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16 September 2002

Ms Kanwaljit Kaur
General Manager
Regulatory Affairs - Gas
Australian Competition and Consumer Commission
PO Box 1199
DICKSON ACT 2602

Dear Kanwaljit

Draft Decision on GasNet's Access Arrangement Revisions for the PTS

Please find attached TXU's response to the Commission's Draft Decision on GasNet's access arrangement dated 14 August 2002.

TXU appreciates the opportunity to respond on the Commission's Draft Decision.

TXU's main concern is with the Commission's decision to accept GasNet's tariff methodology and maintains that the methodology:

1. Does not meet the Code requirements for balancing cost reflectivity, simplicity and not distorting investment.
2. Does not provide the services sought by the market.
3. The 10 peak day injection charge, due to its retrospective calculation, does not provide pricing signals to most end use customers.
4. Requires a complex wash-up process which, due to confidentiality restrictions and unavailable data, cannot be delivered in practice.

TXU requests that the Commission consider simplifying GasNet's tariff structure to reduce the administrative complexity, while preserving some peak pricing signals. TXU believes that this can be achieved by replacing the proposed 10 peak day injection charges with charges based on peak volume charging over the winter period.

TXU is also concerned with the Commission's acceptance of GasNet's proposal for recoupment of any under-recovery of the K factor. Other concerns raised by TXU are mainly around clarity of the Commission's decisions and/or GasNet proposals.

If you require any further information please call Bruce Foot on 03 8628 1523 at your convenience.

Yours sincerely

Caryle Demarte
General Manager
Government & Regulatory Affairs

1 Revenue Elements

Section 6.2.2 of the Commission's Draft Decision.

Proposed amendment 14:

"GasNet must amend clause 4.9 of schedule 4 of its revised access arrangement so that the Maximum Price for each Transmission Tariff Component (MPTC) in step 3 can increase by only one per cent (0.01) above the MPTC in step 2"

Again[1], TXU submits that GasNet's ability to pass through the full extent of a prior year loss, with the further ability to rebalance individual tariffs by up to 1%, is likely to result in retail price shocks and therefore is unacceptable. TXU submit that the K factor recovery must be subject to a rebalancing constraint on tariffs in order to avoid potential retail price shock.

In its deliberations the Commission "recognises that the introduction of an allowance to the K factor in individual tariffs would expose users to increased tariff volatility during an access arrangement period[2]. Further, the Commission notes that by accepting GasNet's proposal "the shift would give GasNet undue scope to rebalance tariffs during the access arrangement period, with the potential to substantially reduce the cost-reflectivity of tariffs established through the current revisions approval process"[3]. TXU believes that this is inconsistent with the section 8 Code cost reflectivity principles.

Further, the Commission's decision results in a shift of risk to the retailers. Given the retailers' in the Victorian market are subject to deemed/default contract provisions there is no certainty of pass through of such increases. It should also be noted that retailers generally tend to have limited working capital and therefore the ability to fund any shortfall is questionable.

TXU notes that in relation to the Commission's Draft Decision on VENCorp's access arrangement, the Commission stated "Given the general support for VENCorp's approach [particularly price certainty], the benefit provided in the form of greater price stability without any significant compromise in the transparency and efficiency requirements placed on VENCorp, the Commission considers that VENCorp's proposal is reasonable and meets the requirements of the Code[4]." TXU believes that the Commission's decision on the GasNet proposal allowing for potential price volatility is inconsistent with that for VENCorp which provides for price certainty.

[1] TXU Issues Paper Submission section 13.
[2] Refer p93 of the Commission's Draft Decision.
[3] ibid.
[4] Refer p25 of the Commission's Draft Decision on VENCorp's revised access arrangement for the Principal Transmission System dated 14 August 2002.

Further TXU notes that, provided GasNet's revenue and volume forecast are the best estimates arrived at on a reasonable basis, then a large K factor is unlikely. TXU understands that the large K factor carryover from the current access arrangement is due to volume forecast error through the Carisbrook pipeline and over the Interconnect. This bias has been amended in GasNet's revised access arrangement, therefore GasNet should be prepared to accept a constraint on its ability to recover any shortfall. This also would place the appropriate incentive on GasNet to ensure that its revenue and volume forecast are the best estimates arrived at on a reasonable basis.

TXU requests the Commission to reconsider its proposed amendment 14 to constrain the ability for GasNet to recover any K factor under-recovery by limits on individual tariff rebalancing (similar to the current access arrangement). In this instance TXU would expect a higher increase than the one per cent proposed by the Commission in its Draft Decision; TXU would support an increase constraint limited to X% (as defined in the proposed price path) such that the overall annual price increase for an individual tariff is limited to CPI.

2 Reference tariff methodology

2.1 Cost allocation and tariff structure

2.1.1 Transmission Refill Tariff

Section 8.1.3 of the Commission's Draft Decision

TXU understands that GasNet's tariff methodology proposal for gas shipped into the Western Underground Storage (WUGS) facility is to charge at the marginal cost, hence the development of the Transmission Refill Tariff. Gas shipped out of WUGS is then subject to GasNet's normal tariff charges. TXU has confirmed this position with GasNet and the Commission.

TXU believes that the current drafting of the Cross System Withdrawal Tariff in schedule 1 of GasNet's access arrangement can be misinterpreted to include gas shipped into WUGS, given that the Connection Point does not exclude WUGS.

TXU requests that the Commission seek clarity from GasNet on the matter and if appropriate, include a proposed amendment reflecting the necessary drafting to effect the intended tariff methodology.

2.1.2 Tariff structure

Section 8.1.5 of the Commission's Draft Decision.

TXU is disappointed in the Commission's Draft Decision that it "is not persuaded that this complexity [of GasNet's proposed tariff structure] would hinder the operation of the market to the extent that the structure should be rejected[5]."

TXU believes that the GasNet proposed methodology:

1. Does not meet the Code requirements for balancing cost reflectivity, simplicity and not distorting investment.

2. Does not provide the services sought by the market.

3. The 10 peak day injection charge, due to its retrospective calculation, does not provide pricing signals to most end use customers.

4. Requires a complex wash-up process which, due to confidentiality and data restrictions, cannot be delivered in practice.

TXU requests that the Commission consider simplifying GasNet's tariff structure to reduce the administrative complexity, while preserving some peak pricing signals. TXU believes that this can be achieved by replacing the proposed 10 peak day injection charges with charges based on peak volume charging over the winter period.

Code Requirements

TXU agrees with the Commission that a service provider is required to strike "an appropriate balance between cost reflectivity, simplicity and not distorting investment, in accordance with the requirements of the Code[6]."

TXU believes that the GasNet proposal does not achieve this balance. Further, GasNet's proposed complex tariff methodology will consume a disproportionate amount of retailers' time given that the GasNet tariffs account for less than 10%[7] of total delivered energy cost. Further, given the lack of actual information in the case of churning customers on individual MDQ allocations by customers or the progressive payment needs in respect of usage, any wash-up process becomes highly problematic (refer to **Appendix** for additional detail). Therefore, TXU believes that the GasNet proposal does not comply with the section 8.1 principles of the Code, particularly section 8.1(e) of the Code that requires "efficiency in the level and structure of the Reference Tariff."

[5] Refer p130 of the Commission's Draft Decision.
[6] Refer p15 of the Commission's Draft Decision on VENCorp's revised access arrangement for the Principal Transmission System dated 14 August 2002.
[7] Average industry position; transmission costs for large industrial and commercial customers represent a higher proportion of their delivered cost.

Services sought by the market

TXU, and it believes other retailers, prefer no peak MDQ charges. TXU notes that in GasNet's November 2001 consultation paper on the proposed tariff design, GasNet concluded[8] that for its revised model "injection charges are based on the monthly injections June – September. No charge outside this period." This is consistent with TXU's expectation and preference to move away from the current wash-up process. It should also be noted that given GasNet's proposed K factor, GasNet has confirmed with TXU that GasNet is indifferent as to the basis of recovery for the injection charges.

Peak and non-peak pricing

TXU appreciates the Commission's preparedness to consider further submissions on the appropriateness or otherwise of peak pricing. Whilst abolishing the 5 MDQ withdrawal days is supported, GasNet's proposed shift to increase the injection component to10 peak injection days creates greater uncertainty on a larger unmeasurable quantity. This further breaks the nexus between the tariff and customer behaviour.

TXU notes that the Commission "is not convinced that congestion is likely in the next access arrangement period. However, it considers that it is possible that congestion could occur in the access arrangement period starting 2008 and is conscious of the need for users to face stable tariff structures. It would be unnecessarily disruptive for all peak signals to be removed for the second period only to be reintroduced in the third period[9]." Further, TXU understands that the Commission wants to ensure that there are sufficient signals for new investment in transmission pipeline infrastructure.

TXU notes the Commission's position, however there is no evidence that most loads (other than a very small number of large loads) would be motivated to change their locational decisions based on transmission pricing signals. Further, TXU believes that any intended price signalling does not reach small customers given that:

1. Injected gas is not measured on a customer basis. Therefore, actual costs cannot be accurately measured and passed through to users.

2. Peak injection days do not necessarily match peak withdrawal days. Tariffs based on the peak injection days therefore may not be recovered at a customer level, unless peak withdrawal days are still defined to the end customer.

[8] Consultation Paper on proposed tariff design for the Victorian Gas Transmission System, page 26.
[9] Refer p132 of the Commission's Draft Decision.

3. Maximum injections are determined retrospectively and unknown in advance.

4. An MDQ cannot be measured for a typical tariff V customer, even at the withdrawal point, given meter readings occur every second month.

On investment signalling, TXU notes the following:

1. VENCorp's annual planning review provides extensive data to the market place on load growth forecasts and identification of likely constraints over the forecast three years. This provides the industry with reliable independent data upon which to base investment decisions.

2. As set out in its submission to the Commission's Issues Paper, TXU believes that the economic efficiency and signalling questions associated with transmission tariffs ought to be considered on a holistic basis together with the structure of the Gas spot market. VENCorp completed a review in March 2001 on the option of introducing hourly locational pricing. The main benefit of introducing hourly locational pricing would be for the spot and forward market prices to manage congestion. The review was subject to extensive consultation with industry participants. It was concluded that congestion occurred too infrequently to justify the costs of shifting to locational hourly pricing at this time, but the option should be considered in the future. The market does provide locational pricing signals through the spot market, uplift payments and ancillary charges.

TXU submits that the GasNet proposal purports to deal with pricing and investment signals that are better dealt with by existing and future commodity based locational pricing signals.

Therefore, a complex system is being imposed on all loads for limited economic efficiency benefits.

Annual wash-up

The Commission notes that the most common concern in relation to peak pricing is the annual wash-up. The Commission states "GasNet, on the other hand, while acknowledging these issues, considers them to be largely connected with the peak withdrawal charge, claiming that it has received little complaint about the peak injection charge[10]."

[10] Refer p133 of the Commission's Draft Decision.

TXU notes that the complexity of the wash-up associated with peak withdrawal and peak injection charges are the same and will become increasingly difficult in a fully competitive market. These complexities and uncertainties are likely to increase costs and may discourage transfers. TXU notes that section 2.24(e) of the Code requires the Commission to take into account "the public interest, including interest in having competition in markets." TXU has set out in the **Appendix** the process required for the annual wash-up associated with GasNet's current and proposed MDQ charges. Further, TXU wishes to note:

1. It is difficult to secure the full co-operation of all retailers in the annual wash-up, given vested positions (i.e. the wash-up may be to their disadvantage).

2. The wash-up process will become extremely complicated in a fully competitive market. Greater risk is likely through customer churn, as the cost may not be recovered from the customer switching.

3. Different gas injection point patterns by retailers confuse the process.

4. The smoothed monthly instalment process and subsequent wash-up does lead to cash flow timing issues for both retailers and customers.

If the Commission accepts GasNet's proposal, then TXU submits that at the very least, GasNet's access arrangement should include details of the wash-up process to be completed by all parties. A corresponding amendment may be necessary to the Gas Transportation Deeds for an industry wide standardised process with significant involvement of and greater data disaggregation by GasNet and for GasNet to co-ordinate wash-ups with Retail customers.

Conclusion

TXU submits that the tariff methodology does not reflect the service sought by TXU and other retailers.

As stated in its submission to the Commission's Issues Paper, TXU's preferred transmission tariff methodology is for tariffs to be levied based on peak and off peak withdrawal volumes[11]. Withdrawal charges can be directly attributed to the customers metered usage. However, TXU accepts that at this stage of the

[11] TXU notes that the GasNet transmission system is more characteristic of a distribution network; that is it has multiple injection points that are located equal distance from the central load (i.e. Metro zone). The Commission notes the "meshed" characteristics of the PTS in its draft decision. TXU believes that the future market development is likely to result in gas flows through the PTS being less Longford centric. As time goes on TXU expects the PTS to operate more and more like a distribution system. TXU notes that for the Victorian distribution networks, the Essential Services Commission has accepted in its draft decision 6 pricing zones, which cover the same area as the GasNet transmission system, with withdrawal based pricing more closely reflecting consumer behaviour.

approval process it is unlikely that such a significant change to GasNet's tariff methodology could occur without creating a significant deferral in the likely approval date (TXU understands this is expected in mid November).

Therefore, to balance the desire to obtain timely approval and the deliberations of the Commission in its Draft Decision, TXU submits that the following changes should be made to GasNet's tariff methodology:

1. Replace the 10 day injection charges with charges based on peak volume over the winter period.

2. Maintain the existing postcode zone allocation methodology.

Substitution of the peak MDQ charging with peak anytime volume charging has the following advantages:

1. Peak period pricing signals are more likely to influence customer behaviour.

2. It avoids the mismatch of injection versus customer consumption and the annual wash-up process (particularly the complexities arising from MDQ charges and customer churn in a fully competitive market).

3 Reference tariff methodology

3.1 Proposed zonal amendments

Section 3.2.4 of the Commission's Draft Decision.

As set out in its submission to the Commission's Issues Paper, TXU notes that the proposal for redefining some zones from post codes to customer transfer meters will require a number of changes to TXU's (and other retailers') back office systems and processes. This will include redevelopment of the billing engine to create new definition zones and detailed mapping of addresses to customer definition (CTMs) to ensure correct quoting.

The fundamental divergence from post codes being the basic building blocks creates significant complexity that has not been contemplated in the design of the retail FRC systems. At this stage of development there is a real risk that a move away from the industry accepted standard of postcodes will not be able to be built into the contestable systems nor delivered in time.

Further, TXU also wishes to re-iterate its preference for further aggregation of GasNet's proposed tariff zones to reduce complexity and thus facilitate development of the fully competitive market.

4 Tariff path

Section 8.2.5 of the Commission's Draft Decision.

TXU notes that the Commission states "GasNet can establish a forecast average tariff path for the period 2003-2007 that produces a small nominal increase in the average tariff over the period with limited initial increase (between 2002 and 2003)[12]."

Further, the Commission states that it "does not consider the proposed tariff path is appropriate or meets the Code principles. In response to concerns from interested parties, the Commission has proposed that the tariff path be smoothed, to the extent practicable, over the access arrangement period[13]."

TXU fully supports such an outcome as it will reduce the potential for price shock to end use customers. However, TXU notes that the Commission has not proposed an amendment along these lines in its Draft Decision and requests that in its final decision, the Commission does so.

5 Services and terms and conditions

Sections 11.1 and 11.2 of the Commission's Draft Decision.

The Commission has required the following amendments to GasNet's proposed revised access arrangement for the PTS:

Proposed amendment 33

GasNet must amend clause 3 of its revised access arrangement, services policy, to include the services that GasNet supplies to VENCorp (that is, making the PTS available to VENCorp in accordance with the SEA and the MSOR). In addition, the reference 'VENCorp Services' in clause 3.2 must be changed to 'VENCorp Reference Services'.

Proposed amendment 34

GasNet must amend clause 8.1 of its revised access arrangement, terms and conditions, to include the terms and conditions on which GasNet supplies the services to VENCorp (which in turn are set out in the SEA and the MSOR).

TXU supports the changes proposed by the Commission.

[12] Refer p149 of the Commission's Draft Decision.
[13] Refer p154 of the Commission's Draft Decision.

TXU also notes that to date, SEA confidentiality restrictions have applied to prevent users access to details of any SEA amendments and thus the terms and conditions upon which GasNet provides services to VENCorp. Therefore, TXU requests the Commission to consider requiring GasNet to ensure that there is a transparent and robust process around any SEA amendments. TXU believes that any SEA amendments are likely to be restricted to physical characteristics as circumstances change.

Further, TXU requests that the Commission requires GasNet to publish or make available to Users the SEA as in force from time to time. Alternatively, this obligation could be achieved through an amendment to the section 5.3.1(a) of MSOR requiring publication of the SEA.

APPENDIX

ANNUAL WASH-UP PROCESS

TXU believes both the current 5 peak day MDQ charges and the proposed future MDQ 10 peak day Injection charges are flawed and as the market becomes fully competitive they have the potential to inhibit competition.

The weaknesses of GasNet's tariff structure have become an issue as the contestable energy markets develop and churn occurs, especially where large industrial and commercial customers require unbundling of tariffs and treat TUoS as a direct pass through. This becomes increasingly problematic as the market becomes fully competitive.

TXU believes that this is inconsistent with the Code:-

1. 2.24(e) of the Code requires the Commission to take into account "the public interest, including interest in having competition in markets."

2. 8.1(e) of the Code requires "efficiency in the level and structure of the Reference Tariff.

In summary, TXU's issues with the wash-up process for peak day MDQ based charging are:

1. The existing tariff methodology, and to a greater extent GasNet's proposed tariff methodology, cannot address the complexities of customer churn in the competitive market. Where a customer churns during a calendar year the Retailer does not have access to the necessary information required to perform an annual wash-up. These complexities and uncertainties are likely to increase costs and may inhibit customer churn.

2. As the peak injections are not directly measurable for any individual customer, the wash-up process is inequitable and results in a need for considerable assumptions for attribution of injections to customers. This process weakens the price signal and creates both complexity and settlement risk.

3. GasNet's proposed tariff methodology adds to the complexity of administering the process. The extra complexity does not in turn deliver a more accurate process to calculate the transmission costs for a given customer.

Wash-up process

Under GasNet's tariff methodology an estimate of the annual peak MDQ charge is levied on retailers on a monthly basis and at the end of the year a wash-up for under or over collections is performed based on the retrospective calculation of the actual charge over the peak MDQ days.

Similarly, the customer's MDQ injection charges are estimated, and smoothed over the year. At the end of the year, for unbundled customers, a similar wash-up process is required to adjust for any over or under payments.

In the worse case, where a customer churns immediately before the winter peak (as occurred in 2000 with the opening of the market) a customer will receive a substantial invoice from their current retailer, being the actual peak day charge less the smoothed monthly payments collected from date of transfer to the end of the year. The customer will then be required to approach their prior retailer for a refund of the progress payments made prior to transfer.

Where a customer moves from a bundled offer to an unbundled price at the date of transfer it is not possible to calculate the notional smoothed monthly payments for that specific customer during the period where the tariff was bundled.

At the end of 2000 TXU approached GasNet, other Retailers and the Commission in an attempt to develop a solution to the above problems. TXU notes:-

1. GasNet was, and we believe still is, constrained by confidentiality and more importantly did not have sufficient data disaggregation in their billing system to provide the appropriate data at a customer level to effect a wash-up.

2. History has shown that a voluntary wash-up process is inefficient and transfers risk to customers as some retailers had, and will continue to have, a vested interest in not participating in the process.

Should peak MDQ charging be continued, an industry wide standardised process with significant involvement of, and greater data disaggregation by GasNet, would be required.

Allocation of Injection Costs to Customers

The settlement process, and the wash-up, fails to accurately attribute multiple injection points to a specific customer for the full or partial year.

Historically for contractual and settlement purposes customers have been assigned to specific injection points and injections have been assumed to equal withdrawals. These assumptions dilute any intended injection based price signalling and are becoming less robust as injection points increase and gas flows change.

However, injections do not equal withdrawals on any given day due to factors such as movement in line pack. This is further complicated given peak MDQ days are not necessarily aligned between multiple injection points and withdrawal zones.

The gas injection sources each winter (particularly on the peak injection days) may substantially differ year by year, depending on gas availability. To the extent the actual volumes by injection point vary from the assumed flows over or under-collecting from customers will occur thereby increasing the residual risk to retailers.

The tariff data needs for retailers and GasNet are quite different. While GasNet does not need to consider customer churn given that the total injections and withdrawals are measured on a daily basis at the principal system level, retailers do.

TXU maintains that while an Injection wash-up can be performed accurately on a retailer/GasNet basis, a wash-up on the customer to retailer level is only approximate, extremely complex but does not achieve the intended cost allocation and consequential price signal.

Complexity of Administration

While TUOS costs contribute on average approximately 10% of the final energy cost, they account for a significant proportion of the administrative cost of producing and reconciling a customer accounts.

The extra complexity of administering GasNet’s proposed injection charge increases costs to customers but still does not enable a direct and cost reflective pass through to a given customer.

Furthermore, the proportional reduction in revenue recovered from peak/MDQ charges as proposed by GasNet suggests the extra complexity in processes is unwarranted. If it is less significant, why make the component more complicated?

Conclusion

In conclusion TXU believes the current and proposed MDQ based tariffs do not achieve the intended price signalling, are complex to administer, may inhibit competition by discouraging customer transfers and create considerable risk to both the customer and the retailer.

TXU believes that GasNet's proposal does not provide sufficient price signals to warrant the additional complexity and therefore the cost of implementation outweighs the benefits. As such, TXU believes that the methodology does not comply with sections 2.24(e) and 8.1(e) of the Code.

To encourage competition, complexity needs to be minimised. As set out in our submission we believe a winter period volume charge is a step in the right direction towards a tariff structure that provides appropriate signals, is certain, measurable and administratively less complex.