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GEOGRAPHIC BOUNDARIES FOR GAS RETAILERS OF LAST RESORT

FINAL DECISION

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1 INTRODUCTION

1.1 Background

Part 3 division 6 of the *Gas Industry Act 2001* (GI Act) establish a gas retailer of last resort scheme (RoLR) for Victoria. The GI Act defines what type of retailer failure will trigger the operation of the RoLR scheme, that is, when:

- a retailer's licence to sell gas is revoked or
- a retailer's right to acquire gas in the wholesale market is suspended.[1]

The GI Act also determines the maximum duration of the RoLR's obligation to supply (three months), and confers on the Essential Services Commission (the Commission) broad discretion to develop and implement the remaining features of the gas RoLR schemes.

In February 2006, the Commission made its final decision on an electricity and gas RoLR scheme for Victoria (2006 final RoLR scheme decision).[2] The key decisions made by the Commission as it applies to the gas industry were:

- RoLR responsibilities were assigned to the three local retailers, AGL Sales (AGL), Origin Energy (Origin) and TRUenergy and
- in the event of a non-local retailer failure in the gas industry, the customers of the failed non-local gas retailer will be allocated to the gas retailer who has the local retailer responsibility for the area where the customer is located.

Local retailers for gas are defined by reference to the franchise area as specified in that retailer's licence immediately prior to 1 October 2002. The franchise areas were defined by postcodes and do not align with the gas distribution network areas.

As the market operator for the gas industry, VENCorp's responsibility in the event of a retailer failure is to transfer customers of the failed retailer to the local retailers. However, the franchise areas specified in the local retailers' licences do not align with the distribution network areas assigned to 'host retailers' in VENCorp's system for wholesale gas settlement purposes implemented post the introduction of full retail contestability.

Consequently, there is a lack of clarity for the industry about the geographical boundaries for which a RoLR would be responsible in the event of a retailer failure.

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[1] Section 49D(5) of the EI Act and section 51D(5) of the GI Act.

[2] Essential Services Commission 2006, *Energy retailer of last resort final decision*, February

1.2 Legislative and regulatory framework for this decision

Under section 51D of the GI Act, the Commission can designate retailers as the retailers of last resort in certain circumstances as a condition of the retailer's licence. Clause 13 of a gas retail licence imposes an obligation on the licensee, when directed to do so by the Commission, to sell gas to customers in certain circumstances when their original retailer fails. The Commission can, through this written direction, specify the geographic area for the RoLR.

1.3 National developments

The Commission notes that the Ministerial Council of Energy (MCE) is currently developing a national RoLR scheme to be implemented by the national regulators from 2010. Therefore, the Commission expects that its RoLR scheme will be superseded in approximately 18 months. The Commission agrees that alternative approaches to the RoLR scheme should be examined during the MCE consultations.

1.4 Consultation process

In August 2008, the Commission released its draft decision on the geographic boundaries for gas retailers of last resort (RoLRs). In the draft decision, the Commission considered two models for determining the boundaries for gas RoLRs, which are the local retailer model and the distribution network model (described in section 2).

The Commission considered that, on balance, the distribution network model imposes the least disruption to industry for a retailer failure that has a low risk of occurring while providing an interim solution until the establishment of a national RoLR scheme. Therefore, the Commission's draft decision was that the geographic boundaries for gas RoLRs be determined by distribution network area.

In response to its draft decision, the Commission received three submissions:

- Joint submission by the local retailers, AGL, Origin Energy and TRUenergy
- Joint submission by the distributors Envestra, Multinet and SP AusNet and
- VENCorp

At their request, the Commission also met with the RoLRs and the distributors separately to further consider issues arising from the draft decision.

2 OVERVIEW

This section provides an overview of the issues associated with determining the geographic boundaries for gas RoLRs.

2.1 Assigning gas RoLR responsibilities

The Commission's 2006 final RoLR scheme decision assigns RoLR responsibilities to the retailer who has the local retailer responsibility (obligation to sell) for the geographic area in which the customer is located. These retailers are AGL, Origin Energy and TRUenergy and the geographic areas in which they have an obligation to sell are defined by postcodes specified in their licences issued prior to 1 October 2002. This is known as the 'local retailer' model.

As the market operator for the gas industry, VENCorp's responsibility in the event of a retailer failure is to transfer customers of the failed retailer to the local retailers. However, the geographic boundaries for local retailers as specified in their original licences are not aligned with the distribution network areas assigned to 'host retailers' in VENCorp's system for wholesale gas settlement purposes post the introduction of full retail contestability.

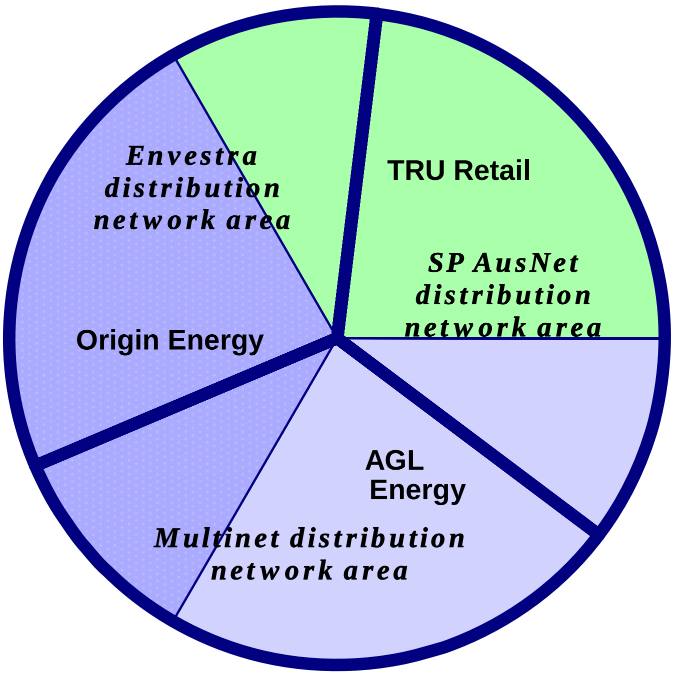
The distributors' responsibility in the event of a failed retailer is to ensure that the RoLRs are efficiently provided with estimated meter reads and other relevant information so that the RoLRs are able to bill customers in a timely manner.

The implications for defining the RoLR geographic boundaries arising from the two approaches are shown in diagram 2.1 and diagram 2.2.

Diagram 2.1 shows the 'local retailer' model for determining the geographic boundaries for RoLR purposes. Under this model, the local retailers overlap two distribution areas, that is:

- Origin's local area covers both Envestra's and Multinet's distribution network areas
- TRUenergy's local area covers both SP Ausnet and Envestra distribution network areas
- AGL's local area covers both Multinet and SP Ausnet distribution network areas.

Diagram 2.1 **Local retailer model**

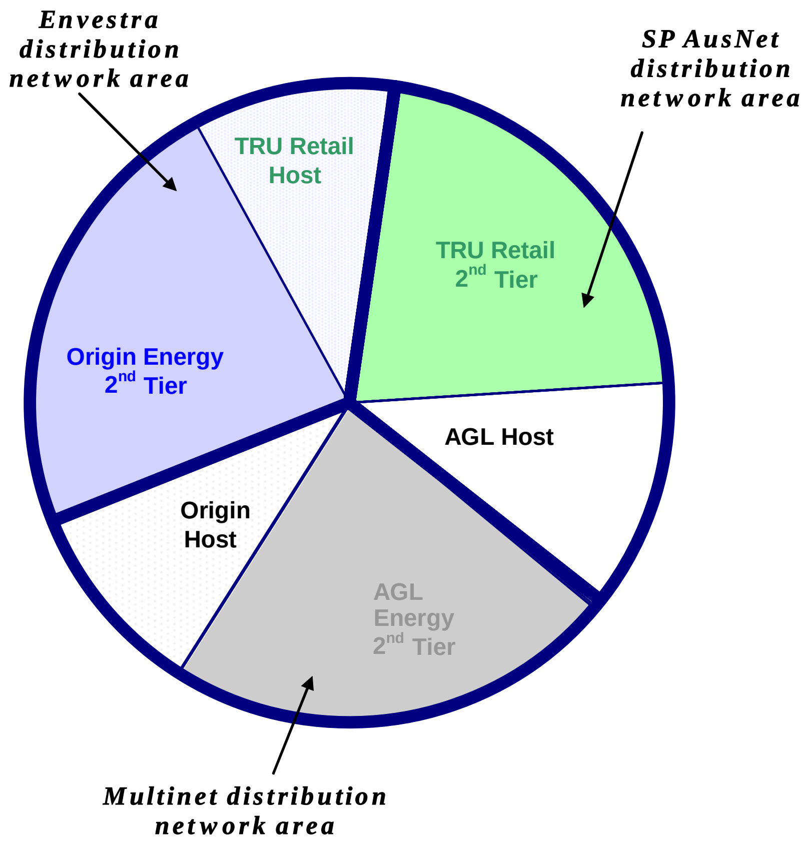


Source: VENCorp

Diagram 2.2 shows that VENCorp's current system of allocation to the 'host retailer' would result in a different allocation for RoLR responsibilities than that assumed under the Commission's 2006 final RoLR scheme decision. For example, under this model:

- Customers in Envestra's distribution network area would be transferred only to TRUenergy, whereas the Commission's final decision expected that they would be transferred to either TRUenergy or Origin.

Diagram 2.2 **Host retailers in VENCorp's system**



Source: VENCorp

3 MODELS FOR GAS ROLR BOUNDARIES

This section outlines the stakeholders' submissions on the two models and discusses the advantages and disadvantages of each model.

3.1 Local retailer model

The local retailers submitted that the boundaries for their RoLR responsibilities should be established on the basis of postcodes as specified in the licences in place in October 2002. At that time, local retailers were assigned responsibilities for customers within these areas, including the obligation to offer supply at specified terms and conditions. In summary, the local retailers considered that the advantages of assigning RoLR responsibilities based on this model were consistency with their existing regulatory obligations and their familiarity with customers in their local area.

In their joint submission to the draft decision, these retailers further argued that the failed retailer's customers would be more familiar with the local retailers as they would have previously had supply from these retailers or would be familiar with their brand name and contact details.

Assigning RoLR responsibilities by the local retailer model would also mean that the same standard offer would apply both to customers of the failed retailer and the local retailer's existing deemed customers.[3] As both types of customers would be on the same contractual arrangements, the local retailers considered that "neighbouring customers can gain support and information from each other during the confusion created by a RoLR event".[4]

3.2 Distribution network model

VENCorp advised that for gas market settlement purposes, it does not use the postcodes as specified in the local retailers' licences.

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[3] Customers, who have not entered into a market contract with any retailer when the gas retail market was opened up to competition in September 2001, are deemed to have entered into a contract with the incumbent retailer in their local area (see section 44 of the GI Act).

[4] AGL, Origin Energy and TRUenergy 2008, *Geographic Boundaries for Gas Retailers of Last Resort – Draft Decision*, August, p. 2.

From October 2002, VENCorp and its industry working group redesigned the wholesale market settlement processes to allocate wholesale gas in each distribution network "by difference". That is, a "host retailer" was designated for each of the distribution network areas, and the total injections into the network were assigned to the "host retailer" minus any metered values belonging to sites in the distribution network supplied by a non-local retailer (see Diagram 2.2).

VENCorp and its industry working group considered postcodes to be inherently unreliable as a means of determining physical location. This resulted in the settlement system being redesigned to use the structure of the metering installation registration number (MIRN) to automatically determine who the "host retailer" is for any site. This is done by reference to the third digit in a gas MIRN, as it signifies to which distribution network the site is connected and therefore by definition who the host is for the site.

VENCorp and the distributors submitted that the preferred model for allocating RoLR responsibilities should be consistent with the above settlement system whereby a single RoLR is assigned to each distribution network area. This is because it would be relatively easy to adapt VENCorp's system to assign a single RoLR to a distribution network area, the distribution network model could accommodate extensions to the Principal Transmission System (PTS) and the customer transfer process would be simple.

3.3 Advantages and disadvantages of each model

In their submissions to the draft decision, the parties provided their views on the perceived advantages and disadvantages of each model.

Understanding the customer base

The local retailers reiterated that, as they are currently familiar with their local retailer areas and associated contractual responsibilities, it would be confusing and unnecessary for them to have to understand a different customer base under the distribution network model.[5]

Conversely, the distributors noted that since retail competition was introduced to the gas market six years ago, customer churn amongst retailers has been prevalent. For example, in July 2008, 52 000 gas customer transfers were lodged in VENCorp's systems. Therefore, the distributors submitted that the local retailers should have sufficient knowledge to price and manage wholesale risks for customers outside their local area. The distributors also noted that:

- the local retailers have market offers available to customers outside of their local areas and
- the Australian Energy Markets Commission has recommended to the Victorian government "…that the regulated price caps fall away for gas customers from the

[5] AGL, Origin Energy and TRUenergy 2008, op. cit., p. 2.

start of 2009. Hence the market is only four months away from the retailers being able to price appropriately in a standing offer form both on and off their former franchise areas. This is likely to involve a new standing offer approach and re-education of their call centre."[6]

Envestra and Multinet considered that distributors would be able to communicate more efficiently with one RoLR at the time of a retailer failure than two RoLRs. The local retailers countered that this perspective is inaccurate as distributors would normally have to communicate with multiple retailers, who make "…requests for service on behalf of millions of customers and their systems are set up to deal with the multitude of retailers."[7] They also argue that distributors will need to communicate with all retailers to manage the failed retailer's outstanding service orders irrespective of the model used to assign RoLR responsibilities.[8]

Impact on customer transfer systems and costs

All participants have different views as to the impact on transfer systems and costs.

VENCorp estimates that it will incur approximately $450 000 to implement the RoLR system changes based on the distribution network model.

An additional $135 000 is estimated to implement the local retailer model and there will be ongoing costs to account for changes to postcode boundaries and the introduction of new postcodes. These costs are not considered to be significant nor processes onerous, but all participants will be required to ensure that their data is aligned with that in the VENCorp system.

The local retailers argue that VENCorp's systems will not require modification if RoLR responsibilities were assigned based on the local retailer model. Their view is that, as all retailers are required to provide VENCorp with their customers' details on a regular basis, VENCorp can use this data to compile customer location details and to transfer customers to their local retailers if a non-local retailer fails.

If RoLR responsibilities were assigned based on the distribution area model, the local retailers argue that they will also incur additional systems costs comparable to VENCorp's.[9] The local retailers verbally advised the Commission that these costs were approximately $25 000 each. Their customer information systems will need modification so customers outside of their local area can be entered in their systems.

Envestra and Multinet accept that manually transferring customers on the basis of postcodes to two RoLRs is possible, but would add unnecessary complexity and

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[6] Envestra, Multinet and SP AusNet 2008, *Defining the Geographic Boundaries for Gas Retailers of Last Resort (ROLR)*, August, p. 4.

[7] AGL, Origin Energy and TRUenergy 2008, op. cit., p 5.

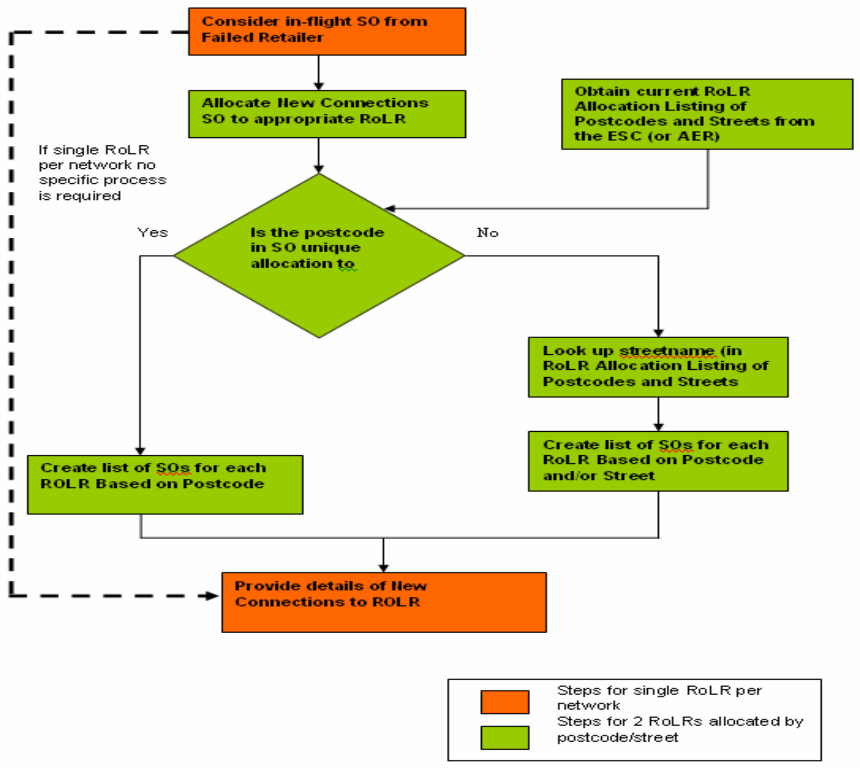
[8] Ibid., pp. 2-3.

[9] Ibid., p. 2.

delay.[10] Specifically, they would need to review service orders from the failed retailer and manually assign them to the correct RoLR.[11] An overview of this process is shown in Diagram 3.1.[12]

The distributors state that, if the distribution network model is adopted, they would not have to make any modifications to their existing systems to account for a RoLR event.

Diagram 3.1 **Distributors' service order process**



Source: Distributors joint submission

[10] According to the distributors, the trade sale of a few thousand customers in the Victorian electricity industry in 2007 took several days to manage manually. The distributors, therefore, contend that the manual transfer of around 30 000 customers could not be managed within acceptable timeframes

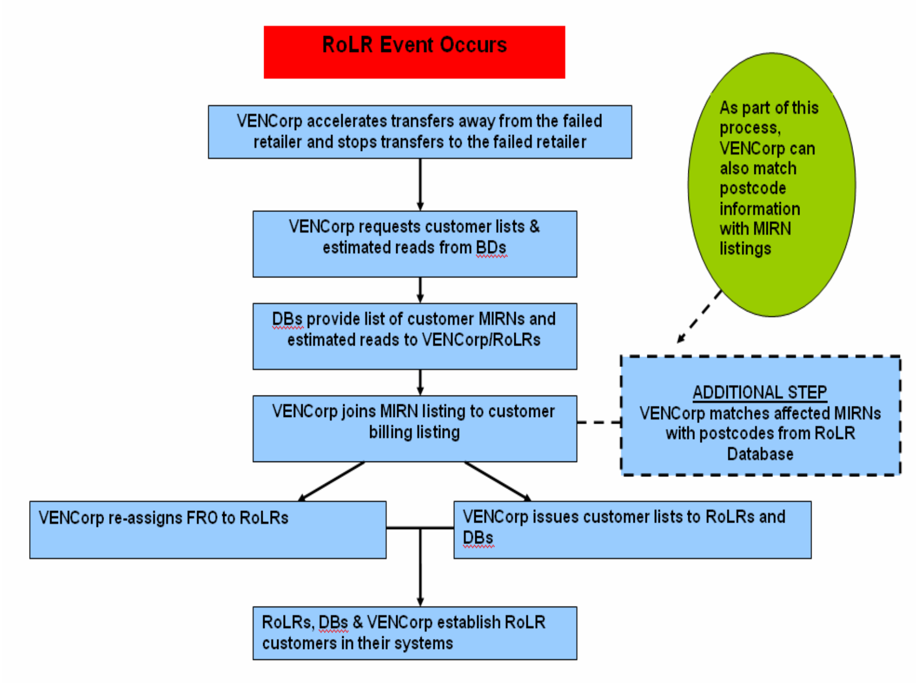
[11] Envestra, Multinet and SP AusNet 2008, op. cit., p. 2.

[12] Ibid., p. 10.

VENCorp also accepts that a manual process of transferring the failed retailer's customers to the RoLRs is possible, but would introduce significant delay to the processing of information and the transfer of data to RoLRs and distributors. This delay could adversely impact on the ability of the RoLRs to manage the spot market risks of purchasing gas to meet a sudden change in customer load characteristics.[13]

The local retailers submitted that the customer transfer process would not be as complicated as the distributors and VENCorp claim. VENCorp's role is simply to change the responsible retailer for a set of MIRNs in their IT systems from one party to another. Under the local retailer model, VENCorp will be required to perform only an additional step in the process as shown in Diagram 3.2. The local retailers do not consider this additional step to be complex.[14]

Diagram 3.2 **VENCorp processes from local retailers' perspective**



Source: Local retailers

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[13] VENCorp 2008, *Response to the Commission's Draft Decision on the Geographic Boundaries for Gas Retailers of Last Resort*, August, p. 3.

[14] AGL, Origin Energy and TRUenergy 2008, op. cit., p. 2.

PTS extension areas

It is argued that a disadvantage of the local retailer model is that it may not easily accommodate extensions to the principal transmissions systems (PTS). Gas supplied by the PTS comes from pipelines owned by GasNet and operated by VENCorp; that is, VENCorp manages wholesale gas settlement for participants in the PTS areas. The PTS carries gas from Longford to Melbourne and then to Victoria's northern and western regional areas.

If the local retailer model was adopted, VENCorp and the distributors note that whenever there is an extension to the PTS, licences would have to be amended by the Commission and their systems would require updating.

The local retailers also acknowledge that their licences would require amendment to include new PTS extension areas, but believe the local retailer model could easily accommodate extensions to the PTS. The local retailers propose that where the PTS is extended into or near areas where there is currently a local retailer, RoLR responsibility should be assigned to that local retailer. Local retailers state that they have already voluntarily assumed supply obligation responsibilities for the PTS extension areas and would not disconnect any customers under a RoLR allocation process. [15]

However, VENCorp is concerned that, should a non-local retailer failure occur before its system has been updated with the new PTS extension areas, the customers may be transferred to the incorrect RoLR.

Issues related to the use of postcodes

VENCorp considers that assigning RoLR responsibilities by postcodes would mean that each RoLR defined area must have a unique set of postcodes to avoid complexity in determining which sites in a shared postcode belong to which RoLR. For example, the postcode 3055 is shared between AGL and TRUenergy. The Commission would need to determine whether the RoLR responsibility for customers with the 3055 postcode should be assigned to AGL or TRUenergy.

The distributors submitted that, under the local retailer model, the Commission would need to update postcodes specified in the local retailers' pre October 2002 retail licences for growth in the network due to the creation of new suburbs, extensions to the PTS and changes to postcode boundaries by Australia Post since October 2002. The distributors further submitted that the Commission would then need to reach an agreement with industry on the allocation of the postcodes amongst the three local retailers and develop a process for ensuring the postcodes remain up to date.[16]

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[15] AGL, Origin Energy and TRUenergy 2008, op. cit., p. 4.

[16] Envestra, Multinet and SP AusNet 2008, op. cit., p. 2.

3.4 Issues related to non-PTS areas

In its consultation with industry, the Commission was made aware that the RoLR legislative and regulatory framework does not allocate a retailer of last resort to the non-PTS areas. In the draft decision, the Commission outlined the issues relating to the complexities of allocating a RoLR to non-PTS areas and indicated that the matter would be raised with the Department of Primary Industries.

In their submissions, the distributors and retailers proposed different models for allocating RoLR responsibilities to non-PTS areas. The distributors and VENCorp also requested the Commission to make an early decision on the proposed scheme. Consequently, the Commission now intends to release an Issues Paper in late October 2008 for further consultation on this matter.

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4 FINAL DECISION

This section sets out the Commission's draft decision and explains the reasons for the Commission's final decision.

4.1 Draft decision

The Commission noted that the local retailers observed that the "MCE findings on RoLR [are] still not decided and any decision made in Victoria should either be seen as interim or delayed until the MCE decision…the Commission's response should be based on delivering a low cost interim solution."[17]

The Commission supported this view and based its draft decision on achieving this outcome for the remaining period for which the Commission has responsibility for energy regulation. Therefore, the draft decision was that the distribution network model imposed the least disruption to industry for a retailer failure that has a low risk of occurring while providing an interim solution until the establishment of a national RoLR scheme. The Commission also noted that the industry is familiar with the distribution network model as it has been a means of wholesale gas settlement since the onset of FRC in 2002.

In making its draft decision, the Commission also considered:

- the distribution network model will result in customers being transferred quickly to the RoLR in the event of their retailer failing
- the systems costs that may be imposed on VENCorp and the distributors if the local retailer model was adopted and on the retailers if the distribution network model was adopted
- the flexibility of the distribution network to accommodate extensions to the PTS
- that local retailers have customers residing outside of their local area. Therefore, it is assumed that that the load profile and characteristics of customers outside of their local area would be used by these retailers to manage their RoLR responsibilities.

[17] Joint submission by AGL, Origin and TRUenergy 2008, *Defining the geographic boundaries for gas retailers of last resort*, July, p. 6.

4.2 Final decision

The Commission understands that, in developing a national RoLR scheme, the MCE may be influenced by the existing jurisdictional RoLR schemes. In this regard, the Commission notes that:

- only Victoria and New South Wales has a RoLR scheme for both electricity and gas[18] and
- the geographic boundaries for the gas RoLRs in New South Wales are determined by the local government areas.[19]

It is currently uncertain how the national RoLR scheme will operate and it is understood that the MCE consultation on this matter may extend well into 2009. Therefore, the Commission is bound to make an interim decision. The basis for this decision is that the geographic boundaries for the gas RoLRs will impose the least cost and least disruption to industry while providing customers with some protection during this interim period. The Commission remains of the view that the distribution network model achieves this objective. The Commission's reasons for this view are discussed below.

Understanding the customer base

The Commission notes that the primary reason put forward by the RoLRs for the local retailer model is their familiarity with their local area and therefore their capacity to provide a better service to customers of a failed retailer in a RoLR event.

In their joint submission, these retailers argued for consistency with their existing obligation to supply requirements, including the standing offer terms and conditions of supply. If the gas geographic boundaries were determined as the distribution network model, then the currently approved tariffs and terms and conditions may not be sufficient to cover the retailers' costs.

The Commission does not consider that these factors are sufficiently robust for accepting the local retailer model for the following reasons:

- in the competitive market, all local retailers have customers residing outside of their local area and therefore it is assumed that their marketing, customer knowledge and experience must extend beyond their local area
- the MCE is currently consulting on an approach to placing the obligation to offer to supply on all financially responsible retailers. Consequently, this direct linkage between a local area and local retailer may progressively weaken as the competitive national market further evolves

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[18] In South Australia, the ACT and Queensland, a RoLR scheme exists only for the electricity industry.

[19] A list of the gas RoLRs in New South Wales and their geographic boundaries can be found on the website of the Independent Pricing and Regulatory Tribunal at www.ipart.nsw.gov.au, under "Gas", "Licensing" and "Authorisation Endorsements".

- in its May 2008 final decision on RoLR customer charges, the Commission foreshadowed the possibility of reviewing the RoLR customer charges in the second quarter of 2009.[20] As necessary, this review could take into account additional costs associated with allocating customers to the gas RoLR based on the distribution network model.

Costs to be incurred in the interim period under the local retailer model

VENCorp estimates that it would incur an additional $135 000 in modifying its system so that it can transfer customers by postcode. Distributors submit that they would also incur costs from having to change their systems and processes to align with changes to VENCorp's system. These costs would not be incurred if the distribution network model was implemented.

The local retailers do not believe that an extensive overhaul of VENCorp's system is necessary as VENCorp can allocate customers to the RoLRs manually by using the information all retailers are required to provide VENCorp. Local retailers also submitted that they would also incur similar systems costs to implement the distribution network model. Local retailers verbally advised the Commission that they would incur approximately $25 000 each in modifying their customer information systems so that they can accept customers outside of their local area.

The Commission considers that the cost imposition for adopting either model do not appear to be substantial for VENCorp, the RoLRs or the distributors. However, the aggregated systems costs to implement the local retailer model are higher than the distribution network model.

In support of the local retailers' submissions, the Commission acknowledges that allocating customers manually is feasible. However, it continues to hold the view that a manual transfer process would not be an efficient way of transferring customers to the RoLRs and increases the risk that customers may be transferred to the incorrect RoLR.[21]

Summary

The Commission recognises that each model has merit and would achieve the objectives of the RoLR scheme. However, the Commission's conclusion is that the distribution network model will:

- impose least cost on the industry overall
- mitigate the risk of customers not being transferred in a RoLR event and
- create the least disruption to the Victorian gas market prior to the MCE decision on the national RoLR scheme.

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[20] Essential Services Commission 2008, *Retailer of last resort customer charges final decision*, May, p. 35.

[21] The Commission acknowledges the local retailers have stated that they would not disconnect any customers under a RoLR allocation process if they were not identified in their local area.

Final decision

The geographic boundaries for the gas RoLRs will be defined by the distribution network area. Therefore:

- AGL will be the gas RoLR for SP AusNet’s distribution network area
- Origin Energy will be the gas RoLR for Multinet’s distribution network area
- TRUenergy will be the gas RoLR for Envestra’s distribution network area