



EnergyAustralia

27 May 2013

Wagga Wagga Revocation
National Competition Council
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Dear Sir/Madam

Re: Application for Revocation of Coverage - Wagga Wagga Gas Distribution System

1. Introduction

EnergyAustralia appreciates the opportunity to comment on Envestra's application for Revocation of Coverage Wagga Wagga Gas Distribution System to the National Competition Council.

We are one of Australia's largest energy companies, providing electricity and gas to over 2.7 million household and business customers in NSW, Victoria, Queensland, South Australia and the Australian Capital Territory. We also own and operate a multi-billion dollar portfolio of energy generation and storage facilities across Australia, including coal, gas and wind assets with control of over 5,600MW of generation in the National Electricity Market. In addition to this, we are also a retailer of natural gas to customers supplied via the Wagga Wagga covered gas distribution system.

Generally, gas distribution systems, unlike several gas transmission systems in Australia, are natural monopolies and regulated as "covered" pipelines under the National Gas Rules (NGR). The exception to this has been very small gas distribution systems where the relevant pipeline has failed to satisfy the "coverage" criteria in the NGR.

The Wagga Wagga gas distribution system is a substantial network supplying over 20,000 end users via 690 kilometres of pipeline. The pipeline exhibits strong monopoly characteristics and should therefore be regulated under the NGR as a "covered" pipeline.

In this submission, we address the key issue of whether the Wagga Wagga gas distribution system satisfies the key coverage criterion (a) and (d) required under section 15 of the National Gas Law (NGL). Envestra state in their application that the pipeline does not satisfy the "coverage" criteria and should not be regulated under the NGR.

The criteria for a gas distribution network requiring "coverage" are set out in Section 15 of the NGL:

- Criterion (a) Access (or increased access) to the services provided by the pipeline would promote a material increase in competition in at least one other market;

- Criterion (b) It would be uneconomic to develop another pipeline to provide the services supplied by the pipeline;
- Criterion (c) Access (or increased access) to the services provided by the pipeline can be provided without undue risk to human health or safety; and
- Criterion (d) Access (or increased access) to the services provided by the pipeline would not be contrary to the public interest.

2. Coverage criterion (a) material increase in competition

The NCC coverage guidelines lists three methods by which the use of market power by a service provider may adversely affect competition in a dependent market under criterion (a).

Envestra addresses criterion (a) in its application. In doing so, it considers the issue of both vertical integration and monopoly pricing and appropriately excludes price collusion as relevant to this situation. In our view, the monopoly pricing issue also encompasses the terms and conditions under which retailers gain access to the distribution network.

2.1 Terms and Conditions

We and other retailers (based on published material and experience attained as a retailer representative at industry forums), have experienced considerable difficulties and had limited success in negotiating terms or amendments to existing terms with Envestra.

Much of our experience in trying to negotiate access to this pipeline has been under the protection of a “covered” pipeline, where a regulator or market operator has also been involved. As such, the prospect of negotiating terms and conditions of access under an uncovered arrangement does not provide us with much confidence that future negotiations, under an uncovered arrangement will achieve fair and reasonable outcomes.

Envestra argues that the countervailing power of large retailers will create robust negotiations when they seek access to a pipeline. They consider that both EnergyAustralia and Origin Energy are large energy wholesalers and retailers as well as active participants with a broad understanding of the regulatory framework. Specifically Envestra states under item 85 that:

EnergyAustralia has extensive experience and understanding of all aspects of the energy supply chain and can therefore be expected to participate in robust negotiations of terms and conditions of access to the Wagga Wagga network.

Despite our experience and knowledge of the regulatory framework we have had very little success in our past negotiations in obtaining access to the pipeline on fair and reasonable terms and conditions.

By way of example, we refer to the recent review for the AER Victorian Envestra AA 2013-17 Draft Decision¹ and draw your attention to the list of suggested changes to the terms and conditions. During the consultation process, retailers suggested **thirty four** changes to the terms and conditions and Envestra gave in principle support to only **four** of these proposed changes.

In addition to this, retailers requested that Envestra adopt a common form approach to the Victorian terms and conditions so that they aligned with the other two distributors in Victoria. Once again this pragmatic (minimal cost impact to Envestra) proposal was denied by Envestra. During this process and the National Energy Customer Framework (NECF) consultation processes, covering the development of distributor/retailer provisions, retailers needed to enshrine the in principle approach of reciprocity for rights and obligations where appropriate. Defining equality of rights and risks is not reflective of a reasonable starting point for contract

¹ <http://www.aer.gov.au/node/14473> AER Draft Decision Envestra 2013-17 Section D Terms and Conditions Submissions

term negotiations that would be conducive to achieving suitable commercial outcomes under a non regulated environment.

2.2 Competitive Market

We agree with Envestra that competition in the Wagga Wagga network over the past decade has not resulted in many gas retailers participating in this market.

This has been primarily caused by the existence of regulated retail pricing and the NSW Gas Market Rules and supporting manual processes for many business transactions. We consider that an uncovered network could further exasperate retail participation in Wagga Wagga. This is evidenced by the neighbouring uncovered Envestra network located in the area surrounding Wagga and the Snowy Mountains region in NSW where Origin is the only retailer.

Also it would not be economic for small retailers to undertake separate negotiations with Envestra in order to enter this gas market.

2.3 Pricing

Envestra intends to pass back the costs of regulation (if coverage was revoked) by way of reduced network tariffs scheduled from July 2014 and to limit any further price increases to be no greater than CPI for the following five years.

Interestingly, we note Envestra has not provided any guarantees of forward efficient pricing that ensures these outcomes are delivered.

On face value, these price changes do not seem unreasonable, however, we question if gas network prices should not in fact decrease as they have done recently in Victoria. There is an information asymmetry between distributors and retailers in understanding and negotiating network tariff changes. Most distribution companies submit confidential pricing proposals to the AER each year, and retailers rely on the AER to make a determination that prices are set efficiently. Under Envestra's proposal to revoke network coverage for Wagga Wagga, we believe we would have less ability than the AER to assess and negotiate efficient pricing outcomes for gas network tariffs.

2.4 Alternative Fuels

Envestra suggests that the countervailing power of end users will minimise Envestra's ability to monopoly price.

For residential customers Envestra highlights the ability to convert natural gas appliances to LPG and for the replacement of natural gas appliances with electric units. We agree that this is possible and history has proven that, over time, fuel switching takes place.

However, in our experience, most customers usually switch appliances at the end of an appliance's life and this is usually after 10-15 years. Envestra would be well aware of this fact as it regularly undertakes forecast load assessments of prospective gas reticulation to existing country towns. The take up rate of appliance conversions from electric to gas even with a fuel premium in existing residential areas is very slow. Conversion of natural gas appliances to LPG can readily occur usually costing around \$300 but this is rarely an option for residential customers who have experienced the benefits of a never ending supply of natural gas to their home. Reticulated natural gas avoids the delivery intrusions and bottle location issues that LPG supply entails.

Moreover the volatility of LPG pricing (based on world parity pricing) is also not welcomed by residential customers accustomed to stable natural gas supply prices.

2.5 Options for Large Customers

For large customers Envestra offers network bypass as an offset to monopoly pricing if it was to occur. In our experience, connections to gas transmission lines are very expensive and

while they do exist they usually occur during the establishment of a large industrial user's premises. Large users will have contemplated this option when they initially connected to the natural gas distribution network and will usually have contributed to their connection costs to the gas distribution network. They are unlikely to reinvest in another connection to a gas transmission network and will not readily take a decision to alter their connection point. Therefore, the opportunity to monopoly price network charges for large customers does exist, to a significant extent, in an uncovered network.

3. Coverage Criterion (d) public interest

Envestra argues that the cost of undertaking a full Access Arrangement (AA) review for Wagga Wagga is around \$2.8M. Interestingly, they allocate a portion of around \$0.5 million of this cost to the Australian Energy Regulator to assess this AA. On this basis, they argue it is in the public interests for Envestra to avoid having to issue a full AA.

Firstly, it is not clear from the Envestra's application what additional short term variable resources that the Australian Energy Regulator (AER) would be able to avoid if it was not required to undertake the Wagga Wagga AA assessment. The AER will be establishing a Consumer Challenge Panel and an ongoing base level of resource expertise to undertake and advise on similar AA reviews and network issues.

Secondly, Envestra already undertakes gas AA reviews for gas networks in Queensland, South Australia and Victoria, costing around \$3.0M - \$3.9M each. These networks have customer numbers that range from around 90,000 to 590,000 customers whereas Wagga Wagga has only 20,000 customers. We suggest that there is no company in a better position than Envestra to maximise the economies of scale and leverage the review data used in the larger networks to offset the AA costs to the Wagga Wagga network. Envestra has advised that some 20 consultant reports were commissioned to support Envestra's Weighted Average Cost of Capital (WACC) derivation as part of the Victorian AA review and a similar number were used for the South Australia and Queensland AA reviews. They now suggest² that this will also be replicated for the Wagga Wagga review. We are of the view that the previous work done on this issue could be used or updated at much lower cost for the Wagga Wagga AA review.

We seek additional clarity on the proposed costs of a Wagga Wagga AA review submitted by Envestra and also suggest more investigation by both the AER and Envestra into how these costs can be reduced. Also Envestra states:

With regard to Criterion (d), it is in the public interest to revoke coverage of the network as there are no benefits to offset the regulatory costs associated with continued coverage of the Wagga Wagga network.

We do not agree with this statement for all of the issues raised in this submission. The certainty and stability of pricing, terms of access for both customers and retailers provided under a regulated AA cannot be underestimated when dealing with a monopoly asset owner. The costs passed on to customers could potentially be higher over the long-term if coverage of the Wagga Wagga gas network were to be revoked. Without any clear and assessable demonstration of the savings, we do not believe that revocation of coverage is in the public interest.

4. Summary

Energy Australia is very concerned with the prospect of a significant gas distribution system being considered for revocation of coverage and, if successful, the flow on prospects for other distribution systems.

² Envestra Wagga Wagga Network Revocation Submission paragraph 105

We are not confident that we would be able to negotiate suitable price, terms and conditions of access with Envestra that would deliver ongoing fair and reasonable gas supply for both customers and EnergyAustralia.

While Envestra has offered to engage³ with retailers to determine a mutually agreeable set of terms to apply should coverage be revoked, past experiences do not endear a successful outcome.

We believe that coverage of the Wagga Wagga Gas Distribution System should be continued and this application by Envestra should be rejected.

Should you require further information regarding this submission please call me on 0478 401 097.

Yours sincerely

[Signed]

Randall Brown
Regulatory Manager

³ Envestra Wagga Wagga Network Revocation Submission paragraph 143