IPART
New South Wales

Independent Pricing and Regulatory Tribunal

Review of regulated retail prices and charges for gas from 1 July 2016

Energy — Final Report
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1 Executive summary

Residential and small business gas customers in NSW have been able to choose their gas retailer and enter into market contracts for the supply of gas for more than 10 years. While most have taken up this opportunity, just under 20% of customers remain on regulated prices under a standard contract with one of the Standard Retailers in this state – AGL, ActewAGL and Origin Energy.

The Independent Pricing and Regulatory Tribunal of NSW (IPART) is responsible for regulating retail gas prices the Standard Retailers charge customers who remain on standard contracts. We use a light-handed regulatory approach that involves reaching voluntary pricing arrangements (VPAs) with each Standard Retailer. The Minister for Industry, Resources and Energy (the Minister) has asked us to reach new VPAs for the period 1 July 2016 to 30 June 2017.

This report explains our final decisions on average changes in regulated retail gas prices and charges in 2016-17.

1.1 Overview of our final decision

Under our final decision, average regulated retail gas prices across NSW will increase by 0.3% (including inflation) on 1 July 2016. This is lower than our draft decision of 0.9%, and below the rate of inflation. The average change varies between -7.5% and 0.8% in the Standard Retailers' individual supply areas (Table 1.1).

Our final decision is based on pricing proposals submitted by AGL and Origin Energy in January 2016, and a revised pricing proposal provided by ActewAGL in April 2016. AGL proposed to increase the Retail Component of its regulated prices (including wholesale gas costs, retail operating costs and retail margin) by the rate of inflation in 2016-17. Origin Energy proposed no change to the Retail Component of regulated prices, and ActewAGL's revised proposal was to decrease the Retail Component by 0.7% in 2016-17 (including inflation), reflecting lower forecast customer acquisition and retention costs.

We have undertaken analysis and commissioned expert advice to assess these proposals. We consider that the average changes in the Retail Component of prices plus the pass through of network prices from 1 July 2016 as proposed by the Standard Retailers are reasonable. This is consistent with our draft decision.

We also made final decisions to agree to the Standard Retailers' proposals to increase their existing miscellaneous charges (eg, late payment fees) by no more than the rate of inflation in 2016-17.

Table 1.1 Final decision on average change in regulated retail gas prices in 2016-17 (including inflation)

Retailer / supply area	Change in Retail Component	Change in Network Component	Overall price change
AGL (Sydney, Wollongong, Newcastle, Dubbo, Orange, Parkes and Riverina)	1.3%	0.0%	0.8%
Origin Energy			
Albury/Murray Valley	0.0%	1.5%	0.4%
Wagga Wagga and surrounds	0.0%	1.3%	0.6%
ActewAGL			
Capital	-0.7%	0.0%	-0.4%
Queanbeyan	-0.7%	-19.5%	-7.5%
Shoalhaven	-0.7%	1.5%	0.2%
NSW average[a]			**0.3%**

a Sales volume-weighted average.

Note: The inflation rate for 2016-17 in our final decision is 1.3%.

Source: IPART.

1.2 Changes since our draft decision

Average price changes under our final decision are lower than under our draft decision. This is because our updated forecast of inflation in 2016-17 (1.3%) is lower than under our draft decision (1.8%).

In addition, final gas network prices in the Queanbeyan area are substantially lower than we estimated for our draft decision. As Standard Retailers directly pass through gas network prices into their retail prices, overall average price changes in the Queanbeyan region are falling by 7.5% under our final decision compared to a 0.5% increase under our draft decision.

A full comparison of our draft and final decisions is provided in Chapter 7.

1.3 Why price changes are steady in 2016-17

Based on our analysis and expert advice for this review, we anticipate little change in the underlying costs that make up regulated gas prices in 2016-17.

Over the past few years a key factor putting upward pressure on regulated retail gas prices was rising wholesale gas costs, that is, the costs retailers incur to purchase gas from upstream producers. The commencement of liquid natural gas (LNG) exports from Queensland gave east coast gas producers the option of selling gas overseas at higher international prices. Because of this structural change in the market, domestic gas prices were rising towards international prices.

Our view is that the upward pressure on retail prices from rising wholesale gas costs has eased for the time being. International gas prices, which are typically set with reference to oil prices, have fallen in recent times on the back of lower oil prices. We consider that an efficient retailer would enter into contracts to purchase gas a year in advance of supply and would use the spot market to balance their contract volumes. For this reason we do not anticipate an immediate material impact of lower oil prices on wholesale gas costs in 2016-17. In addition, there are other factors keeping wholesale costs steady in 2016-17, rather than reducing them. The commencement of LNG exports has resulted in a tight supply-demand balance, with less competition on the supply side in the wholesale market.

We are forecasting lower wholesale gas costs in 2018-19 as the low oil price starts flowing through into contract prices.

1.4 How customers are affected by our final decision

To estimate the impact of our final decisions, we have calculated an indicative annual gas bill for residential and business customers with average usage in each gas supply area (Table 1.2 and Table 1.3).

We cannot calculate how our final decisions will affect individual customers' annual gas bills. The likely impact will depend on individual customer circumstances such as how much gas they use, who their Standard Retailer is, and how the Standard Retailer changes these individual prices.

From 1 July 2016, most residential customers on regulated prices will see a small increase in their annual bills ranging up to $7, while ActewAGL's customers in the Queanbeyan and Capital regions will see a reduction of $89 and $5 respectively in their annual bills. As small business gas customers typically consume more gas, their annual bills are higher. Under our final decisions the impact on typical annual bills for small business customers will range from a reduction of $464 to an increase of $39 in 2016-17.

Table 1.2 Indicative annual bill for typical residential customers of each Standard Retailer ($nominal, inc GST)

	GJ pa	Current bill in 2015-16	Estimated bill in 2016-17	Change ($)	Change (%)
AGL	23	891	898	7	0.8%
ActewAGL (Capital)	35	1,195	1,190	-5	-0.4%
ActewAGL (Queanbeyan)	35	1,195	1,106	-89	-7.5%
ActewAGL (Shoalhaven)	35	1,188	1,190	2	0.2%
Origin Energy (Albury)	44	1,054	1,059	5	0.4%
Origin Energy (Murray Valley)	31	1,097	1,102	5	0.4%
Origin Energy (Wagga Wagga)	42	1,313	1,320	7	0.6%

Source: IPART.

Table 1.3 Indicative annual bill for typical small business customers of each Standard Retailer ($nominal, inc GST)

	GJ pa	Current bill in 2015-16	Estimated bill in 2016-17	Change ($)	Change (%)
AGL	184	5,037	5,076	39	0.8%
ActewAGL (Capital)	246	6,306	6,279	-27	-0.4%
ActewAGL (Queanbeyan)	246	6,197	5,733	-464	-7.5%
ActewAGL (Shoalhaven)	246	7,026	7,040	14	0.2%
Origin Energy (Albury)	209	4,154	4,172	18	0.4%
Origin Energy (Murray Valley)	346	7,721	7,755	34	0.4%
Origin Energy (Wagga Wagga)	212	4,117	4,140	23	0.6%

Source: IPART.

1.5 Competition in the retail gas market

We have been asked to assess the level of competition in the retail gas market in NSW and identify any measures that will strengthen competition. The NSW Government has committed to removing price regulation from 1 July 2017 if certain conditions are met, including an increase in the level of competitive offers available to retail customers in regional NSW.[1]

Our final finding is that competition is working effectively for around 95% of small gas customers in NSW. This includes customers in Sydney, Wollongong, Newcastle, Dubbo, Orange, Parkes and parts of the Riverina region.

1 NSW Department of Industry – Resources & Energy, *Retail gas prices – the way forward,* http://www.resourcesandenergy.nsw.gov.au/energy-supply-industry/consumer-assistance/retail-gas-prices-the-way-forward, accessed 29 March 2016.

There is less intense competition in regional areas including Wagga Wagga, Gundagai, Cooma, Temora, and Albury/Murray Valley. In these areas there are only one or two active retailers and a few different market offers for customers to choose from. There is currently no competition in the Shoalhaven area where only ActewAGL's regulated offer is available to small gas customers.

In our view these different outcomes in regional areas have arisen because of the structure and design of the NSW gas market. There are substantial fixed costs involved in transporting and retailing gas to customers. The limited geographic pipeline coverage also means there is a relatively small customer base, particularly in regional areas. These factors may deter some retailers from entering regional gas markets. However, even in areas where there is currently only one retailer, the threat of competition can be effective at protecting customers.

There are a number of projects underway to introduce or improve retail gas competition in NSW, including for the 5% of small customers in regional areas:

- the Australian Energy Market Operator (AEMO) is due to complete a project to harmonise business to business (B2B) arrangements on regional distribution networks by early 2017. This would reduce costs and make it easier for retailers to supply gas to regional customers. We are aware of at least one retailer who has indicated it will enter regional areas when this work is complete.
- AEMO is also working with stakeholders on a project to include the Shoalhaven area in its retail market procedures, which means by early 2017, gas customers in this area will be able to switch retailers for the first time and retailers will be able to compete for these customers.
- the Australian Energy Market Commission's East Coast Wholesale Gas Markets and Pipeline Frameworks Review is examining ways to make it easier for new retailers to access transmission capacity to transport gas to customers.

In our view a competitive market provides the best form of protection for customers, providing more choice and better price and service outcomes. We consider that if the NSW Government decides to deregulate retail gas prices then this would remove another barrier for retailers entering regional gas markets and would promote competition. If gas prices are deregulated, the NSW Government has indicated that IPART would be responsible for monitoring competition and prices in the retail gas market.

Final finding

1 That competition is working effectively for around 95% of small retail gas customers in NSW and projects are underway that would increase competition for the remaining 5% of small customers by early 2017.

2 That deregulating retail gas prices would remove a barrier to entry in the retail gas market and support further competition in NSW.

1.6 Indicative price changes in 2017-18 and 2018-19

While we have not been asked to reach a pricing agreement with the Standard Retailers in 2017-18 and 2018-19, we have been asked to provide indicative price changes in these years. We also invited the Standard Retailers to provide their indicative price changes in these years.

Our final findings are set out in the table below. Overall, we estimate that regulated retail gas prices to increase by around the rate of inflation in 2017-18. This is in line with the Standard Retailers' indicative price changes for 2017-18. In 2018-19 we consider that regulated retail prices would fall by between 2.2% and 3.6%, depending on the Standard Retailer.

Table 1.4 Indicative changes in regulated retail gas prices in 2017-18 and 2018-19 (including inflation, %)

Retailer	2017-18			2018-19		
	Retail	Network	Overall	Retail	Network	Overall
AGL	2.5%	2.5%	2.5%	-5.5%	2.5%	-2.2%
Origin Energy - Albury/Murray Valley	2.5%	2.5%	2.5%	-5.4%	2.5%	-3.1%
Origin Energy - Wagga Wagga	2.5%	2.5%	2.5%	-7.1%	2.5%	-3.1%
ActewAGL – Capital	2.5%	2.5%	2.5%	-7.0%	2.5%	-3.2%
ActewAGL – Queanbeyan	2.5%	3.8%	2.9%	-7.0%	3.8%	-3.6%
ActewAGL – Shoalhaven	2.5%	2.5%	2.5%	-7.0%	2.5%	-3.1%

Note: We assumed an inflation rate of 2.5% in 2017-18 and 2018-19.
Source: IPART.

In 2018-19, the main driver of our indicative prices is lower wholesale gas costs. As discussed in Chapter 6, based on expert analysis, we are forecasting lower wholesale gas costs in 2018-19 as lower oil prices start to flow through to domestic wholesale gas prices. Standard Retailers' proposals did not forecast this reduction.

While these indicative price changes represent our best estimates, they should be interpreted with caution. Uncertainty in network price changes and the wholesale gas market over the next few years makes forecasting overall price changes problematic. In our 2013-16 review of retail gas prices we established annual reviews to manage risk and uncertainty associated with forecasting cost components in unregulated markets more than 1-year in advance.

1.7 What does the rest of this report cover?

The rest of this report is structured as follows:

- Chapter 2 outlines the terms of reference and context for this review, and how it influences the objectives for the review
- Chapter 3 sets out our process for the review and the approach we used to make our final decisions
- Chapter 4 sets out our final findings on competition in the retail gas market
- Chapter 5 sets out our final decisions on the form of regulation
- Chapter 6 sets out our final decisions and our assessment of the Standard Retailers' proposed changes to the Retail Component for 2016-17
- Chapter 7 sets out the overall change in regulated retail gas prices under our final decisions
- Chapter 8 sets out our final decisions on miscellaneous charges
- Appendices A – D provide supporting information.

2 Context for the review

In conducting this review and making our decisions, we need to ensure we comply with the Minister's referral letter and the objectives of the *Gas Supply Act 1996* (the Act). We also need to take into account key market and regulatory developments that form the context for the review.

2.1 Minister's referral letter

The Minister for Industry, Resources and Energy has asked IPART to continue to regulate retail prices, fees and charges for small retail gas customers for the period 1 July 2016 to 30 June 2017, in accordance with section 27 of the Act. In particular, we are to continue to use a light-handed approach to regulation by reaching VPAs with the Standard Retailers for this period.

As part of our review, we have also been asked to:

- forecast indicative retail gas prices for each year from 1 July 2017 to 30 June 2019, and
- review the competitiveness of the retail gas market in NSW and provide advice on any additional measures that could be implemented to strengthen competition in the NSW retail gas market.

In reviewing the competitiveness of the market, we are to consider:

- The pass-through of network price reductions into retail market contracts. This may include the extent of price decreases, the timeliness of price changes, and communication around price changes.
- The diversity in retail market offers to cater to different market segments. This may include competition on the fixed supply charge.

The Minister's referral letter is provided in Appendix A.

2.2 Objectives of the Act

The Act has a number of objectives, which IPART aims to achieve through the regulation of retail gas prices. These objects, which are set out in section 3 of the Act, are:

- to encourage the development of a competitive market in gas, so as to promote the thermally efficient use of gas and to deliver a safe and reliable supply of gas in compliance with the principles of ecologically sustainable development
- to regulate gas reticulation and gas supply, so as to protect the interests of customers
- to facilitate the continuity of supply of natural gas to customers, and
- to promote the safe use of gas.

Our view is that we can best meet these objectives by regulating retail gas prices in the long-term interest of gas customers. We consider that this encompasses:

- encouraging the efficient use of gas by setting regulated prices to recover the efficient costs of supply
- promoting customer choice and efficient entry and investment in the retail gas market by:
  - ensuring regulated retail prices provide an appropriate return
  - promoting regulatory certainty and transparency in regulatory decision making, and
  - where possible, reducing any barriers to entry and customer participation in the retail market
- ensuring the financial viability of efficient retailers by taking account of the risks faced by efficient and prudent gas retailers.

In addition, section 3(5) of the Act imposes duties on IPART and the Minister which are relevant to the regulation of retail gas prices. Those duties, which apply in relation to NSW's gas users, are to promote the efficient and safe use of gas.

2.3 Market and regulatory developments

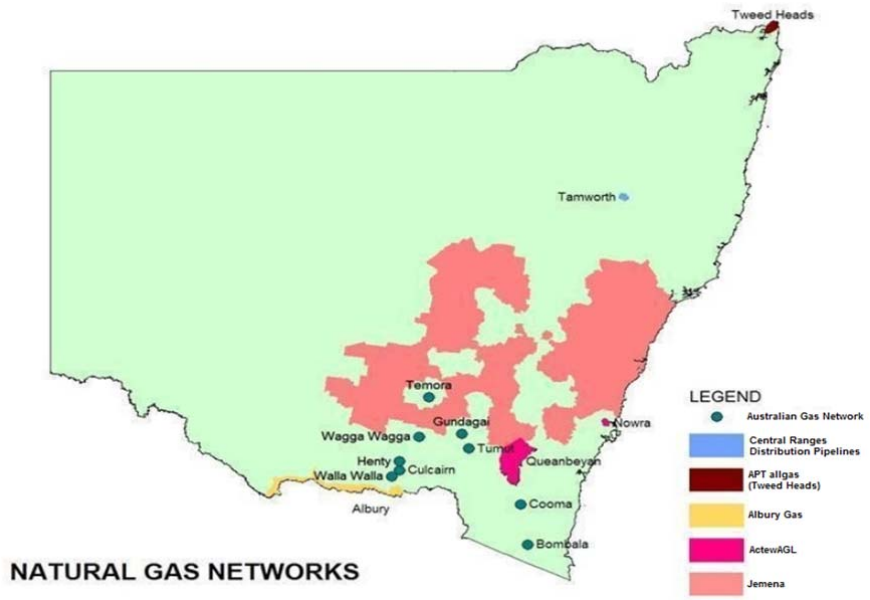
There are several substantial developments in the gas market and regulatory environment that we need to take into account in this review. These include:

- changes to gas distribution network prices in NSW for 2016-17
- ongoing changes in the wholesale gas market in eastern Australia
- other regulatory reviews of the wholesale gas market, and
- other regulatory reviews of competition in the retail gas market in NSW.

2.3.1 Changes to gas distribution network prices for 2016-17

Gas distribution networks across NSW charge retailers for using the network to deliver gas to their customers. The largest gas distribution network in NSW is owned and operated by Jemena (Figure 2.1).

Figure 2.1 NSW/ACT gas network areas



Note: IPART does not have a pricing agreement that covers the Tweed Heads network. This is part of the south-east Queensland distribution network area.

Data source: Adapted from NSW Department of Industry, Resources & Energy, *Gas connections*, http://www.resourcesandenergy.nsw.gov.au/energy-consumers/energy-providers/household-gas-connections, accessed 22 March 2016.

The Standard Retailers are generally required to pay prices determined by the AER for the use of gas distribution networks. The exceptions are the Shoalhaven, Murray Valley and Wagga Wagga and surrounding areas, where gas network prices are unregulated. Where pipelines are not regulated, retailers would generally negotiate terms and conditions for pipeline access. In our regulatory framework gas network prices are 'passed through' to small gas customers in their gas bills. As the costs of the gas distribution network make up around half of a typical retail gas bill, changes in gas network prices will have an important influence on the overall change in retail gas prices.

Since our draft decisions in April, regulated network prices for 2016-17 have been announced. This is further discussed below.

Jemena's 2015-20 access arrangement

In our Issues Paper, we noted that based on Jemena's access arrangement average network prices were expected to fall by around 12% (excluding inflation) in 2016-17[2], and that Jemena had applied to the Australian Competition Tribunal (ACT) for merits review of the AER's decision.[3]

On 26 February 2016, the ACT handed down its decision in relation to Jemena's appeal, directing the AER to remake a number of matters in relation to Jemena's access arrangement. While the ACT found that the AER was correct in some matters, it directed the AER to remake its decisions in relation to capital expenditure, the cost of corporate income tax, and the cost of debt.[4] The AER has subsequently applied to the Federal Court for a judicial review of some aspects of the ACT's decision.[5]

Resolution of the judicial review is likely to take some time. To provide stakeholders with stability, predictability and transparency around network prices on 1 July 2016, the AER entered into an enforceable undertaking with Jemena Gas Networks (NSW) Ltd in May 2016.[6] The undertaking means that Jemena's network prices will remain constant in nominal terms in 2016-17 (ie, existing network prices will not change – no CPI adjustment). This is consistent with our estimate of Jemena's network prices in our draft decision.

ActewAGL's 2016-21 access arrangement

In November 2015 the AER made a draft decision on ActewAGL's access arrangement for the ACT, Queanbeyan and Palerang gas network areas for 2016-21. This draft decision was for a network price reduction of 25.68% (excluding inflation) in 2016-17.[7] In January 2016 ActewAGL Distribution made a revised access arrangement proposal. In this revised proposal ActewAGL Distribution sought a 3.78% (excluding inflation) increase in network prices in 2016-17.[8]

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2 AER, *Final Decision Jemena Gas Networks (NSW) Ltd Access Arrangement 2015-20 Overview*, June 2015, p 18.

3 https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/jemena-gas-networks-nsw-access-arrangement-2015-20/appeal, accessed 29 March 2016.

4 More information on the Australian Competition Tribunal's judgement is available on its website, http://www.judgments.fedcourt.gov.au/judgments/Judgments/tribunals/acompt/2016/2016acompt0005 , accessed 7 June 2016.

5 https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/jemena-gas-networks-nsw-access-arrangement-2015-20/appeal, accessed 29 March 2016.

6 https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/pricing-proposals-tariffs/jemena-gas-networks-nsw-annual-tariffs-2016%E2%80%9317, accessed 26 May 2016.

7 AER, *Draft Decision ActewAGL Distribution Access Arrangement 2016 to 2021 Overview*, November 2015, p 23.

8 ActewAGL Distribution, *Response to the AER's draft decision 2016-21 ACT, Queanbeyan and Palerang Gas Network Access Arrangement,* January 2016, p 6.

The AER released its final decision on 26 May 2016.[9] Based on this decision network prices for ActewAGL's regulated gas customers in the Queanbeyan region will fall by 19.47% including inflation. This is substantially lower than we estimated in our draft decision (ie, 1.8% increase including inflation), and therefore overall regulated retail price changes for customers in this area will also be lower.

2.3.2 Ongoing change in eastern Australia's wholesale gas market

There has been substantial change in the east coast gas market over the past several years, and this change will continue in the coming years. Due to the recent commencement of liquid natural gas (LNG) exports from Queensland, domestic gas prices are now being influenced by international gas prices. By the time all six planned LNG plants are operating, east coast gas production would almost need to triple relative to 2014 levels to meet demand from LNG exports and domestic users.[10] There is some uncertainty about whether there are sufficient domestic gas supplies to meet LNG export commitments. With many domestic gas supply agreements expiring, market uncertainty may be reflected in negotiations for domestic gas supplies.[11]

2.3.3 Other regulatory reviews of eastern Australia's wholesale gas market

Partly in response to this substantial change, the Australian Competition and Consumer Commission (ACCC) and the AEMC are currently conducting reviews of various aspects of the wholesale gas market. The period in which these reviews are being conducted coincides with our review period.

ACCC's East Coast Gas Inquiry

This inquiry was in response to concerns by market participants and governments about the efficiency and effectiveness of the wholesale supply of gas in eastern Australia. The inquiry examined the structure of the gas industry, focusing on the:

- supply and demand characteristics
- gas supply and transportation arrangements
- ability of industry participants to access gas reserves and key infrastructure
- pricing outcomes
- availability and accuracy of information
- dynamics of gas trading, and
- nature of interactions between industry participants.[12]

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9 https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/actewagl-act-queanbeyan-and-palerang-access-arrangement-2016-21, accessed 26 May 2016.
10 ACCC, *East Coast Gas Inquiry – Issues Paper*, June 2015, p 8.
11 Ibid, pp 8-9.
12 Ibid, p 4.

The ACCC released its report shortly after our draft decisions were released in April 2016. The ACCC found that the reliability of future gas supply is affected by three significant factors coinciding:

- significant demand from the LNG projects, which has diverted gas from traditional sources of domestic supply
- low oil prices reducing the ability and incentive of producers across the entire east coast gas market to explore for and develop gas
- moratoria on onshore gas exploration and development and other regulatory restrictions in New South Wales, Victoria and Tasmania, and potentially the Northern Territory, prohibiting new gas supply.[13]

The ACCC also made recommendations related to the regulatory framework for gas pipelines as it considers the current gas access regime is not imposing an effective constraint on the behaviour of a number of unregulated pipelines. The ACCC recommended that the current coverage criteria in the National Gas Law be replaced with a new test, and that the COAG Energy Council should ask the AEMC to consult on the specific matters that should be considered when applying the test and how it should be implemented.[14]

AEMC's East Coast Wholesale Gas Market and Pipeline Frameworks Review

The AEMC is reviewing the design, function and roles of short-term trading gas markets and gas transportation arrangements in eastern Australia, at the request of the COAG Energy Council. The review has two stages.

The Stage 1 final report released in July 2015 outlined areas where reforms may be required to accommodate the changing dynamics created by LNG exports and coal seam gas production, and recommended immediate actions for consideration by the Energy Council to enhance the transparency and efficiency of the market.[15]

In the Stage 2 draft report released in December 2015, the AEMC recommended an inter-linked package for gas market development including:

- changes to wholesale gas trading markets
- improvements to pipeline capacity frameworks, and
- additional information to support the market.

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13 ACCC, *Inquiry into the east coast gas market*, April 2016, p 18.

14 Ibid, pp 18, 20.

15 The AEMC recommended i) creating a new gas price index (led by the Australian Bureau of Statistics) which measures the trends in prices payable under bilateral contracts over time to improve price transparency, ii) harmonising gas market start times across three spot markets to reduce compliance costs and barriers to trading across multiple hubs, iii) removing the restriction that only AEMO or the Victorian Government can propose rule changes regarding the DWGM to reduce a barrier for smaller market participants and potential new entrants to influence market development, and iv) enhancing information to improve gas pipeline trading capacity. AEMC, *Stage 1 Final Report East Coast Wholesale Gas Market and Pipeline Frameworks Review*, 23 July 2015, pp 40–43.

The recommendations are designed to promote a competitive wholesale gas market through lower barriers to entry, promotion of competition and increased efficiency.[16]

The Stage 2 final report will reflect consideration of the ACCC's findings in its East Coast Gas Inquiry and any necessary refinements to the AEMC's recommendations in the Stage 2 draft report.[17]

AEMC's Victorian Declared Wholesale Gas Market Review

The AEMC is also reviewing the pipeline capacity, investment, planning, and risk management mechanisms in the Victorian Declared Wholesale Gas Market (DWGM) at the request of the Victorian Government. This review will identify reforms to improve liquidity, transparency and flexibility of the Victorian gas market in light of significant structural changes resulting from the development of LNG exports.

The AEMC released a draft report in December 2015, proposing a series of changes to the DWGM. The draft recommendation was for the design of a new Southern Hub trading model covering the existing Victorian declared transmission system. The proposed changes are anticipated to fundamentally improve the outcomes of the Victorian gas market by providing participants with greater flexibility to physically trade gas in the market, and establishing the preconditions required for financial risk management products to develop. The changes will also create market-driven signals for investment in the pipeline system, a feature currently absent from the Victorian DWGM. Overall, the proposed reforms are expected to deliver an effective and competitive wholesale gas market which minimises barriers to entry, lowers transaction costs and provides greater price transparency.[18]

On 13 May 2016 the Victorian Government granted the AEMC an extension to provide a Draft Final Report by 14 October 2016.[19] Stakeholders will have the opportunity to respond to the Draft Final Report before a Final Report is issued.

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16 AEMC, *East Coast Wholesale Gas Market and Pipeline Frameworks Review, Stage 2 Draft Report*, 4 December 2015, pp ii-vi.

17 Ibid, p iii.

18 AEMC, *Review of the Victorian Declared Wholesale Gas Market, Draft Report*, 4 December 2015, p i.

19 AEMC, *Extension of time for Review of the Victorian Declared Wholesale Gas Market, Information Paper,* 17 May 2016 http://www.aemc.gov.au/getattachment/985d02a8-1c1d-467d-83ed-f50b77314c4e/Information-sheet---Review-Extension.aspx.

2.3.4 Other regulatory reviews of competition in the NSW retail gas market

The AEMC conducts annual reviews of competition in retail electricity and gas markets in all jurisdictions of the National Energy Market. In its most recent review (completed in June 2015) it found that competition in NSW's retail gas market is effective, although less intense in regional areas of the state.[20]

In October 2015, the AEMC published an approach paper for its 2016 annual review of competition, which sets out its intended approach for the review and seeks stakeholder submission on the approach and on the state of competition. The AEMC will release a final report by the end of June 2016.[21]

As noted above, the Minister recently announced that the NSW Government will look to deregulate retail gas prices from 1 July 2017 if certain conditions are met, including an increase in the level of competitive offers available to customers in regional NSW.[22]

2.4 Stakeholder submissions on contextual factors

In response to our Issues Paper, AGL agreed that an important contextual factor for this review is the transformation of the eastern Australian wholesale gas market due to the significant demand for LNG over a relatively short period of time.[23] Similarly, the submission from Origin Energy agreed with the range of contextual factors outlined in the chapter.[24]

20 AEMC, *2015 Retail Competition Review, Final Report*, June 2015, pp 87-125.

21 http://www.aemc.gov.au/Markets-Reviews-Advice/2016-Retail-Competition-Review, accessed 2 November 2015.

22 http://www.resourcesandenergy.nsw.gov.au/energy-supply-industry/consumer-assistance/retail-gas-prices-the-way-forward accessed 7 June 2016.

23 AGL submission, December 2015, p 2.

24 Origin Energy submission, December 2015, p 3.

3 Our approach and process

As discussed in Chapter 2, the Minister has asked that we continue to regulate retail gas prices by reaching a pricing agreement with each Standard Retailer. We consider this approach has been successful in promoting the objectives of the Act to date. In our view, it has protected the interests of customers by limiting price increases to movements in efficient costs, encouraging retail competition, minimising unnecessary regulatory intervention, and facilitating a transition towards the removal of retail price regulation.

Accordingly, as the first step in our review, we invited each of the Standard Retailers to propose a new VPA to apply from 1 July 2016 to 30 June 2017. The VPA covers:

- its proposed approach for determining average prices, form of price control and mechanisms to manage risk and uncertainty, and
- its proposed average changes in regulated retail prices and charges for 2016-17 and indicative changes for 2017-18 and 2018-19.

We then conducted public consultation and detailed analysis, as outlined in Box 3.1. In the sections below we provide an overview of our analytical approach and then respond to stakeholder submissions on this approach.

3.1 Overview of our approach

In broad terms, the approach we used to make our final decisions on a VPA with each Standard Retailer in 2016-17 includes the following steps:

1. Assess the level of competition in the retail gas market in NSW and identify any measures that will strengthen competition.
2. Assess each Standard Retailer's proposed VPA, including the approach for determining average prices and mechanisms to manage risk and uncertainty. We have taken into account the review context discussed in Chapter 2, stakeholder submissions and our assessment of the level of competition in the NSW retail gas market in Step 1.

3. Assess each Standard Retailer's proposed average price change in 2016-17. We have focussed on whether the proposed price changes are consistent with those an efficient and prudent new entrant retailer would incur in supplying small retail customers on regulated prices in 2016-17, and thus whether the proposed average price changes are reasonable. We have also outlined indicative price changes in 2017-18 and 2018-19.
4. Decide whether or not to agree to each Standard Retailer's proposed VPA for 2016-17, based on our assessments in Steps 2 and 3. In making this decision, we have considered whether each VPA is reasonable and balances the objectives in the *Gas Supply Act 1996*.

Box 3.1 Process for this review

The process we followed in conducting this review included public consultation and detailed analysis. As part of this process, we:

- Invited the Standard Retailers to propose a new VPA for the 2016-17 review period.
- Released an Issues Paper in November 2015. This paper explained the terms of reference for the review, outlined our proposed approach for assessing the Standard Retailers' proposals, and discussed the key issues we would consider. It also invited all interested parties to make a submission in response to this paper.
- Received the Standard Retailers' proposals and invited stakeholder comments on these proposals in February 2016. We received a revised proposal from ActewAGL in April 2016.
- Sought further information from the Standard Retailers on the costs underlying their proposals.
- Engaged consultants, NERA Economic Consulting and Marsden Jacob Consulting, to provide expert advice on wholesale gas costs.
- Conducted our own analysis in line with the approach outlined in Section 3.1, considering all stakeholder submissions and comments.

We received two submissions on our Draft Report. We also held a public hearing on the Draft Report on 3 May 2016. We have considered all submissions and comments from stakeholders in preparing this final report and finalising VPAs for the 2016-17 review period.

3.2 Stakeholder submissions on our approach

Submissions from gas retailers broadly supported the steps in our approach.[25] However, the submission from PIAC recommended that we review our policy of setting the price based on the costs of a new entrant into the market. It considers that this does not encourage new entrants into the market, and allows the established retailers to earn higher profits.[26]

In our view, considering efficient costs for a new entrant retailer appropriately balances our review objectives of prices that reflect efficient costs in the short term, and promote competition in the long term. In relation to wholesale gas costs, we are considering the efficient costs for a retailer supplying gas at prevailing market prices, rather than costs under a legacy agreement. In relation to retail operating costs, we are considering efficient costs for a retailer that has economies of scale, rather than a smaller retailer with higher (per customer) costs.

25 See submissions from EnergyAustralia, December 2015, p 2; Origin Energy, December 2015, p 4; ActewAGL, December 2015, p 1.

26 PIAC submission, December 2015, p 7.

4 Competition in the retail gas market

The first step in our approach is to assess the level of competition in the retail gas market in NSW and identify any measures that will strengthen competition. As part of our assessment, the Minister has specifically asked us to consider:

- the pass through of network price reductions into retail market contracts (including the extent of price changes, the timeliness of price changes and communication around price changes), and
- the diversity in retail market offers to cater to different market segments. This may include competition on fixed supply charge.

The NSW Government has committed to removing price regulation from 1 July 2017 if certain conditions are met, including an increase in the level of competitive offers available to retail customers in regional NSW.[27]

In this chapter we outline our final findings on competition in the retail gas market. Our assessment is informed by the findings from the consumer and retailer surveys commissioned by the AEMC for its review of retail competition, from discussions with retailers, other regulators, stakeholder submissions and analysis of market statistics obtained from the AER, AEMO and EnergyMadeEasy.

4.1 Overview of our final findings on competition

Our final finding is that competition is working effectively for around 95% of small gas customers in NSW. This includes customers in Sydney, the Central Coast, Wollongong, Newcastle, Dubbo, Orange, Parkes and parts of the Riverina region.[28]

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27 NSW Department of Industry – Resources & Energy, *Retail gas prices – the way forward*, http://www.resourcesandenergy.nsw.gov.au/energy-supply-industry/consumer-assistance/retail-gas-prices-the-way-forward, accessed 29 March 2016.

28 Jemena's network area is where most gas retailers are active in NSW. Jemena Natural Gas Network distributes gas to over 1.3 million homes and businesses throughout NSW. http://jemena.com.au/about/what-we-own/our-assets/jemena-gas-network, accessed 7 June 2016.

There is less intense competition in regional areas including Wagga Wagga, Gundagai, Cooma, Temora, and Albury/Murray Valley. In these areas there are only one or two active retailers and a few different market offers for customers to choose from. There is currently no competition in the Shoalhaven area where only ActewAGL's regulated offer is available to small gas customers.

In our view these different outcomes in regional areas have arisen because of the structure and design of the NSW gas market. There are substantial fixed costs involved in transporting and retailing gas to customers. The limited geographic pipeline coverage also means there is a relatively small customer base, particularly in regional areas. These factors may deter some retailers from entering regional gas markets. However, even in areas where there is currently only one retailer, the threat of competition can be effective at protecting customers.

There are a number projects underway that will introduce or improve retail gas competition in NSW, including for the 5% of small customers in regional areas:

- the Australian Energy Market Operator (AEMO) is due to complete a project to harmonise business to business (B2B) arrangements on regional distribution networks by early 2017. This will reduce costs and make it easier for retailers to supply gas to regional customers. We are aware of at least one retailer who has indicated it will enter regional areas when this work is complete.
- AEMO is also working with stakeholders on a project to include the Shoalhaven area in its retail market procedures, which means by early 2017, gas customers in this area will be able to switch retailers for the first time and retailers will be able to compete for these customers.
- the Australian Energy Market Commission's East Coast Wholesale Gas Markets and Pipeline Frameworks Review is examining ways to make it easier for new retailers to access transmission capacity to transport gas to customers.[29]

In our view a competitive market provides the best form of protection for customers, providing more choice and better price and service outcomes. We consider that if the NSW Government decides to deregulate retail gas prices then this would remove another barrier for retailers entering regional gas markets and would promote competition. If gas prices are deregulated, the NSW Government has indicated that IPART would be responsible for monitoring competition and prices in the retail gas market.[30]

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29 http://www.aemc.gov.au/Markets-Reviews-Advice/East-Coast-Wholesale-Gas-Market-and-Pipeline-Frame Accessed 7 June 2016.

30 'The NSW Government will also expand IPART's existing Market Monitor activities from electricity only, to include gas. In its role as Market Monitor, IPART will conduct annual reviews to make sure that competition is still effective in NSW.' http://www.resourcesandenergy.nsw.gov.au/energy-supply-industry/consumer-assistance/retail-gas-prices-the-way-forward, accessed 7 June 2016.

Final finding

1 That competition is working effectively for around 95% of small retail gas customers in NSW and projects are underway that would increase competition for the remaining 5% of small customers by early 2017.

2 That deregulating retail gas prices would remove a barrier to entry in the retail gas market and support further competition in NSW.

4.2 Our assessment of competition indicators

In conducting our assessment we have placed an emphasis on regional areas and have considered four competition indicators:

- barriers to entry, exit and expansion
- customer participation and outcomes
- price movements, and
- rivalry and price and product diversity.

These indicators were supported by gas retailers in their submissions to our Issues Paper.[31] The submission from PIAC recommends that customer satisfaction should also be an indicator of the effectiveness of competition and that assessing competition by looking at the number of plans available is not sufficient.[32] We have considered customer satisfaction as part of our customer participation and outcomes indicator.

4.2.1 Barriers to entry, exit and expansion

Low barriers to entry mean that it is easy for new retailers to enter the market and compete for customers – and therefore incumbent retailers face an ongoing threat of competition from new entrants. This threat of competition provides the most effective protection for customers from the exercise of market power.

Retailer's views on barriers to entry

Entry and expansion into NSW retail gas market was given a 'median' rating by gas retailers in the AEMC's 2015 competition review. The median rating suggested that ease of entry and expansion is reasonable, but economies of scale and scope were important in being able to compete effectively in the market.[33]

31 See submissions from AGL, December 2015, p 3 and Origin Energy, December 2015, p 5.
32 PIAC submission, December 2015, p 5.
33 AEMC, *Final Report 2015 Retail Competition Review*, 30 June 2015, p 111.

Gas retailers identified the following factors as potentially impeding entry and expansion in the NSW retail gas market:

- **Wholesale market conditions –** including access to and the price of gas, given the tightening demand and supply conditions in the wholesale gas market.
- **Transmission capacity** - retailers have cited gaining access to and the price of capacity on transmission pipelines as a potential barrier. The ACCC in its April 2016 Inquiry into the East coast Gas market report voiced concern over the concentration of power and the lack of competition in the gas transmission industry that may be adversely affecting gas supplies.[34]
- **Retail price regulation** - retailers considered that ongoing price regulation deters new entrants from retailing in the NSW market.
- **Sydney Short Term Trading Market (STTM)** - retailers noted the complexity and relatively high transaction costs of participating in the Sydney STTM, as well as the inability to effectively hedge against all risks in the market as a potential barrier to entry.
- **B2B procedures** - NSW distribution networks require bespoke systems to meet its different B2B procedures, which retailers reported that adds to the cost of entry.
- **Other regulatory factors** – including AEMO's prudential requirements, registration, accreditation and certification process may also pose impediments for new entrants.

In addition, some specific barriers in regional NSW gas markets were reported by retailers:

- **Size of customer base** - In some regional areas, the customer base may be too small to warrant entry or geographic expansion, particularly given the additional costs associated with negotiating access to pipelines and the fixed cost nature of gas transportation services.
- **Higher customer acquisition costs -** there are higher customer acquisition costs due to the small size of the customer base in these areas.
- **Limited geographical pipeline coverage -** limited geographical coverage of pipeline networks in rural and regional areas.
- **Capacity of regional pipelines -** the capacity of some regional pipelines has been fully contracted by a single retailer or a small number of retailers under long-term contracts and the cost of expanding capacity for what is likely to be a relatively small customer base may not be justified.

34 ACCC, *Inquiry into the east coast gas market*, April 2016, pp 92-111.

PIAC's submission to our draft report put the view that we had not sufficiently considered these regional barriers to entry. PIAC also noted that the ACCC's East Coast Gas Inquiry raised concerns of 'hoarding' capacity on some regional pipelines which could pose a significant barrier to entry.[35]

The need to negotiate access to pipelines contributes to higher fixed costs to enter the retail gas market relative to the retail electricity market. The limited geographic coverage of gas pipelines also means there is a relatively small gas customer base, particularly in regional areas. These factors may deter some retailers from entering regional gas markets and would most likely mean fewer retailers compete for small gas customers in regional areas, relative to metropolitan areas. However even where there are only one or two retailers active, the threat of competition can be effective at protecting customers.

The ACCC's East Coast Gas Inquiry did not identify where it has concerns about incumbent retailer(s) hoarding transmission capacity. Its review included Queensland, New South Wales, Australian Capital Territory, Victoria, South Australia and Tasmania. Our analysis and inquiries for this review have not revealed any issues in relation to hoarding transmission capacity that pose a concern for competition for small customers in regional NSW at this point in time.

The AEMC's East Coast Wholesale Gas Markets and Pipeline Frameworks Review is recommending ways to make it easier for retailers to access/trade transmission capacity. The AEMC recommended in its draft report three reforms with the aim of creating flexible, lower cost and non-discriminatory access to pipeline capacity:

- introduction of an auction for contracted but un-nominated capacity with a regulated reserve price on all pipelines
- mandatory creation of capacity trading platforms, through which information regarding all capacity trades, including prices, must be published. Capacity product standardisation would facilitate trading through the platform, and
- publication of the actual (not advertised) price of all primary capacity sales, and terms and conditions of those sales which might impact the price.[36]

Projects underway should make it is easier to enter the retail gas market. In addition to the AEMC's review relating to transmission capacity, AEMO is due to complete a project to harmonise B2B arrangements on distribution networks by early 2017. This would reduce costs and make it easier for retailers to supply gas to regional customers. In the AEMC's 2015 retail competition review many retailers noted the potential for new entry to occur if retail price regulation is removed in NSW.[37]

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35 PIAC submission, May 2016, pp 1-2.

36 AEMC, *East Coast Wholesale Gas Market and Pipeline Frameworks Review*, Stage 2 Draft Report, December 2015, p 51.

37 AEMC, *Final Report 2015 Retail Competition Review*, 30 June 2015, p 114.

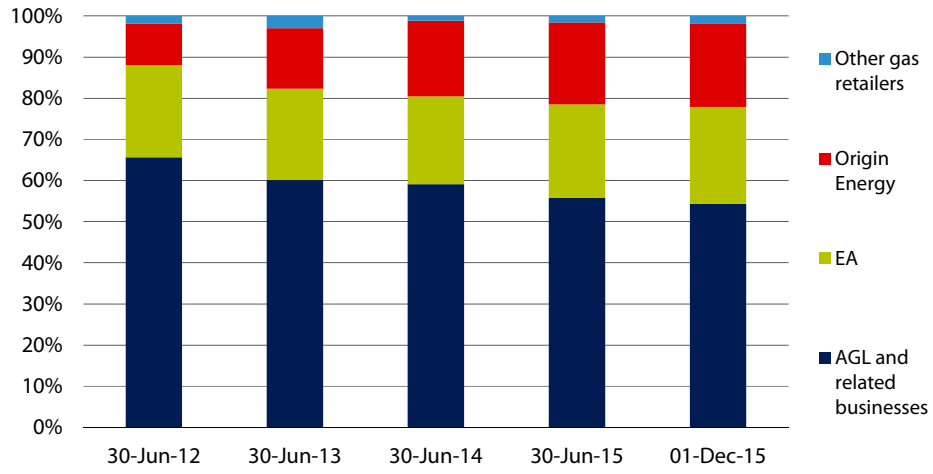
Number of retailers and market concentration

Barriers to entry affect the number of retailers contesting the market. We do not consider that there is a minimum or optimum number of retailers needed for a competitive market. However, generally speaking, the presence of more retailers enhances rivalry and encourages retailers to offer more diverse and better value products and services.

As at May 2016, there were seven retailers actively serving around 1.3 million small customers (residential and small business) in NSW. As discussed in Section 4.2.4, not all retailers are active in all parts of NSW. Over the past few years there have been two new retailers enter the market, CovaU and M2 Energy (trading as Dodo Power and Gas).

Collectively the 'big three' retailers, EnergyAustralia, Origin Energy and AGL related gas businesses supply around 98% of the NSW retail gas market (Figure 4.2).

Figure 4.1 Change in NSW retail market share – Residential gas customers in NSW[a]

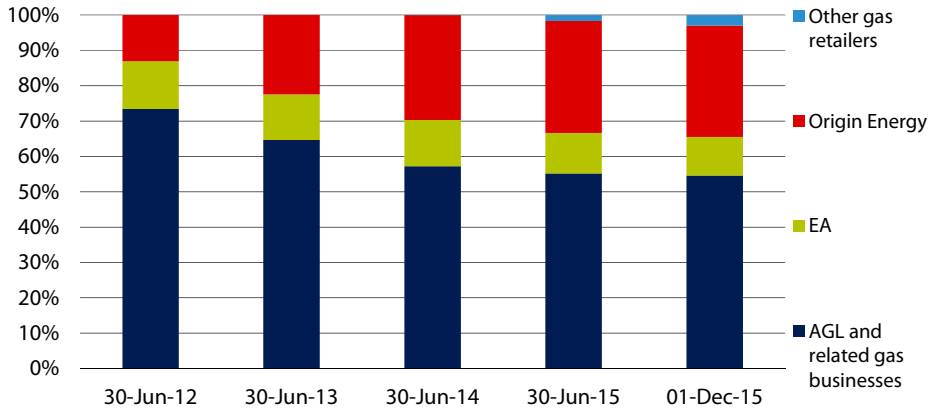


a The terms of reference require us to focus on small retail customers; hence we excluded large industrial gas users from our analysis. Small customers comprise residential and small business customers.

Data source: AER and IPART.

As at December 2015, AGL and related businesses have the largest market share in the retail gas market (54%), followed by EnergyAustralia (23%) and Origin Energy (20%). Smaller gas retailers such as Lumo Energy, Red Energy, CovaU and M2 Energy compete for the remaining 3% of the market and they are steadily increasing their share. New entrant CovaU, in particular, expanded rapidly in the small business market in the 15 months to December 2015.

Figure 4.2 Change in NSW retail market share – Small business gas customers in NSW[a]



a The terms of reference require us to focus on small retail customers; hence we excluded large industrial gas users from our analysis. Small customers comprise residential and small business customers.

Data source: AER and IPART.

4.2.2 Customer participation and outcomes

Customer participation refers to customers being aware of the choices available to them in the market, and investigating the offers available to them to identify a better gas plan or retailer for their circumstances. Customer outcomes refer to how satisfied customers are with their participation in the market and with their retailer in general.

In a competitive market, we would expect most customers to be aware of the choices available to them, and many customers to be shopping around for a better deal. In markets where competition is working effectively, we would expect most customers to be satisfied with their participation and experience in the market.

Much of the information needed to assess customer participation and outcomes is gathered from customer surveys. The AEMC conducts these surveys annually. We have used the survey findings from the AEMC's 2015 review.[38] For example, this review found that in NSW:

- 88% of residential gas customers were aware that they can choose their retailer. In regional NSW, 83% of customers were aware they can choose their gas retailer, up from 67% in 2014.[39]

38 The AEMC's 2016 final report will not be completed in time for our review.

39 AEMC, *Final Report 2015 Retail Competition Review*, 30 June 2015, p 91.

- Around 12% of customers switched gas retailers in 2013-14, and up to 24% changed gas plan with their existing retailer.[40] Over the last five years, gas switching rates were higher than for other products and services, including car, home and health insurance, banking and internet services.[41]
- 86% of residential customers who switched gas retailers or gas plans were happy with the decision.[42]

While most customers indicate that they are satisfied with their experience in the market, for some customers their experience is different. In 2014-15, EWON received a 5% increase in retail gas-related complaints compared with the previous year.[43] The overall number of complaints remained low in the retail gas industry at 5,392 which equated to four complaints for every 1,000 retail gas customers in NSW.[44] Over 90% of these complaints are from residential gas customers, 30% of which are living in regional and remote areas of NSW. Common issues behind complaints to EWON included high and disputed bills, estimated account and errors in billing, wrongful disconnections and debt collection.[45] Customer service and transfer issues also contributed to the rise in complaints.

The rising cost of gas over the past few years is having an impact on affordability. In 2014-15, the AER reported 7,555 gas disconnections which equated to around six disconnections for every 1,000 gas residential customers in NSW. This represents an increase of around 54% in residential gas disconnections from the previous year. The AER data shows that the number of gas disconnections can fluctuate from year to year; in 2013-14 there was a 35% drop in gas disconnections. Gas being a discretionary fuel means disconnection could be influenced by a range of seasonal factors, as well as price and demand for alternative fuels such as electricity, wood and LPG. The AER retail customer statistics shows there are currently 5,180 gas customers placed on a hardship program, which means around four gas customers requested financial assistance per 1000 households in NSW.[46] The average debt level of most of these gas customers on entering hardship programs is under $500.[47] Overall gas bill in arrears are broadly less than half the amount of debt owed in electricity.

40 Ibid, pp 93-94.
41 Ibid, p 101.
42 Ibid, p 95.
43 EWON, *Annual Report 2014-15,* p 23.
44 Based on retail gas customer numbers reported by the AER in December 2015 quarter. Gas retail complaints number reported in EWON Annual report 2014-15, p 23.
45 EWON, *Annual Report 2014-15,* p 27.
46 AER website, *2015-16 Q2 Customers on a Hardship Program by Jurisdiction*, https://www.aer.gov.au/retail-markets/retail-statistics/2015-16-q2-customers-on-a-hardship-program-by-jurisdiction
47 AER website, *2015-16 Q2 Debt Levels of Gas Customers Entering Hardship Programs by Retailer*, https://www.aer.gov.au/retail-markets/retail-statistics/2015-16-q2-debt-levels-of-gas-customers-entering-hardship-programs-by-retailer

We consider that affordability issues are best addressed through targeted financial hardship programs and energy concession schemes.

We conclude from the findings of the AEMC's consumer survey, AER and EWON retail performance statistics, that overall most retail customers are satisfied with their gas retailers. There are areas of concern, as highlighted by complaints to EWON in relation to estimated account and errors in billing, wrongful disconnections and debt collection, where energy retailers need to improve to provide a better customer experience.

4.2.3 Price movements

In a competitive market, we would expect that in the long term, retail prices would change broadly in line with changes in efficient costs. In the short term, price movements may be greater or less than changes in efficient costs, but we expect to see some general relationship between prices and costs.

This indicator involves us assessing whether the retail gas price changes that occurred on 1 July 2015 were consistent with a competitive market. To do this we compared average annual bills based on a sample of offers available on EnergyMadeEasy[48] between June and August 2015 (ie, before and after price changes on 1 July).

We found that the movements in average bills over this period were broadly consistent with the change in the largest cost driver - gas network price changes. Between June and August 2015:

- Average annual gas bills in Jemena's network area dropped on average by between 9% to 12%, in line with the change in the regulated retail gas price and the reduction in Jemena's network charges.
- In other network areas (including APA, Australian Gas Networks and ActewAGL) annual bills increased by similar percentages to the regulated retail prices in these areas (between around 2% to 7%), broadly reflecting CPI changes in network prices in these areas.

We consider that our findings on price changes are consistent with competitive market outcomes.

Timing and communication of retail price changes

The NSW Government requested that we investigate the timing and communication around retail price changes. To do this we analysed data in EnergyMadeEasy and held discussions with AER staff to determine when retailers updated their retail offers/prices to reflect changes in network prices on 1 July 2015. We focussed on retail prices in the Jemena network area, as retail prices in this area fell (on average) on 1 July 2015.

48 https://www.energymadeeasy.gov.au/.

We found that while some retailers took a number of weeks, post 1 July 2015, to update some of their market offers, other retailers promptly updated their offers close to the 1 July price change. We were advised by retailers that there are lags between when regulated prices are updated on 1 July and when market contract prices are updated. For example, this is because of the time to notify customers by mail and to schedule billing changes. AGL advised us that in previous years when there were price increases on 1 July, there were delays of a couple of weeks to update market prices.

The National Energy Retail Law requires retailers to communicate standing and market offer prices in accordance with the AER Retail Pricing Information Guidelines (Guidelines) and notify the AER of those prices or any variation.[49] The AER is responsible for monitoring, investigating and enforcing compliance with the obligations under the Retail Law and Retail Rules. Under the Guidelines, a retailer must submit information to the AER on each generally available offer for EnergyMadeEasy within two business days of the offer becoming available to customers. However, there are no specific requirements on retailers to update their retail prices within a designated timeframe following network price changes on 1 July 2015.

4.2.4 Rivalry and product diversity

The number of active retailers and the number of gas offers available to customers vary throughout NSW. Table 4.1 summarises the offers and the range of discounts that are available on EnergyMadeEasy in different parts of NSW. While there are fewer offers available in regional areas, on average the range of discounts available is similar to those offered to metropolitan customers.

The level of discounts ranges from 2% to 16% on the usage component of prices and may be conditional on on-time payment or signing up to a duel fuel offer.[50] Retailers also offer introductory rebates and credits, and guaranteed fixed rates to attract new customers. Other non-price incentives in these offers include frequent flyer points, vouchers, and online shopping programs. There are recent examples of market-led innovation and product diversity. For example, Origin Energy recently introduced fixed price contracts for gas and electricity usage. This product is designed to avoid bill shock by allowing customers to pay the same fixed amount on their utility bills each fortnight or month regardless of their usage.[51]

49 National Energy Retail Law (NSW), ss 24, 37.

50 EnergyMadeEasy search results, https://www.energymadeeasy.gov.au/ accessed 31 May 2016.

51 Herald Sun, *Origin Energy to offer fixed price contracts for gas and electricity usage*, 12 March 2016. http://www.heraldsun.com.au/business/companies/origin-energy-to-offer-fixed-price-contracts-for-gas-and-electricity-usage/news-story/8272ae411a1d25b69748fcf2b58b8dc5

Table 4.1 Gas offers published on EnergyMadeEasy (residential customers)

Town/area	Sample postcodes	No. of offers	No. of retailers	Range of Discounts	Gas distributor
Sydney area	2040	24	7	2% - 16%	Jemena
Newcastle area	2300	24	7	2% - 16%	Jemena
Albury/Murray Valley	2640/2713	8	2	10% -15%	Australian Gas Networks
Queanbeyan	2620	9	3	10% -15%	ActewAGL
Cooma/Bombala	2630/2632	6	1 (Origin)	10% -12%	Australian Gas Networks
Temora/Culcairn/ Henty/Walla Walla	2666/2660/ 2658/2659	6	1 (Origin)	10% -12%	Australian Gas Networks
Gundagai/Tumut	2722/2720	6	1 (Origin)	10% -12%	Australian Gas Networks
Wagga Wagga / Uranquinty	2650/2652	6	1 (Origin)	10% -12%	Australian Gas Networks
Tamworth	2340	6	1 (Origin)	10% -12%	APA Group
Nowra (Shoalhaven)[a]	2541	1	1 (ActewAGL)	NA	ActewAGL

a Currently only one regulated gas offer is available in Nowra. Contestability will be introduced in the Shoalhaven region when AEMO completes the project to harmonise business to business (B2B) arrangements on regional distribution networks, anticipated completion date is early 2017.

Note: The range of discounts available is based on offers published on the EnergyMadeEasy website as at 31 May 2016. The EnergyMadeEasy website may not have all offers published, and actual offers available may vary over time.

Source: www.energymadeeasy.gov.au, accessed 31 May 2016.

Our terms of reference ask us to look at the diversity and competition on the fixed supply charge (FSC). We focussed on the Jemena network area as this is where more than one retailer is active. In the Jemena network area the FSC currently ranges from 48.61 to 61.72 cents per day (c/day). The FSC in the regulated price is 54.01 c/day. Around 75% of the regulated FSC relates to the retailer's fixed charge and the remainder is the network fixed charge. We consider that there is reasonable variability on the FSC in current market offers in Jemena's network area.

4.3 Stakeholder submissions on competition, retail price deregulation and consumer protection

Submissions to our issues paper from Origin Energy and AGL supported the view that gas retail competition in NSW is effective. The submission from PIAC put the view that competition in NSW has stalled, particularly in regional areas.[52] NCOSS also considered the current level of competition in rural and regional NSW to be insufficient for deregulation to occur.[53] EnergyAustralia stated that given the size of some regional markets and other supply-side constraints, the degree of competition will not be as prevalent as it is in metropolitan areas.[54]

Currently, around 20% of small retail customers in NSW remain on standard contracts.[55] PIAC submitted that retail price deregulation will leave these customers without protections. PIAC is also concerned that this will adversely affect customers in regional areas because, in PIAC's view, competition in regional markets might never substantially increase because of the small number of customers.[56]

We do not agree that retail price deregulation would leave customers on standard contracts without protections. In our view a competitive market provides the best form of protection for customers, providing more choice and better price and service outcomes. In addition to IPART taking on a market monitoring role, there remain other protections for customers.

The National Energy Customer Framework (NECF) imposes a legal obligation on all energy retailers in NSW to support customers who are experiencing financial difficulties and are unable to pay their energy bills. For example, under NECF energy retailers must:

- put in place and adhere to a customer hardship policy that is approved by the AER[57]
- offer financial assistance to vulnerable customers, including a payment plan or Centrepay options, or debt reduction to manage bill payments on an ongoing basis[58]
- identify appropriate government concession programs and financial counselling services and notify hardship customers of those programs and services,[59] and

52 PIAC submission, December 2015, p 4.
53 NCOSS submission, March 2016, p 4.
54 EnergyAustralia submission, December 2015, p 2.
55 AER quarterly retail performance statistics for quarter 2 2015-16. https://www.aer.gov.au/retail-markets/retail-statistics/2015-16-q2-gas-contract-types-by-jurisdiction accessed 7 June 2016.
56 PIAC Submission, May 2016 at pp.1-2.
57 National Energy Retail Law (NSW) No 37a, Part 2, Division 6, Sections 43 - 45.
58 National Energy Retail Law (NSW) No 37a, Part 2, Division 7, Section 50.
59 National Energy Retail Law (NSW) No 37a, Part 2, Division 7, Section 44.

- not commence debt recovery or disconnection process where a residential customer continues to abide by the terms of their payment plan.[60]

The National Energy Retail Rules (NERR) place restrictions on energy retailers and distributors relating to disconnections. The NERR prohibits disconnection of premises belonging to a small retail customer where they have made a complaint, directly related to the reason for the proposed disconnection, to the distributor or to the energy ombudsman and the complaint.[61]

The NERR imposes pre-contractual duty on standard retailers to advise small retail customers of the standing offer available when making a market offer at the time of sale. In addition, standing offer prices set by electricity retailers can only be changed once every six months.

The NSW Government introduced the NSW Gas Rebate on 1 July 2015 to help eligible NSW households to pay their natural gas bills. The NSW Gas Rebate provides $90 (excluding GST) a year to eligible customers who hold a natural gas account with a natural gas retailer of their choice. There is also a Family Energy Rebate and a Low Income Household Rebate available to eligible customers.[62]

These customer protection measures would continue to apply if the NSW Government decides to deregulate retail gas prices. We maintain our view that targeted programs and concession frameworks are the most appropriate way to assist vulnerable customers.

60 National Energy Retail Law (NSW) No 37a, Part 2, Division 7, Sections 51.

61 National Energy Retail Rules, Division 3, Part 6, Sections 116, 120 Restrictions on de-energisation (or disconnection) of premises—small customers.

62 http://www.resourcesandenergy.nsw.gov.au/energy-consumers/financial-assistance/rebates, accessed 2 June 2016.

5 Assessing the form of regulation

The second step in our approach is to assess the Standard Retailer's VPA. As part of their proposed new VPAs, we asked the Standard Retailers to propose:

- the approach for determining average price changes
- the form of price control, and
- mechanism(s) for managing risk and uncertainty.

The sections below provide an overview of our final decisions on the VPAs. We then discuss what each Standard Retailer proposed, and provide more detail on how we made our final decisions.

5.1 Overview of our final decisions on the VPAs

Our final decisions are to agree to the Standard Retailers' proposed form of regulation, including:

- determining average regulated prices as the sum of the Retail and Network Components
- maintaining a weighted-average price cap (WAPC) form of price control, and
- including a special circumstances clause for managing risk and uncertainty.

This form of regulation will continue to allow the Standard Retailers to set the Retail Component of regulated prices subject to a WAPC, and pass through the network cost component. It will also provide flexibility to adjust prices (either up or down) in limited circumstances where there are unanticipated changes in costs. We consider this is consistent with the objectives to protect the interests of customers and encourage retail competition, and minimises unnecessary regulatory intervention. These final decisions are consistent with our draft decisions.

5.2 Approach for determining average regulated prices

1 IPART's final decision is to agree to the Standard Retailers' proposals to determine average regulated prices as the sum of the Retail and Network components.

Under the current VPAs, average regulated prices are determined as the sum of:

- the Retail Component, which includes wholesale gas and transmission costs, retail operating costs and a retail margin, and
- the Network Component, which includes gas distribution costs.[63]

All three Standard Retailers proposed to continue with the R + N approach for determining average regulated prices in 2016-17.[64] No stakeholders objected to this approach and in our view it is appropriate to continue using it in 2016-17. It is also consistent with our final decision on the form of price control discussed below.

5.3 Form of price control

2 IPART's final decision is to agree to the Standard Retailers' proposals to retain the weighted average price cap on the Retail Component and pass through the Network Component.

All Standard Retailers proposed to continue using a WAPC to govern the amount by which the Retail Component of regulated retail gas prices can change.[65] Under a WAPC, the Standard Retailers can set the Retail Component of their regulated prices themselves, but must ensure that the average change in their regulated prices does not exceed the cap specified in the VPAs.

Our final decision is that the WAPC form of price control should be retained for the Retail Component. We consider that there is sufficient competition in the retail gas market to continue using a light-handed form of price control, such as a WAPC for the Retail Component of regulated prices. We also consider that a WAPC is likely to result in prices that reflect the cost of supply and minimise the risk of regulated retail prices distorting the competitive market.

All Standard Retailers proposed to continue to directly pass through the Network Component into retail prices. In most cases the prices for using the gas distribution network are regulated by the AER.

Our final decision is that the Network Component should continue to be passed directly through into retail prices. Passing them through into retail prices ensures that Standard Retailers can recover these costs.

63 Previously there was also a separate Carbon Component however this component was removed from regulated gas prices following the repeal of the Carbon Pricing Mechanism.

64 ActewAGL proposal, January 2016, p 1; AGL proposal, January 2016, p 16; Origin Energy proposal, January 2016, p 9.

65 ActewAGL proposal, January 2016, p 1; AGL proposal, January 2016, p 16; Origin Energy proposal, January 2016, p 9.

5.4 Mechanisms for managing risk and uncertainty

3 IPART's final decision is to agree to the Standard Retailers' proposals to include a special circumstances clause in the VPAs.

Whenever we agree to pricing proposals that rely on forecasts of costs over the regulatory period, there is a risk the costs that an efficient and prudent retailer incurs differ from the forecast costs. For example, this may be because the Standard Retailers and IPART did not have reliable information, or made incorrect assumptions, or because unanticipated events or circumstances affected the costs.

To some extent, this risk is considered an ordinary part of business and is compensated for through the retail margin, which rewards a business for the systematic risk it faces. However, where the risk (or the cost) is due to regulatory or taxation changes outside of the regulated entity's control, or contextual factors make it difficult to forecast the cost with a high degree of certainty, it can be addressed through additional regulatory mechanisms.

For the 2016-17 review period each of the Standard Retailers proposed retaining the special circumstance clause in its VPA[66]. This clause specifies that the Standard Retailers may apply to IPART to vary regulated prices outside the WAPC in special circumstances. These circumstances include, but are not limited to, regulatory changes, taxation changes, and unanticipated gas field price reviews.

Our final decision is that the special circumstances clause should be retained in the VPAs. The special circumstances clause is symmetrical, so that it can be initiated by IPART or the Standard Retailer[67]. We consider this provides an appropriate balance between regulatory certainty (in terms of 'locking in' average price movements) and regulatory flexibility, by providing a mechanism that allows regulated prices to vary in special circumstances.

66 ActewAGL proposal, January 2016, p 1; AGL proposal, January 2016, p 16; Origin Energy proposal, January 2016, p 9.

67 In previous VPAs only the Standard Retailer could initiate special circumstances.

6 Assessing the proposed change to the Retail Component

The third step in our approach is to assess the Standard Retailer's pricing proposals for 2016-17.

We have considered each Standard Retailer's proposed change to the Retail Component of regulated prices and assessed whether it is reasonable and balances the objectives for this review. Consistent with our approach in previous reviews, we have not made decisions on individual cost components, but instead focussed on the reasonableness of the overall pricing proposal.

To inform our assessment we determined a reasonable range for the change in the Retail Component for each Standard Retailer in 2016-17. If the Standard Retailer's proposed change in the Retail Component fell within this range, we made a final decision to accept the proposal.

In this chapter, we provide an overview of our final decisions and then discuss our analysis in detail.

6.1 Overview of our final decisions on the change in the Retail Component

4 IPART's final decisions are to:

- Agree to AGL's proposal to increase the Retail Component of prices by the change in CPI in 2016-17.
- Agree to ActewAGL's revised proposal to reduce the Retail Component of prices by 2.0% (excluding inflation) in 2016-17.
- Agree to Origin Energy's proposal for Albury/Murray Valley and Wagga Wagga to keep the Retail Component of prices unchanged (including inflation).

6.2 Approach to assessing the proposed changes to the Retail Component

As noted above, to assess the Standard Retailer's pricing proposals, we determined a reasonable range for the percentage change in the Retail Component for each Standard Retailer in 2016-17. This involved:

- undertaking analysis and establishing ranges for the efficient costs that comprise the Retail Component of prices; wholesale gas costs, retail operating costs and retail margin
- determining the midpoint of the range for each of these underlying cost components
- using these midpoints, calculating the percentage change in the Retail Component for each Standard Retailer relative to the costs currently included in its regulated prices and establishing a range of ±5% around this percentage change, and
- making a final decision to agree to the Standard Retailer's proposed change in the Retail Component if it fell within our range, or alternatively invite it to submit a revised proposal.

6.3 Assessing the underlying Retail Component costs

To assess the Standard Retailers' proposed change in the Retail Component in 2016-17, we analysed the underlying cost components which include wholesale gas costs, retail costs and retail margin.

6.3.1 Wholesale gas costs

Wholesale gas costs are the costs faced by an efficient retailer to meet the demand of its customers and include commodity cost and transportation cost, the costs associated with being able to meet peak demand (ie, cost of deliverability) and other market-related costs.

We engaged NERA Economic Consulting (NERA) and Marsden Jacob Associates (MJA) to provide advice on a benchmark range of wholesale gas costs for each Standard Retailer for 2017-19 and assess the Standard Retailers' proposed wholesale gas costs. NERA and MJA's final report is available on our website.[68]

[68] IPART website: http://www.ipart.nsw.gov.au/Home/Industries/Gas/Reviews/Retail_Pricing/Review_of_regulated_gas_retail_tariffs_and_charges_from_1_July_2016.

NERA and MJA modelled wholesale gas costs under 12 scenarios reflecting uncertainties around the timing of contract negotiation for a new entrant retailer, oil prices, the availability of gas and the costs associated with managing peak demand, and a different customer mix.[69] We have made a final decision to accept the advice from NERA and MJA. Our reasonable range for wholesale gas costs is based on the minimum and maximum from NERA and MJA's scenarios for each Standard Retailer. Table 6.1 sets out these reasonable ranges for 2017-19.

Table 6.1 Reasonable range for wholesale gas costs ($2015-16, $/GJ)

	2016-17	2017-18	2018-19
AGL	11.25 – 13.38	11.46 – 13.45	10.02 – 12.04
ActewAGL	10.84 – 13.07	11.02 – 13.11	9.55 – 11.66
Origin Energy – Albury/Murray Valley	10.77 – 13.37	11.26 – 13.71	10.07 – 12.55
Origin Energy – Wagga Wagga	10.90 – 13.53	11.05 – 13.54	9.54 – 12.06

Note: NERA and MJA's ranges are in $ January 2016. The ranges in the table are in $2015-16.

Source: NERA and Marsden Jacob Associates, *Forecasting wholesale gas costs for standard retail gas suppliers in NSW – A report for IPART*, 5 April 2016, p 60.

Purchasing strategy of an efficient new entrant retailer

As discussed in Chapter 3, we have considered efficient wholesale gas costs for a new entrant retailer. In estimating efficient wholesale gas costs, NERA and MJA assumed a new entrant retailer is supplying gas to a retail customer base of substantial scale, and evaluated how it would purchase its gas requirement for 2017-19. In their view, the most efficient and prudent purchasing strategy for such a retailer would be to enter into one or more bilateral gas supply agreements (GSAs) and use spot markets such as the short term trading market (STTM) as a balancing market. This is consistent with AGL and Origin Energy's view that new entrant retailers or major gas retailers would purchase gas through bilateral contracts.[70]

We do not agree with PIAC's view that a new retailer would buy gas on the STTM and that the lower prices from the STTM should be reflected in how much the standard retailers are allowed to charge.[71] It may be reasonable to purchase gas through the STTM for a new entrant retailer with a small customer base. However, for retailers with a larger customer base, without any ability to manage the wholesale gas price associated with selling fixed price contracts to its retail customers, this strategy would expose them to substantial price volatility. Therefore, we do not consider spot market prices represent the wholesale gas costs that would be faced by an efficient new entrant retailer.

69 NERA and Marsden Jacob Associates, *Forecasting Wholesale Gas Costs for Standard Retail Gas Suppliers in NSW – A Report for IPART*, April 2016.

70 AGL submission, December 2015, p 4; Origin Energy submission, December 2015, pp 6-7.

71 PIAC submission, December 2015, p 6.

In estimating wholesale gas costs, NERA and MJA considered that wholesale gas contracts would include an oil-linked pricing component. This is in line with Origin Energy's view that gas supply contracts for 2016-17, which were struck recently, contain an element of oil price indexation. On the contrary, AGL submitted that not all domestic gas contracts are indexed to oil prices, and for those that are, the oil-linked component may only be a partial component. EnergyAustralia submitted that while it may become more common that gas prices are linked to oil prices in the future, it does not consider this is relevant for contracts in 2016-17 as the low oil prices from August 2014 to January 2015 have resulted in the market looking for alternative pricing indicators.

We consider it is reasonable to assume that wholesale gas contracts include an oil-linked pricing component. Based on publicly available information, NERA and MJA found that the Standard Retailers have recently signed GSAs that contain an oil-linked pricing component.

Length and timing of gas supply agreements

NERA and MJA considered that an efficient new entrant retailer would enter into GSAs for a duration that matches the duration of retail gas contracts being sold to their potential customers. They considered that typically retailers would be able to maintain customers for one to three years, and therefore it would be reasonable to expect that the new entrant retailer would seek GSAs with terms of one, two or three years. On this ground, NERA and MJA adopted the new entrant retailer entering into contracts for two years as the base case and in most other scenarios in their modelling.

NERA and MJA considered that a new entrant retailer entering into GSAs with short terms of two years would typically initiate contract negotiation between one and two years prior to the commencement of its retail gas supply. Therefore, they adopted the new entrant retailer signing gas contracts 1-year in advance as the base case and conducted a sensitivity test using the new entrant signing two years in advance. This is not consistent with Origin Energy's submission that we should be considering gas contracts agreed three years ago (ie, in 2013-14) for retail supply in 2016-17. We agree with the advice from NERA and MJA that contracting one to two years in advance of supply is a reasonable assumption for an efficient new entrant retailer.

Impact of oil prices on gas commodity prices for 2017-19

Given that Asian LNG prices are an important factor influencing domestic gas prices, and Asian LNG prices are indexed to oil prices, we asked NERA and MJA to evaluate how the current low prices are likely to affect the efficient new entrant retailer in 2017-19. The falling oil prices resulted in a downward revision in oil price forecasts, causing a substantial difference in oil price forecasts between two years ago and now. This implies that prices could differ materially depending on when contracts have been negotiated.

As discussed above, an efficient and prudent contracting strategy for a new entrant retailer is to enter into new GSAs a year in advance of its retail gas supply. As a result, the impact of lower oil prices will lag gas contract prices, and this is the reason why we do not anticipate an immediate material impact of the low oil price on the wholesale gas costs for 2016-17. For supply in 2016-17, the efficient new entrant gas retailer would have struck gas contracts in 2015-16 before the considerable decline in the oil prices. However, we expect lower wholesale gas costs in 2018-19 as the low oil prices start flowing through to the underlying contract prices.

Cost of additional deliverability

The cost of deliverability refers to the costs associated with meeting peak demand. GSAs typically provide a degree of flexibility to allow retailers to manage peak demand. NERA and MJA estimated the cost of deliverability that an efficient new entrant retailer would incur for deliverability services required in addition to those in their GSAs.

To estimate the additional deliverability cost, NERA and MJA identified the facilities that are capable of providing maximum demand quantity such as Iona storage and Dandenong LNG, and estimated the costs of these facilities. Then they determined the quantity of MDQ required for different customer mixes (eg, small and large NSW customers and customers in Victoria), and estimated the cost of MDQ on $ per GJ basis per annum for each Standard Retailer.[72]

Overall, NERA and MJA found that LNG projects would likely have reduced the availability and increased the price of MDQ service for gas retailers. However, NERA and MJA's estimates of additional deliverability costs are below that submitted by AGL in its confidential pricing proposal to IPART.

Other factors affecting gas commodity prices for 2017-19

NERA and MJA considered that there are a number of other factors affecting gas costs for 2017-19.

- **Supply-demand balance:** A tight supply-demand balance would impinge on gas prices. While LNG exports are driving a substantial increase in demand for gas, a fall in the rate of production is predicted as the main producing gas basins are being depleted. In addition, the falling oil price has affected the commercial viability of gas extraction, reducing commercially viable gas reserves in the Cooper basin.

[72] Authorised Maximum Daily Quantity (Authorised MDQ) and Authorised Maximum Daily Quantity Credit Certificate (AMDQ CC) are transportation rights in the Declared Transmission System (DTS). http://www.aemo.com.au/Gas/Metering-and-Settlements/Victorian-Declared-Wholesale-Gas-Market/Authorised-Maximum-Daily-Quantity-AMDQ, accessed 7 June 2016.

- **Limited competition in the east coast gas market:** In the southern states of the east coast gas market, competition is limited. Esso/BHP has the majority share with Santos and Origin Energy being the other major owners. Having few sellers negatively affects the buyer's negotiating power. When the low oil price reduces substantially contract gas prices, the long-run marginal cost of gas production is most likely to set a floor to the price that a gas producer agrees to sell gas on a long-term contract.
- **Oil and foreign exchange hedging:** Retailers usually hedge their exposure to oil price and foreign exchange risks. This is likely to limit the extent to which retailers can pass the impact of the low oil price to customers.

6.3.2 Retail costs

Retail costs include retail operating costs (ROC) which are the costs a retailer would incur in performing the retail functions required to serve its small customer base. These include customer service (eg, operating call centres), billing and collecting revenue, finance, IT systems, regulatory compliance costs, energy trading costs, and an appropriate allocation of corporate overheads.

Retail costs also include costs associated with customer acquisition and retention (CARC). These costs include marketing and advertising campaigns, reward and loyalty programs.

For this review we undertook analysis of ROC using two approaches:

- **Bottom-up approach** which involves detailed financial analysis of the retail operating costs, using data provided by the Standard Retailers.
- **Benchmarking approach** which involves comparing ROCs adopted by regulator's in other jurisdictions.

Based on our analysis using these approaches, we consider that a reasonable range for ROC in 2016-17 is **$97 to $118 per customer** ($2015-16). This does not include costs associated with acquiring and retaining customers. This ROC range is unchanged in real terms (ie, excluding inflation) since the range we established in our 2013 review ($91 to $110 per customer, $2012-13).[73] This is equivalent to a productivity improvement similar to the economy overall.

We continue to consider that a level of CARC should be allowed in regulated prices that leads to a reasonable transition to a deregulated market for gas (ie, where most customers have moved off regulated prices to a market offer). Including an amount of CARC is necessary to balance the short term objective of setting prices that reflect efficient costs and the longer term objectives of promoting competition.

[73] IPART, *Review of regulated retail prices and charges for gas - From 1 July 2013 to 30 June 2016 – Final Report*, June 2013, p 36.

We include $16/customer ($2015-16) of CARC in our reasonable range to assess the retailer's pricing proposals. This is also unchanged in real terms since the reasonable range we established in the 2014 review.[74] We have only considered direct costs in this benchmark CARC amount, eg, costs of advertising and marketing. It does not include indirect costs, such as the implicit cost of providing price discounts.

Appendix B provides more details on our analysis of ROC and CARC and our response to stakeholder submissions.

6.3.3 Retail margin

The retail margin compensates the Standard Retailers for the systematic risks associated with supplying gas to small customers on regulated tariffs. These systematic risks stem from factors such as variations in demand and economic conditions.

For this review, we undertook a benchmarking analysis in line with the approach that SFG Consulting used in previous advice to IPART.[75] Based on our analysis we did not find sufficient evidence to suggest that the existing retail margin range should be increased or decreased.

We consider that a reasonable range for the retail margin in 2016-17 is between 6.3% and 7.3% based on earnings before interest, taxes, depreciation and amortisation (EBITDA) margin. This range is unchanged from our 2013 review.[76] All three Standard Retailers have proposed a retail margin that falls within this range. More information on our analysis of the retail margin is provided in Appendix C.

6.4 Our reasonable range for the Retail Component

To assess the Standard Retailers' pricing proposals, we established a reasonable range for the change in the Retail Component in 2016-17 for each Standard Retailer. To establish the reasonable range, we:

- determined the midpoint of the range for each of these underlying cost components discussed in Section 6.3
- using these midpoints, calculated the percentage change in the Retail Component for each Standard Retailer relative to the costs currently included in its regulated prices and establishing a range of ±5% around this percentage change, and

74 IPART, *Changes in regulated retail gas prices from 1 July 2014 – Final Report*, June 2014, p 28.
75 SFG, *Estimation of a competitive profit margin for gas retailers in New South Wales*, Final Report, 4 June 2013.
76 IPART, *Review of regulated retail prices and charges for gas - From 1 July 2013 to 30 June 2016 – Final Report*, June 2013, p 36.

- made a final decision to agree to the Standard Retailer's proposed change in the Retail Component if it fell within our range, or alternatively invite it to submit a revised proposal.

6.4.1 Determining the midpoints for underlying cost components

The midpoint of each of the underlying cost components discussed in Section 6.3 is summarised in Table 6.2 below.

Table 6.2 Midpoint of the ranges for the Retail Component in 2016-17 ($2015-16)

	Wholesale gas ($/GJ)			ROC + CARC ($/customer)				Retail margin (% EBITDA)		
	Low	High	Mid	Low	High	Mid	CARC	Low	High	Mid
AGL	11.25	13.38	12.32	97	118	108	16	6.3%	7.3%	6.8%
Origin Energy – Albury/Murray Valley	10.77	13.37	12.07	97	118	108	16	6.3%	7.3%	6.8%
Origin – Wagga Wagga	10.90	13.53	12.22	97	118	108	16	6.3%	7.3%	6.8%
ActewAGL	10.84	13.07	11.96	97	118	108	16	6.3%	7.3%	6.8%

Source: IPART and NERA and Marsden Jacob Associates, *Forecasting wholesale gas costs for standard retail gas suppliers in NSW – A report for IPART*, 5 April 2016, p 60.

6.4.2 Establishing the reasonable range for the change in the Retail Component

Based on the midpoints in Table 6.2 we calculated the percentage change (excluding inflation) for each Standard Retailer in 2016-17, relative to the costs included in its current regulated prices. This percentage change is shown in the midpoint column in Table 6.3. To account for the uncertainty surrounding these underlying costs, we consider it is appropriate to establish a range around this midpoint percentage change. As shown in Table 6.3, we have established a range of ±5% around the midpoint.

6.4.3 Comparing each retailer's pricing proposal to the reasonable range

Table 6.3 shows our reasonable range and the Standard Retailers' proposed change in the Retail Component for 2016-17. AGL's and Origin Energy's proposed change in the Retail Component for 2016-17 is below the upper end of our reasonable range and we made a final decision to agree to these proposals.

ActewAGL's original proposal to increase the Retail Component by the rate of inflation in 2016-17 was above our reasonable range for the draft decision and we invited them to revise their proposal. Their revised proposal submitted in April 2016 was to reduce the Retail Component by 2% (excluding inflation), reflecting lower forecast customer acquisition and retention costs. ActewAGL's revised proposal was at the top end of our reasonable range and we made a draft decision to accept this.

Since our draft decision, the AER released its final decision on gas network prices for ActewAGL's customers in the Queanbeyan region.[77] The AER's final decision was below the estimate we used for our draft decision. The lower network prices for ActewAGL also affect the Retail Component of prices. This is because retailers earn a retail margin on the Network Component – a smaller Network Component means a smaller retail margin (in dollar terms). Given this, our updated reasonable range for the Retail Component for ActewAGL is -12.5% to -2.5% (from -12.0% to 2.0% in our draft decision).

Table 6.3 Assessment of Standard Retailers' pricing proposal based on our reasonable range for the Retail Component (real % change)

	Overall reasonable range			Our assessment	
	Low (-5%)	Midpoint	High (+5%)	Retailer proposed	Accept
AGL	-5.7%	-0.7%	4.3%	0.0%	Yes
Origin Energy – Albury/Murray Valley	-0.6%	4.4%	9.4%	-1.8%	Yes
Origin Energy – Wagga Wagga	-2.3%	2.7%	7.7%	-1.8%	Yes
ActewAGL	-12.5%	-7.5%	-2.5%	-2.0%	Yes

Source: IPART.

While ActewAGL's proposal to reduce the Retail Component by 2% excluding inflation falls just above our revised reasonable range, on balance we made a final decision to agree to ActewAGL's pricing proposal for 2016-17 in the context that there are currently three active retailers in the Queanbeyan area offering nine different gas offers. Of the nine offers, four have discounts on the usage rates of between 10% and 15%.

[77] ActewAGL (ACT, Queanbeyan and Palerang) - Access arrangement 2016-21: https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/actewagl-act-queanbeyan-and-palerang-access-arrangement-2016-21, accessed 7 June 2016.

7 Overall changes in regulated retail gas prices

Average regulated retail gas prices are determined as the sum of:

- the Retail Component, including wholesale gas and transmission costs, retail operating costs and a retail margin, and
- the Network Component, including gas distribution costs.

In Chapter 6 we outlined our final decisions on the change in the Retail Component in 2016-17. As noted in Chapter 5 we have agreed with the Standard Retailer's proposal to pass through the Network Component into retail prices.

In this chapter we outline the overall change in regulated retail gas prices under our final decision. We also provide our forecast of indicative price changes in 2017-18 and 2018-19.

7.1 Overall changes in regulated retail gas prices in 2016-17

Table 7.1 summarises the overall average price change in regulated retail gas prices in 2016-17 under our final decisions.

Table 7.1 Final decision on average change in regulated retail gas prices in 2016-17 (including inflation)

Retailer / supply area	Change in Retail Component	Change in Network Component	Overall price change
AGL (Sydney, Wollongong, Newcastle, Dubbo, Orange, Parkes and Riverina)	1.3%	0.0%	0.8%
Origin Energy			
Albury/Murray Valley	0.0%	1.5%	0.4%
Wagga Wagga and surrounds	0.0%	1.3%	0.6%
ActewAGL			
Capital	-0.7%	0.0%	-0.4%
Queanbeyan	-0.7%	-19.5%	-7.5%
Shoalhaven	-0.7%	1.5%	0.2%
NSW average[a]			**0.3%**

[a] Sales volume-weighted average.

Note: The inflation rate for 2016-17 in our final decision is 1.3%.

Source: IPART.

Across NSW, regulated retail gas prices will increase slightly by an average of 0.3% (including inflation) on 1 July 2016, which is less than the rate of inflation. Across the Standard Retailers, the average change in regulated prices will vary. Most small customers on regulated prices will experience a slight price increase, ranging from 0.2% to 0.8% including inflation. However, for ActewAGL's customers in Capital and Queanbeyan regions, the regulated price will **decrease** by 0.4% and 7.5% respectively, including inflation.

7.1.1 Changes since our draft decision

Average price changes under our final decision are lower than under our draft decision (see Table 7.2). This is because our updated forecast of inflation in 2016-17 (ie, 1.3%) is lower than under our draft decision (ie, 1.8%).

In addition, final gas network prices in the Queanbeyan area are substantially lower than we estimated for our draft decision. As Standard Retailers directly pass through gas network prices into their retail prices, overall average price changes in the Queanbeyan region are falling by 7.5% under our final decision compared to a 0.5% increase under our draft decision.

Table 7.2 Draft decision on average change in regulated retail gas prices in 2016-17 (including inflation)

Retailer / supply area	Change in Retail Component	Estimated change in Network Component	Overall price change
AGL (Sydney, Wollongong, Newcastle, Dubbo, Orange, Parkes and Riverina)	1.8%	0.0%	1.1%
Origin Energy			
Albury/Murray Valley	0.0%	2.0%	0.6%
Wagga Wagga and surrounds	0.0%	2.5%	1.1%
ActewAGL			
Capital	-0.2%	0.0%	-0.1%
Queanbeyan	-0.2%	1.8%	0.5%
Shoalhaven	-0.2%	1.8%	0.6%
NSW average[a]			**0.9%**

[a] Sales volume-weighted average.

Note: Forecast inflation in 2016-17 for our draft decision was 1.8%.

Source: IPART.

7.2 Impact of our final decisions on customers

Based on our final decision on the overall price changes for 2016-17, we have estimated indicative annual gas bills for residential and business customers with average usage in each gas supply area (Table 7.3 and Table 7.4).

For most residential customers on regulated prices, there will be a small increase in their annual bills ranging from $2 to $7 per annum, while ActewAGL's customers in the Queanbeyan region will save on average around $89 per annum in their annual bills; and to a lesser extent, customers in the Capital region will also see a slight reduction of $5 in their annual bills. Similarly, most small business customers in NSW will experience a slight increase in their annual bills, ranging from $14 to $39 per annum. Annual bills are estimated to decrease by $464 and $27 per annum for those in ActewAGL's Queanbeyan and Capital regions, respectively.

Table 7.3 Indicative annual bill for typical residential customers of each Standard Retailer ($nominal, inc GST)

	GJ pa	Current bill in 2015-16	Estimated bill in 2016-17	Change ($)	Change (%)
AGL	23	891	898	7	0.8%
ActewAGL (Capital)	35	1,195	1,190	-5	-0.4%
ActewAGL (Queanbeyan)	35	1,195	1,106	-89	-7.5%
ActewAGL (Shoalhaven)	35	1,188	1,190	2	0.2%
Origin Energy (Albury)	44	1,054	1,059	5	0.4%
Origin Energy (Murray Valley)	31	1,097	1,102	5	0.4%
Origin Energy (Wagga Wagga)	42	1,313	1,320	7	0.6%

Source: IPART.

Table 7.4 Indicative annual bill for typical small business customers of each Standard Retailer ($nominal, inc GST)

	GJ pa	Current bill in 2015-16	Estimated bill in 2016-17	Change ($)	Change (%)
AGL	184	5,037	5,076	39	0.8%
ActewAGL (Capital)	246	6,306	6,279	-27	-0.4%
ActewAGL (Queanbeyan)	246	6,197	5,733	-464	-7.5%
ActewAGL (Shoalhaven)	246	7,026	7,040	14	0.2%
Origin Energy (Albury)	209	4,154	4,172	18	0.4%
Origin Energy (Murray Valley)	346	7,721	7,755	34	0.4%
Origin Energy (Wagga Wagga)	212	4,117	4,140	23	0.6%

Source: IPART.

7.3 Indicative price changes in 2017-18 and 2018-19

While we have not been asked to reach a pricing agreement with the Standard Retailers in 2017-18 and 2018-19, we have been asked to provide indicative price changes in these years. We also invited the Standard Retailers to provide their indicative price changes in these years.

Table 7.5 sets out the Standard Retailers' indicative changes in the R component and our forecast indicative changes in the Retail Component for 2017-18 and 2018-19. To form our indicative price changes we used an approach consistent with our assessment of the retailer's pricing proposals discussed in Chapter 6. In particular, we used the midpoint of NERA and MJA's forecast wholesale gas costs for 2017-18 and 2018-19. We used the midpoint ROC of $108 and CARC of $16 in $2015-16, and the midpoint retail margin of 6.8% as shown in Table 6.2.

All Standard Retailers indicated that the Retail Component of their regulated prices in 2017-18 will remain unchanged in real terms. As these are within our reasonable ranges for 2017-18 we have adopted this as our indicative price change.

For 2018-19, all Standard Retailers' indicative changes in the Retail Component exceed our reasonable ranges. The midpoints of our reasonable ranges indicate a reduction in the Retail component by between -9.4% and -7.6% in real terms. However, all Standard Retailer indicated no change in real terms (Table 7.5). The main driver of this difference is lower wholesale gas costs. As discussed in Chapter 6, lower wholesale gas costs are predicted in 2018-19 as the low oil price starts affecting gas contract prices. The Standard Retailers' indicative prices are based on wholesale gas costs increasing in line with CPI.

Table 7.5 Standard Retailers' and IPART's forecast changes in the Retail component in 2017-18 and 2018-19 (% excluding inflation)

Retailer	Retailers' indicative changes		IPART's forecast indicative changes			
	2017-18	2018-19	2017-18		2018-19	
			Range	Mid	Range	Mid
AGL	0.0%	0.0%	-4.2% to 5.8%	0.8%	-12.8% to -2.8%	-7.8%
Origin Energy - Albury/Murray Valley	0.0%	0.0%	-2.2% to 7.8%	2.8%	-12.6% to -2.6%	-7.6%
Origin Energy - Wagga Wagga	0.0%	0.0%	-4.5% to 5.5%	0.5%	-14.4% to -4.4%	-9.4%
ActewAGL	0.0%	0.0%	-4.3% to 5.7%	0.7%	-14.3% to -4.3%	-9.3%

Note: We assumed an inflation rate of 2.5% in 2017-18 and 2018-19 based on the midpoint of the RBA target range.

Source: Standard Retailers' pricing proposal and IPART.

Table 7.6 sets out our forecast indicative changes in the overall regulated prices in 2017-18 and 2018-19. Given the uncertainty around network prices we have assumed that the average network prices in 2017-18 and 2018-19 will increase by the rate of inflation in all areas apart from ActewAGL's Queanbeyan area. The average network price changes in the ActewAGL Queanbeyan area is based on the AER's recent final decision.[78] Our forecast changes in the Retail Component (see Table 7.5) imply that the overall regulated retail gas price will increase by around the rate of inflation in 2017-18, and decrease by between 2.2% and 3.6% depending on the Standard Retailers.

Table 7.6 Indicative changes in overall regulated prices in 2017-18 and 2018-19 (including inflation, %)

Retailer	2017-18			2018-19		
	Retail	Network	Overall	Retail	Network	Overall
AGL	2.5%	2.5%	2.5%	-5.5%	2.5%	-2.2%
Origin Energy - Albury/Murray Valley	2.5%	2.5%	2.5%	-5.4%	2.5%	-3.1%
Origin Energy - Wagga Wagga	2.5%	2.5%	2.5%	-7.1%	2.5%	-3.1%
ActewAGL – Capital	2.5%	2.5%	2.5%	-7.0%	2.5%	-3.2%
ActewAGL – Queanbeyan	2.5%	3.8%	2.9%	-7.0%	3.8%	-3.6%
ActewAGL – Shoalhaven	2.5%	2.5%	2.5%	-7.0%	2.5%	-3.1%

Note: We assumed an inflation rate of 2.5% in 2017-18 and 2018-19 based on the midpoint of the RBA target range.

Source: IPART.

While our forecast changes for 2018-19 reflect our best estimates of wholesale gas costs for 2018-19 based on the latest oil price forecasts, they should be interpreted with caution. There is considerable uncertainty about future oil price movements and how much low oil prices would reduce wholesale gas costs. If we had been asked to review prices for three years, we would recommend that wholesale gas costs be reviewed annually, consistent with our 2013 review. In our past retail electricity and gas reviews, which covered a 3-year regulatory period, we conducted annual reviews to manage the risk and uncertainty associated with forecasting cost components in unregulated markets more than 1-year in advance.

78 AER, *Final Decision ActewAGL Distribution Access Arrangement 2016 to 2021 – Overview*, May 2016, p 20. Available at https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/actewagl-act-queanbeyan-and-palerang-access-arrangement-2016-21, accessed 2 June 2016.

8 Miscellaneous charges

In addition to charges for gas supply, energy retailers levy non-tariff fees and charges (or miscellaneous charges). These charges arise from particular events associated with the supply of energy to individual customers – for example, as a result of a request from a customer, or when a customer fails to pay a bill.

Miscellaneous charges are not consistent across the Standard Retailers, and comprise both retail and network charges. Retail miscellaneous charges are levied by the Standard Retailers. They are set via each retailer's pricing agreement, which specifies the maximum level for each charge. Retail miscellaneous charges include:

- late payment fees
- dishonoured payment fees, and
- account establishment fees.

Network miscellaneous charges are levied by network distribution service providers, but are passed through to the customer by the retailer. They may include fees for special meter reads, network disconnection and reconnection and permanent disconnection. In general, network miscellaneous charges are set in the network service provider's Access Arrangements which are regulated by the AER.

In this chapter we outline our final decisions on the Standard Retailer's proposed changes to miscellaneous charges.

8.1 Overview of final decisions on miscellaneous charges

5 IPART's final decisions are to:

- agree to the proposals by AGL, ActewAGL and Origin Energy to change their existing retail miscellaneous charges by no more than the change in the CPI, and
- allow Standard Retailers to pass through to customers network miscellaneous charges and to add the regulated retail administration fee.

We consider that it is reasonable for the retailers to maintain the real level of existing fees and charges, and therefore our final decision is to agree to the proposed changes in miscellaneous charges. The resulting retail miscellaneous charges for each Standard Retailer are set out in Table 8.1. These are slightly lower than set out in our draft decision as our revised forecast of inflation in 2016-17 is lower.

Table 8.1 Retail miscellaneous charges ($2016-17, excluding GST)

Fee	AGL	ActewAGL	Origin (Albury Murray Valley and Wagga Wagga)
Late payment fee	12.08	13.39	12.00
Account Establishment Fee	27.36	27.25	34.29
Account Establishment Fee (pensioners)		13.39	
Dishonoured payment	15.19	29.09	27.45
Retail administration fee	2.84		2.69
Collector call fee	41.40		
Attendance (debt collection) first visit		41.35	
High bill field visit		67.94	

Note: AGL does not currently charge customers the account establishment fee but may do so in the future. The dishonoured payment fee is the maximum that AGL can charge. Forecast inflation in 2016-17 is 1.3%.

8.2 Retail miscellaneous charges

8.2.1 Late payment fees

Late payment fees are charged when customers pay their gas bill after the due date. Under the National Energy Customer Framework (NECF), there are some circumstances when Standard Retailers **cannot** impose a late payment fee. These include:

- If the customer is a hardship customer.
- If that bill, or another bill given to the customer under the contract is the subject of a matter being considered by the energy ombudsman.
- If the bill is subject to an arrangement to pay by instalment under a payment plan.
- If any part of the bill is paid by a voucher issued under the Energy Accounts Payment Assistance Scheme.
- If the retailer is aware that the customer has sought assistance to pay the bill from a participating community welfare organisation that issues such vouchers.

The Standard Retailers are proposing to increase their late payment fees in 2016-17 by the change in CPI.

8.2.2 Other retail miscellaneous charges

Standard Retailers may also charge fees to establish an account, for dishonoured payments and in relation to disconnection or potential disconnection. These include collector call fees (where the premises are visited to disconnect supply but the customer agrees to make a payment) and high bill field visit fees. In some cases, this type of miscellaneous fee is levied by the network service provider. Standard Retailers should provide this information on their websites.

The Standard Retailers proposed to increase the other miscellaneous fees they levy by the change in the CPI or less.[79] We consider that it is reasonable for the retailers to maintain the real level of existing fees and charges, and therefore we have made a final decision to agree to these proposals.

While not a regulated charge, retailers may also collect a security deposit from gas customers. The arrangements under which a retailer may request a security deposit and the amount of such a deposit are set out in the National Energy Retail Rules.[80]

8.2.3 Administration charge on network non-tariff fees and charges

As noted above, networks also levy miscellaneous fees for certain services. Typically, these include special meter readings, meter testing and disconnection/reconnection of gas supply. The fees differ across networks.

The gas retailers are the interface between the gas networks and the customer. Retailers state that they incur costs taking calls, requesting the network service, advising customers of costs, processing orders, including fees on customer accounts and collecting the revenue.

AGL and Origin Energy propose to continue including an administration fee on network non-tariff fees and charges in their pricing agreements. For 2016-17, they propose to increase in this charge by no more than the change in the CPI. We consider this to be reasonable.

79 AGL, *AGL Proposal for Regulated Retail Gas Prices in NSW for 2016-17 – Public Submission,* 27 January 2016, p 19; Origin Energy, *Review of Regulated Gas Retail Tariffs from 1 July 2016 – Pricing Proposal,* 27 January 2016, p 10; ActewAGL, *Review of Regulated Retail Prices and Charges for Gas from 1 July 2016 to 30 June 2017,* 27 January 2016, p 3.

80 See Part 2, division 6 of the National Energy Retail Rules.

8.3 Submissions on miscellaneous charges

A submission from NCOSS considered that it was unreasonable that certain miscellaneous charges are levied on customers, because of customer's ability to pay and double-counting on behalf of retailers. NCOSS submits:

- account establishment fees and security deposits limit the ability to switch back to a standard retail contract
- late payment fees and dishonoured payment fees restrict any vulnerable customers from being able to pay back their accounts in full, and
- retail administration fees are a form of 'double-dipping' by the retailers who also earn a ROC allowance.[81]

We consider it is reasonable that retailers are able to recover the efficient cost of running their business. When we review retail operating cost (ROC) we ensure that this amount excludes any recovery of costs through separate fees (eg, the late payment fee). Therefore, we consider that our final decision on an appropriate range for retail operating costs and our final decision on miscellaneous charges avoid double-recovery of costs.

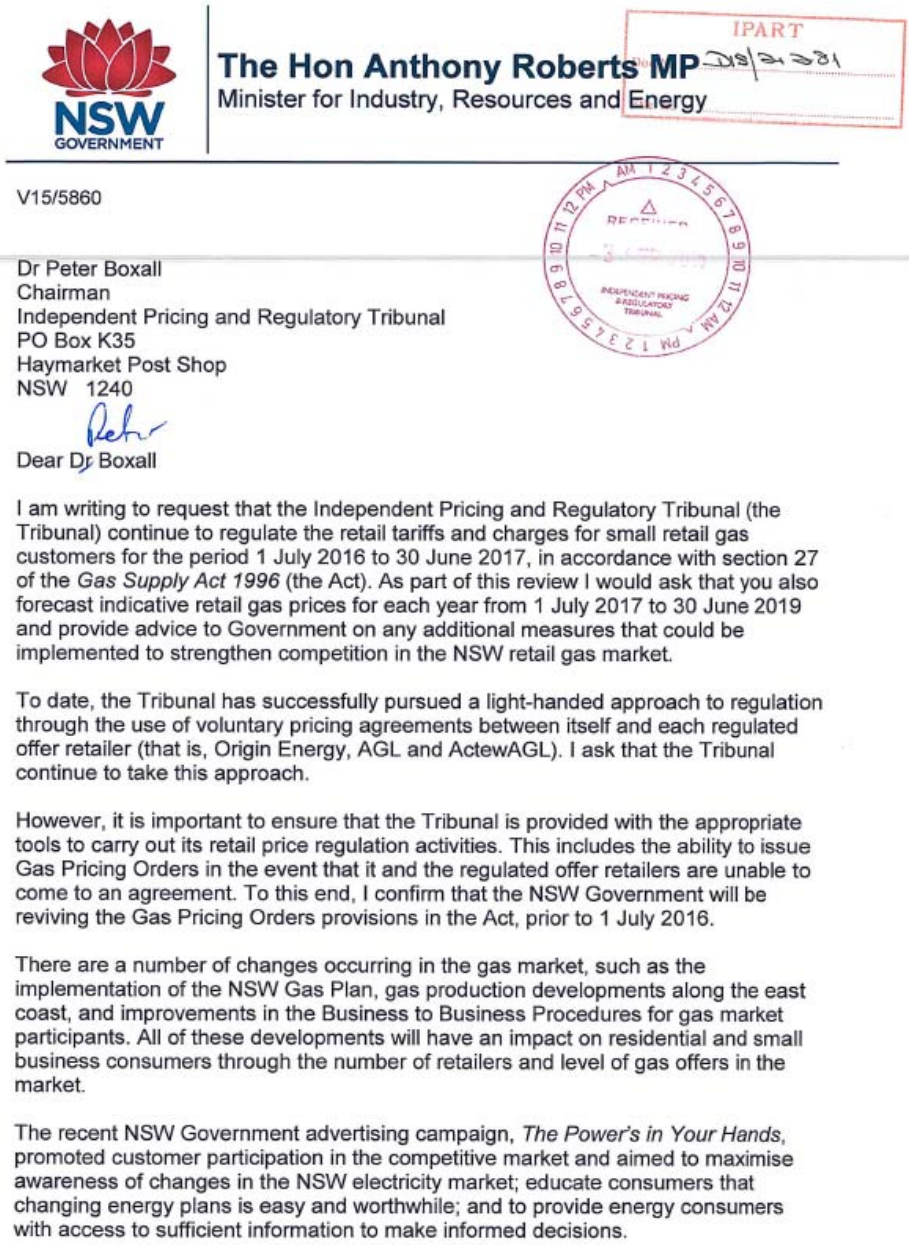
The retail administration fee is a charge for the cost of administering fees charged by the network distribution business and passed through to customers (eg, disconnection/reconnection and special meter reading fees). As noted above, retailers incur costs to administer such fees, and we consider it reasonable that they can recover these costs.

The arrangements under which a retailer may request a security deposit and the amount of such a deposit are set out in the National Energy Retail Rules.

[81] NCOSS submission, March 2016, p 4.

Appendices

A Minister's referral letter



The Hon Anthony Roberts MP
Minister for Industry, Resources and Energy

IPART

V15/5860

Dr Peter Boxall
Chairman
Independent Pricing and Regulatory Tribunal
PO Box K35
Haymarket Post Shop
NSW 1240

Dear Dr Boxall

I am writing to request that the Independent Pricing and Regulatory Tribunal (the Tribunal) continue to regulate the retail tariffs and charges for small retail gas customers for the period 1 July 2016 to 30 June 2017, in accordance with section 27 of the *Gas Supply Act 1996* (the Act). As part of this review I would ask that you also forecast indicative retail gas prices for each year from 1 July 2017 to 30 June 2019 and provide advice to Government on any additional measures that could be implemented to strengthen competition in the NSW retail gas market.

To date, the Tribunal has successfully pursued a light-handed approach to regulation through the use of voluntary pricing agreements between itself and each regulated offer retailer (that is, Origin Energy, AGL and ActewAGL). I ask that the Tribunal continue to take this approach.

However, it is important to ensure that the Tribunal is provided with the appropriate tools to carry out its retail price regulation activities. This includes the ability to issue Gas Pricing Orders in the event that it and the regulated offer retailers are unable to come to an agreement. To this end, I confirm that the NSW Government will be reviving the Gas Pricing Orders provisions in the Act, prior to 1 July 2016.

There are a number of changes occurring in the gas market, such as the implementation of the NSW Gas Plan, gas production developments along the east coast, and improvements in the Business to Business Procedures for gas market participants. All of these developments will have an impact on residential and small business consumers through the number of retailers and level of gas offers in the market.

The recent NSW Government advertising campaign, *The Power's in Your Hands*, promoted customer participation in the competitive market and aimed to maximise awareness of changes in the NSW electricity market; educate consumers that changing energy plans is easy and worthwhile; and to provide energy consumers with access to sufficient information to make informed decisions.

However, the NSW Government acknowledges that customers in some areas of New South Wales may have limited offers to choose between. The Government asks IPART to review the competitiveness of the retail gas market through NSW. In particular, IPART is asked to consider:

- the pass through of network price reductions into retail market contracts. This may include the extent of price decreases, the timeliness of price changes and communication around price changes; and
- the diversity in retail market offers to cater to different market segments. This may include competition on the fixed supply charge.

The NSW Government recognises the need to respond to developments in retail gas competition to ensure that customers can benefit from competitive market offers.

The Tribunal is to carry out its retail gas price regulation activities unless otherwise advised by me.

Yours sincerely

Anthony Roberts MP
Minister for Industry, Resources and Energy

B More information on retail costs

In this appendix we provide more information on our assessment of efficient retail costs. We have considered two types of retail costs:

- **Retail operating costs** (ROC) - costs an efficient retailer would incur in performing the retail functions required to serve its small customer base. These include customer service (eg, operating call centres), billing and collecting revenue, finance, IT systems, regulatory compliance costs, energy trading costs, and an appropriate allocation of corporate overheads.
- **Customer acquisition and retention costs** (CARC) - costs retailers incur to attract new customers and retain existing customers in a competitive market. These costs include marketing and advertising campaigns, reward and loyalty programs.

B.1 Overview of our range of retail costs

We consider that a reasonable range for ROC in 2016-17 is **$97 to $118 per customer** ($2015-16). This does not include costs associated with acquiring and retaining customers.

This ROC range is unchanged in real terms (ie, excluding inflation) since we established the range in our 2013 review ($91 to $110 per customer, $2012-13).[82] This implies a productivity improvement similar to the economy overall.

We also consider that it is reasonable to include $16/customer ($2015-16) of CARC in developing a reasonable range to assess the retailer's pricing proposals. This is also unchanged in real terms since the reasonable range we established in the 2014 review.[83]

In the sections below we discuss our analysis of ROC and CARC in more detail.

[82] IPART, *Review of regulated retail prices and charges for gas – From 1 July 2013 to 30 June 2016 – Final Report*, June 2013, pp 33-34.

[83] IPART, *Changes in regulated retail gas prices from 1 July 2014 – Final Report*, June 2014, p 28.

B.2 Retail operating costs

To develop a reasonable range for ROC we:

- analysed retail cost information provided by the Standard Retailers (bottom up approach), and
- compared other regulator's decisions on retail costs (benchmarking approach).

B.2.1 Bottom-up approach

The bottom up approach involves analysing ROC data provided by the Standard Retailers to determine which costs are included, what factors drive these costs and to test it for reasonableness. Where necessary we made some adjustments to the information provided to us, including:

- removing advertising and marketing campaign costs as these are included in CARC
- removing costs of depreciation and amortisation as these costs are compensated through the retail margin
- reducing bad debt costs per customer by 50%, where reported bad debt costs include both electricity and gas customers[84]
- removing costs that are recovered through separate fees (miscellaneous charges), for example through late payments fees.

After making these adjustments the results from the bottom-up approach are summarised in Table B.1.

Table B.1 Summary of bottom up analysis (ROC per customer, $2015-16)

	Low	High
Bottom-up ROC	96	128

Source: Data provided by Standard Retailers and IPART.

While the low end of our bottom-up analysis is essentially unchanged in real terms (ie, excluding inflation) since our 2013 review, the high end is around $15 higher.

We undertook further inquiries and requested further information to determine whether there were any factors that caused the ROC to increase over the past few years. However, we consider that the increase in the high end in Table B.1 is the result of one of the Standard Retailers using a different accounting and cost allocation methodology than that previously used to report ROC data to IPART,

[84] In line with our approach in the 2013 review, we have reduced bad debts costs by 50% where these include electricity and gas customers. Retailers have advised us that the only substantial difference between electricity and gas retail costs is costs associated with bad debt, with bad debt costs being lower for gas (as gas bills are lower).

and does not represent a real increase. In addition, there are some costs included in this high end result that relate to customer acquisition and retention, but we are unable to quantify this amount. While the high end of the ROC range in Table B.1 is overstated, as discussed in Section B.2.3, we have excluded this from our overall recommended range for ROC.

B.2.2 Benchmarking approach

The benchmarking approach involves comparing ROCs adopted in other regulatory decisions. In some instances other regulators' decisions on ROC are made with reference to IPART's previous decisions and so there is some circularity in the analysis.

The benchmarking analysis is summarised in the table below. We consider that these results do not provide much additional information as two of the three regulator's decisions are referenced to IPART's previous decisions.

Table B.2 Summary of benchmarking analysis ($/customer, $2015-16)

Source of information	ROC / customer	Notes
IPART 2013 Gas Review	$97 - $118	
IPART 2013 Electricity Review	$118	
QCA 2015-16 Electricity Review	$123	Includes late payment costs
OTTER 2016-17 Electricity Review	$137	Includes some CARC related costs
ICRC 2015-16 Electricity Review	$118	

Note: Allowances are rounded to the nearest dollar.
Source: Various.

The QCA's ROC decision for 2015-16 is based on IPART's 2013 electricity determination (although the QCA added late payment costs back in as in Queensland regulated retailers can't charge late payment fees). To the ROC allowance of $123 the QCA also added an amount of around $46 per customer ($2015-16) for CARC.[85] In the QCA's draft determination for 2016-17 it decided not to benchmark ROC with other regulator's decisions, but to undertake a comprehensive review of retail costs. The total retail costs it estimated for the draft determination ($232/residential customer) includes an amount for ROC, CARC and retail margin. As the results are not disaggregated into these components we are unable to directly compare them with other decisions in Table B.2.[86]

[85] QCA, *Regulated Retail Electricity Prices for 2015-16 – Final Determination*, June 2015, pp 27-30. More information on the breakup of retail operating costs and CARC is provided in the QCA's 2013-14 decision; QCA, *Regulated Retail Electricity Prices 2013-14 – Final Determination*, May 2013, p 50.

[86] QCA, *Regulated Retail Electricity Prices for 2016-17 – Draft Determination*, March 2016, pp 22-36.

The Tasmanian regulator's decision of $137 per customer[87] is based on a bottom up assessment of the regulated retailer's (Aurora Energy) proposed ROC and a comparison of the ROC allowances of other regulators. While OTTER did not exclude nor specifically allow any CARC, it notes that Aurora Energy's operating costs include a number of 'CARC type' costs. To fulfil its legislative objective of promoting competition, OTTER considers that Aurora Energy should be permitted to recover these CARC related costs (eg, advertising costs and costs associated with defensive campaigns).[88]

For the last few years, the ICRC has adopted IPART's 2013 retail operating cost allowance of $110 per customer ($2012-13). Each year it has been indexed by the change in CPI. The Commission has not included CARC in regulated prices.[89]

B.2.3 Our recommended ROC range for 2016-17

We consider that the results from the bottom-up and benchmarking approach support maintaining the reasonable range for ROC from our 2013 review in real terms (ie, excluding inflation). This is a ROC range of **$97 to $118 per customer** in 2016-17 ($2015-16).

In our 2013 review, the lower end of our reasonable range for ROC was based on the low result from our 2013 bottom up analysis. Our updated bottom up analysis for 2016 produced a result that is essentially unchanged in real terms (ie, excluding inflation) since our 2013 review.

We have not included the high end of our bottom up analysis ($128/customer) in our reasonable range for ROC as this result includes CARC. Instead, we have maintained the top end of our 2013 ROC range in real terms. The only regulator's decision from the benchmarking approach that is not directly derived from previous IPART decisions (OTTER, $137) falls above our reasonable ROC range. However, as noted above, this allowance includes CARC and so is not directly comparable to our ROC range.

B.2.4 Stakeholder submissions on ROC

EnergyAustralia considered that our (bottom up and benchmarking) approach to ROC was reasonable.[90] The submission from AGL noted that, provided that cost allowances for wholesale gas and retail margin are maintained, the ROC allowance should also be retained in real terms. However, it referred to the QCA's decision on ROC which is around $50 per customer higher than IPART's

87 OTTER's decision of $138.45 per customer in $2016-17 is converted to $2015-16 using inflation rate of 1.31% for 2016-17.

88 Office of the Tasmanian Economic Regulator, *Investigation to determine maximum standing offer prices for small customers on mainland Tasmania – Final Report*, May 2016 pp 56-57.

89 ICRC, *Retail Electricity Price Calibration 2015-16 – Final Decision*, June 2015, p 20.

90 EnergyAustralia submission, December 2015, p 4.

assessment.[91] Origin Energy submitted that the reasonable ROC range from our 2013 review ($91 to $110 per customer excluding CARC in $2012-13) is below Origin Energy's published cash cost to serve of $159 per account in financial year 2015, including CARC.[92] The submission from PIAC recommended that we use the low end of our range for ROC, and not the higher value.[93]

We have considered information provided by retailers and other regulator's decisions in determining a reasonable ROC range for 2016-17. As discussed above, our bottom up and benchmarking approaches exclude CARC, are designed to avoid double-counting of costs, and where necessary reduce bad debt costs to reflect a gas (as opposed to electricity) customer.

As discussed in Chapter 6, we have used the midpoint of our ROC range in 2016-17 to assess the retailer's pricing proposals. We consider that, given the uncertainty of estimating the efficient level of ROC, using the midpoint of the range is a reasonable approach and is preferred to taking the low end of the range as recommended by PIAC.

B.3 Customer acquisition and retention costs

To assess the retailer's pricing proposals we have included CARC of $16/customer ($2015-16). This amount in is unchanged in real terms since the reasonable range we established in the 2014 gas review.

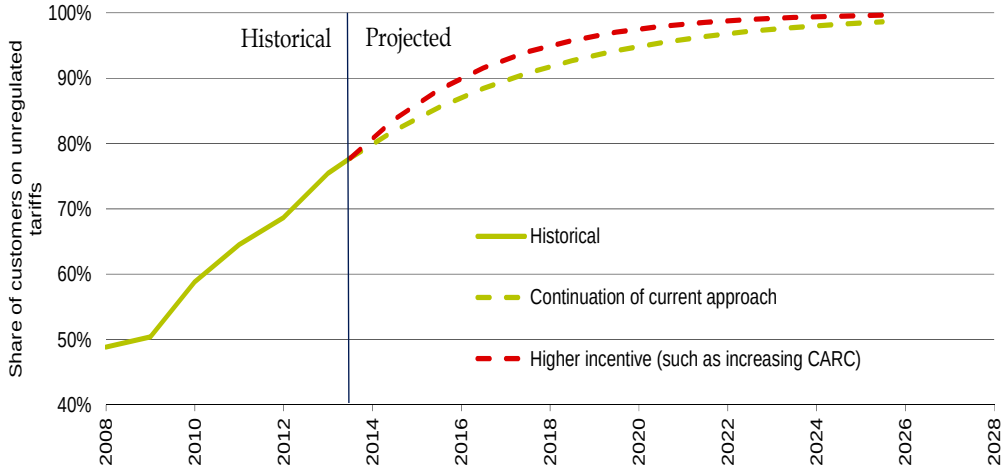
B.3.1 Why we have included CARC in assessing the retailer's proposals

We continue to consider that a level of CARC should be allowed in regulated prices that leads to a reasonable transition to a deregulated market for gas (ie, where most customers have moved off regulated prices to a market offer). The amount of CARC that we have included in assessing the retailer's proposals represents direct costs of marketing and advertising, not an indirect allowance to facilitate price discounts.

In our 2014 review, we used a model to compare the level of CARC in prices with the transition time to a largely deregulated market. A higher CARC will lead to a more rapid transition to a largely deregulated market and a lower incentive to a less rapid transition. Based on this model we anticipated that, across NSW, around 90% of small retail gas customers would be on market offers by around 2016 (see Figure B.1).

91 AGL submission, December 2015, p 4.
92 Origin Energy submission, December 2015, p 8.
93 PIAC submission, December 2015, p 7.

Figure B.1 Customers on market offers under alternative regulatory incentives



Note: The standard transition model is an S-shaped function. This analysis uses a Gompertz function: $\frac{\dot{c}}{c} = -\propto \log\left(\frac{c}{\bar{c}}\right)$ where c is the share of adopters (in this case of an unregulated price or market offer), $\dot{c}$ is the rate of change of adopters, $\bar{c}$ is final adoption level (in this case 100%) and $\propto$ is a parameter that determines the speed of change. The speed of change under alternative incentives is mapped to historical observed changes.
Data source: IPART calculations.

B.3.2 Stakeholder submissions on CARC

In its submission, PIAC recommended that IPART remove the CARC allowance as it is not facilitating switching to market contacts. It submitted that the transition to market contracts is not occurring as quickly as we predicted, and therefore the CARC allowance is not working.[94] The submission from NCOSS also recommended that the CARC allowance be removed as it provides large retailers with a competitive advantage over new entrants.[95] In contrast, Origin Energy noted that failure to allow for CARC is likely to stifle competition and result in an increase in tariffs when regulation ends.[96]

In our view, including an amount of CARC is necessary to balance the short term objective of setting prices that reflect efficient costs and the longer term objective of promoting competition. A competitive market is the best protection for customers. A competitive market will better allocate resources, and lead to lower prices and improved product offerings. Without a competitive market, there would be little discipline on retailers to innovate and to seek efficiencies. As is the case with natural monopolies, such as electricity networks, customers would in effect rely on the regulator to counter retailers' inevitable market power and

94 PIAC submission, December 2015, p 7.
95 NCOSS submission, March 2016, Section 1.
96 Origin Energy submission, December 2015, p 8.

drive efficiency improvements. Ultimately, this would lead to higher prices because regulation is less effective than competitive forces in driving efficiency.

The amount of CARC that we have included in assessing the retailer's proposals represents direct costs of marketing and advertising, not an indirect allowance to facilitate price discounts.

We do not agree with NCOSS that including CARC in our assessment provides a competitive advantage for large incumbent retailers. If any CARC that is included in regulated prices was removed, this would lower the level of prices as noted by NCOSS. However, a lower regulated price will make it more difficult for a new entrant retailer to enter the market and win customers. This is because a new entrant will incur advertising and marketing costs to attract customers, and will likely need to offer a price discount off the regulated price. The ability of a new entrant retailer to do this is lessened if there is no CARC included in the regulated price.

With regard to PIAC's submission that the market has not transitioned as quickly as we expected, we consider that this would lend support to increasing the CARC allowance – not removing it. As noted above, in our view a higher CARC will lead to a more rapid transition to a largely deregulated market and a lower incentive to a less rapid transition. The model that we applied in our 2014 review recognised that the rate of transition will slow as the proportion of customers who remain on regulated prices gets lower. For some customers, the search costs involved in selecting a better offer outweighs the saving that they would make from switching. In these instances, it is a rational decision for them not to participate in the market.

C More information on retail margin

In this appendix we provide further information on our analysis of the retail margin. In our previous retail energy price reviews, we engaged Strategic Finance Group (SFG) to provide advice on an appropriate retail margin for gas retailers, using the following three approaches:

- **Expected returns approach** - which estimates the expected cash flows that a retailer will earn and the systematic risk associated with these cash flows, and determines a retail margin that will compensate investors for this systematic risk.
- **Benchmarking approach** – which involves estimating retail margins of a set of comparable retail firms listed in international markets.
- **Bottom-up approach** – which assumes the consideration paid for acquisition of retail electricity and gas businesses reflects the market value of an energy retailer, and the retail margin would provide an appropriate return on investment.[97]

We are not able to commission SFG to update its modelling for our 2016 review. We consider it unlikely that another consultant would be able to replicate SFG's proprietary modelling. However, rather than develop a new retail margin methodology this year, we have undertaken our own analysis. We consider our analysis provides reasonable assurance that the retail margin range from our 2013 review remains appropriate in 2016-17.

C.1 Overview of our range on the retail margin

Our reasonable range for the retail margin in 2016-17 is between 6.3% and 7.3%, based on earnings before interest, taxes, depreciation and amortisation (EBITDA) margin. This range is unchanged from our 2013 review.

[97] SFG, *Estimation of a competitive profit margin for gas retailers in New South Wales*, Final Report, 4 June 2013.

C.2 How we developed our range

As indicated above, in the past we have used three approaches to recommend a range for the retail margin. As we are unable to commission SFG to update these approaches this year, we considered whether we or another consultant would be able to replicate SFG's methodology. Our view is that while SFG's benchmarking approach could reasonably be replicated and therefore updated, this is unlikely for the expected returns and bottom-up approaches.

In our previous gas reviews, the benchmarking approach has consistently provided a retail margin range which is generally within the final overall retail margin range (for example, see Table C.1). Therefore, we consider that if the updated benchmarking analysis for 2016 is similar to the results in 2013 then this would suggest that the overall retail margin range remains appropriate. As shown in Table C.1, in 2013 SFG recommended a retail margin range of **6.3% to 7.3%** based on the equally weighted average of the retail margins (EBIDA/Sales, %) estimated under the three approaches described above.

Table C.1 Retail margin analysis in the 2013 retail gas review

Approach for estimating retail margin	EBITDA range
Expected returns approach	4.7% to 6.0%
Benchmarking approach	6.2% to 6.4%
Bottom-up approach	7.9% to 9.4%
Equally weighted average	**6.3% to 7.3%**

Source: SFG, *Estimation of the regulated profit margin for gas retailers in New South Wales*, 4 June 2013.

C.2.1 Updated benchmarking analysis

We undertook updated benchmarking analysis based on SFG's approach used in the 2013 retail gas review. We found that the observed retail margins of listed retailers have remained stable since the 2013 review.

Overall, our updated analysis indicates that the retail margin for an efficient gas retailer is unlikely to have changed, and therefore, we consider the current retail margin range of 6.3% to 7.3% remains appropriate.

Sample

We analysed a sample of 746 listed retailers from 1980 to 2015, which comprises 8,890 annual observations. Consistent with SFG's approach, we included in our analysis all firms listed in Australia, Canada, UK, US and New Zealand which are classified by Industry Classification Benchmark (CB) as "Drug retailers", "Food retailers and wholesale", "Apparel retailer", "Broadline retailers", "Home improvement", or "Specialty retailers". We excluded observations in which ratios[98] were above the 99th percentile or below the 1st percentile to ensure that the results are not affected by extreme outcomes.

Results

As shown in Table C.2, the updated mean EBIT margin is 5.1%, the median is 4.9%, and the 90% confidence interval is 5.0% to 5.3%. The corresponding figures reported in SFG's 2013 report were a mean of 5.2%, a median of 4.9% and the 90% confidence interval of 5.1% to 5.4%.

The mean EBITDA margin is 7.5%, the median is 7.1%, and the 90% confidence interval is 7.3% to 7.6%. The corresponding figures reported in SFG's 2013 report were a mean of 7.5%, a median of 7.0% and the 90% confidence interval of 7.4% to 7.7%. A complete summary of the results is provided in Table C.2 below.

Table C.2 Benchmarking analysis of retail margins for listed energy retailers

	Sample period	N	EBITDA/Sales (%)				EBIT/Sales (%)			
			Mean	Median	Low	High	Mean	Median	Low	High
2013 review	1980-2012	7,990	7.5	7.0	7.4	7.7	5.2	4.9	5.1	5.4
2016 update	1980-2015	8,890	7.5	7.1	7.3	7.6	5.1	4.9	**5.0**	**5.3**

Source: IPART analysis and SFG.

As highlighted in the 2013 SFG report, the appropriate profit margin for comparison with gas retailers is the EBIT margin of listed retailers rather than the EBITDA margin. This is because listed energy retailers are more capital intensive than gas retailers, incurring depreciation and amortisation charges which are 2.3% of sales, on average. We present the EBITDA margins in Table C.2 for completeness.

[98] Observations in which the EBITDA margin, EBIT margin, Book-to-market equity ratio, book-to-market assets ratio and Value/EBIT ratio are below the 1st percentile or above the 99th percentile are excluded.

To obtain the EBITDA margin for a representative **gas retailer**, SFG used the EBIT margin for listed energy retailers and added back in estimates of depreciation and amortisation for a gas retailer. We followed the same approach to obtain the EBITDA margin range for a gas retailer, and updated SFG's model to add depreciation and amortisation for a gas retailers to the EBIT margin range of 5.0% to 5.3% that we estimated for listed energy retailers in Table C.2.

The resulting EBITDA margin for a **gas retailer** is **6.3% to 6.6%**. This is very similar to the benchmarking range obtained in our 2013 review (6.2% to 6.4%).

In our previous gas reviews, the benchmarking approach has consistently provided a retail margin range which is generally within the final overall retail margin range. Therefore, we consider that it is reasonable to maintain the overall retail margin range from the 2013 review.

Table C.3 shows the summary statistics for the listed retailers included in our sample by country and sub-industry. In addition to EBIT margin and EBITDA margin, the table reports leverage ratio, which is calculated as debt/(debt + market capitalisation), book-to-market ratio, which is calculated as (book value of equity + debt)/(market capitalisation + debt) and Value/EBIT, which is calculated as (market capitalisation + debt)/EBIT.

Table C.3 Summary statistics for 746 listed retailers in Australia, Canada, New Zealand, UK and USA from 1980 to 2015

	N	EBIT/Sales (%)				EBITDA/Sales (%)				Leverage (%)				Book-to-market assets (%)				Value/EBIT			
		Mn	Md	L	H	Mn	Md	L	H	Mn	Md	L	H	Mn	Md	L	H	Mn	Md	L	H
All firms	**8890**	**5.1**	**4.9**	**5.0**	**5.3**	**7.5**	**7.1**	**7.3**	**7.6**	**22**	**15**	**22**	**22**	**69**	**62**	**69**	**70**	**10.7**	**10.2**	**10.4**	**11.0**
Country																					
Australia	595	4.9	4.6	4.3	5.6	7.4	6.6	6.8	8.0	19	13	18	20	67	58	64	70	9.5	10.2	8.6	10.4
Canada	521	5.4	4.8	5.0	5.7	7.3	6.8	7.0	7.6	27	25	25	28	79	76	77	82	9.9	9.2	9.0	10.8
New Zealand	181	6.4	7.5	5.5	7.3	8.8	10.1	7.9	9.6	20	13	18	23	67	59	63	72	11.2	9.9	9.5	12.9
UK	2478	5.2	5.1	5.0	5.5	7.6	7.3	7.3	7.8	19	13	18	19	69	58	68	71	10.1	9.7	9.6	10.6
USA	5115	5.1	4.8	4.9	5.2	7.4	7.0	7.3	7.6	24	16	23	24	69	62	68	70	11.2	10.5	10.9	11.6
Sub-Industry																					
Apparel retailers	1876	6.8	7.1	6.5	7.0	9.6	9.8	9.4	9.9	15	7	14	16	64	55	62	65	9.8	9.5	9.3	10.3
Broadline retailers	1134	5.4	5.8	5.1	5.8	7.8	8.0	7.4	8.2	21	15	20	22	72	65	70	74	10.2	10.2	9.5	10.9
Drug retailers	397	4.7	4.9	4.2	5.2	6.3	6.2	5.7	6.8	15	10	13	16	57	49	54	60	13.1	11.6	11.8	14.4
Food retailers & wholesalers	1665	3.3	3.4	3.1	3.5	5.2	4.9	5.0	5.4	29	24	28	30	71	67	69	72	11.0	10.1	10.4	11.5
Home improvement	594	7.6	7.6	7.1	8.0	9.9	9.8	9.5	10.4	18	11	17	19	59	51	56	61	12.4	10.8	11.2	13.5
Specialty retailers	3224	4.6	4.3	4.4	4.9	7.0	6.3	6.7	7.2	25	19	24	25	75	69	74	76	10.7	10.4	10.2	11.2

Note: Observations with the EBITDA margin, EBIT margin, Book-to-market equity ratio, book-to-market assets ratio and Value/EBIT ratio below the 1st percentile or above the 99th percentile are excluded.

Source: IPART analysis based on data from Thomson Reuters Datastream.

C.2.2 Stakeholder submissions on the retail margin

In its submission, PIAC reiterated its concern about allowing a higher retail margin for the three regulated retailers, as they are well established and do not require a higher retail margin to attract retail customers.[99] It also recommended that IPART review the retail margin allowance to ensure they are representative for an existing retailer in a competitive market.

Four submissions to our Issues Paper commented on retail margin. AGL, Origin and EnergyAustralia supported the current retail margin range. Specifically, AGL considers the current retail margin allowance of 7% remains appropriate if wholesale and ROC allowance are maintained.[100] Origin submits that the retail margin should continue to be expressed as a fixed proportion of total costs (ie, an EBITDA margin), and that the regulatory risks of setting a retail margin are asymmetrical. If the regulated tariff is set too low then standard retailers will not make a reasonable return and retail competition will be stifled. If retail margins are set too high then excess returns will be removed by more intense retail competition.[101]

PIAC recommends that IPART set the retail margin at the lower value of 6.3% and review the building block components to ensure this is an accurate reflection of the risks to the standard retailers.[102] PIAC also submits that there is little analysis of the difference in risk between a standard retailer and a market retailer and it is not clear why the standard retailers require a retail margin to manage variation in demand and economic conditions. These are part of doing business and the standard retailers should not be compensated as customers shift off the standard contracts, given the standard retailers are the three big retailers and customers are most likely to move to one of their market contracts.[103]

In relation to PIAC's comment, we consider the retail margin is an important factor in the Retail Component of retail gas prices. As discussed in the Issues Paper, gas retailers face a range of risks and some of these risks are "systematic" which are out of their control (eg, risks associated with demand and economic conditions). The retail margin represents the reward to investors for investing capital in a retail business and for accepting systematic risks associated with providing retail services. Failing to adequately compensate investors will lead to under-investment by existing retailers, deter entry into the market by new retailers, and stifle competition.

We consider that our analysis provides reasonable assurance that the retail margin range of 6.3% to 7.3% is appropriate for an efficient retailer in a competitive market. As discussed in Chapter 6, we have used the midpoint of this range to assess the retailer's pricing proposals for 2016-17.

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99 PIAC submission, March 2016, p 3.
100 AGL submission, December 2015, p 6.
101 Origin submission, December 2015, pp 8-9.
102 PIAC submission, December 2015, p 7.
103 Ibid, p 6.

D Summary of submissions

Table D.1 Summary of submissions on the Issues Paper, the Standard Retailers' pricing proposals and IPART's responses

Question	Stakeholder comments	IPART's responses
Q1. Are there any other contextual factors that we should consider that could materially affect our review?	AGL considers the most important factor is the transformation of the eastern Australian wholesale gas market due to the significant demand for LNG over a relatively short period of time. Origin agrees with the factors identified by IPART. The most significant considerations are: – the shift in the supply demand balance due to LNG export projects – the associated impact of the oil price on domestic wholesale gas prices – rising production costs – the continued development of retail competition in NSW, and – changes in gas network prices. It also comments that gas wholesale prices would be broadly bounded by short run marginal netback prices at the upper end and producers' costs at the lower end. In the near term gas prices are likely to rise as producers bring on additional higher cost, unconventional supply sources that were previously uneconomic to develop to meet the increased demand for gas (p 2). EnergyAustralia submits that South East Australia is predominantly disconnected to Queensland due to shipping constraints and consequently international gas market pricing is less applicable in NSW (p 4).	In our view LNG exports from Queensland are relevant to wholesale prices in NSW. Numerous industry experts and reviews recognise that the NSW gas market is being influenced by LNG exports from Queensland. For example, – In their advice to IPART, ACIL Allen (2013-14) and Jacobs Consulting (2014-15 and 2015-16) discussed the commencement of LNG exports from Queensland and the influence this was having on wholesale gas prices in eastern Australia.[a] – The Australian Competition and Consumer Commission (ACCC), Australian Energy Market Commission (AEMC) and Productivity Commission (PC)'s reviews emphasise that the LNG projects are significantly altering the supply and demand dynamics in the domestic gas industry in Eastern Australia.[b] – NERA and Marsden Jacobs also discuss the importance of LNG exports on the wholesale market in their advice to IPART for this review.[c] We agree with AGL and Origin and have considered their comments in our analysis of efficient wholesale gas costs.
2. Do you agree with our proposed approach to the review? Are there any ways we can improve this approach?	**Agree** AGL supports light-handed regulation for 2016-17. As an alternative to the "bottom-up" approach, AGL proposed to maintain the current allowances for the Retail Component of regulated retail prices and to allow retail competition to provide the best price outcomes. This reduces the focus	We consider that a bottom-up assessment of the retailer's proposals is appropriate. In light of recent gas market developments, we consider it is timely and important that we review the underlying costs for the Retail Component of regulated retail prices, and

Question	Stakeholder comments	IPART's responses
	on forecasting costs, supports continued competitive activity and is more relevant with the potential move to price deregulation. No major change in the costs that form part of the Retail Component expected for 2016-17 would support continued competitive activity and pose little risk that retail customers would face uncompetitive prices. If IPART decides to adopt the bottom-up approach, AGL considers an appropriate approach would be, consistent with IPART's previous approach, to establish a likely range of forecast costs and evaluate retailers' proposal against this range (pp 2-3). Origin Energy (p 4), ActewAGL (pp 1-2) and EnergyAustralia (pp 2-3) support our proposed approach.	analyse how LNG exports from Queensland and low oil price are influencing retailers' wholesale gas costs for their supply in NSW for 2016-17. Our assessment is provided in Chapter 6 of this report.
	Do not agree PIAC recommends that IPART review its policy of setting the price based on the costs of a new entrant into the market as this does not encourage new entrants and allows the established retailers to earn higher profits (p 7). This approach has not encouraged new entrants and has allowed the three big retailers to earn increased profits as a result of higher prices (p 6). It also recommends that IPART: – take account of the impact on vulnerable, time-poor customers who are not able to make a choice and stay on the standard contract when setting prices for the coming year (p 5), – use its competition review to assess competition from the customer perspective and to examine the impact of the previous price increases on customers (p 7), and – adopt a precautionary approach to determining the VPAs for the coming period given the uncertainty and the current major gas market reviews (p 7).	In our view considering efficient costs for a new entrant retailer appropriately balances our review objectives of prices that reflect efficient costs in the short term, and promote competition in the long term. A competitive market drives efficiency, innovation and protects customers from unreasonable price increases. We consider that for some customers, the decision not to find a better offer likely means that the search costs involved in selecting a better offer outweighs the saving that they would make from switching. In these instances, it is a rational decision for them not to participate in the market. For other customers there are language or other barriers preventing them from finding a better deal. In our view, targeted programs and concession frameworks are the most appropriate way to address these issues. We do not consider price regulation can protect customers from price increases due to market factors, other regulatory and policy factors, or general financial distress.

Question	Stakeholder comments	IPART's responses
3. Do you agree with the indicators we propose to use to assess competition in the retail gas market (barriers to entry, expansion and exit, customer participation and outcomes, price movements, and price and product diversity)? Are there other indicators or sources of information we should consider?	**Agree** AGL (p 3) and Origin Energy (p 4) agree with the proposed indicators, and that retail competition is effective (AGL commented on competition in the Jemena network area). **Do not agree** PIAC views that competition in NSW has stalled given the current levels of retail competition. The market is still dominated by three big retailers (serving 96% of all customers in NSW) and for many customers outside of the metropolitan areas, there is only one retailer with two offers to choose from (p 4). Given the difficulty new retailers are having in securing long term gas supply contracts and navigating the STTM, there does not appear to be room for an increase in competition in the foreseeable future. PIAC recommends IPART to include demand-side customer-centric indicators in reviewing competition (p 6). PIAC submits that it is not enough to have a high degree of choice for the market to be competitive. The choices need to be quality choices and there needs to be accessible information about these choices to ensure that customers are able to make meaningful decisions, particularly for vulnerable and time-poor customers who may not act on choices available and thus remain on standard contracts, and pay more than necessary (pp 3-5). In response to the Standard Retailers' pricing proposals, NCOSS submitted that currently there are insufficient levels of competition in rural and regional parts of NSW to enable deregulation to occur in a manner which would benefit consumers in these areas (p 4). **Other indicators/sources to consider**	Our final finding is that competition is working effectively for around 95% of small gas customers in NSW. This includes customers in Sydney, Wollongong, Newcastle, Dubbo, Orange, Parkes and parts of the Riverina region. There is less intense competition in regional areas including Wagga Wagga, Gundagai, Cooma, Temora, Albury/Murray Valley & Queanbeyan. In these areas there are only one or two active retailers and few different market offers for customers to choose from. There is currently no competition in the Shoalhaven area where only ActewAGL's regulated offer is available to small gas customers. There is work underway to introduce or improve retail gas competition in regional areas. The Australian Energy Market Operator (AEMO) is due to complete a project to harmonise business to business (B2B) arrangements on regional distribution networks by early 2017. This will reduce costs and make it easier for retailers to supply gas to regional customers. We are aware of at least one retailer who has indicated it will enter regional areas when this work is complete. AEMO is also working with stakeholders on a project to include the Shoalhaven in its retail market procedures. On completion expected in early 2017, gas customers in this area will be able switch retailers for the first time and retailers will be able to compete for these customers. In our view a competitive market provides the best form of protection for customers, and provides more choices and better price and service outcomes. We consider that if the NSW Government decides to deregulate gas

Question	Stakeholder comments	IPART's responses
	PIAC submits that customer satisfaction should also be an indicator of the effectiveness of competition (assessing competition by looking at the number of plans available is not sufficient). Also, it recommends that IPART take account of customer indicators, such as debt, hardship and complaints (p 5).	prices then this would remove another barrier for retailers entering regional gas markets and would promote competition. If gas prices are deregulated, the NSW Government has indicated that IPART will be responsible for monitoring competition in the retail gas market.
	EnergyAustralia suggests that in assessing the growth or increase of competition, IPART considers the work being initiated by the Council of Australian Governments, Energy Council relating to the National Gas Objective to promote efficient investment in natural gas (p 2).	In relation to PIAC comments on effective and informed choice for customers, we consider the quantity and quality of energy options are just one measure of effective competition. As discussed in Chapter 4, we have also considered other indicators of competition. We do not consider that because some people do not participate in the market, that this means there is a problem with the market. Instead, it likely means that for many of these customers, the search costs involved in selecting a better offer outweighs the saving that they would make from switching. In these instances, it is a rational decision for them not to participate in the market.
	Other comments *(1) Assessing competition in regional areas* AGL considers that there is only one retailer in regional NSW because of the relatively small customer base, which makes it difficult to recover the establishment costs of market entry. Also, gas is a fuel of choice and electricity prices do provide a limit on gas prices (p 3). EnergyAustralia considers that it is important to assert that competition in regional areas will not be as prevalent as it is in metropolitan areas. Therefore, even if the competition metrics in regional NSW are lower in absolute terms, any positive movements in and awareness of competition would be good indicators of improved competition (p 2).	In relation to Jemena's submission, we analysed data in Energy Made Easy and held discussions with AER staff to determine when retailers updated their retail offers/prices to reflect changes in network prices on 1 July 2015. Focusing on Jemena's network area, we found that while some retailers took a number of weeks post 1 July 2015 to update some of their offers, other retailers promptly updated their offers close to the 1 July price change. There have also been delays in previous years when prices were increasing. This is discussed further in Chapter 4.
	(2) Examining the diversity of offers in assessing competition: AGL submits that the fixed component of retail prices is set up in line with the principle of cost reflective pricing (to pass through fixed component of network charges and retail operating costs which are mostly fixed). AGL does not offer discounts off the fixed charges (though it offers one off credit). Some retailers do offer discounts off the total bills including fixed charges (p 3). Origin Energy submits that retail offers show limited	We agree with EnergyAustralia and AGL that streamlining business-to-business procedures will make it more commercially viable for new entrants to

Question	Stakeholder comments	IPART's responses
	variation in NSW gas supply charges, and that it is likely to reflect the nature of regulated pricing in NSW where the regulated standing tariff becomes a benchmark against which retailers compete. It considers that retailers are likely to replicate the incumbents' tariff structure to assist customers in comparing offers. Tariff diversity is likely to improve as retail price regulation is removed (eg, Victoria) (p 5). *(3) Examining the pass through of network prices*: Jemena submits that it has noticed that retailers did not pass on the initial savings in market offers for several weeks after 1 July 2015, and these retailers could have made abnormal profits over this period. Jemena suggests IPART test the reasons for these lags and their extent, and whether similar lags occurred when network prices increased (p 2). Origin Energy submits that it would caution against drawing conclusions on the effectiveness of competition based on the extent to which network prices appear to have been passed through to customers. While Origin Energy has passed through network price changes, it notes that the retail prices offered by other retailers may vary due to a number of factors. *(4) Harmonising business to business procedures*: EnergyAustralia submits that harmonising and streamlining business-to-business procedures will reap significant benefits for the market and simplify transactions between participants from May 2016. EnergyAustralia expects this to entice new market entrants and increase competition (p 2). AGL submits that the development of business-to-business procedures will assist in improving commercial outcomes. *(5) Prohibiting early termination fees from market contracts*	expand into the NSW retail market. AEMO is due to complete a project to harmonise business to business (B2B) arrangements on regional distribution networks by early 2017. This will also reduce costs and make it easier for retailers to supply gas to regional customers. In relation to NCOSS' submission on early termination fees, we found that new gas market contracts typically do not charge an ETF which has reduced switch costs for consumers. Retailers are increasingly offering flexible contract terms and moving away from fixed term contracts. For example, based on more than 50 different gas offers currently available in Sydney urban area, only eight are fixed term contracts of up to two years.

Question	Stakeholder comments	IPART's responses
	In response to the Standard Retailers' pricing proposals, NCOSS submitted that prohibition of early termination fees (ETFs) from market contracts would remove another impediment to effective competition. ETFs impose a cost disincentive for customers to switch retailers if they find a better deal. While NCOSS would prefer such fees to be prohibited altogether, at the very least, it contends there ought to be regulation surrounding the amounts that can be charged, such as that currently in place in relation to the retail electricity market.	
4. Do you agree with our preliminary views to retain the approach to determining average price changes, the weighted average price cap form of price control and the special circumstances clause? If not, why?	AGL (p 4), Origin Energy (p 6) and EnergyAustralia (p 3) agree with the current approach of determining average regulated prices as the sum of the Retail and Network Component, continuing to use the weighted average price cap form of price control and retaining the current special circumstances clause. PIAC recommends IPART adopt prices at the lower range of that proposed by the standard retailer to protect customers from potential bill increases.	Our final decision is to agree to the Standard Retailers' proposals to: ▾ determine average regulated prices as the sum of the Retail and Network Components, ▾ retain the weighted average price cap on the Retail Component, ▾ include a special circumstances clause in the VPAs. We do not agree with PIAC's recommendation to adopt prices at the lower end of the range. We consider it important to ensure that regulated prices reflect the efficient costs of supplying gas for a new entrant in 2016-17. Therefore, we assessed whether the Standard Retailers' forecast costs underlying the proposed Retail Component are consistent with those an efficient and prudent retailer would incur in supplying gas in 2016-17.
5. How would an efficient new entrant gas retailer purchase its gas requirement for 2016-17? Would it purchase gas through bilateral contracts, spot market transactions or a mix of the two?	**Long-term bilateral contracts** AGL and Origin Energy submit that new entrant retailers or major gas retailers would purchase gas through long-term bilateral contracts. – AGL comments that spot markets are too high a risk to secure gas, and it does not believe an efficient new entrant retailer would procure gas through the STTM (p 4).	We agree with AGL and Origin Energy's view that new entrant retailers or major gas retailers would purchase gas through bilateral contracts. In estimating efficient wholesale gas costs, our consultants, NERA and Marsden Jacob Associates (MJA), assumed a new entrant retailer is supplying gas to a retail customer base of substantial scale, and evaluated how it would purchase its gas requirement for 2016-19. In their

Question	Stakeholder comments	IPART's responses
	– Origin Energy suggests that IPART assume that the new entrant retailer adopts a conservative approach to purchasing and seeks to secure cost certainty through bilateral contracts (p 6).	view, the most efficient and prudent purchasing strategy for such a retailer would be to enter into one or more bilateral gas supply agreements (GSAs) and use spot markets such as the short term trading market (STTM) as a balancing market.
	Spot market transactions PIAC submits a new retailer would buy gas on the STTM given that many existing gas customers are having difficulty in securing new gas contracts. It adds that the lower prices from the STTM should be reflected in regulated gas prices (p 6).	We do not agree with PIAC's view. It may be reasonable to purchase gas through the STTM for a new entrant retailer with only a few customers. However, for retailers with a larger customer base, this strategy would expose them to substantial price volatility, without any ability to manage the wholesale gas price associated with selling fixed price contracts to its retail customers.
	Depends on the business circumstance EnergyAustralia submits that new entrants may use bilateral contracts and/or spot market transactions based on what is best for their business. New entrants would consider risks associated with: – managing a misalignment between the lengths of Gas Transport Agreements and bilateral Gas Supply Agreements – not being able to secure gas if the major gas producers are fully contracted for 2016-17. EnergyAustralia submits that new entrants are unlikely to enter a market over a short period (p 3).	
6. Given the uncertainty in wholesale markets, what is the likely length of new domestic wholesale gas contracts negotiated in 2016-17?	AGL and Origin Energy consider the length of new gas supply contracts is likely to be 2-3 years**.** – AGL submits that IPART should consider risks associated with the misalignment of contractual lengths as retailers are obliged to have long term gas transportation contracts to facilitate gas delivery (eg, AGL entered a 3-year gas supply agreement and a 15-year gas transportation contract) (pp 4-5) . – Origin Energy submits that IPART should be considering the contracts a new entrant secured in 2013-14 to 2015-16 for supply in 2016-17, rather than	In estimating wholesale gas costs, NERA and MJA's base case scenario assumed a contract length of 2 years. NERA and MJA considered that an efficient new entrant retailer would enter into GSAs for a duration that matches the duration of retail gas contracts being sold to their potential customers. They considered that typically retailers would be able to maintain customers for one to three years, and therefore it would be reasonable to expect that the new entrant retailer would seek GSAs with terms of one, two or three years.

Question	Stakeholder comments	IPART's responses
	supply contracts negotiated in 2016-17. Origin Energy notes that these contracts, if on a fixed price basis, may have been secured at higher prices than current oil prices suggest (pp 6-7).	We do not agree with Origin Energy's view that we should be considering gas contracts agreed three years ago (ie, in 2013-14) for retail supply in 2016-17. Based on expert advice, we consider that a new entrant retailer entering into GSAs with short terms of two years would typically initiate contract negotiation between one and two years prior to the commencement of its retail gas supply.
7. Are there any other changes in non-price terms and conditions in domestic gas contracts we should consider in determining wholesale gas costs for an efficient new entrant retailer? Why?	**High cost of managing peak demand** – AGL submits that there is a material increase in the cost of deliverability. New supply contracts have less flexible delivery conditions (eg, in the provision of swing gas and the 'take or pay' conditions), and this increases demand for gas storage to manage the variability of gas demand throughout the year, increasing the cost of managing peak demand (p 5). – Origin Energy expects that contracts sought by a new entrant focused on serving mass market customers would require a high level of Maximum Daily Quantity (ie, supplying load flexibility). The cost to procure Maximum Daily Quantity (MDQ) from producers, storage services or transportation services is higher than has historically been the case based on recent contract negotiations and market transactions (pp 6-7). – Origin Energy submits that producers are seeking to operate their plants at higher capacity factors and as a consequence the ability to deliver increased supply on particular days is becoming more costly for retailers (the cost of securing MDQ) (p 4). **High price premium** – Origin Energy submits that if new entrants secure oil linked gas supplies, they face significant oil price volatility risk, and the decision to hedge oil price risk would be also complex. So, it would be reasonable to	We agree with AGL and Origin Energy's submissions. NERA and MJA considered that LNG projects in Queensland are placing significant pressure on the gas delivery and storage infrastructure, subsequently reducing the availability and increasing the price of MDQ services for gas retailers. In estimating the efficient wholesale gas costs, NERA and MJA considered a retailer would purchase appropriate oil and foreign hedging cover if entering into an oil-linked GSA. However, NERA and MJA did not included hedging costs in wholesale gas costs as the extent to which an entrant retailer may be exposed to oil prices is uncertain. They noted that the cost of hedging is typically in the order of 5 to 10 cents per GJ and would have only a marginal impact on wholesale gas costs (p 50).

Question	Stakeholder comments	IPART's responses
	assume that new entrants would need to factor in a material price premium to accommodate this risk (pp 6-7). – Origin Energy submits that a new entrant retailer may seek greater contract volume flexibility to manage the uncertainty of its sales forecasts during a growth phase. This will most likely require a lower take or pay commitment in supply contracts, for which producers will apply a premium (pp 6-7).	
8. Do you agree that prices of new domestic gas contracts are likely to be indexed to oil prices? If not, why?	**Agree** – Origin Energy submits that it would be reasonable to assume that gas supply contracts for FY2016-17 struck recently would contain an element of oil price indexation (pp 6-7). **Do not agree** – AGL submits that not all domestic gas contracts are indexed to oil prices, and for those whose prices are linked to oil prices, oil price may be only a partial component. AGL submits that in the current low oil price environment, the price mechanism in gas contracts has changed to reflect the prevailing domestic gas market prices (p 5). – EnergyAustralia submits that while it may become more common that gas prices are linked to oil prices in the future, it does not consider this is relevant for contracts in 2016-17. Lower oil prices from August 2014 to January 2015 have resulted in the market looking for alternative pricing indicators (p 4).	In estimating wholesale gas costs, NERA and MJA assumed that wholesale gas contracts include an oil-linked pricing component. This is consistent with Origin Energy's view. We do not agree with AGL and EnergyAustralia. We consider it is reasonable to assume that wholesale gas contracts include an oil-linked pricing component. Based on publicly available information, NERA and MJA found that the Standard Retailers have recently signed GSAs that contain an oil-linked pricing component.

Question	Stakeholder comments	IPART's responses
9. How are low oil prices likely to affect wholesale gas costs for an efficient new entrant retailer in 2016-17?	AGL submits that regardless of whether there is oil indexation, domestic prices under new gas contracts are negotiated based on the prevailing market price of gas determined by the level of supply and demand, the cost of new supply and market structure. Current oil prices do not have a material impact on the prices of new wholesale gas contracts, given the existing market fundamentals in eastern Australia (pp 5-6). Origin Energy submits that IPART will need to consider the balance of the new entrant's portfolio between fixed price and oil linked supply, the nature of the indexation and the extent and timing of any oil price hedging activity and certainty of load to be hedged. IPART will also need to consider significant volatility to which retailers are exposed, and a significant risk premium attached to any oil price exposure accepted by a new entrant (p 7).	We asked NERA and MJA to evaluate how the current low prices are likely to affect the efficient new entrant retailer in 2017-19. NERA and MJA considered that, since an efficient new entrant retailer enters into new GSAs a year in advance of its retail gas supply, there would be a lagging impact of oil prices on gas contract prices by a year. As a result, we are unlikely to observe an immediate material impact of the low oil price on the wholesale gas costs for 2016-17. However, lower wholesale gas costs are likely in 2017-18 and 2018-19 as the low oil price starts flowing through to the underlying contract prices.
10. Are there any other issues we should consider in forecasting wholesale gas costs for an efficient new entrant retailer in 2016-17?	**Availability of ramp gas** AGL (p 6) and EnergyAustralia (p 3) submit that the availability of 'ramp gas' is less likely in 2016-17 as all LNG trains become operational by then. They comment that ramp gas is not reliable, not appropriate source of gas from a wholesale perspective, and relying on ramp gas is highly risky. **Increasing cost of maximum demand quantity (MDQ)** Origin Energy submits that IPART will need to consider the costs of securing MDQ for a new entrant as discussed in Q7 (pp 7-8). **Credit standing of a model new entrant retailer** Origin Energy submits that gas purchasers with a poor or no credit rating may be required to provide credit support or prepay for their gas ahead of receipt of gas. It suggests the credit standing of IPART's model new entrant retailer needs to be considered (pp 7-8).	In line with AGL and EnergyAustralia's submission, we do not consider the availability of ramp gas would have an impact on wholesale gas costs for an efficient new entrant retailer in 2016-17, based on NERA and MJA's advice. We agree with Origin Energy's view that the cost of MDQ is increasing. NERA and MJA commented that LNG projects in Queensland are placing significant pressure on the gas delivery and storage infrastructure, subsequently reducing the availability and increasing the price of MDQ services for gas retailers. However, we do not agree with Origin Energy's submission in relation to the credit standing of a new entrant retailer. In estimating efficient wholesale gas costs, NERA and MJA assumed a new entrant retailer to be supplying gas to a retail customer base of a substantial scale. Such new entrants are unlikely to have credit ratings that would restrict its gas procurement.

Question	Stakeholder comments	IPART's responses
11. What is the prudent and efficient level of retail operating costs for Standard Retailers in 2016-17? Do you agree with our proposed approach for estimating these costs? If not, how can we improve our approach?	**Agree** AGL suggests, provided that wholesale gas costs and retail margin remain unchanged, the current ROC should also be retained in real terms. – It notes that the current benchmark ROC allowance for NSW retail gas prices is lower than that allowed for retail electricity prices and the benchmark ROC determined by the Queensland Competition Tribunal in its final determination on regulated retail electricity prices in Queensland for 2015-16 (p 6). Origin Energy submits that IPART's ROC range in 2013 (ie, $91-$110 excluding acquisition and retention costs) is below its published cash to cost to serve, which was $159 per account for FY2015 including retention/acquisition costs. It supports including a Customer Acquisition and Retention Allowance as it is important part of a retailer's retail operating costs in a competitive market (p 8). EnergyAustralia supports our proposed approach to assessing operating costs (p 4). **Do not agree** PIAC submits that the current CARC is not facilitating switching to market contracts, and hence it should be removed from the regulated price. – AGL and ActewAGL's regulated prices for 2013-14 included CARC. They are established retailers with a high proportion of market share, so it is unclear to PIAC why they should be allowed to recover these costs from standard contract customers. – PIAC also comments that IPART predicted that 90% of small gas customers in NSW will be on market contracts by 2016, and to meet that target, by 2015 85% of customers should be on market contracts.	Our reasonable range for ROC in 2016-17 is $97 to $118 per customer ($2015-16). This does not include costs associated with acquiring and retaining customers. In relation to PIAC's recommendation to consider ROC for an established retailer, we already consider the efficient ROC for an established retailer, rather than a new entrant retailer. We do not agree with PIAC and NOCSS's comment. We include CARC of $16/customer ($2015-16) in developing a reasonable range to assess the Standard Retailers' pricing proposal. This is also unchanged in real terms since the reasonable range we established in the 2014 review. In the 2014 gas report, we put the view that a level of CARC should be allowed in prices that will lead to a reasonable transition to a largely deregulated market for gas. The analysis in our 2014 gas report showed that the retail gas market had transitioned more rapidly than electricity towards market contracts. We expected that 90% of small gas customers would likely be on market offers within 4 years (ie, by 2018). We considered that this was a reasonable transition path, and there was no reason to make an adjustment to regulated retail gas prices to incorporate an additional CARC allowance. However, if we did allow for an additional CARC allowance then this would likely speed up the movement off regulated prices. PIAC's comments that the market has not transitioned as quickly as we expected would lend support to increasing the CARC allowance – not removing it.

Question	Stakeholder comments	IPART's responses
	However, based on the AER retail performance report, only 76% of customers were on market contracts as of 1 June 2015. This shows the CARC allowance is not working. – PIAC recommends that IPART set the ROC at the lower value of $91 and not the higher value of $110 (pp 6-7). In response to the Standard Retailers' pricing proposals, PIAC recommended that IPART review CARC based on that of an established retailer, rather than that of a new retailer (p 5). In response to the Standard Retailers' pricing proposals, NCOSS submitted that 'removing CARC from the Retail Component would not only lead to lower prices for consumers, but it would also remove a competitive advantage which the big three retailers could hold over new entrants. This in turn would perpetuate barriers to effective competition' (p 4).	
12. What is an appropriate retail margin for 2016-17? Do you agree with our proposed approach for estimating the retail margin? If not, how can we improve our approach?	**Agree** AGL considers the current retail margin allowance of 7% remains appropriate if wholesale and ROC allowance are maintained (p 6). EnergyAustralia supported our approach (p 4). Origin Energy submits that the retail margin should continue to be expressed as a fixed proportion of total costs (ie, an EBITDA margin), and suggests to consider additional risks inherent in the gas industry and specifically in NSW: – the supply of gas is not an essential service and therefore gas uptake is not as predictable as electricity connections with the subsequent increased volumetric risk, and	Our range for an appropriate retail margin range is 6.3% to 7.3%. In relation to PIAC's comment, we consider retail margin is an important factor in the Retail Component of retail gas prices. As discussed in the Issues Paper, gas retailers face a range of risks and some of these risks are "systematic" which are out of their control (eg, risks associated with demand and economic conditions). The retail margin represents the reward to investors for investing capital in a retail business and for accepting systematic risks associated with providing retail services. Failing to adequately compensate investors will lead to under-investment by existing retailers, deter entry into the market by new retailers, and stifle competition.

Question	Stakeholder comments	IPART's responses
	– gas consumption levels in NSW, especially Origin Energy's Albury and Murray Valley regions, are considerably low, contributing to lower revenue per customer. Hence applying retail margin as a percentage of revenue would result in a very small, inadequate dollar amount. Also, Origin Energy submits that the regulatory risks of setting a retail margin are asymmetrical. If the regulated tariff is set too low then standard retailers will not make a reasonable return and retail competition will be stifled. If retail margins are set too high then excess returns will be removed by more intense retail competition (pp 8-9). **Do not agree** PIAC recommends that IPART set the retail margin at the lower value of 6.3% and review the building block components to ensure this is an accurate reflection of the risks to the standard retailers (p 7). PIAC also submits that there is little analysis of the difference in risk between a standard retailer and a market retailer and it is not clear why the standard retailers require a retail margin to manage variation in demand and economic conditions. These are part of doing business and the standard retailers should not be compensated as customers shift off the standard contracts, given the standard retailers are the three big retailers and customers are most likely to move to one of their market contracts (p 6). In its submission to the Standard Retailers' pricing proposals, PIAC reiterated its concern about allowing a higher retail margin for the three regulated retailers as they are well established and do not require a higher retail margin to attract or retail customers. They also recommended that IPART review the retail margin allowance to ensure they are representative for an existing retailer in a competitive market (pp 3-4).	

a ACIL Tasman, *Final Public Version – Cost of Gas for the 2013 to 2016 Regulatory Period, A Report on the Wholesale Cost of Gas for the Review for Standard Retailers in New South Wales – Prepared for IPART,* 13 June 2013.

b ACCC, *East Coast Gas Inquiry – Issues Paper*, June 2015; AEMC, *East Coast Wholesale Gas Market and Pipeline Frameworks Review, Stage 2 Draft Report*, 4 December 2015; Productivity Commission, Examining Barriers to More Efficient Gas Markets, March 2015.

c NERA and Marsden Jacob Associates, *Forecasting Wholesale Gas Costs for Standard Retail Gas Suppliers in* NSW – Draft report for IPART, April 2016.

We received two submissions to our Draft Report. ActewAGL provided support for our draft decisions while PIAC raised some concerns with respect to our assessment of competition. In the table below we summarise the issues raised by PIAC in its submission and our responses.

Table D.2 Summary of PIAC's submission on the Draft Report and IPART's responses

Issue	IPART's responses
1. Removal of retail gas price regulation will leave the 20% of customers still on standard contracts without protections	We do not agree that retail price deregulation would leave customers on standard contracts without protections, as there are other protections for customers. The National Energy Customer Framework (NECF) imposes a legal obligation on all energy retailers in NSW to support customers who are experiencing financial difficulties and are unable to pay their energy bills. For example, under NECF energy retailers must: ▾ put in place and adhere to a customer hardship policy that is approved by the AER ▾ offer financial assistance to vulnerable customers, including a payment plan or Centrepay options, or debt reduction to manage bill payments on an ongoing basis, ▾ identify appropriate government concession programs and financial counselling services and notify hardship customers of those programs and services, and ▾ not commence debt recovery or disconnection process where a residential customer continues to abide by the terms of their payment plan. The National Energy Retail Rules (NERR) place restrictions on energy retailers and distributors relating to disconnections. The NERR prohibits disconnection of premises belonging to a small retail customer where they have made a complaint, directly related to the reason for the proposed disconnection, to the distributor or to the energy ombudsman and the complaint. The NERR imposes pre-contractual duty on standard retailers to advise small

Issue	IPART's responses
	retail customers of the standing offer available when making a market offer at the time of sale. In addition, standing offer prices set by electricity retailers can only be changed once every 6 months.
2. IPART has not sufficiently considered barriers to entry in regional gas markets, including: ▾ size of the customer base ▾ higher customer acquisition costs ▾ limited geographical pipeline coverage, and ▾ capacity on regional pipelines. The ACCC found that there are issues of access and capacity in regional pipelines – with concerns of potential hoarding by incumbent retailers.	Barriers to entering the retail gas market were considered in the AEMC's 2015 competition review. This review found: ▾ the median rating from retailers for the ease of entry and expansion in the retail gas market was 'neither difficult nor easy'. Two larger retailers rated it 'very easy' while others rated it as either 'difficult' or 'neither difficult nor easy'. ▾ overall, respondents (retailers) viewed the continued application of retail price regulation and tightening conditions in the wholesale gas market as the most significant impediments. ▾ respondents considered that over the next one to two years, entry and expansion conditions will likely improve once the B2B harmonisation project is complete and if the NSW Government decides to remove retail price regulation.[a] The AEMC's review and the ACCC's East Coast Gas Inquiry also found there were some barriers specific to regional areas: ▾ **Small customer base/higher customer acquisition costs/limited geographic coverage:** The need to negotiate access to pipelines contributes to higher fixed costs in gas relative to electricity. The limited geographic coverage also means there is a relatively small customer base, particularly in regional areas. These factors may deter some retailers from entering regional gas markets. A smaller customer base will most likely mean that fewer retailers will compete for small gas customers in regional areas, relative to metropolitan areas. However even where there are only one or two retailers active, the threat of competition can be just as effective at protecting customers. The B2B improvements that the AEMO is working on will help to reduce costs for entering regional markets.[b] ▾ **'Hoarding' capacity on regional pipelines:** The ACCC East Coast Gas Inquiry heard evidence from some regional gas users that retailers on regional pipelines may have been making it harder for users to obtain or accept commodity gas offers from other retailers, or for other suppliers to make offers, including by: – not being willing to offer stand-alone transport capacity when sought by a

Issue	IPART's responses
	user – offering prices for stand-alone transport capacity that are much higher than the transport prices implied by the shipper's bundled commodity and transport pricing offers.[c] The ACCC will be investigating whether the availability or pricing of capacity on regional pipelines raises any concerns as a possible contravention of the misuse of market power provisions or the exclusive dealing provisions of the *Competition and Consumer Act 2010* (CCA).[c] The ACCC does not identify where it has these concerns - its review included Queensland, New South Wales, Australian Capital Territory, Victoria, South Australia and Tasmania. Notwithstanding the ACCC's findings, our analysis to date has not revealed any issues in relation to hoarding transmission capacity that pose concern for competition for small customers in regional NSW at this point in time.
3. The ACCC found that competition from electricity provides a weak form of constraint on pipelines.	In our Draft Report we noted that electricity and gas are (imperfect) substitutes which act as a market mechanism limiting gas price increases (at least in the long run). The ACCC considered evidence over the past two to three years. We are of the view that over the longer term electricity and gas are substitutes and this would pose some constraints on gas price increases.
4. For many customers, gas is not a fuel of choice – they will have to continue to use gas-powered appliance regardless of whether this is the more affordable option. It recommends IPART provides some measures to ensure these customers are protected.	As discussed above, we maintain the view that over the longer term electricity and gas are substitutes and this would pose some constraints on gas price increases. However, in the short term there could be some customers who will be unable to switch fuels (eg renters). Specific measures to assist customers with affordability of gas are a matter for the NSW Government. The NSW Government introduced the NSW Gas Rebate on 1 July 2015 to help eligible NSW households to pay their natural gas bills. The NSW Gas Rebate provides $90 (excluding GST) a year to eligible customers who hold a natural gas account with a natural gas retailer of their choice. There is also a Family Energy Rebate and a Low Income Household Rebate available to eligible customers.
5. PIAC is concerned about the timing of price deregulation given the impact of the LNG export industry. It recommends that IPART provide a transitional tariff to insulate consumers from price shocks.	Introducing a transitional tariff is a decision for the NSW Government. The NSW Government asked IPART to provide indicative prices for the two years 2017-18 and 2018-19 (see Chapter 7). These may be used in any negotiations on transitional tariffs. While these indicative price changes represent our best

Issue	IPART's responses
	estimates, they should be interpreted with caution. Uncertainty in network price changes and the wholesale gas market over the next few years makes forecasting overall price changes problematic.

a K Lowe Consulting, *AEMC 2015 retail competition review: Retailer surveys – Report for the AEMC*¸ May 2015, pp 28-33.

b AEMC, *2015 retail competition review – Final report,* 30 June 2015, pp 113-114.

c ACCC, *Inquiry into the east coast gas market,* April 2016, pp 15-16.

Source: PIAC's submission to the Draft Report, May 2016.