8 February 2010

Review of regulated retail tariffs and charges for gas 2010-2013
Independent Pricing and Regulatory Tribunal
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ORIGIN ENERGY'S VOLUNTARY TRANSITIONAL PRICING ARRANGEMENT

Origin Energy Retail (Origin) is a standard retail gas supplier to over 20,000 small customers in the Albury/Moama and NSW Murray Valley districts (AMV) as well as a new entrant gas supplier in other areas of the New South Wales (NSW) gas mass market.

Origin greatly appreciates the opportunity provided by the Independent Pricing and Regulatory Tribunal (IPART) to make further submission with regard to its draft voluntary transitional pricing arrangement (VTPA) for standing gas customers in the AMV, covering the period 1 July 2010 to 30 June 2013.

As outlined in Origin's initial draft submission of October 2009, Origin needed to undertake a significant level of analysis of its retail tariffs and the relevant network charges in order to determine the appropriate price path for the period from 2010 to 2013. This analysis has been completed and Origin is now in a position to provide IPART with its recommended retail price path and suitable transparency around the calculation as required.

It is important to note that Origin is still proposing that its bundled default tariff will consist of a retail (R) and network (N) component and it is the retail component that will be regulated under the VTPA. This process is described in further detail below.

In its October 2009 VTPA submission, Origin proposed that the average increase in the R component of default tariffs for both Albury and the Murray Valley be constrained to CPI+1 per cent for each year from 1 July 2010 until the end of the new VTPA. This assumed that the bundled retail tariffs for both the Albury and Murray Valley districts were providing a positive retail margin and as such, the price path was set in line with the expected annual changes in retail costs forecast for the next three year period. This remains the case with regard to Origin's forecast of retail costs.

However, further analysis of the cost reflectivity of the bundled retail tariffs in the Albury region has highlighted that significant changes in transmission and distribution network charges, not taken into account in the settings of the current VTPA, have caused the retail tariffs in the Albury region to be on average, making significant negative margins.

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The question then arises about how best to adjust for this historical error while retaining the integrity of a price-path based on an R + N approach for the next three years. Origin's preferred approach is to assess both the R and N components for 2010 using a cost build up. The first year of the new price-path can be based on a true cost build up and allow for an explicit adjustment of the R and N components then rely on the VTPA constraint to apply to the second and third year of the price path. This does appear to provide the most transparent approach to correcting the historical under-recovery.

However, Origin understands that IPART may wish to apply the VTPA approach from the first year. This is of some concern as the format of a true R + N approach (where N is a direct pass through), does not provide a straightforward approach to ex-post adjustments at the transition from one VTPA period to the next. Nevertheless, Origin's VTPA proposal assumes that the VTPA will start from 1 July 2010 and as a result, the R component of the tariff for 2010-11 effectively acts as the adjustment factor. Based on this approach, Origin is proposing:

- that the average increase in the retail component of default tariffs for the Albury district be constrained to CPI+10 per cent on 1 July 2010, and be constrained to CPI+1 per cent for each following year until the end of the VTPA; and
- that the average increase in the retail component of default tariffs for the Murray Valley district be constrained to CPI+1 per cent for each year from 1 July 2010 until the end of the VTPA.

This submission explains Origin's amended proposal and the reasons for the significant change.

Scope of the VTPA

For this VTPA, Origin proposes the following methodology:

1. Origin's default retail prices are to be subject to the agreement for a 3 year period from 1 July 2010 to 30 June 2013.

2. Default retail tariffs are to be defined as being comprised of:

   – the retail component (R);

   – the distribution network component (N) being all the regulated charges levied by a distribution network operator; and

   – a carbon component, being the charges levied by a retailer for direct and indirect costs attributable to a CPRS (if a CPRS or similar scheme is introduced during the period).

3. The retail component includes:

   – the wholesale gas cost (inclusive of MDQ costs) adjusted for published transmission and distribution network loss factors;

   – the market related AEMO charges adjusted for network loss factors;

   – transmission costs, adjusted for distribution losses; and

   – retail operating costs and retail margin (see also point 4 below).

4. The VTPA will regulate the annual changes in the R component of the default tariff but the VTPA will also allow:

 - Origin to determine an appropriate carbon pass-through amount subject to oversight by IPART and including a mid-year review in 2012-13 at Origin's discretion;
 - Origin to apply to IPART to vary the R component by more than the price constraint as a result of special circumstances;
 - Origin to implement a full and direct pass-through of all changes in distribution network charges; and
 - a margin is added to these costs so that the overall margin on the bundled tariff is equivalent to the retail margin percentage.[1]

<u>Unexpected network cost changes under previous VTPA</u>

In the current VTPA, the default tariff was considered as a bundled tariff with no distinction between the network and retail components. Therefore, the CPI and CPI+2 per cent price constraint applied to the Albury and Murray Valley retail tariffs were forecast to cover all changes in retail and wholesale costs as well as changes to transmission and distribution network charges.

The transmission and distribution network charges for the AMV are derived from:

- the GasNet transmission tariffs to carry the gas to Albury via the GasNet principal transmission line (PTL) and to the Murray Valley by the Murray Valley pipeline or Echuca pipelines; and
- Envestra's regulated network charges for Albury and unregulated network charges for the NSW Murray Valley[2].

However, during the 2007 to 2010 period, transmission and distribution network charges for the AMV changed significantly as:

- a new Access Agreement for GasNet transmission tariffs was approved by the AER to apply for five years from 2008 to 2013. Although the overall change was within expectations, the specific transmission charges applying to the Albury network increased by almost 80 per cent in 2008. As transmission charges make up 10 per cent of the total cost, this had a significant impact on the costs of supplying the Albury region;
- a new 5 year Access Arrangement for Envestra's distribution network was approved by the Essential Services Commission of Victoria (ESCV) to cover the period from 1 July 2008 to 31 December 2012 with an initial P0 impact on network tariffs on 1 July 2008 of 5 per cent. As distribution charges make up over 40 per cent of the total cost, this also had a significant impact on the costs of supplying the Albury region; and

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[1] In the alternate, as in South Australia, the margin on the R component must be increased to a percentage equivalent to a reasonable return on sales on the bundled price. In this case, the CPI + 10% proposal on the R component would need to be adjusted.

[2] http://www.envestra.com.au/operational_info/tariffs.html. The Victoria July 2009 tariffs include 2009 tariffs for Murray Valley NSW and Albury.

- an Envestra appeal with respect to this Access Arrangement was partially upheld during 2009 with a resultant uplift in Albury network tariffs of an additional 2 percent on 1 July 2009 and an increase in the annual changes to CPI+2 per cent per annum. For 2009-10 alone, this amounted to a further unexpected increase in the network charges of 4 per cent.

This highlights the issue that the result of any future determinations is unknown and can have a significant impact on the effectiveness of any retail price path set by Origin and is why Origin has proposed that the new VTPA only regulate a retail component and pass through network charges.

However, this does resolve the deterioration in the cost reflectivity of the Albury retail tariffs that occurred over this VTPA which is why Origin has had to re-examine it price path proposal for the Albury region for 1 July 2010.

<u>Gas retail tariffs under the VTPA</u>

Origin's VTPA proposal is to regulate the retail component and allow annual pass-through of the change in network charges applied by the network operator from 1 July 2010. However, the current VTPA refers to a bundled retail tariff so the issue for Origin is what the retail and network components for 2009-10 are (given that the current retail tariffs for Albury are not cost reflective) that the proposed VTPA will escalate for 2010-11 and onwards.

Origin's proposal is based on its understanding that the 2010-11 retail tariffs will be derived from escalating these 2009-10 retail and network tariff components so it infers that:

- the network component for 2009-10 is cost reflective and will be escalated according to the change in network tariffs; but
- the retail component is therefore not cost-reflective (especially for Albury) and requires a significant escalation in year one.

Origin notes that if IPART were to derive the 2010-11 networks component directly from the published network tariffs then Origin would be able to maintain a CPI+1 per cent increase in retail component for the Albury region in 2010-11 as the adjustment to network charges would drive the required tariff increase.

<u>Customer Impacts</u>

Whatever methodology is finally used, the impact on retail tariffs is necessarily the same if they are to be made cost-reflective.

For the Murray Valley, the total impact on an average residential customer consuming 32 GJ per annum (assuming network charges increase at CPI) is around $22 per annum (GST exclusive) over the period or 3 per cent.

For the Albury region, the total impact on an average residential customer consuming 40 GJ per annum (assuming network charges increase at CPI+2 per cent) is $52 or over 8 per cent in 2010-11 but only $22 per annum or 3 per cent thereafter (GST exclusive).

Origin has attached its proposed VTPA that incorporates these adjustments but if you have any further questions in relation to this submission, please contact Patrick Whish Wilson on (07) 3867 0620 in the first instance.

Yours sincerely

B J Hughson

Bev Hughson
National Manager Regulatory and Relationships

Attachment A: Origin's Amended VTPA Proposal

Draft Voluntary Transitional Pricing Arrangements for Origin for supply of natural gas to small gas customers (consuming 0-1 TJ a year)

1 July 2010 to 30 June 2013

The Independent Pricing and Regulatory Tribunal of New South Wales (the Tribunal) and Origin Energy Retail Limited (Origin) each agree to the following Voluntary Transitional Pricing Arrangements (VTPA).

1. Background

1.1 Origin and the Tribunal wish to continue the light-handed approach to default prices for small gas customers in the Albury and Murray Valley districts, as under the Voluntary Transitional Pricing Arrangements July 2004 to June 2007.

1.2 The Tribunal notes that Origin is of the view that at the cessation of the VTPA in June 2013, retail gas prices in the Albury and Murray Valley should be set by market forces.

1.3 The default tariffs for small customers were previously treated as a bundled tariff under the Voluntary Transitional Pricing Arrangements July 2004 to June 2007. The default tariffs constructed under this VTPA will continue to be billed on the basis of a single bundled tariff but will be comprised of a retail component (R) and a separate network component (N).

1.4 This VTPA applies only to the R component with the distribution network charges to Origin being passed directly through to customers. The separate components, (R) and (N), will be provided by Origin to the Tribunal each year, and made available on request to customers.

1.5 Upon the commencement of a Carbon Pollution Reduction Scheme (CPRS), there will be an additional retail charge, which for the purposes of this VTPA will be considered as a separate component, referred to as the Carbon component. (C).

1.6 Default tariffs will therefore be comprised of:

a) N+R – prior to the commencement of a CPRS; and

b) N+R+C – once the CPRS has commenced.

1.7 The Tribunal notes that Origin has advised that the VTPA pricing arrangements, as they apply to the retail (R) component only, are expected to result in the R component of the default prices increasing at or below:

a) CPI+10 per cent for the Albury district for the 1 July 2010;

b) CPI+1 per cent for the Albury district for the period 1 July 2011 to 30 June 2013; and

c) CPI+1 per cent for the Murray Valley district for the period 1 July 2010 to 30 June 2013;

1.8 Although this VTPA permits a full and direct pass-through of the distribution network component (N) in all default prices, Origin will not make changes to default prices arising from the network component within 6 months of the last change in default prices. Origin will advise the Tribunal at least one month in advance of any change.

1.9 Although this VTPA permits a full and direct pass-through of the carbon component (C) in all default prices, Origin will not make changes to default prices arising from the carbon component within 6 months of the last change in default prices. Origin will advise the Tribunal at least one month in advance of any change.

2. Application

2.1 This VTPA will apply to the R component of the default prices for small gas customers for the period 1 July 2010 to 30 June 2013.

2.2 This VTPA replaces any previous such voluntary transitional pricing arrangements between the Tribunal and Origin.

2.3 Nothing in this VTPA affects the Tribunal's ability to impose a Gas Pricing Order pursuant to section 27 of the Gas Supply Act or any other powers of the Tribunal.

3. Arrangements for default prices for Albury and NSW Murray Valley

3.1 Origin undertakes to:

a) make default prices available to all small gas customers in these regions; and

b) allow small gas customers who have accepted a competitive market offer to revert to Origin's default prices without penalty once they have met their contractual obligations.

3.2 Origin may vary the default prices for small gas customers without approval from the Tribunal on the basis that:

a) the average annual retail component increase is at or below CPI+1 per cent for the Albury and the Murray Valley districts;

b) the change in the network component is based on a direct pass-through of distribution network costs; and

c) the carbon component is calculated in accordance with the principles set out in 3.12.

3.3 The notification arrangements set out from clause 3.4 to clause 3.8 only apply to the approved changes under clause 3.2. They do not apply to changes arising from special circumstances (see 3.9)

3.4 Origin is required to advise the Tribunal of any change in default prices at least 1 month before they will take effect. Origin is required to provide the Tribunal:

a) notification of the increase in default prices; and

b) supporting information showing that each component of the default prices have varied in accordance with clause 3.2.

3.5 The Tribunal will notify Origin in writing whether they are satisfied that the proposed increase in default prices accords with the principles of this VTPA with respect to the change in the R value and/or the pass-through of distribution network charges or CPRS costs, within 10 business days of receipt.

3.6 If the Tribunal is not satisfied with the proposed increase in default prices:

a) Origin agrees to submit an amended proposal within 5 business days; and

b) the Tribunal agrees to notify Origin whether it is satisfied with that amended proposal within 5 business days.

3.7 Origin will publish its standard retail gas prices (subject to the review process above) on its website, including the separate R and N components and total standard retail price for each tariff. The publication of the standard prices on the website must occur at least 1 business day before the amended standard prices come into effect.

3.8 Origin will publish a Public Notice in a relevant regional or mass circulation paper as soon as possible after the receipt of the Tribunal' approval informing customers of the amendments to the gas standard prices and the website address for details of the new prices.

3.9 Should Origin consider it necessary as a result of Special Circumstances (as defined in clause 3.10) to vary the average annual retail component outside of the limits in paragraph 3.2 then the Tribunal's agreement is required and:

a) Origin must advise the Tribunal no later than 3 months before the date of effect of the increase (eg by 1 April for 1 July increase). This period may be varied by the mutual agreement of Origin and the Tribunal;

b) Origin must provide a justification statement to the Tribunal specifying the basis of the increase and providing relevant information supporting the increase;

c) The Tribunal may undertake an investigation of relevant costs incurred by Origin to satisfy itself of the validity of the increase proposed;

d) Origin will provide reasonable cooperation with the Tribunal during such reviews;

e) The Tribunal will notify Origin in writing of its decision on the proposed price variation 15 business days prior to the proposed date of effect of the increase;

f) Origin will publish the revised Default Prices (subject to the review process above) on its website in the manner set out in 3.7at least one business day before the amended prices come into affect; and

g) Origin will publish a Public Notice in a relevant regional or mass circulation paper as soon as possible after the receipt of the Tribunal's approval informing customers of the change in the gas Default Prices and the website address for details of the new prices.

3.10 For the purposes of clause 3.9, Special Circumstances include, but are not limited to, events that result in changes to costs such as regulatory changes, taxation changes, an unanticipated field price review or fundamental changes to gas market frameworks and arrangements, but not including any RoLR event.

3.11 Changes in Default Prices resulting from a RoLR event will be made in accordance with the prevailing NSW legislation on the administration of RoLR and applicable charges and by agreement with the Tribunal and not subject to the time periods set out in 3.9.

3.12 Upon introduction of a Carbon Pollution Reduction Scheme, Origin:

a) will advise the Tribunal of the carbon component no later than 3 months before the date of the proposed use of the carbon component or date of effect of the proposed increase (e.g. by 1 April for 1 July increase);

b) can vary the period by the agreement of the Tribunal; and

c) will provide the Tribunal with sufficient information to demonstrate and verify how it has calculated the pass-through amount.

4. Arrangements for miscellaneous charges

4.1 In relation to miscellaneous charges, the Tribunal and Origin agree that:

a) Any variation to miscellaneous charges as part of the 2010-2013 VTPA application[3] (other than to reflect changes in CPI or to pass-through increases in third party costs) will be subject to the Tribunal's agreement prior to implementation; and

b) Any proposed new miscellaneous retail charge (beyond the charges proposed separately by Origin to the Tribunal for commencement in 1 July 2010) will not be introduced without the Tribunal's agreement. Origin agrees that new miscellaneous charges will be established on a cost reflective basis.

4.2 Origin is required to advise the Tribunal of the increase in a miscellaneous charge one month before the relevant date (subject to paragraph 4.7) providing supporting information showing that miscellaneous charges have varied within the limits in paragraph 4.1 above.

4.3 The Tribunal will notify Origin whether they are satisfied with the proposed increase in miscellaneous charges within 10 business days of receipt.

4.4 If the Tribunal is not satisfied with the proposed increase in miscellaneous charges:

a) Origin agrees to submit an amended proposal within 5 business days; and

b) the Tribunal agrees to notify Origin whether it is satisfied with that amended proposal within 5 business days.

4.5 Origin will publish its revised miscellaneous charges (subject to the review process above) on its website at least 1 business day before the changes come into effect.

4.6 The processes outlined in sections 4.1 to 4.5 will also apply to any new miscellaneous charges that arise from the introduction of a new network service charge.

4.7 Where Origin proposes an increase or introduction of a miscellaneous retail charge that requires the Tribunal's agreement:

a) Origin must advise the Tribunal no later than 3 months before the date of effect of the miscellaneous charge (e.g. by 1 April for 1 July increase). This period may be varied by the mutual agreement of Origin and the Tribunal;

b) Origin must provide a justification statement to the Tribunal specifying the basis of the miscellaneous charge and providing relevant information supporting the increase;

c) The Tribunal may undertake an investigation of relevant costs incurred by Origin to satisfy itself of the validity of the miscellaneous charge proposed;

d) Origin will provide reasonable cooperation with the Tribunal during such reviews;

e) The Tribunal will notify Origin in writing of its decision on the proposed price variation no later than 15 calendar days prior to the proposed date of effect of the increase;

f) Origin will publish its new retail miscellaneous charge on its website at least 1 day before the charge comes into effect.

[3] subject to the qualification set out in clause 3.2.2 of the submission

5. Definitions

In this VTPA:

a) **CPI** means the consumer price index, All Groups index number for the weighted average of eight capital cities as published by the Australian Bureau of Statistics, or if the Australian Bureau of Statistics does not or ceases to publish the index, then CPI will mean an index determined by the Tribunal that is its best estimate of the index.

b) The change in the CPI for any given financial year t/(t+1) will be equal to the December to December change in the preceding calendar year (t-1), determined as follows to 2 decimal places:

$$CPI_{t/(t+1)} = \left\{\frac{CPI_{Mar(t-1)} + CPI_{Jun(t-1)} + CPI_{Sep(t-1)} + CPI_{Dec(t-1)}}{CPI_{Mar(t-2)} + CPI_{Jun(t-2)} + CPI_{Sep(t-2)} + CPI_{Dec(t-2)}} - 1\right\} \times 100\%$$

c) **default price** means a fee or charge for the supply of natural gas to a small gas customer by Origin under a standard form customer supply contract excluding miscellaneous charges

d) **financial year** means 1 July to 30 June of any year

e) **Gas Supply Act** means the *Gas Supply Act 1996 (NSW)*

f) **miscellaneous charge** means a fee or charge in addition to the default price for the supply of natural gas to a small gas customer by Origin under a standard form customer supply contract as published by Origin on its website in accordance with paragraph 4.5 (including but not limited to an account establishment fee, late payment fee, fee for dishonoured payment, late payment fee, fee for dishonoured payment and fee for special meter read)

g) **small gas customer** means a small retail customer whose consumption of natural gas at a premises is 0-1 terajoules (TY) a year

h) **small retail customer** has the same meaning given to that term under the Gas Supply Act

i) **standard form customer supply contract** has the same meaning given to that term under the Gas Supply Act

j) **standard supplier** has the same meaning given to that term under the Gas Supply Act

6. Interpretation

In this VTPA:

a) reference to an Act, legislation or law includes regulations, rules, codes and other instruments under it and consolidations, amendments, re-enactments or replacements of them;

b) words importing the singular include the plural and vice versa (for instance, the reference to a default price includes default prices and vice versa); and

c) headings are for convenience only and do not affect the interpretation of this VTPA.