15 June 2017

Essential Services Commission
Level 37, 2 Lonsdale Street
Melbourne VIC 3000

Submitted via email to: energy.submissions@esc.vic.gov.au

Dear Sir/Madam,

Re: Review of Unaccounted for Gas Benchmarks: Draft Decision Methodology - May 2017

Introduction

Red Energy (Red) and Lumo Energy (Lumo) welcome the opportunity to respond to the Essential Services Commission (the Commission) review of the Unaccounted for Gas Benchmarks, Draft Decision – Methodology (the Draft Decision).

Unaccounted for Gas (UAFG) measures the difference between the measured quantity of gas entering the gas distribution system from various supply points and the gas delivered to customers. In Victoria, UAFG is managed through a benchmarking process which is applied for each year of the regulatory period. As a result, this review will set the UAFG benchmarks for the 2018-2022 period.

Following our review of the Commission's Draft Decision which it plans to apply for the 2018-2022 period, we support the decision to:

- use of the revealed cost approach with a multi-year average to calculate the UAFG benchmarks;
- disregard possible reductions in UAFG resulting from the distributors' mains replacement programs;
- not account for possible increases in UAFG caused by the continued deterioration of the distribution network;
- consider whether there are any efficiencies that can be achieved by the distributors and adjust the UAFG benchmarks accordingly; and
- retain separate UAFG benchmarks for Class A and Class B customers.

We outline reasons for this below. The Commission's proposal will provide a fair and efficient set of UAFG benchmarks for distributors (DBs) to perform against in the next regulatory period. This will deliver more efficient UAFG outcomes consistent with the National Gas Objective.

Revealed cost approach with multi year average to calculated UAFG benchmarks

Red & Lumo support the revealed cost approach combined with multi year average to calculating UAFG benchmarks in the next regulatory period because:

- the DBs have been subject to a profit maximising incentive structure in the previous regulatory period so their performance should reflect an efficient level of UAFG; and

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- the revealed cost approach takes into account the actual circumstances of DBs, even when their individual drivers of UAFG are not accurately known and out of their control.

Nevertheless, we do agree that the incentive structure may become unreliable if the DBs believe that the benchmarks for the future period will be based on past performance as is the potential for DBs to underinvest in the current period which would lead to higher actual UAFG outcomes. With future UAFG benchmarks in the next regulatory period based on actual outcomes in the current period, the UAFG benchmarks may end up being inefficiently high.

As such, we support the Commission's decision that requires each DB to provide a detailed explanation regarding how it has sought to efficiently reduce it UAFG levels during the 2013-2017 regulatory period. This should give the Commission confidence that the DBs have been investing efficiently in measures to reduce UAFG in the previous regulatory period.

Disregarding possible reductions in UAFG resulting from the distributors' mains replacement programs

Red and Lumo support the Commission's decision to disregard possible reductions in UAFG resulting from the DBs mains replacement programs.

Any decision by the Commission to account for possible reductions in UAFG as a result of the DBs mains replacement programs, without also accounting for variations related to the other known causes of UAFG, could bias the forecast of UAFG.

No account for possible increases in UAFG caused by the continued deterioration of the distribution network

Red and Lumo support the Commission's decision to disregard possible increases in UAFG caused by the continued deterioration of the distribution network.

Any decision by the Commission to account for possible increases in UAFG causes by the continued deterioration of the distribution network, without also accounting for variations related to the other known causes of UAFG, could bias the forecast of UAFG.

Consider whether there are any efficiencies that can be achieved by the distributors and adjust the UAFG benchmarks accordingly

Red and Lumo support the Commission's decision to consider whether there are any other efficiencies that could be achieved by the DBs in the 2018-2022 regulatory period.

The revealed cost approach does rely on the assumption that the DBs are efficiently minimising UAFG. Therefore, the Commission will require that the DBs provide a detailed explanation of how they have sought to reduce their UAFG levels efficiently in the 2013-2017 regulatory period.

As the DBs may have an incentive to artificially inflate their actual UAFG levels during the 2013-2017 regulatory period (especially in the later years of the regulatory period), we strongly support the Commission's further investigation of whether additional efficiencies can be made in the next regulatory period.

Following the Commission's investigation, if the Commission determines that there are additional efficiencies that can be achieved by the DBs in the next regulatory period, then we would support a downward adjustment of the forward UAFG benchmarks for the next regulatory period.

Retain separate UAFG benchmarks for Class A and Class B customers

Red and Lumo are comfortable with the Commission's decision to apply separate benchmarks for Class A and Class B customers.

We acknowledge that there could be some merit in a single UAFG benchmark due to the fact that injections for gas of Class A and Class B customers are not measured separately. However, because Class A customers are serviced by high pressure mains that have very low leakage rates compared with the high, medium and low pressure mains that service Class B customers, it makes sense to apply separate benchmarks.

Conclusion

Red and Lumo are pleased to have the opportunity to respond to the Commission's review of the Unaccounted for Gas Benchmarks, Draft Decision - Methodology, May 2017.

Overall, we are pleased with the Commission's approach to setting the UAFG benchmarks for the following period. As such, we support their proposal in the draft determination.

About Red and Lumo

Red and Lumo are 100% Australian owned subsidiaries of Snowy Hydro Limited. Collectively, we retail gas and electricity in Victoria and New South Wales and electricity in South Australia and Queensland to approximately 1 million customers.

For further enquiries regarding this submission, please call Con Noutso, Regulatory Manager on .

Yours sincerely

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