a sufficient need to modify the Market System Operating Rules to address the alleviation of any potential constraint.

Noting that GasNet's proposal attempts to balance objectives within sections 8.38 and 8.42, justification of improved cost reflectivity appears to have been a decision made in isolation to the likely impact upon incumbent retailers in the Victorian gas market.

4.2 Peak Usage Cost Allocation

Origin has considered GasNet's arguments regarding the allocation of costs on peak and non-peak relativities. In its submission on the Commission's Issues Paper in May 2002[10], Origin indicated that the removal of peak withdrawal tariffs and relying on peak injection day tariffs only was inappropriate, as it would dilute demand management signals to end-users. Further, it was felt that assigning these costs directly to a particular customer or group of customers would be difficult to accomplish with any accuracy.

However, it is also Origin's view that the elimination of the five-peak day withdrawal tariff is an appropriate change to the tariff structure as the tariff implemented failed to transmit signals to customers most likely to have responsive demand profiles. Furthermore, due to it's ex post nature of calculation and application (i.e. the annual wash-up process) administering the tariff generated uncertainties and costs beyond the control of retailers. Origin does not reject peak usage price signals on a withdrawal basis overall, but recognises that their identification, design and implementation could not be achieved in the timeframe remaining for the development of the access arrangement.

The proposed recovery of 27% of GasNet's costs via the ten-peak day injection charge maintains the uncertainty generated under the five-peak day injection and withdrawal charges. Origin believes in an environment of full retail contestability (which will be in operation in Victoria at the commencement of the second regulatory period), the annual wash-up process associated with GasNet's proposal (and previous access arrangement) will generate difficulties for retail participants. In particular:

- Assigning peak injection charges to individual customers would at best be accomplished on an estimated basis.

- Participants utilise differing gas trading strategies that may result in divergent injection profiles based upon relationships with supply sources, further complicating the wash-up process.

- Actual costs incurred by individual customers will be difficult to pass through in a practical sense due to the physical movement of customers within (and out of) the PTS and the churn of customers between retailers.

- Because of the difficulty of assigning costs to customers, objectives of cost reflectivity cannot be satisfied with the peak injection tariff mooted.

[10] Page 8-9

Since the peak injection charge is unlikely to improve upon the operational efficiency of the current tariff methodology (with the exception of the removal of peak withdrawal charges), Origin would ask the Commission to simplify the recovery of peak charges by replacing the ten peak injection day approach with a tariff that reflects a peak injection season, based upon forecast degree days.[11] Such an approach would retain the current structure of the GasNet proposal (recovery of 27% of costs from peak injections), but would eliminate the uncertainty generated (in a contestable environment) by the lottery basis for determining peak injection days. The difference between expected revenue from the peak injection charge and the actual volumes injected over the peak season could be corrected in a similar fashion to the K factor approach, allowing changes to access period t+1's peak season injection tariff that would reflect under/over recovery in period t. Retailers would have some confidence prior to the peak season of what would formulate the basis and distribution of GasNet's cost recovery associated with peak injections. Any adjustment between forecast and actual would be proportional to the contribution made by the broader categories of tariff D and V customers by their allocated injection zone, eliminating the recovery issue associated with churning and relocating end use customers.

Origin agrees with the Commission that injection pipelines are unlikely to face constraint before the end of the second regulatory period and with the assessment that tariffs should reflect constraints moving forward into the third access period in order to avoid price shocks to customers as injection (and potentially withdrawal) assets become constrained. However, it is not clear to Origin what rationale was applied by GasNet to apply a ten peak-day injection tariff (for more than a quarter of its regulated costs) rather than a methodology that would have allowed greater certainty amongst participants and GasNet alike.

5. Draft Decision Impact on Retail Costs

As discussed briefly in Section 4.1, the quantum of cost change generated by altering existing electronic customer billing systems is not fully appreciated by Origin at the present time. Origin is currently examining the likely impact of the access arrangement (with the Commission's amendments where appropriate). It would be Origin's intention to pass this information to the Commission when known.

A preliminary observation of the magnitude of financial impacts of re specifying systems is that such change may involve a redesign of various elements of Origin's billing software as it applies to Victoria, which would carry with it substantial costs in terms of time and personnel. The extent of change associated with GasNet's proposal, its impact on users, and whether the access arrangement is a more appropriate vehicle to promote cost reflectivity than the Victorian market carriage system (amended through the Gas Market Consultative Committee), has not been articulated to Origin's satisfaction to date.

6. Conclusions

Origin acknowledges the time constraints faced by GasNet and the Commission in finalising the access arrangement in order to meet a January 1 2003 commencement date. However, the peak cost recovery approach and the potential for volatility that may be generated by the application of the K factor in its present form warrant examination in order to reduce uncertainty and balance appropriately the risks of gas market participants in the competitive portion of the gas market

[11] Origin recognises that in the future a peak injection day may occur in the summer due to increased gas-fired generation, and at such a time, a probability of exceedence electricity maximum demand injection charge may warrant examination.

(trading and retail) and those participants with lower risk profiles (by virtue of their monopoly status; e.g. transmission network service providers).

At this stage of the regulatory process, Origin would suggest that the appropriateness of peak injection/withdrawal relativities is a largely philosophical discussion. Instead, Origin would ask the Commission to examine the method by which peak injection tariffs are recovered from the market. Origin would suggest a peak season tariff; known to participants ex ante (with a correction factor similar to average revenue control for variances in forecast versus actual peak injection volumes) would be more appropriate than continuing to rely on a lottery approach.