

6 June, 2001

Ms Marianne Herbert
Voluntary Pricing Principles Review
Independent Pricing and Regulatory Tribunal
PO Box Q290, QVB Post Office,
Sydney NSW 1230

Dear Ms Herbert

Gas Pricing in Albury, Wagga Wagga and Other Regional Centres in NSW Supplied by Origin Energy and Great Southern Energy – Issues Paper

AGL Energy Sales and Marketing Limited (AGL ES&M) welcomes the opportunity to provide comments on the Issues Paper on gas pricing in Albury, Wagga Wagga and regional centres in NSW supplied by Origin Energy and Great Southern Energy.

AGL ES&M supports the Independent Pricing and Regulatory Tribunal's (the Tribunal's) light handed approach to price regulation in NSW, Albury and Wagga Wagga in transition to full retail contestability. Transitional regulation in the form of Voluntary Pricing Principles (VPPs) are more suitable in providing an environment that fosters competition while alleviating community concerns that could arise about price movements and levels during the lead up to effective competition.

AGL ES&M believes that where markets are fully competitive, it is inappropriate to regulate retail prices. Regulation, if not carefully designed, has the potential to distort markets with the result of disproportionate allocation of risk to the incumbents, barriers to entry for new entrants, and arbitrary allocation of benefits to some customers and costs to others. AGL ES&M believes that under full retail contestability the market will be the best determinant of benefit, cost and risk allocation between participants. AGL ES&M supports the Tribunal's view that once effective competition is established, market forces should ensure that suppliers provide services of the quality demanded by customers, and that they do not earn excessive profit.

AGL ES&M notes that in the transition to full retail contestability, price stability and customer protection will be key objectives of customers, governments and regulators. In this respect AGL ES&M accepts that price certainty in the form of safety net prices during the transition is necessary. It is, however, important that transitional regulatory arrangements and provisions for subsequent reviews avoid imposing an unnecessary cost burden on the industry or the regulators.

Further, for the transition to a competitive market to be effective the default prices must provide sufficient incentive for competitors to enter the market. It is also important that pricing arrangements adopted take into account the evolutionary nature of the competitive market and allow sufficient flexibility to accommodate costs that are currently not known.

Default prices must be allowed to be varied to include pass-through of new charges or step changes in charges.

The gas market in NSW, with the probable exception of Albury, will have systems in place to enable full retail contestability from 1 January 2002.

AGL ES&M supports that the current VPPs remain the basis for price regulation in Albury and Wagga Wagga for the following reasons:

- A review is not likely to be completed before the expiry of the current VPPs
- the current VPPs already take into account the cost of supply to Albury and Wagga Wagga and it would be more efficient to continue with the arrangements,
- with full retail contestability scheduled from 1 January 2002 the market will provide sufficient protection for customers.

AGL ESM notes that the issues paper does not provide an evaluation of gas price movements in Albury and Wagga Wagga but is aware that both Origin Energy and Great Southern Energy have implemented tariffs changes within the current VPPs in the past year.

If you have any questions regarding this submission please contact Kam Khelawan, Manager Regulatory Development on (02) 9922 8611 or khelawan@agl.com.au.

Yours sincerely,

Phil James
General Manager Business Strategy

Comments on the Issues Paper on Gas Pricing in Albury, Wagga and other Regional Centres in NSW Supplied by Origin Energy and Great Southern Energy.

The Gas Supply Amendment (Retail Competition) Bill

AGL ES&M notes that the Tribunal may be required to make a Gas Pricing Order (GPO) under the Act within a specific timeframe and in accordance with a reference from the Minister.

AGL ES&M believes that the current VPPs for NSW and Albury and Wagga Wagga fall within the mix of pricing arrangements allowed under the Gas Supply Act. The side constraints approach effectively sets the maximum price that a retailer may charge to its regulated customers. Further under the current VPPs, the Tribunal retains the right to implement a GPO.

AGLES&M is of the view that in transition to full retail contestability, default pricing arrangements, either VPPS or a GPO, should allow:

- adequate flexibility to manage risk in a competitive market and accommodate step changes in cost structures
- allow for the pass through of costs currently not known or beyond the control of retailers, and
- allow sufficient “headroom” to encourage competition to develop in the market.

Price constraints should also enable retailers to achieve full cost recovery of default prices within a reasonable period of time without resulting in price shocks to customers.

AGL ES&M proposes that if the Tribunal is required to implement a GPO it adopt the current VPPs which have been developed after comprehensive price reviews for gas retail businesses in NSW as the GPO.

Retailer of Last Resort Obligation

AGL ES&M is concerned with the proposal by the Ministry of Energy and Utilities (MoEU) that retailer of last resort service (ROLR) be provided at no more than the default tariffs set by the Tribunal.

AGL ES&M believes that in the initial stages of full retail contestability it would not be unreasonable to require the incumbent retailers to be the default retailer in the event that customers are stranded without a contract. However, in the event that a retail supplier has ceased to trade, retailers may have to procure supply for significant numbers of customers at short notice which is likely to accrue significantly higher costs of supply. As competition increases, this risk will become more onerous.

AGL ES&M is of the view that the default prices will not be sufficient to meet the cost of supply under ROLR situations and as such believes that retailers should not be required to make supply available at default prices. Supply under ROLR situations will need to reflect any additional costs that are either passed onto the specific group of customers supplied under ROLR obligations or passed through in the default prices.

Issues

Coverage of Regulation

- Which tariffs should be regulated

Consistent with the arrangements for AGL Retail Energy Limited (AGLRE), NSW electricity in terms of size of bills, and developments in the Victorian market, AGL ES&M proposes that customers using up to 1TJ be covered by transitional regulation.

The various customer protection regulations and industry codes (translated into standard form customer contracts) are also designed for the supply of gas to customers using less than 1 TJ. AGL ES&M is of the view that risks to retailers of providing services as a default supplier and under ROLR situations will increase if the larger (1-10TJ) customers were included for provision of default services.

- Regulation of other areas

AGL ES&M notes the requirement on the Tribunal to provide safety net prices for customer in all areas of NSW. AGL ES&M supports this objective but note that there will be additional costs for separate default pricing arrangements in specific regional centres.

Where cost of supply to areas in NSW is materially different to a retailer's overall cost structure, that retailer will have the incentive to implement a different default price in that area. Where costs differentials are not material a retailer may choose to carry the cost differentials as a subsidy within its overall operations.

AGL ES&M believes that it is not necessary for the Tribunal to determine default prices for all regional centres. Instead incumbent retailers should be required to offer at least one default tariff in areas supplied by it. If a retailer finds that the costs of supply to some areas are materially different then it may seek to offer alternative default prices with the approval of the Tribunal.

This will be a more efficient way to implement safety net prices rather than carrying out "mini price reviews" for different regional centres in NSW.

Form of Regulation

AGL ES&M supports the continuation of the current voluntary pricing principles for GSE and Origin with the Tribunal reserving the right to issue a Gas Pricing Order at any time.

Setting of Price Limits

Price limits should strike a balance between avoiding price shocks to customers and the need to achieve full cost recovery (plus a reasonable margin). Step changes in cost of supply and costs associated with full retail contestability that are not known with any certainty should be treated as pass through costs. In addition, price limits should allow for management of risks in a competitive market, for example risk associated energy purchasing and fixed term contracts.

Retail margin

AGL ES&M believes that the main objective of price regulation in the lead up to full retail contestability is customer protection - to manage price impact on customers and provide a *safety net* for customers to allow them time to familiarise themselves with the competitive market before participating in it.

Regulation of margins should not become the basis for transitional regulation. There is a risk that in doing so the regulators may distort the operation of competitive markets or in fact inhibit competition. The market itself should determine the “correct level” of retail margin. The UK is an example of a cautious withdrawal from margin regulation by a regulator. After three years of operation of the competitive market in the UK, Ofgem (the regulator for energy markets in the UK) decided to remove price control on British Gas Trading’s (BGT’s) tariffs¹.

With full retail contestability due to commence from 1 January 2002, any retailer abusing its monopoly position in the supply of gas to derive short term monopoly profits will do so at its own peril.

Miscellaneous Charges

AGL ES&M believes that the cost of additional customer specific services, such as disconnections and reconnections should be borne by those customers utilising the services. The rest of the market should not be required to bear such customer specific costs.

AGL ES&M agrees that any variations to existing fees and charges should be approved by the Tribunal.

Recovery of contestability costs

Neither external nor internal contestability costs for NSW can be established with any certainty at this stage. AGL ES&M supports an arrangement where costs of contestability are treated as pass-through costs.

AGL ES&M notes that retailers will also need to contribute additional authorisation fees to cover Government expenditure on full retail contestability. These should also be treated as pass-through costs.

¹ Final Determination, Review of Natural Gas Prices, May 2001 by the ICRC in ACT.