



Jemena Limited
ABN 95 052 167 405

Level 14
1 O'Connell Street
Sydney NSW 2000
Locked Bag 5001
Royal Exchange
NSW 1225

T +61 2 9270 4500
F +61 2 9270 4501
www.jemena.com.au

18 September 2009

E-mail: MCETMarketReform@ret.gov.au

Mr Geoff Houen
Gas Market Development Section
National Energy Market Branch
Department of Resources, Energy and Tourism
GPO Box 1564
Canberra ACT 2601

Dear Mr Houen

**Submission on the National Framework for the Connection of Retail Customers to
Natural Gas Distribution Networks**

Jemena appreciates the opportunity to provide comments on the MCE-SCO's draft policy paper on the above framework, referred to as 'the gas connections framework'. Jemena was also represented at the workshop held on 9 September to discuss the MCO-SCO proposals. Our comments are provided in the attachment.

Jemena directly owns Jemena Gas Networks (NSW) Ltd (**JGN**), the largest distributor of natural gas in NSW, with over one million connections. Through its asset management business, Jemena also provides asset management services to other gas and electricity businesses in Australia.

We have worked closely with the Energy Networks Association (ENA) in the development of the ENA's submission on the gas connections framework, and support that submission. Jemena urges MCE-SCO to provide for a framework which is simple, transparent and low cost, and which relies on existing cost recovery mechanisms as much as possible.

Should you wish to discuss this submission please contact Sandra Gamble, Group Manager Regulatory, on (02) 92704512 or email: sandra.gamble@jemena.com.au.

Yours sincerely

Sandra Gamble
Group Manager Regulatory

ATTACHMENT:

Jemena comments on on the National Framework for the Connection of Retail Customers to Natural Gas Distribution Networks

1. Introduction

The policy draft paper of 2 September sets out MCE-SCO's intentions at a high level.¹ For covered networks, Jemena understands the main features to be:

- Distributors must provide a basic connection service intended for the majority of small retail customers;
- Distributors may specify additional 'standardised' connections;
- For each service distributors will provide a schedule showing what is provided to the customer, timeframes for connection and connection charges (if any);
- Any additional costs must be quoted to the customer;
- The AER will approve details of each service having regard to certain criteria;
- There will be provision for negotiated connection services in accordance with a SCO negotiating framework;
- The connections framework will allow a retail customer to apply directly to a distributor for connection, and specified timeframes will govern this process;
- Third parties may facilitate connections on behalf of customers, but the customer will be deemed to be making the application;
- SCO has devised a capital contributions policy for connections that would otherwise be uneconomic, including a reimbursement policy.

While the high level features of the framework seem clear, Jemena's understanding from the 9 September workshop was that there will be a considerable degree of flexibility for distributors in its practical implementation. Jemena strongly supports this approach. We see it as imperative to avoid a detailed, prescriptive, and potentially costly legislative framework for connections, the costs of which must necessarily be passed on to customers. Such an approach would work against SCO's stated intention for a simple connection process for the majority of small retail customers.

We note that SCO proposes that terms and conditions dealing specifically with new connections will be included in the NECF's model standard distribution contract.

2. Existing connections frameworks and SCO proposal

An outline of how connections are presently dealt with under the gas access regime was recently provided to MCE-SCO by the ENA:

The calculation of connection charges is largely regulated through the national gas access regime by the setting of a reference tariff and the process for identifying conforming capital expenditure and relevant capital contributions (or alternative mechanisms for appropriately recovering non-conforming capital expenditure). In many cases, the distributor does not levy a charge for connection, as the expenditure is conforming under the NGR and is rolled into the capital base. This can be the case for both small and large customers.

The gas 'connection' service is therefore different to that provided in electricity, where the connection of a customer is a matter of regulatory obligation. Where a gas connection obligation exists, that obligation is generally an obligation to offer to connect, or to connect subject to the payment of relevant charges. The connection

¹ MCE Standing Committee of Officials Draft Policy Position: *The National Framework for the Connection of Retail Customers to Natural Gas Distribution Networks*, 2 September 2009.

service is generally not separately defined, but is instead intrinsically linked to the reference tariff and the revenue to be derived from the User in respect of that connection. The User is usually a retailer but can be a large customer.

The current gas access regime therefore already provides some of the elements of the national connections framework².

Given this explanation, Jemena is encouraged by statements made at the 9 September workshop which appear to recognise that the gas connections framework envisaged by SCO can be harmonised with the gas access regime. These statements included:

- Customers currently bear, directly or indirectly, the costs of connecting premises to the network;
- Different access arrangements have different ways of recovering connection capital expenditure;
- Recovery of expenditure (through tariffs and charges) for basic and additional standard connection services is to be as agreed between distributors and the AER as part of these services.³

Jemena suggests that one approach could be that, for covered pipelines, the basic connection service defined by the distribution business would align with the reference service that is currently provided to users under the access arrangement. The cost of a basic connection could be conforming capital expenditure that would be incurred by a prudent service provider acting efficiently and in accordance with accepted good industry practice⁴. Distributors therefore would not need to impose a specific charge for a basic connection.

A variation to this approach would be to require the service provider to include in its access arrangement a 'customer connections policy' which includes the schedule (required under the connections framework) indicating what service is provided to the customer, timeframes for connection and additional connection charges (if any). This policy would be approved at the same time as the access arrangement. This would harmonise the connections framework with the access regime and ensure there is no separation between requirements arising from the AER's approval role for basic and standardised connection services, and those services supplied and charged for under the access arrangement.

Alignment with the gas access regime is a low-cost option for both distributors and customers. It is vastly superior to any approach which envisages the total separation of forecast connection costs from other forecast capital expenditure and the recovery of those costs through individual charges applied to every single retail customer through a new and costly administrative support structure. It is also unclear in what way the AER could approve connection costs if they were divorced from the capital approval criteria of the existing access framework.

3. Role of intermediaries

Jemena recognises that SCO does want the option for retail customers to approach distributors directly. The policy paper states:

The Gas Connections Framework will allow a customer to apply directly to a distributor for connection to the distributor's network. Third parties, such as retailers or gasfitters, may facilitate connections and apply on behalf of customers, but it will not be mandatory for them to do so⁵

² ENA letter to DITR, *Comments on Draft Policy Paper on Gas Connections*, 10 July 2009.

³ SCO slide presentation, Melbourne 9 September 2009.

⁴ NGR 79(1).

⁵ MCE-SCO, op. cit. p 10.

In Jemena's view, intending customers would be most unlikely have the competency to arrange their own connection by taking full responsibility for the safety of their gas installation which the distributor is obliged to connect to, and have the ability to define their own supply requirements such peak load and gas pressure. An intermediary of some kind is needed to evaluate these matters.

Jemena's view is that it would be appropriate under the connections framework for distributors to have the obligation to receive connection requests from responsible parties on behalf of the end-use customer, including retailers, licensed gasfitters and builders or certified engineers. Under this model the distributor would deal with a much smaller number qualified parties as a business to business transaction at a much lower cost. Supporting this, all new installations or modifications would be required to be performed by a licensed gasfitter, and so they are the most appropriate party to request and receive the connection cost as a simple part of the quoting process to the end-use customer.

Jemena notes from the policy paper that a distributor's obligation to connect will be subject to (inter alia) intending customers satisfying pre-conditions for safety and technical requirements in the relevant jurisdiction codes⁶. In Jemena's view, it would be simplistic to assume that contact with the distributor would be a 'one-stop shop' for the intending customer, given that pre-conditions need to be satisfied, and that this will generally involve third parties.

In any event, a retailer must always be involved in the energisation function. There needs to be absolute clarity that the scope of the Gas Connection Framework does not include energisation which should be a service requested by and exclusively provided to a retailer.

Jemena considers that there are more efficient and transparent ways of facilitating connection than by providing an option for intending customers to contact distributors initially. One such mechanism could be for distributors to provide a web-based information service which lists the localities where gas is available in the distributor's area of supply, and the general pre-requisites for connection. This would provide an initial indication to the intending customer of whether connection is likely to be a straightforward matter. The web site could also list third parties who can assist intending customers in meeting connection requirements and who could liaise with distributors in ascertaining if additional connection charges would be required and, if so, report those charges directly to the intending customer.

4. Treatment of connection assets for capital contributions

The policy paper observes that under the NGR, a distributor may (a) recover conforming capital expenditure which is added to its capital base and recovered through tariff revenue; or (b) levy a capital contribution on a user but not have that portion of the asset base considered in future revenue determinations.⁷ The paper also notes that the NGR do not provide for retail customers paying connection costs directly to distributors. SCO therefore proposes that:

- Connection assets paid for by customers will be treated as gifted network assets to permit a distributor to recover as revenue the reasonable operating and maintenance costs of servicing these assets, consistent with the approach in the Electricity Connections Framework;
- There will be a reimbursement scheme for extensions to distribution networks that are initially paid for and used by a single customer and subsequently used by a number of customers. The scheme will provide an equitable way to share extension costs. The reimbursement scheme will apply to distribution network extensions only⁸.

It appears to Jemena that these proposals are both electricity-based, and do not accord with current practice under the NGR.

⁶ MCE-SCO op. cit. p 5.

⁷ NGR 79 and 82.

⁸ MCE-SCO op. cit. ss 8.2 and 8.3.

Cost recovery for potentially uneconomic connections

The policy paper says that where the cost of an individual customer connection is evaluated to be more than the amount provided for in the distributor's standard charges, then the distributor can recover additional costs of the connection from that customer.⁹

This is different to the current approach where connections are evaluated as to whether they are economic (NPV positive), and taking into account any need for network expansion to connect customers. In section 2 above, Jemena suggested an approach whereby the cost of a basic connection service would be conforming capital expenditure and therefore a distributor would not need to impose a specific (predetermined) charge for such a connection. The approach suggested in the policy paper appears to expect distributors to cost a standard connection configuration and assume any connection cost different to that to be subject to a contribution, irrespective of what other factors might be involved - such the potential gas load (which is fundamental to an economic test). Under this proposed approach it appears likely that more intending customers would have to pay contributions than at present (even where connections are economic), which will weaken the market competitiveness of gas. It also appears inconsistent with the access regime which has a test for network expansion (NGR 79(2)(b) – the incremental revenue test).

The policy paper notes on page 16 that the proposed treatment of connection assets does not otherwise change the arrangements for user capital contributions under the NGR. Nevertheless, In Jemena's view, SCO's proposals will inevitably lead to two alternative systems being applied to customers – one through retailers seeking network extension and passing any user capital contributions on to customers (in some manner which retailers choose) and one through distributors recovering the uneconomic portion of a connection cost directly from customers. It is not clear to Jemena how SCO intends these two systems to coexist and possibly even interact.

Jemena would support a provision in the rules for distributors to directly charge intending customers for the uneconomic portion of their connection cost¹⁰, provided that the calculation of that cost is based on an economic test taking account of all relevant variables affecting the particular connection or connections. This process would lie outside of the access regime, but would be aligned with it by the requirement that only the economic (conforming) capital expenditure of connection would become part of the regulated asset base.

Reimbursement scheme for extensions to distribution networks

Jemena understands that the rationale for the reimbursement scheme for previously dedicated assets is to provide consistency with the electricity connections framework and ensure that the original customer will be partially compensated for what has later become a shared asset.

At present, where a distributor seeks a capital contribution from an intending customer, then the amount of the contribution is not included in the regulated asset base. As a result, the distributor is entitled to obtain a return only on that part of the capital expenditure is 'justifiable' and 'conforming' under the NGR.

Currently gas distribution networks do not recover contributions from persons that obtain an advantage from the original extension to the network for which a capital contribution was required. Conceptually, the original connection will have met the justifiable/conforming tests by means of a capital contribution, while any additional connections would be likely to meet the tests without a contribution. The NGR therefore do not require a reimbursement scheme to be in place as a matter of economic efficiency.

In fact, Jemena suggests that the concept of 'reimbursement' is quite erroneous because all that distributors would be doing is transferring money amounts between an additional

⁹ MCE-SCO op. cit. p. 9.

¹⁰ This could be a condition in the relevant connection contract.

customer or customers and the original customer. However, in deciding to pay a capital contribution upfront, the original connecting customer will have fully recognised the economic value of gas to themselves. There is no economic distortion in this instance that requires rectification by a transfer payment scheme.

The question arises then as to what if any benefits such a scheme might have. The policy paper suggests that the scheme would:

- 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.

Jemena does not see these presumed benefits as compelling. For example, in relation to the third, a soundly designed economic formula, plus the distributor's long experience in estimating potential network loads, should minimise the risk of major miscalculation.

In general, Jemena considers that for gas the benefits of a reimbursement (transfer payment) scheme are negligible, while the costs would be substantial and real. Given the role of gas as a discretionary fuel, 100 per cent potential customer uptake along a network extension is totally unrealistic, unlike the case with electricity network extensions. In Jemena's estimation, the number of connections requiring a capital contribution would represent a very small percentage of total annual connections, probably making a long lived reimbursement scheme (as proposed by SCO) itself an uneconomic activity for distributors.