Submission

to the

Economic Regulation Authority

regarding

Proposed Revisions to the Access Arrangement for the Mid-West and South-West Gas Distribution Systems

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1 Background

Synergy is pleased to provide comment to the Economic Regulation Authority (**Authority**) on the proposed revisions by WA Gas Networks (**WAGN**) to the Access Arrangement for the Mid-West and South-West Gas Distribution Systems (**Access Arrangement**).

The proposed revisions to the Access Arrangement (**Proposed Revised Access Arrangement**) were submitted by WAGN to the Authority on 29 January 2010. The Proposed Revised Access Arrangement is part of the regulatory framework establishing, among other things, the terms and conditions, including price, upon which a third party can gain access to the pipelines for the 2010 to 2013/14 access arrangement period.

Since entering the retail gas market in 2003, Synergy has become the second largest gas retailer in Western Australia (**WA**). Synergy purchases gas from the Carnarvon and Perth basins and utilises the Mid-West and South-West Gas Distribution Systems (**GDS**) to deliver gas to customers consuming 180 GJ of gas or more a year in the area bounded by the south west interconnected electricity system (**SWIS**), extending to Geraldton in the north, Kalgoorlie in the east and Esperance in the south east, which includes the Perth metropolitan area.

2 Executive Summary

The revenue proposal submitted by WAGN for the 2010 to 2013/14 access arrangement period represents a substantial increase to the target revenue for the 2005 to 2009 access arrangement period. If accepted by the Authority, the proposed revenue would translate to significant tariff increases for customers.

Given the magnitude of the increases proposed, and the lack of publically available information substantiating those increases, Synergy submits that it is essential for the Authority to carefully scrutinise the information presented by WAGN to ensure that the proposed expenditure is both necessary and meets the criteria specified in the National Gas Rules[1] (**NGR**).

Synergy has a number of concerns with the proposals presented in the Proposed Revised Access Arrangement, specifically:

- The significant upwards creep in capital expenditure, resulting in the total proposed return on capital base being substantially higher than that for the 2005 to 2009 access arrangement period. Synergy does not have access to sufficient financial information to determine whether these increases are in accordance with the NGR;

- The total proposed forecast operating expenditure being substantially higher than the incurred operating expenditure for the 2005 to 2009 access arrangement period, with considerable increased spend in a number of operational areas. Synergy does not have access to sufficient financial information to determine whether these increases are in accordance with the NGR;

[1] National Gas Rules 2009

- The proposed reference tariffs, which are likely to cause significant price shocks to customers across many tariff classes, particularly to customers in tariff class A2;

- The proposed haulage contract, which omits several essential service levels including those of particular importance to A1, A2 and B2 customers.

These issues are discussed in more detail below.

3 Total Revenue

As noted by the Authority in its Issues Paper[2], the total revenue proposed for the 2010 to 2013/14 access arrangement period is significantly higher than that for the 2005 to 2009 access arrangement period, ranging from a 36 percent increase in 2010/11 to a 47 percent increase in 2013/14 when compared with the total revenue figure for 2009.

Unfortunately, Synergy does not have access to sufficient information to determine whether these increases meet the various requirements of the NGR. To the extent it has been able, Synergy has expressed its views on certain areas where it has particular concerns. However, given the lack of publically available information, Synergy requests the Authority to carefully review the sufficiency of the information provided by WAGN and to clearly set out in its draft decision the process it adopted in forming its view of whether the Proposed Revised Access Arrangement meets the NGR requirements, together with the Authority's detailed reasons.

Synergy acknowledges the building block approach to determining total revenue as specified in Rule 76 of the NGR. However, Synergy considers that the composition of particular building blocks used by WAGN to determine total revenue needs to be carefully scrutinised by the Authority, particularly given the lack of publically available information. If WAGN earns more than a fair return, or if any costs are recovered more than once, then the resulting cost to customers would be above an efficient level.

Return on capital base

Synergy is concerned that the total return on capital base for the 2010 to 2013/14 access arrangement period is more than 60 percent higher than that for the 2005 to 2009 access arrangement period.

Synergy has the following specific concerns:

- The capital expenditure incurred during the 2005 to 2009 access arrangement period was some 8 percent higher than forecast. Prior to rolling this additional expenditure into the initial capital base for the 2010 to 2013/14 access arrangement period, the Authority will need to determine whether it meets the criteria in Rule 79 of the NGR whereby new conforming capital expenditure is identified as capital expenditure which (a) would be incurred by a prudent service provider acting efficiently in accordance with accepted good industry practice and (b) is justifiable.

- WAGN does not adequately explain why forecast conforming capital expenditure for the 2010 to 2013/14 access arrangement period is approximately 27 percent more than that incurred during the 2005 to 2009 access arrangement period. Synergy submits the Authority should require WAGN to provide a more detailed publically

[2] Mid-West and South-West Gas Distribution Systems - Issues Paper on the Proposed Revisions to the Access Arrangement, Economic Regulation Authority, Western Australia, 26 February 2010

available explanation to enable proper public scrutiny. In particular, the information provided by WAGN does not include sufficient detail about the key projects to be undertaken in the 2010 to 2013/14 period and their costs and the basis for assessing whether the expenditure is prudent. For example, the substantial increase in the total capital expenditure per incremental customer connection unit rate (as high as $3,500 per new connection compared with the historical rate of $1,000-$2,750) is justified[3] as "*planned reinforcement of the high pressure parts of the network to allow extension of the WAGN GDS as the Perth metropolitan area continues to grow*", yet no specific details of this project are available. The Authority will need to have regard to the appropriateness of the capital expenditure for network augmentation in terms of forecast demand and for network replacement in terms of the general condition and age of the network.

- There is a significant increase in the proposed real pre-tax rate of return, up from 6.78 percent for the 2005 to 2009 access arrangement period to 11.1 percent for the 2010 to 2013/14 access arrangement period. The Authority will need to determine whether the proposed rate of return is appropriate. Synergy notes that, under rule 40(3) of the NGR, the Authority has full discretion concerning the rate of return if there is a preferable alternative.

Forecast operating expenditure

Table 3.1 shows the percentage difference between the forecast operating expenditure for the 2010 to 2013/14 access arrangement period and the actual operating expenditure for the 2005 to 2009 access arrangement period. The total forecast operating expenditure for the 2010 to 2013/14 access arrangement period is some 25 percent higher than the incurred operating expenditure for the 2005 to 2009 access arrangement period, with noticeable increases in almost all operational areas.

Operating Expenditure	Percentage Change	Percentage of Total Operating Expenditure
Network	+7%	48%
Marketing	+303%	2%
Corporate	+24%	13%
Information Technology	+18%	10%
Full Retail Contestability	-7%	0%
Regulatory Cost	+143%	10%
Unaccounted for Gas	+82%	17%
Total	**+25%**	**100%**

Table 3.1: Percentage change in operating expenditure 2010 to 2013/14 forecast vs 2005 to 2009 incurred

Synergy urges the Authority to carefully scrutinise the marked increases in expenditure. In particular:

- Proposed expenditure on external consultants should be carefully examined to determine whether it is prudent;
- Proposed increased spend on information technology needs to be analysed to ensure it pertains only to systems essential for servicing WA gas customers and not

[3] Access Arrangement Information for the WA Gas Networks Gas Distribution Systems, WA Gas Networks Pty Ltd, 29 January 2010, pp 22.

to non-essential “bells and whistles” systems or those pertaining to customers in other jurisdictions (the previous owner of the GDS, Alinta Limited, also owned the gas distribution network in New South Wales and some systems may have been, and may still continue to be, shared).

- Proposed increased regulatory spend, for example on systems that monitor compliance with market rules and obligations, needs to be prudent.

4 Reference Tariffs

Synergy is concerned that the reference tariffs proposed by WAGN are likely to cause price shocks to customers across many tariff classes, particularly to customers in tariff class A2.

A2 tariff class

NGR Rule 94(4) states that, for a tariff consisting of two or more charging parameters, each charging parameter must be determined with consideration to the associated transaction costs and to whether customers belonging to the relevant tariff class are able, or likely, to respond to price signals.

Synergy currently retails gas to a significant number of A2 tariff class customers consuming between 10 and 35 TJ of gas per annum. These include hospitals and aged care facilities, bakeries, manufacturing plants, food processing and packaging plants, universities and local councils. Based on the proposed reference tariffs, as much as 60 percent of an A2 customer’s total annual charge will now be comprised of a fixed charge of $34,115 per annum, a significant increase from the current charge of $556.13 per annum. This means that the ability of these customers to respond to usage-based price signals is likely to be severely limited.

Since the released by WAGN of its Proposed Revised Access Arrangement, Synergy has spoken with a number of customers concerning the intended tariff changes. The table below summarises the anticipated annual price impact on individual classes of customers and customer reaction to the tariff changes.

Business Category	Expected Annual Price Impact	Customer Reaction
Manufacturing	+50%	Price rises will eat into company profits as contracts will not enable increases to be easily passed on to customers.
Manufacturing	+36%	Business is under increasing pressure to reduce overheads to keep manufacturing in WA viable as opposed to producing product in New Zealand, China and Singapore. With intended tariff increases, cost competitiveness with interstate plants (Victoria and New South Wales) will become an issue and business' position in the national manufacturing arena will be compromised.
Manufacturing	+29%	Price impact is too high and will affect business operations.
Manufacturing	+24%	Profit margins in this line of business are currently minimal and customer will face "severe financial strain" with further price rises. Products on offer will need to be reconsidered; products which return the least margin will be expired. This in turn will have an impact on the number of people employed. Viability of business as a whole will need to be reassessed.
Food processing	+34%	Price impact will affect business operations and price increases will ultimately be passed through to customers.
Food processing	+48%	Price impact will affect business operations and increased costs will be passed through to customers.
Beverage production	+20%	Price rises will be passed through to customers.
Hospital	+71%	Customer is not able to reduce gas consumption to counter increased prices and therefore budget and operating costs will be greatly affected.

Table 4.1: Synergy A2 tariff customers - anticipated annual price impact and customer reaction

Cost allocation

Synergy asks that the Authority carefully scrutinise the reference tariffs proposed for each tariff customer class.

As noted earlier in this submission, the proposed increase in capital expenditure for the 2010 to 2013/14 access arrangement period is justified by WAGN as being for planned reinforcement to enable growth in the Perth metropolitan area. For present purposes, Synergy is prepared to assume[4] that network reinforcement of this type benefits all customers and hence related capital expenditure should be spread across customer classes according to the benefits afforded to each customer class. Customers in a particular tariff class should not be allocated more than their fair share of costs. Indeed, if customers do not benefit at all from particular expenditure then they should not be allocated any cost.

[4] Synergy submits there is insufficient information on what work is being planned for Synergy to form any concluded view.

Tariff glide path

Should the Authority determine that all of the proposed reference tariffs are justified, Synergy would urge that a glide path approach to fixed charges be considered, particularly for A2 tariff customers. As evidenced in Table 4.1, this particular class of customers will be severely impacted by the proposed increases. Synergy would be happy to discuss this approach further with both WAGN and the Authority.

Tariff class reallocation

Some customers that have been assigned to a certain tariff class actually consume significantly more or less than the usage parameters of that particular tariff class. For example, Synergy is aware of some A2 tariff customers consuming 5 to 10 TJ annually and of others consume in excess of 50 TJ per annum, well outside the 10 to 35 TJ per annum consumption band for that class of customers.

Generally, a customer is assigned to a reference tariff class by WAGN based on its anticipated throughput. Given the proposed significant increases in reference tariffs, Synergy considers that customers should be given the option of transferring, from the commencement of the 2010 to 2013/14 access arrangement period on 1 January 2011, to a tariff that best corresponds with their anticipated throughput. This offer should be made regardless of whether or not the customer's contract is due for renewal at that time.

5 Haulage Contract

Synergy has reviewed the haulage contract proposed by WAGN, which sets out the terms and conditions upon which WAGN will provide services to a user for the haulage of gas from specified receipt points to specified delivery points.

Synergy would support clarification by the Authority of the service standards set out in the haulage contract. Given the dependency of retailers on distributors in performing the retailers' functions, it is important that service standards are consistent with both retailers' and distributors' obligations under regulatory instruments and the Retail Market Rules[5], otherwise there is a real risk that a retailer will not be capable of meeting its regulatory, commercial or contractual obligations. Additionally, provisions should facilitate compliance with these agreed service levels. This will improve standards of service provided to customers and will improve the effectiveness of retail competition in the WA gas market by ensuring that all retailers are treated equitably.

Specific comments

The table below comprises Synergy's comments pertaining to specific clauses of the haulage contract. Synergy would be pleased to discuss these in more detail with the Authority and with WAGN.

[5] Retail Market Rules Version 5.9, Retail Energy Market Company (REMCo), 1 October 2009

Clause	Description	Synergy Comment
4.2(a) *Ongoing obligation to pay*	A User must pay WAGN the Haulage Charge for each Haulage Service to which the User has obtained access even if WAGN is unable to provide the Haulage Service in respect of the Delivery Point.	Synergy considers that a User should not pay for a Haulage Service it does receive.
5.9(c) *Gas balancing*	A User must agree that nothing in the Haulage Contract makes WAGN liable to the User in respect of any loss, damage or other consequence suffered by the User.	Synergy considers that WAGN should be liable where that loss, damage or other consequence suffered by the User was caused by or contributed to by WAGN's negligence or breach of contract or regulatory obligations.
6.1(b) *Title to Gas*	A User must indemnify WAGN against any Claim brought by any person against WAGN in respect of any Gas delivered into the WAGN GDS.	Since gas entering the GDS must meet specification, the onus should be on WAGN to accept or reject the gas at the gate station rather than deliver out of specification gas, particularly as a User may not have any notice of, or way to prevent, delivery of out of specification gas.
6.7(b) *Delivery facilities installation, maintenance and operation*	If, in the course of installing User Specific Delivery Facilities or Standard Delivery Facilities, WAGN causes damage to land or premises, then WAGN will, in its absolute discretion, either fill in any ground or at the User's expense and without obtaining prior consent from User, restore the land or premises.	Synergy considers this unreasonable and believes that WAGN should take all reasonable steps to restore the land or premises to its prior condition at WAGN's expense. Further, a retail User should not be put in a position where it is liable to WAGN for its unilateral actions, which negatively impact the retailer's customer.
6.7(d) *Delivery facilities installation, maintenance and operation*	If User is required to compensate User's Gas customer for any damage done in circumstances where WAGN would be liable, then WAGN will indemnify User to the extent of the **lesser** of: (i) the value of the compensation User's Gas customer receives from User; and (ii) the value of compensation which would be payable by WAGN to User under clause 6.7(c), if the damage had been suffered wholly by User instead of User 's Gas customer.	Synergy considers that WAGN should indemnify User to the **greater** of the value of compensation payable under (i) and (ii), otherwise a User is, through no fault of its own, likely to be out of pocket..
7.3(b) *Curtailment for certain activities*	WAGN may wholly or partially Curtail Gas deliveries at any time at least 10 days after giving a User written notice.	Synergy considers that this timeframe is insufficient.
12.1(a) *Replacement of Haulage Services*	WAGN may, by written notice to a User, replace the Haulage Service provided at a Delivery Point with a different Haulage Service at that Delivery Point.	Synergy considers that a User should be able to request WAGN in writing to replace the Haulage Service with a different Haulage Service and WAGN must use reasonable endeavours to meet the request.
9.1 *Invoicing*	Provision of network billing fields.	Synergy considers that each Payment Claim should include the network billing fields relevant to that Delivery Point. This would greatly assist Users in ensuring that data is accurate.
9.1(c) *Invoicing*	A Payment Claim comprises a summary of the Haulage Charges payable by the User.	Synergy considers that the calculation of those charges should be included.
16.1(b)(i)	Liability	There should be a comma after the word "point" in the first line and another comma

Clause	Description	Synergy Comment
		immediately before the word "undertaken" in the second line to ensure that the qualifier of "undertaken under this Haulage Contract or otherwise pursuant to law" applies to both refusal to accept gas and curtailment.
16.1(b)(ii)	Liability	Add "through no fault of the Service Provider" at the end of the paragraph.
20.4(b) *Format for information exchange*	Where information is not exchanged in accordance with clause 20.4(a), WAGN may recover from the person providing or requesting the information the reasonable additional costs involved in dealing with the information.	Synergy considers that a User should also be able to recover reasonable costs incurred by it if information is not exchanged in accordance with clause 20.4(a).
22.1 *Dictionary*	Definition of Indirect Damage	Synergy suggests this definition be extended to include a loss of goodwill or business reputation.

Table 5.1: Synergy's comments regarding specific clauses of the haulage contract

Service levels

Synergy submits that certain service levels essential to contestable gas customers should be included in the haulage contract. The inclusion of service standards for A1, A2 and B1 customers, particularly concerning timeframes, is necessary to ensure that these customers and their retailers are treated fairly and equitably.

The table below includes service levels that Synergy considers essential for inclusion in the haulage contract. The timeframes have been proposed by Synergy in consultation with customers. Synergy would be happy to discuss these further with the Authority, WAGN and other interested parties. Synergy suggests the Authority consider holding a public forum.

Request for	Tariff Class	Timeframe Perth Metro	Timeframe Non-Metro
Meter & service connection	A1 (>35 TJ) A2 (10-35 TJ) B1 (<10 TJ)	40 BDs 20 BDs 10 BDs	Synergy would like to discuss with the Authority and WAGN reasonable timeframes that are achievable on a reasonable cost basis.
Meter &/or service upgrade	A1 A2 B1	40 BDs 20 BDs 10 BDs	
Regulator removal - disconnect service in street	A1/A2/B1	5 BDs	
Regulator reinstallation - reconnect service in street	A1/A2/B1	5 BDs	
Permanent service disconnection	A1/A2/B1	10 BDs	
Special read	A1/A2/B1	2 BDs	
Cluster development	A1/A2/B1	10 BDs	
Emergency change over	A1/A2/B1	2 hours	
Apply/remove meter lock	A1/A2/B1	5 BDs	
Meter retake & test	A1/A2/B1	10 BDs	
Meter data accuracy response	A1/A2/B1	2 hours	
Dissatisfied customer	A1/A2/B1	5 hours	
Commercial Gas Connection Enquiry response	A1/A2/B1	5 BDs	
Other Service Order Response	A1/A2/B1	5 BDs	

Table 5.2: Proposed service levels for A1, A2 and B1 customers

6 Summary

In summary, Synergy recommends that the Authority:

- Ensures WAGN has provided sufficient information to substantiate the increases sought in the financial elements of the Revised Proposed Access Arrangement;
- Determines whether the additional capital expenditure incurred by WAGN during the 2005 to 2009 access arrangement period meets the criteria in Rule 79 of the NGR;
- Ascertains the appropriateness of the forecast conforming capital expenditure for the 2010 to 2013/14 access arrangement period, which is some 27 percent higher than that incurred during the 2005 to 2009 access arrangement period;
- Establishes whether the proposed real pre-tax rate of return of 11.1 percent is reasonable;
- Carefully scrutinises the conspicuous increase in forecast operating expenditure;
- Thoroughly reviews the reference tariffs proposed by WAGN for each tariff customer class. Synergy is concerned that these reference tariffs are likely to cause significant price shocks, particularly to customers in tariff class A2 consuming between 10 and 35 TJ of gas per annum;
- Considers a glide path approach to fixed charges, particularly for A2 tariff customers;
- Clarifies the service standards set out in the Haulage Contract;
- Considers the inclusion of service standards for A1, A2 and B1 customers to ensure that these customers and their retailers are treated fairly and equitably.

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