energy networks association

18 September 2009

Geoff Houen
Gas Market Development Team
Department of Resources, Energy and Tourism
GPO Box 9839
Canberra ACT 2601

By email: geoff.houen@ret.gov.au

Dear Mr Houen

Draft Policy Position on the National Framework for the Connections of Retail Customers to Natural Gas Distribution Networks

Thank you for the opportunity to provide feedback on the MCE-SCO's Draft Policy Position on the National Framework for the Connection of Retail Customers to Natural Gas Distribution Networks (the Paper).

ENA appreciated attending the workshop held on 9 September 2009 because it provided additional information on how officials saw various elements of the framework operating and how it would work alongside existing regulatory regimes, in particular the gas access regime. However, there are still a number of aspects of the framework that are unclear.

1. ENA understanding of the proposed framework

The following summary represents ENA's understanding of the proposed framework and the comments in the remainder of this submission are made on this basis. ENA understands:

1. Uncovered networks will be subject to the National Energy Customer Framework (NECF), unless a jurisdiction elects that a specific uncovered network is exempt from some or all of the obligations under the framework. This is intended to support the obligations on retailers under the NECF.

2. Consequently, the framework is designed so that it regulates connections to both covered and uncovered networks (unless otherwise specified), while continuing to allow for the operation of the gas access regime where applicable.

3. For covered networks this would mean that the Basic Connection Service, as defined by the distribution business, could:

    - align with the connection service that is provided under the Reference Tariff service that is currently defined and provided to Users under the access arrangement; or

    - be a different service.

4. The cost of a Basic Connection could:

   - be conforming capital expenditure with a positive overall economic value in which case distributors may not need to impose a charge for connection;[1] or

   - include a level of non-conforming expenditure, resulting in a capital contribution charge levied on the specific customer requiring connection.

5. A distributor may propose a connection service that would include the flexibility to require capital contributions where a connection was not economic.

6. The objectives behind the requirement for AER approval of a Basic Connection Service appear to be to ensure that the Basic Connection Service:

   - meets the needs of the majority of customers; and

   - provides a reasonable level of service.

7. It is therefore anticipated that when distributors propose a Basic Connection Service in respect of a covered network, assuming that it meets the above objectives and for a covered network is consistent with the access arrangement (which has already been approved), the approval process would be straightforward and the Basic Connection Service would be signed off by the AER.

8. The framework is designed to be flexible so as to:

   - Allow customers to apply directly to a distributor for connection.

   - Allow distributors (and retailers) to continue to use existing practices in undertaking their obligations to connecting customers. For instance, if customers have historically approached a retailer to apply for a connection and the retailer initiates the connection process via a B2B transaction, this practice can continue for the majority of connections. However, the framework will not mandate these arrangements.

   - Provide information to customers in an efficient and low cost manner.

   - Allow each distributor to develop its own application form so that it obtains the information necessary to develop the connection.

9. The framework is intended to encourage the uptake of natural gas by ensuring that connections are provided using a simple process and minimal cost.

ENA have a number of concerns with respect to the understood proposed framework outlined above. These concerns are detailed in the remainder of this submission. ENA notes that further issues may only be identified when the framework is developed into draft legislative form.

[1] This charge is ultimately passed to all customers and hance is a levy on all network connections.

2. Application to uncovered gas networks

The application of the NECF and the associated gas connection framework and associated obligations to uncovered networks (unless a jurisdiction elects that a specific network is exempt), does not acknowledge that:

1. Uncovered networks are small in nature and represent only a very small fraction of total gas supplied to customers.

2. Uncovered networks are not considered to have market power rather they face competitive pressures and therefore have a clear and direct incentive to connect customers at a reasonable price and level of service.

3. Uncovered networks operate on small margins and must compete strongly in the energy market. Any additional costs imposed on these networks further affects their viability.

Given these factors ENA is concerned that the proposed framework which is designed to bring uncovered networks under the NECF will result in less than optimal outcomes.

ENA recommends that uncovered networks be initially excluded from the connection regime and the NECF, with inclusion only mandated if experience dictates otherwise.

3. Potential change to existing processes

As noted above, although ENA understands that the framework is intended to be flexible so that distributors can continue to use existing practices in undertaking their obligations in respect to connecting customers, the requirement to provide an alternative, for example the option for customers to approach the distributor directly to arrange a connection where that option currently does not exist, will result in duplicated processes and increased costs. Business efficiencies are predicated upon standard processes. Once a standard process has been implemented, it is inappropriate to allow unfettered deviations from that process.

In many cases the introduction of a new process will not be a trivial change. Implementation will require industry (distributors, retailers and AEMO) to:

- review and where appropriate change:
  - established retailer and B2B procedures;
  - industry safety arrangements including associated approvals;
- make extensive changes to existing systems that have been largely automated based on existing approaches; and
- revise their approach to customer interfacing (for distributors this may mean establishing customer call centres).[2]

[2] It is noted that the Victorian gas industry, through the Retail Management Consultative Committee as part of a medium to long term retail strategy and process review, gave consideration to a move to a more Distributor focussed new connections process. After extensive process consideration the cost/benefit analysis showed that there were industry cost increases which did not offset the industry and customer benefits.

Industry remains concerned that the proposed changes to existing processes do not adequately recognise that there are already processes in place established by the industry and the previous market system operators (now AEMO) which provide effective and efficient connection services for a large proportion of customers.

For instance, in Victoria which has significant gas penetration and high levels of take-up in gas supply areas, the majority of new connections are handled through simple B2B transactions from the customer's retailer to the distributor as defined in the AEMO Retail Market Procedures and associated protocol documents. These processes are utilised for about 90% of new connections and achieve the Victorian obligation to connect customers within 20 business days.

Distributors accept that under the proposed connections framework they will be required to have a contractual relationship with the customer; however, industry remains unclear as to the rationale for the requirement that customers be able to arrange connection directly with the distributor and is unsure what problem is being addressed.

Distributors are of the view that provided there is transparency as to the key elements of a connection contract; i.e. the description of the connection, associated costs and timeframes, then customers will be in a position to understand the basis of their connection arrangements, costs and timing. This transparency would encourage intermediaries to better represent the customer's requirements to the distributor and pass through the distributor's costs without adding a margin.

While ENA supports officials' intention that the framework be flexible so that connections can be undertaken using a simple process and with minimal cost, flexibility that allows the customer to deal with the distributor directly means that the process is no longer standardised and may increase costs, especially in Victoria. ENA considers that a clear identification of the problem that is being addressed may result in solutions that continue to allow for standardised processes and as a result more effectively encourage the uptake of natural gas.

4. AER approval role

The Paper notes that the AER will approve each connection service, including timeframes and charges, on the basis that they provide reasonable levels of service, having regard to:

- the National Gas Objective;
- the distributor's historic practices; and
- the geographical nature of their network.

These criteria are quite vague and it is difficult for distributors to know how they would be applied in practice. If the AER is to have an approval role, then the criteria to be used in their decision making must be clear.

Industry submits that it would be more appropriate for the AER to have a monitoring and compliance role rather than an approval role for schedules because:

- there are existing incentives on distributors to connect customers in order to grow their business; and

- generally gas is in competition with alternate sources of energy such as electricity; therefore it is already subject to competitive pressures to ensure economic connection.

In moving to a national regime, regulatory burden such as that which results from the AER approval process should be reduced where possible as associated costs are ultimately borne by gas customers.

5. Capital contributions

As previously submitted, under the access regime gas distributors are not required to provide connection services where they are demonstrably not economic. All a distributor is required to do is to offer services to delivery points on the existing network, subject to there being sufficient capacity.

Under Rule 79 of the NGR, the current framework provides that conforming capital expenditure (which could include capital expenditure required to establish a connection) forms part of the capital base. As a result, it can be recovered through the reference tariff.

In the event that a connection could not be justified under Rule 79 distributors may propose that the User pays a capital contribution so that the connection is NPV neutral for the distributor. The access regime allows the User to decide whether they wish to pay the capital contribution and in what form the capital contribution is passed on to the customer. Where the User elects to pay the capital contribution, the cost of the connection less the capital contribution can be rolled into the capital base under the NGR.

At page 16 the Paper states:

> It is SCO's intention that the following proposed treatment of connection assets does not otherwise change the arrangements for User capital contributions under the NGR.

At page 17 the Paper continues:

> SCO acknowledges that for certain customers the cost of connection may be uneconomic for distributors under these approved charges. Customers may opt to pay additional charges, or distributors may require the payment of such additional charges in order for the connection to go ahead. For distributors subject to access regulation, the additional charges will be required to be no more than that which is needed for the connection to be economic.

Based on these statements, there seem to be both an individual capital contributions scheme and a scheme under the access arrangement. It is not clear how these schemes will co-exist.

The gas access regime establishes a legal relationship between the distributor and the access seeker or User under the access arrangement. The access arrangement does not contemplate third parties, such as customers, obtaining rights or obligations under the access arrangement. Generally the rights and obligations of third parties are found in jurisdictional instruments.

ENA assumes that MCE-SCO would not want to rework the access regime so that third parties obtain rights and obligations; ENA considers that conceptually it is simpler for capital contributions to be recovered directly from customers. This is because:

- under the framework, distributors will be required to provide connection services directly to customers;
- capital contributions do not affect the distributor's return under the access arrangement; and
- in practice when distributors propose a capital contribution, currently they do so either to the User who then passes the cost on to the customer or directly to the customer.

ENA therefore recommends that the distribution contracts provide that where a connection is not economic, the distributor offers the connection subject to the capital contribution and a customer accepts the offer, distributors have the right to recover a fee from the customer that would make the connection NPV neutral for the distributor.

This will ensure the framework supports the proposed process whereby a distributor may propose a connection service that would include the flexibility to require capital contributions where a connection was not economic. As set out above, distributors should have the flexibility to choose whether such connections fall within a Basic Connection Service or Additional Standard Service.

6. Reimbursement scheme

In respect of the reimbursement scheme for previously dedicated assets, ENA understands that the rationale for this is to ensure consistency with the Electricity Connections Framework and ensure that the original customer will be partially compensated for what has later become a shared asset, providing an equitable way for extension costs to be shared.

Currently, when considering a proposed connection, gas distributors make an assessment of the present value of the future expected revenue stream associated with the proposed extension. As set out above, only the difference between the present value of the revenue (the expected revenue) and the expenditure (being the cost of the connection) is recovered through capital contributions or surcharges. Based on this assessment it is decided whether or not a capital contribution or surcharge will be required and if required, the amount, in accordance with the NGR.

Where a capital contribution is required then the amount of the contribution is not included in the regulated asset base. As a result, the distributor is entitled to recover the return only on that part of the network where the capital expenditure is 'justifiable' and 'conforming' under the NGR. Consequently, the original customer does not pay network charges on the non-conforming part of the expenditure.

In assessing the return on the extension, in practice distributors apply a realistic assessment of take up rates by other customers so that the original customer's contribution is not assessed as though it was the only connection using the extension. Distributors also take into account the highly interconnected nature of gas networks. This means that the level of contribution is therefore likely to be lower than is the case with electricity where extensions are generally to the periphery of the network and are costed on a different basis.

ENA considers that for gas, the current methodology best facilitates the uptake of natural gas because the distributor is able to allow for additional economic connections and therefore provides certainty to customers at the time they undertake their investment in appliances and equipment.

In addition, for gas, setting up a scheme to facilitate reimbursement would be costly and due to the low numbers of capital contributions, would be unlikely to result in any real benefit. For instance, in South Australia, approximately 10,000 small customers are connected every year. Of those, approximately 100 customers are required to pay a capital contribution and on average that contribution is around $2,500. It is estimated that the cost of implementing and maintaining a reimbursement scheme is likely to run into the hundreds of thousands of dollars, while the value of reimbursements in South Australia would likely be significantly less than the cost of the scheme. One of the reasons for this is that even where a premise is in the vicinity of an extension, the customer may not choose to connect because gas, unlike electricity, is not an essential service.

Industry considers that a reimbursement scheme is unlikely to have a material impact on the following outcomes as contended by the policy paper:

- result in efficient connections that otherwise might not have been constructed (since each connection is already assessed on grounds of economic efficiency);
- minimise distortions that might arise if a number of customers delay connecting so as not to be the first to connect and bear the full extension cost; and
- protect the initial customer against the risk that the cost and revenue formula used to calculate their contribution underestimate the distribution network revenue facilitated by the connection.

Rather the costs of administering the scheme are likely to outweigh any benefit.

ENA does not support the introduction of a scheme.

7. Implementation

As discussed above and as gas distributors have noted on previous occasions, gas must compete strongly in the energy market. Due to energy consciousness, average gas consumption is exhibiting a declining trend nationally, and gas distributors must maintain high levels of customer service to maintain network utilisation. There have been minimal issues surrounding gas connections to date, and while a national regime is desirable, the costs and benefits must be carefully assessed. If regulation is deemed necessary for gas, ENA recommends that it should be as light-handed as possible, and that for gas, consideration should be given to having any detailed obligations in low level instruments that are amenable to change.

As previously submitted, ENA considers that in implementing the NECF and the gas connections framework:

- MCE-SCO should adopt a model that imposes a framework that will result in the least costs to the industry as a whole, as costs are ultimately borne by customers.
- The framework should be flexible rather than overly prescriptive.

8. Transitional issues

As discussed at the workshop, to the extent that the introduction of the framework imposes costs on distributors or changes the operation of the access arrangement, it will be important that the transition to the new regulatory regime be made at the time of the regulatory reset process.

Industry notes that transitional issues will also have to be considered as part of the broader NECF package.

9. Process

Industry is concerned that it will only have one opportunity to review the exposure draft in so far as it relates to the gas connections framework and the electricity connection framework when the frameworks are released as part of the second exposure draft of the NECF.

ENA considers that in the interests of establishing a workable and effective NECF, including the gas connections framework, and doing so as expediently as possible, it is essential that further operational details be made available prior to the release of the second exposure draft. An alternative would be for industry review of the framework once comments received on the second exposure draft of the NECF have been incorporated. This process will ensure that the final framework is workable and effective and does not impose unnecessary costs on the industry as this could impede other government objectives such as to increase the uptake of natural gas.

Thank you again for the opportunity to provide comments on the draft policy positions. ENA would be happy to provide further assistance as the policy positions are further refined and the drafting instructions are developed. If you require further information or clarification before then please contact Abbe Hutchins on 02 6272 1519.

Yours sincerely

Andrew Blyth
Chief Executive