

Response to IPART

Review of

Draft 2005 NSW Access Arrangement

AGL Gas Networks

A submission by Origin Energy

19 April 2004

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1. Introduction

Origin Energy (Origin) welcomes the opportunity to provide the Independent Pricing and Regulatory Tribunal (IPART) with comments on the AGL Gas Network's (AGLGN's) proposed Access Arrangement to take effect from 1 January 2005.

In this submission, Origin raises some general issues and comments on some specific concerns.

Origin has approached this review on the premise that customers and the Australian economy as a whole are the key beneficiaries of vigorous competition in the energy industry. As real competition takes shape, customers receive the benefit from new entrants and incumbents competing for market share by offering cheaper and more innovative services.

While the gas industry is well established in NSW, effective competition measured by customer churn rates, in the NSW gas market is somewhat less advanced than Victoria. Origin contends that effective gas market competition is fostered in an environment where barriers to competition are minimised.

In Origin's experience, one of the key barriers to retail competition is inconsistency between Use of System Agreements and Access Arrangements between States and Fuels. These inconsistencies, in turn, lead to costly variations to the systems and processes required by participants to operate in the energy industry across different states.

Another barrier to competition is preferential treatment of one industry participant over another. Access Arrangements, if developed in accordance with the National Third Party Access Code for Natural Gas Pipeline Systems, have the potential to minimise preferential treatment and thus enhance retail competition.

In the interests of industry efficiency, Origin encourages initiatives that, where possible, support consistency between Energy Distribution and Retailing across State jurisdictions and preclude preferential treatment between participants.

2. Specific Issues

2.1 Access Arrangement Terms & Conditions

General

Section 3.6 of the National Third Party Access Code for Natural Gas Pipeline Systems obliges the Service Provider to provide terms which are in the Regulator's opinion, reasonable.

While AGLGN has provided broad terms and conditions in this submission, Origin is aware of AGLGN's more detailed "*General Terms and Conditions*" used in conjunction with the current Access Arrangement. A copy of the detailed "*General Terms and Conditions*" was not been presented by AGLGN for this review of the 2005 Access Arrangement.

Origin's comments are based on the broad terms and conditions provided with AGLGN's current submission.

2.2 Cost Pass Through

AGLGN Access Arrangement for NSW Gas Networks Section 3.11(b) - Unaccounted For Gas (UAG)

AGLGN states in Section 3.11(b) of the Access Arrangement that Reference Tariffs will be adjusted for the actual cost of UAG in the previous year. This implies that the Reference Tariffs may be adjusted up or down in accordance with UAG costs.

However, Section 4.2.3 (Incentive Mechanism) of the Access Arrangement states that "*AGLGN will retain any benefit where it achieves a lower UAG level than the amount assumed for each year of the Access Arrangement Period.*"

While it is reasonable that AGLGN reaps the benefit of proper stewardship of UAG in reduced losses, Origin considers it a poor incentive mechanism for AGLGN if it allows AGLGN to pass through increased UAG costs if it performs poorly in this area. This is particularly more significant when considering that AGLGN has the greatest influence over UAG than any other party in the market.

Origin therefore recommends a modified and more efficient incentive mechanism that is consistent with network UAG management in other States. This mechanism should reward AGLGN for improved UAG management and that require that AGLGN bears the costs of poor UAG management.

This consistent incentive mechanism would not only address financial cost concerns but should also minimise the leakage of natural gas to the atmosphere and the associated the environmental impact.

AGLGN Access Arrangement for NSW Gas Networks

Section 3.11(c) - Cost Pass Through (Discretionary Pass Through of Cost Variations)

Section 3.11(c) sets out that AGLGN *may* vary Reference Tariffs where there is a material impact on the cost of providing reference services. This implies that tariff increases or reductions are at AGLGN's discretion.

Unfortunately, there is no compulsion on AGLGN to reduce tariffs where there is a material reduction in the cost of providing reference services.

Therefore, for consistency with Section 8.3 of the National Third Party Access Code for Natural Gas Pipeline Systems, and for a more efficient NSW gas industry, Origin recommends that tariff reductions be made compulsory where there is a material reduction on the cost providing reference services.

2.3 Taxation & GST

Section 3.11(c) - Cost Pass Through Change in Tax Event

AGLGN defines a Change in Tax Event for the purposes of Cost Pass-Through as;

“A change in the way or rate at which a Relevant Tax is calculated (including a change in the application or official interpretation of Relevant Tax); ...”

Origin contends that a Change in Tax Event should not extend to “changes in official interpretation”. Adoption of this principle should contribute toward a more efficient NSW gas industry.

AGLGN Access Arrangement for NSW Gas Networks

Section 5.1 - Bare Transfers

Section 5.1 provides for transfer of a service from one party to another under a bare transfer. Origin understands that this transfer may also have unintended GST consequences, in that both the User and Shipper may have to account for GST on the transfer.

Further clarification is warranted to ensure compliance with GST legislation.

AGLGN Access Arrangement for NSW Gas Networks

Section 6.5 - Compensation for Holding Security

Origin is concerned that it is not clear whether the Compensation for Holding Capacity is in fact consideration for extra services performed (taxable for GST) or is actually consideration for damages suffered by AGLGN (not taxable for GST).

Origin recommends amendment of this clause to clarify whether GST is payable.

**AGLGN Access Arrangement Information for NSW Network Networks
Schedule 2A; Paragraphs 62 & 63 - Title to Gas**

Origin is concerned that there may be unintended GST implications under the current wording of these paragraphs.

When a User injects gas into the pipe for transportation, does the User retain title to the gas while the gas is in the network or does it pass to AGLGN until it reaches the destination point, where the User receives title again?

The transfer of title to the gas could give rise to a taxable supply for GST, provided there is any consideration for the transfer. No industry participant currently accounts for GST on these transactions and to do so would be administratively difficult.

This is an industry issue and the various industry bodies are attempting to agree an accepted GST treatment with the ATO - however until a solution has been determined there is a risk that AGLGN and the User will have to account for GST on these transactions.

Origin therefore recommends clarification of this clause to align with GST legislation.

**AGLGN Access Arrangement for NSW Gas Networks
General - Gas Swaps**

Origin notes that although no cash is exchanged in a gas swap, gas may be defined as a "consideration" under GST legislation therefore producing a requirement to issue Tax Invoices.

There is no mention of invoicing principles for gas swaps in the Access Arrangement. Further development is required to comply with GST legalisation.

2.4 Security for Payment**AGLGN Access Arrangement for NSW Gas Networks
Section 10 - Security for Payment**

While Origin believes that there is a requirement to protect AGLGN's ability to collect its tariffs from Retailers, Origin is concerned that AGLGN's requirements for security for payment are too subjective and open to contention.

Origin therefore recommends replacement clauses similar to those proposed by Country Energy, which in turn are similar to the prudential requirements outlined in Victorian gas Access Arrangements, Victorian electricity Use of System Agreements and the South Australian Coordination Agreement, and which set out objective measures that;

- Describe objective requirements to invoke a bond or credit support, such as a minimum objective credit rating,
- Allow for a payment guarantee by an entity with sufficient Credit Rating,
- Describe the amount of the bond and/or credit support invoked, and
- Specify a finite duration for a bond or credit support after invocation, instead of an indefinite duration.

Origin believes that such an initiative will increase commonality between systems and processes and help reduce the potential for preferential treatment of industry participants.

2.5 Invoicing & Disputes

AGLGN Access Arrangement for NSW Gas Networks Schedule 2A; Paragraphs 38 & 39 - Accounts and payments

Origin is concerned that AGLGN's proposed clauses relating to Accounts and Payments are too subjective, open to contention and do not allow for common business practices such as;

- Short payment of invoices by the amount in dispute in the case of disputes notified to the payee before the due date.
- How retrospective disputes are to be handled
- How to handle amounts in dispute but later found to be correct.
- The rate of interest to be applied to unpaid amounts.

To avoid the potential for preferential treatment of retailers, Origin therefore recommends the implementation of amended specific clauses that provide detail on how these common issues are to be handled.

2.6 Ring-Fencing

AGLGN Access Arrangement for NSW Gas Networks General

Origin notes that AGLGN is an associate of a Retailing organisation under Section 4 of the National Third Party Access Code for Natural Gas Pipeline Systems. Origin is also unaware of any Ring-Fencing guidelines published in NSW that cover this relationship.

Origin therefore urges AGLGN and IPART to ensure that Ring-Fencing provisions under the code are strictly adhered to in order to foster unprejudiced and reasonable competition between Retailers.

2.7 Revenue Determination

AGLGN Access Arrangement Information for NSW Network Networks 5.6.1.8 - Dividend Imputation Utilisation Rate

The value of imputation credits to investors (γ) has a direct bearing on the regulated revenue received by AGLGN from its assets. In short and with all other factors being equal; a low γ would cause AGLGN to recover more revenue than if a high γ were imposed.

In its determination of WACC, AGLGN advises that it strongly believes that the value of γ should be set at 0.0. Nevertheless, AGLGN rightly concedes that such a low value of γ would conflict with precedents set by IPART and other Australian Regulators and suggests that a γ of between 30% and 50% is more appropriate.

Origin Energy believes that a γ of 50% is too low and probably based on empirical estimates of γ made before changes to tax legislation were introduced in July 2000 that increased the value of γ .

Prior to July 2000, imputation credits expired in the same tax-year. However, under the New Business Tax System (Miscellaneous) Act (No. 1) 2000, imputation credits could be reclaimed from the Australian Taxation Office, making them more valuable to Australian investors and increasing the value of γ .

In the interests of industry efficiency, Origin therefore recommends that a higher, more appropriate value of γ be used for AGLGN's calculation of WACC.

Accordingly, an increased γ implies that the revenue recovered by AGLGN should be reduced.

3. Summary

In the interests of the customer benefits derived from an efficient Gas Industry, Origin Energy restates its commitment to reasonable consistency between energy Use of System Agreements and Access Arrangements between States.

Origin Energy
19 April 2004