Kleenheat

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PRIVATE AND CONFIDENTIAL

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Economic Regulation Authority
PO Box 8469
PERTH BC WA 6849

Email: publicsubmissions@erawa.com.au

Kleenheat submission on the proposed revised access arrangement for Mid-West to South-West Gas Distribution Systems (GDS).

Dear Sir/Madam,

Thank you for the opportunity to provide feedback on ATCO's 2020 – 24 Access Arrangement ("AA5") for the Mid-West and South-West Gas Distribution Systems ("GDS").

By way of background, Kleenheat is a retailer of natural gas on the GDS, with approximately 200,000 business and residential customers. Kleenheat is part of the Wesfarmers Limited group, which includes large and small gas users on the GDS, such as Coles[1], AGR, CSBP and other brands. Kleenheat and related companies are both a retailer and consumers. Kleenheat believes that while AA5 should provide reasonable returns for the GDS operator, it is important for its customers, and for the broader business community, that access to the GDS remains affordable.

Broadly, Kleenheat has concerns that AA5 proposes significant increases in reference tariffs, together with a high level of operating and capital expenditure, and the impact this is likely to have on WA households and businesses.

In response to this submission, Kleenheat would like to make the following comments on specific areas of the proposal:

1. Reference Tariffs

Whilst the proposed reference tariff price increases have been described as "just $14 more a year per household (on average)[2]", the actual price increase from the end of AA4 is much more. The actual increase requested for B3 meters from 2019 is as follows[3]:

[1] Subject to approval of demerger proposal, see https://www.wesfarmers.com.au/our-businesses/coles/coles-demerger

[2] http://www.atcogas.com.au/About-Us/Who-We-Are/Our-5-Year-Plan

[3] Figure 1.4 - https://yourgas.com.au/wp-content/uploads/2018/09/ATCO-2020-2024-Plan-1.pdf?utm_source=plan_downloads&utm_medium=2020-24_Plan_page

Time period	$	%
From 2019 to 2020	38	23
2020 to 2021	6	3
2021 to 2022	6	3
2022 to 2023	6	3
2023 to 2024	7	3
Total	63	~35

Kleenheat acknowledges that this is an attractive increase to the network owner. ATCO has advised that this price path was chosen based on results obtained from a "Voice of Customer" engagement process, in which two price path options were presented to customers. After being given the opportunity to view the material presented in these sessions, Kleenheat has concerns as to whether the price path options were presented in an unbiased manner and whether customers were made aware of the large increase from 2019 to 2020.

To test the results of ATCO's Voice of Customer program, Kleenheat undertook an anonymous survey, asking how households prefer to manage increases to household expenses. The survey presented two price path options, the same as those presented by ATCO. The nature of the expenses were referred to only as 'household expenses'. Neither ATCO or Kleenheat were mentioned. 61 per cent of customers in Kleenheat's survey voted against the ATCO proposal, in favour of steady, moderate increases over a five year period.

Competition has introduced considerable savings to customers in the WA natural gas market. Large cost increases, such as the one proposed, will likely see price increases to consumers.

2. Operating expenditure

Kleenheat questions the level of conservatism inherent within the operating expenditure forecasts, and the potential for over-estimation. This concern is raised as a result of ATCO's actual and forecast operating expenditure for the AA4 period, which was significantly lower than the Economic Regulation Authority's ("ERA") approved amounts.

As observed over calendar years 2015 to 2017, ATCO maintained its operating expenditure at levels[4] materially lower than the ERA approved amounts (with savings averaging over $10 million, or approximately 15 per cent per year). However, as part of its AA5 submission, ATCO's forecast expenditure for the remainder of AA4 and for AA5 is expected to rise.

Kleenheat also questions ATCO's decision not to allow for a productivity adjustment in the AA5 operating expenditure forecasts, stating its benchmark performance is already considered efficient in comparison to its peers. Kleenheat question the reasonableness of this approach, and whether this indicates an assumption that further productivity improvements and efficiencies are no longer necessary. Benchmarks against other gas pipeline owners in Australia are an important measure, but it should be noted that some networks are generally understood to be 'gold plated' to earn higher returns for owners, and the Australian Competition and Consumer Commission, and the Australian Energy Regulator are looking closely at price reviews for all network operators.

[4] ATCO Gas Australia, *Access Arrangement Information,* 31 August 2018, p. 73, Figure 11.2

3. Capital expenditure

Kleenheat is concerned with the levels of capital expenditure forecast over AA5, in particular network sustaining and network growth capital expenditure.

3.1 Network sustaining capital expenditure

Kleenheat questions whether the increased level of network sustaining capital expenditure is reasonable given the trend over the AA4 period of continued improvement and outperformance in reliability of the network. As highlighted by the ERA[5], the historical trend in the System Average Interruption Frequency Index ("SAIFI"), has been one of year-on-year improvement. It appears this has been achieved with network sustaining capital expenditure levels remaining materially in line with the ERA AA4 approved limits.

For AA5, ATCO is proposing to increase network sustaining capex by approximately $54 million, an increase of 24.5 per cent. ATCO is also looking to set the AA5 target SAIFI at levels above the current trend (i.e. an easier target). Although it is understood not all of the network sustaining capital expenditure relates to maintaining reliability of the network, the above approach appears counter-intuitive.

3.2 Network growth capital expenditure

Kleenheat questions the level of network growth capex. For AA5, ATCO is forecasting to connect 83,300 new customers at a capitalised cost of $172.6 million (resulting in an average of $2,072 per customer). For AA4, ATCO forecast connecting over 100,000 new customers at a capitalised cost of $187.4 million (an average of $1,874 per customer). This works out as an average cost increase of 10.6 per cent per customer between AA4 and AA5.

ATCO notes it has used historical unit rates to calculate its forecast[6], and that these rates include cost-efficiencies from the contractor rates implemented in 2016. Assuming this statement is correct, it is unclear why the average cost per new connection is expected to rise by nearly 11 per cent.

4 Demand forecasts

Kleenheat questions the reasonableness of the demand forecasts, in particular the relatively steep decline in B3 demand per customer.

5 Oversized meters

Kleenheat have [redacted] customers with B1 meters installed. These meters are larger than the B3 meters used for most residential homes and small businesses, and are used for loads up to 10,000 GJs. The standing charge payable to ATCO for B1 meters is currently $1,002.38 p.a. vs $104.77 p.a. for B3 meters, a considerably higher fixed cost. For Kleenheat's B1 customers, [redacted] per cent use less than 500 GJ p.a. and [redacted] per cent use less than 100 GJ. The under-used B1 meters tend to predominantly be government sites such as schools and local councils.

ATCO has advised that:

- The size of the meter installed depends on advice from the gas fitter regarding the type of appliances to be used at the premises.
- The size of the meter installed may be specified by the customer.
- Larger meters are installed for relatively small loads if the appliances require a large flow of gas in a short time frame.

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[5] ERA, *Access Arrangement Issues Paper*, 11 October 2018, p. 17, Figure 4

[6] ATCO Gas Australia, *Access Arrangement Information*, 31 August 2018, p. 96, Section 12.5.1

Even given the above, it seems there has been some over specification of meters on the network, which in turn results in higher prices for those customers. The reasonableness of installation of the majority of these meters is questioned.

5. Special Meter Reads

Kleenheat supports the introduction of special meter reads as a reference ancillary service, and welcomes a decrease in this tariff. However, Kleenheat questions the reasonableness of the proposed tariff in comparison to other gas distribution networks, and whether this price sufficiently reflects any efficiency gains achieved through economies of scale as market churn increases as a result of increased competition in the WA Natural Gas market.

Kleenheat compared ATCO's special meter read tariff with a sample of five other gas distribution network operators:

Network operator	Cost of special meter read ($)
Multinet (Vic)	6.54
Australian Gas Networks (Vic & NSW)	9.00[7]
Australian Gas Networks (SA)	10.20
AusNet (Vic)	9.05
Jemena (NSW)	14.80
Average excluding ATCO (proposed)	9.92
ATCO (proposed)	12.82

ATCO's proposed special meter read tariffs would be the second most expensive across those sampled above. The lowest priced tariff was 49 per cent cheaper and the average price 23 per cent cheaper than ATCO. This appears to be inconsistent with an efficient operator.

In summary, the issues raised above all align with Kleenheat's key concern that access to the GDS remains affordable for WA households and businesses in order to allow for continued, healthy competition in the WA natural gas market.

Kleenheat would welcome the opportunity to discuss these issues further with the ERA.

For further information, or to discuss any of the points raised above, please contact Toby Devenish at tdevenish@kleenheat.com.au or 9312 9450.

Yours faithfully

[redacted]

Sarah York
General Manager, Natural Gas & Electricity

[7] Metropolitan rate.