

Final Report

Review of the Delivered Price of Natural Gas in Wagga Wagga and Albury

**INDEPENDENT PRICING AND REGULATORY TRIBUNAL
OF NEW SOUTH WALES**

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Submissions

Public involvement is an important element of the Tribunal's processes. All submissions made to this review that are not subject to confidentiality are available for public inspection at the Tribunal's offices and via the Tribunal's website. Transcriptions of public hearings are also available.

Public information about the Tribunal's activities

A range of information about the role and current activities of the Tribunal, including copies of latest reports and submissions can be found on the Tribunal's website at www.ipart.nsw.gov.au.

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1 INTRODUCTION

1.1 Background

In keeping with the commitments made in 1994 by the Council of Australian Governments, the NSW Government is introducing competition in the supply of natural gas. This involves a series of stages including:

- development of third party access regimes for transport systems, setting out terms and conditions for the use of distribution pipes
- the progressive introduction of contestability to customer groups
- regulation and monitoring of prices by the Tribunal until effective competition is established.

This report primarily addresses the Tribunal's approach to the last of these three stages. However, as the establishment of effective competition requires implementation of the first two stages, it is useful to also outline the current state of play with respect to these reforms (see chapter 2).

1.1.1 Purpose of the review

Delivered prices to the tariff market in Wagga Wagga, Albury, Moama and NSW Murray Towns are not regulated.

In this review the Tribunal proposes to consider the following:

- should the tariff market in the above regions be regulated?
- if so, how should prices be regulated?
- are suppliers receiving an appropriate return?
- is regulation required once the retail market is contestable?

1.1.2 Review process to date

The Tribunal began its review of the delivered price in Wagga Wagga, Albury, Moama and NSW Murray Towns in August 1997. In accordance with the processes set out in section 32(2) of the *NSW Gas Supply Act 1996* and Part 4 of the *Independent Pricing and Regulatory Tribunal Act 1992*, the Tribunal released an issues paper on tariff regulation, held a public hearing, and called for submissions from interested parties.

Submissions were received from Great Southern Energy (GSE) and the Albury Gas Company (AGC) in September 1997. These submissions were made available to interested parties and subsequently the Tribunal received submissions from stakeholders. The submissions are outlined in Appendix 2. A public hearing was held on 6 November 1997 in Wagga Wagga.

In March 1998 the Tribunal released a further consultation paper on the review of the delivered price of natural gas in Albury and Moama. The purpose of this consultation paper was to inform interested parties of the progress of the review and to provide additional

material provided by AGC in support of its proposals. Submissions received in response to this consultation paper are also outlined in Appendix 2.

The Tribunal duly considered the submissions in response to the issues and consultation papers and resolved:

- not to regulate the delivered price in the Murray Valley towns. This decision was taken in light of the fact that gas supply to those towns was being introduced for the first time, and this was occurring through a competitive tender process. (In July 1995 the Central Murray Regional Development Corporation chose the AGC to supply the region with natural gas.)
- to postpone its determination of the delivered price of gas to the tariff market in Wagga Wagga and Albury to allow the tariff and access reviews to run concurrently. Transportation prices are a significant component of the delivered price of gas. It was therefore practical for a deferral of this type to take place. This decision was widely supported by submissions to the Tribunal. In addition, the incumbent retailers agreed to a price freeze until the review process advanced.

The Tribunal has completed its access review for gas distribution networks operated by Great Southern Network's (GSN)¹ and its review of the Access Arrangement submitted by the AGC is now nearing completion. In respect of AGC, the Tribunal issued its final decision on the Access Arrangement in December 1999 and a final approval is expected in February 2000.

In light of the status of the access reviews for GSN and AGC, the Tribunal is now in a position to finalise its review of delivered tariffs in Wagga Wagga and Albury. The Tribunal issued a draft decision in October 1999, which outlined the Tribunal's preferred approach to tariff regulation in these regions as NSW moves towards full retail contestability. In response to this draft decision three submissions were received from interested parties.² The Tribunal has carefully considered these submissions in preparing this final report. Energy 21 Pty Limited (Energy 21)³ has also recently provided further supporting information regarding its tariff levels for the Tribunal's assessment.⁴

1.2 Overview of draft decision

The Tribunal concluded in its draft decision that residential, commercial and industrial customers in Albury and Wagga Wagga are not being overcharged for gas. In Wagga Wagga, GSE's tariff market prices are considered reasonable in relation to the cost of service. In Albury, Energy 21 offers the lowest tariff market prices in NSW.

The progressive introduction of competition into the tariff market is expected to keep prices down in future. However, the Tribunal will continue to monitor prices and will retain the power to regulate those prices.

¹ Following non compliance with its final decision, the Tribunal drafted its own Access Arrangement which it approved in September 1999.

² See chapter 3 of this report.

³ AGC's Supplier's Authorisation was transferred to Energy 21 on 3 February 1999.

⁴ See Appendix 1 of this report.

The Tribunal sought agreement from GSE and Energy 21 to voluntary pricing principles. These principles will allow customers to stay on the current tariffs through a “grace period” following the introduction of competition. The objective is to smooth the transition and allow customers to easily adapt to new market conditions. A customer on existing tariffs using 1-10 TJ’s (eg a small business) should be given the option of remaining on those ‘default tariffs’ until 31 December 2000. Customers using 0-1 TJ (eg households) should be able to remain on the default tariffs until 30 June 2001.

The voluntary principles also include:

- side constraints on pricing to the residential market and
- a requirement to provide prior notification to the Tribunal of any increases to default tariffs.

Residential customers’ bills should not increase by more than the greater of \$20 or 5 per cent real over the bill for the same gas consumption in any period of one year. One-month prior notice of changes to any default tariffs is required.

1.3 Report outline

Chapter 2 of this report provides an overview of the market and regulatory environment in NSW. Chapter 3 examines the major issues raised in submissions in response to the Tribunal’s draft decision. Chapter 4 examines the form of future tariff regulation and chapter 5 outlines the Tribunal’s conclusion. Schedule 1 outlines the voluntary pricing principles which is the light handed approach adopted for tariff regulation in the transitional period to full retail competition. Appendix 1 provides further analysis of reasonableness of Energy 21’s tariffs based on supporting recently provided to the Tribunal. A full list of submissions to this inquiry is outlined in Appendix 2.

The Tribunal has not repeated its analysis of the following issues, which can be found in its draft decision:

- reasonableness of current tariff market prices in Wagga Wagga (chapter3)
- assessment of the likely effectiveness of competition (chapter 4)
- regulatory objectives of tariff regulation (chapter 5).

This report should therefore be read in close conjunction with the draft decision⁵.

⁵ The draft decision can be viewed or down loaded from the Tribunal’s web site at www.ipart.nsw.gov.au in the Updates section listed on 5 October 1999.

2 MARKET AND REGULATORY ENVIRONMENT

2.1 Existing tariff market in Wagga Wagga and Albury

2.1.1 Wagga Wagga

Situated halfway between Sydney and Melbourne, Wagga Wagga is a significant regional centre with a population of approximately 57,000. The largest inland city in NSW, it is the commercial centre of the Riverina district. It is strategically located on the route of the recently commissioned Wodonga to Wagga Wagga pipeline connection between the Victorian and New South Wales gas networks.

Gas has been available in Wagga Wagga since the late 1880s. Manufactured gas was used until natural gas from the Cooper Basin became available in 1981. The supply and reticulation of gas was a business of the Wagga Wagga City Council from the introduction of gas until 27 June 1997 when GSE acquired the utility. To meet ring fencing requirements under the National Third Party Access Code for Natural Gas Pipeline Systems (the Code) GSE has established a wholly owned subsidiary to operate the gas network, Great Southern Energy Gas Networks Pty Limited. Operating and maintenance and support services are currently provided by GSE, which charges GSN for these services. GSE is also the incumbent gas retailer on the GSN system.

The Wagga Wagga system currently serves about 14,000 customers purchasing a total of approximately 1.5 petajoules of gas each year, which is transported through 525 km of pipes/mains.

Most of the gas consumers in Wagga Wagga are tariff customers.⁶ They consume about 45 per cent of total gas sold. The tariff market can be separated into residential, commercial and industrial sub-classes. Residential customers account for 96 per cent of all natural gas customers in Wagga Wagga and consume about 34 per cent of the total Wagga Wagga load. Of all the households in Wagga Wagga with access to gas mains, 85 per cent are connected to gas. By comparison, about 60 per cent of households with access to the gas mains are connected in Sydney, while 80 per cent are connected in South Australia.

The other tariff customer sub-class is industrial and commercial customers. There are over 400 industrial and commercial customers in Wagga Wagga consuming 11 per cent of total gas sold.

There are also 14 contract customers.⁷ These customers account for the remaining 55 per cent of gas consumed. Commercial uses range from board processing, wool combing and hospital services, to plywood manufacture and asphalt production. Gas is also used by large army and airforce establishments and by Charles Sturt University.

⁶ Tariff customers are end use customers consuming less than 10 TJ per annum.

⁷ Contract customers are end use customers consuming more than 10 TJ per annum.

2.1.2 Albury

AGC transports gas to Albury, Moama, Jindera (in the Hume Shire) and the NSW Murray Valley towns. Since 1 December 1997, AGC has been a wholly owned subsidiary of Stratus Networks. More recently, Stratus Networks and its ‘stapled’ retail arm, Energy 21 were purchased by a consortium of Boral Energy and Envestra. Stratus Networks owns and operates distribution networks in north and south-eastern Victoria as well as the Mornington Peninsula. Although Stratus Networks own it, AGC operates a discrete network, which serves customers in NSW. AGC also has its own audited financial accounts. Energy 21 is the incumbent retailer supplying gas to Albury, Moama and Jindera.

AGC’s distribution network in Albury, Jindera and Moama is about 325 kilometres in length and serves approximately 16,000 customers who consume a total of about 3 petajoules of gas per year. Natural gas was officially turned on at the Albury city gate on 2 June 1977. Reticulation of natural gas to the town of Jindera commenced on 29 August 1995 and to Moama two days later.

Most of the gas consumers served by AGC network are tariff customers. They consume about 32 per cent of total gas sold. Within this total, AGC network has about 100 industrial and commercial customers that consume about 9 per cent of total gas sold.

About 95 per cent of all natural gas customers using AGC network are residential customers. Of all the households that have access to the Albury network, 84 per cent are connected to gas.

There are also eight contract customers who account for the remaining 68 per cent of gas consumed. These customers generally use gas for commercial uses ranging from a variety of processing and manufacturing plants to hospital services.

Although Moama is located in NSW, its distribution network is an extension of the network serving Echuca in Victoria and is not connected to the distribution network serving Albury and Jindera. There are towns with similar characteristics to Moama in the Central Murray region.

2.2 Regulation and oversight of prices by the Tribunal

2.2.1 The Tribunal’s regulatory powers in the tariff market

The Tribunal may regulate the price of gas supply to the tariff market by making a gas pricing order under section 27 of the *Gas Supply Act 1996*. A gas pricing order can be issued at any time and is the Tribunal’s principal power in regulating gas tariff market prices. Essentially, a gas pricing order can:

- establish a methodology within which tariff prices for delivered gas must be set or establish maximum tariffs or maximum average tariffs; and
- prohibit the imposition of certain charges.

There is currently no gas pricing order in effect for the Wagga Wagga and Albury tariff markets. However, the knowledge that a gas pricing order could be introduced at any time along with the Tribunal’s ongoing price monitoring may have a role in constraining tariff market prices. The Tribunal’s power to issue a gas pricing order can also influence the

nature of negotiations with retailers over the voluntary acceptance of pricing principles. The Tribunal will maintain the power to issue a gas pricing order following the introduction of contestability for tariff market customers.

Under s32(1) of the *Gas Supply Act 1996*, the Tribunal may conduct investigations for the purpose of enabling it to exercise its functions under the Act, including making a gas pricing order. An investigation must be consistent with the Act's statutory objectives. The objectives of the Act are listed in s3(1). They are:

- to encourage the development of a competitive market in gas so as to promote the thermally efficient use of gas and deliver a safe and reliable supply of gas in compliance with the principles of ecologically sustainable development contained in section 6 (2) of the *Protection of the Environment Administration Act 1991*.
- to regulate gas reticulators and gas supply, so as to facilitate open access to gas reticulation systems and promote customer choice

To ensure that objectives are met for gas supply and gas users, the Tribunal (and others) have the duties outlined in sections 3(4) and (5) of the Act.

- 3(4) In relation to persons involved in the supply of gas (authorised suppliers and licensed distributors), the duties are as follows:
- (a) to ensure that the public receives the benefit of a competitive gas market
 - (b) to take proper account of the interests of tariff customers in respect of gas pricing and other terms of gas supply
 - (c) to take proper account of the business interests of persons supplying gas to the tariff market
 - (d) to encourage the development of competitive gas supply in the non-tariff market, with a focus on free and fair trade.
- 3(5) In relation to gas users the duties are to promote the efficient and safe use of gas.

2.2.2 Development of third party access regimes for distribution systems

Under the National Third Party Access Code for Natural Gas Pipeline Systems (the Code) the owner of a covered pipeline submits an Access Arrangement and subsequent revisions for approval by the relevant regulator. Access Arrangements set out the terms and conditions (including reference prices) for the transport of gas through the transmission and distribution pipes. Access Arrangements are intended to ensure capacity to finance reticulation of gas and seek to ensure sufficient funds are available for a prudent service provider to maintain the safety and integrity of the network system. The technical regulation of safety requirements is a responsibility for the Ministry of Energy and Utilities.

While the Australian Competition and Consumer Commission (ACCC) reviews most of the large scale transmission pipes⁸ which transport gas from the source to the city gate (haulage costs), the state regulator, in this case the Tribunal, reviews the Access Arrangements for distribution systems from the city gate to the customer (transport costs). Transport costs generally form upwards of a half of the total cost of tariff market gas supply costs.

⁸ As listed in the code.

2.3 The contestability timetable

The NSW gas market has been progressively open up to competition since August 1997. The latest tranche to become contestable occurred on 1 October 1999 when tariff customers consuming 1-10TJ⁹ per annum became eligible. In practice, uncertainty regarding network contestability costs, limitations on the availability of alternative sources of gas and some technical/contractual issues have resulted in little movement away from the incumbent retailer. Hopefully these problems will be resolved shortly resulting in greater choice of gas supplier. The introduction of full retail contestability is scheduled to occur on 1 July 2000. This is well before other state gas markets are fully open to competition.¹⁰

3 SUBMISSIONS IN RESPONSE TO DRAFT DECISION

The Tribunal received four submissions from the following organisations:

- GSE
- AGL
- Public Interest Advocacy Centre (PIAC)
- Boral Energy Limited.

The Tribunal in its draft decision concluded that the tariffs in Albury and Wagga Wagga are reasonable. Those who put in submissions have not disputed this. The Tribunal also outlined its expectation that competition will be effective in constraining prices in the future and, as a consequence, favoured light handed regulation of tariff prices.¹¹ GSE and AGL supported this approach. However, PIAC expressed concerns that not every customer may receive the benefits of competition and as a consequence closer and longer regulatory involvement may be required.

Specific comments raised in these submissions are summarised below together with the Tribunal's comments.

3.1 GSE

Side constraints

The proposed side constraint limit, in any period of 12 months, any increases to residential customers' default tariffs to \$20 (nominal) or 5 per cent real, whichever is the greatest. GSE suggested that both amounts should be expressed in real terms. The Tribunal notes that no evidence has been provided to justify a change to the proposed side constraints, which it considers are sufficiently generous.¹²

⁹ Customers whose gas bill would normally be between \$10,000 –100,000 per annum.

¹⁰ For example, Victorian residential customers will be contestable from 1 September 2001.

¹¹ People who are interested in this analysis together with the Tribunal's assessment of the likely effectiveness of competition should read chapters 3 and 4 of the draft decision since this analysis/assessment have not been repeated here. This report should therefore be read in close conjunction with the draft decision.

¹² Especially when taking into account that certain unavoidable costs are outside of the constraints.

Indirect Tax Reform

GSE raised the following issues:

- some existing contracts are linked to CPI and do not exempt the Goods and Services Tax (GST) effect
- GST exempt CPI figure may not be produced by the Australian Bureau of Statistics (ABS)
- There are various economic models that can be used to determine GST compliance with differing results. An audit of the impact of tax reform may therefore be difficult.

As a general principle, the Tribunal would normally have no objections to a retailer, if it so desires, passing through all increases in unavoidable costs. This is demonstrated by the Tribunal position on the pass through of network costs. The Tribunal has indicated that any increases in network charges can be passed through even if these increases were above the limits imposed by the side constraints. At this stage, the Tribunal is unaware of any other retailer contracts where significant increases are envisaged in the next 18 months¹³ that could not be included within the limits imposed by the side constraints. However, there is nothing preventing a retailer approaching the Tribunal to seek a review of the voluntary pricing principles where increases in other unavoidable costs would exceed the current limits imposed in the side constraints.

A new tax system is due to commence on 1 July 2000 and will:

- introduce a 10 per cent GST
- remove the wholesale sales tax and make changes to the excise on petrol and diesel and some other indirect taxes.

In addition to the GST, changes to the taxation system, including reducing the rate of corporate income tax and abolishing accelerated depreciation, are also planned.

The package of taxation changes will affect the prices of all goods and services, including lowering those where the wholesale sales tax is higher than the GST. This will affect the economy-wide CPI calculated by the ABS. The impact on individual businesses will reflect their operating and capital costs and revenue structure.

The Tribunal uses the CPI figure across the industries it regulates to:

- index revenues during the regulatory period
- index the regulated capital base until the start of the next regulatory period
- set limits on price movements.

In respect to gas tariff regulation, CPI is used to place limits on price movements. The side constraints on pricing exclude the impact of GST and other associated tax reforms. As a consequence, the CPI used to determine the 5 per cent limit on real price increases must exclude the impact of the GST and associated tax changes. Failure to do this would result in double counting.

¹³ Remaining time for the grace period.

The Tribunal is aware that there is likely to be substantial changes in the utilities' costs and that these changes will differ substantially from the economy-wide impact reflected in the CPI. The Tribunal appreciates that in the market place there are several economic models being used to determine GST compliance. These models, depending on assumptions used, may come up with different results. The Tribunal is discussing GST compliance issues with ACCC and is reviewing some of the economic models designed for this purpose.

The Tribunal's treatment of GST impacts involves no 'windfall' loss or gain for the utility owner. The impact on the consumer will equal the net impact of the GST package¹⁴ on the retailer. To implement this method, the Tribunal requires the utilities to provide more information.

The Tribunal will require an audit of the changes in costs under the GST package. This audit will be funded by the utilities. In consultation with the industry, the Tribunal will establish procedures for this audit. Each utility will be required to obtain the Tribunal's agreement on the consultant to be appointed for the audit.

3.2 AGL

GSE incremental cost approach

The Tribunal notes AGL's comments suggesting that the average cost of gas supply is partly being met by the GSE's electricity market. AGL states that its broader concern relates to differences in the timetables for the introduction of contestability in gas and electricity markets and suggest that this may lead to an artificial advantage to electricity utilities entering the gas market.

Contestability timetables

AGL states that competitive neutrality requires that government owned electricity businesses should not receive more favourable treatment than private businesses from the anomaly in the contestability timetable. The Tribunal acknowledges that contestability timetables in electricity and gas industries are matters for government. The Tribunal understands that AGL has raised this matter with the Government and AGL's request to align the timetables was not supported. The Government believes that differences in the deregulation timetables will not result in any significant problems.

Other retail contestability issues

AGL states that in the long run customers must be better off from the introduction of contestability, through lower prices and better levels of service. The Tribunal and the MoEU need to consider this in designing and developing systems. AGL also suggests that retailer of last resort provisions need to be developed.

The Tribunal believes that the development of new procedures and systems to achieve lower prices and better levels of service is primarily an issue for network operators and retailers. To facilitate the timely introduction of full gas retail contestability in NSW, the MoEU established a Gas Retail Project. Through a Steering Committee and a number of working groups, industry, government, regulators and other interested stakeholders are examining procedures and systems required for retail contestability. The development of retailer of last resort provisions is also being considered as part of this process.

¹⁴ The net impact may include incremental compliance costs.

Take-or-pay

AGL suggest that retailers' take-or-pay commitments should be treated as a stranded cost and recovered from users. They cite North American regulatory experience to support this position. The Tribunal and its predecessor, the Gas Council of NSW, have previously examined the impact of take-or-pay contracts. Both bodies have concluded that take-or-pay should be resolved commercially with no need for regulatory intervention at this time. The Tribunal considers that there is no new evidence that warrants a change in this position.

Unaccounted for Gas (UAG)

AGL prefers UAG to be treated as a network operator expense rather than a direct retailer cost. The Tribunal notes that there are precedents for UAG to be treated by either approach. Since GSN and the AGC have opted for UAG to be treated as a retailer's cost and the Tribunal has already accepted this as part of GSN's and AGC's Access Arrangements, no changes to this treatment are proposed.

3.3 PIAC

Increase in fixed charges

PIAC expressed concern regarding the introduction of fixed network charges in Wagga Wagga. PIAC suggests that, even if these new charges are spread over five years, this may represent significant price shocks to small residential users. The Tribunal considered this matter as part of a separate review of GSN's Access Arrangement. In this review, the Tribunal did not object to GSN's proposal to introduce standing charges to recover some of its fixed costs. This type of charging is consistent with utility pricing elsewhere. The Tribunal approved the standing charges at a level that will be accommodated within the proposed voluntary pricing constraints. This should avoid any significant price shocks to small residential consumers if GSE or other retailers choose to pass on these standing charges.

Voluntary pricing principles

PIAC suggests that a grace period for residential customers should be longer than 12 months since not all customers will switch suppliers. Further, default tariffs should reduce over time so that all customers receive benefits of increased competition.

Overseas experience has shown that utility markets can be transformed with the introduction of full competition. However, benefits of greater competition in the NSW gas market has been restrained primarily due to upstream supply issues. These problems are progressively being resolved and are expected to largely disappear with the completion of the Eastern Gas Pipeline¹⁵ in September 2000. In these circumstances, a grace period of 12 months after the introduction of full retail contestability is considered sufficient. If further measures are required they can be considered at that time.

The Tribunal does not support PIAC's suggestion that default tariffs should be reduced over time. Effective competition is meant to deliver lower prices and/or improved services. Notwithstanding this, the Tribunal notes PIAC's view that not all customers may receive the benefits of competition. The voluntary pricing guidelines (including default tariffs) are designed to provide sufficient safeguards for tariff customers during the transitional period

¹⁵ A new major transmission line supplying Bass Strait gas to Sydney and the NSW market generally.

to full competition. During this time, the Tribunal will closely monitor the impact of competition on the NSW gas market. Based on its observations, together with a proposed public forum to be held in about 18 months time, the Tribunal will assess the impact of competition and determine whether any further regulatory action is required.

Community Service Obligations (CSOs)

PIAC expressed concern that if the Tribunal did not issue a gas pricing order there would be no obligation on the State Government to fund CSOs in the gas industry. Currently, the Government funds CSOs in the electricity industry. In the gas industry, pensioner rebates¹⁶ are provided by retailers and are ultimately recovered through gas prices. The different treatment of CSOs between the two industries raises competitive neutrality concerns. The Government has acknowledged this problem and the *Gas Supply Act 1996* was amended to provide, where appropriate, for the future payment of CSOs by the Government. However, future funding by the Government is linked to the Tribunal issuing a Gas Pricing Order. Since the Tribunal does not intend to issue a Gas Pricing Order, there is no obligation on the Government to fund the existing or new CSOs.

The payment of CSOs is a question for Government. However, the Tribunal will write to the Government outlining the consequences of not issuing Gas Pricing Orders. The Tribunal will also suggest to the Government that it consider funding the existing CSOs paid by incumbent gas retailers to address the competitive neutrality issue outlined above.

3.4 Boral Energy Limited

Boral provided financial and other information in support of no formal price control in Albury prior to contestability in June 2000. For more detail analysis see Appendix 1.

3.5 Overview of submissions

The Tribunal is of the view that there are no new substantive issues raised in the submissions that would warrant a change to its proposed light handed approach to gas tariff regulation at this time. The Tribunal will review this decision in about 18 months time to determine the impact of competition and whether any further regulatory action is required. The Tribunal will write to the Government regarding the payment of existing CSOs.

4 FUTURE TARIFF REGULATION

Two of the critical issues addressed in this review have been the reasonableness of current prices, and the likelihood of competition constraining these prices into the future. The Tribunal's analysis suggests that current average tariff prices are reasonable, and that competition will constrain these prices into the future. Competition can also bring additional benefits in the form of product innovation that may not otherwise occur in a regulated market.

¹⁶ The only CSO currently provided by incumbent gas retailers.

This suggests that it may be possible to avoid regulation of prices via a gas pricing order by relying primarily on competition and ongoing monitoring to constrain prices. The Tribunal considers that a gas pricing order may not be necessary provided that the Tribunal continues to be satisfied that:

- gas prices remain reasonable
- customers, or classes of customers are not being overcharged
- customers are not under 'pressure' to enter into contracts, particularly contracts for long terms, without adequate exit provisions.

The Tribunal believes that, during the transitional period to full retail competition, tariff regulation would be best served by the introduction of light handed voluntary pricing principles. These principles were outlined in Tribunal's draft decision. The Tribunal has written to Energy 21 and GSE¹⁷ regarding the acceptance of the voluntary pricing principles. Both companies gave in principle support to voluntary tariff principles and sought clarification on aspects of the proposal. Subsequent discussions with these companies have led to the voluntary pricing principles being further refined. Both companies have now formally accepted the voluntary pricing principles, which are outlined in Schedule 1 of this report.

5 CONCLUSION

The Tribunal does not consider that there is a need for gas pricing orders at this time. This view is based on the fact that current prices are reasonable and the expectation that competition will be effective in constraining prices in the future. However, the dynamics of the retail market post contestability can not be predicted with certainty.

Due to this uncertainty, the Tribunal will continue to monitor developments in the tariff market to ensure prices remain reasonable and intends in about 18 months time to conduct a forum on the impact of competition. This forum will consider, among other things, whether voluntary pricing guidelines (including default tariffs) should continue for residential customers. The Tribunal will, however, consider the introduction of gas pricing orders if, amongst other things, existing tariffs are not maintained for a specified grace period following contestability or if side constraints on residential tariffs are exceeded. For this purpose, the grace period and residential side constraints presently considered appropriate by the Tribunal are contained in the Voluntary Pricing Principles set out in schedule 1.

In reaching this conclusion, the Tribunal has taken into account its duties under s3(4)-(5) of the *NSW Gas Supply Act 1996*. These were also discussed by the Tribunal in section 5.1 of the draft decision and applied here in reaching this conclusion. By adopting a light handed regulation of the tariff market through the Voluntary Pricing Principles, the Tribunal is ensuring that the public receives the benefit of a competitive gas market (s3(4)(a)) whilst also taking proper account of the interests of tariff customers in respect of gas pricing and other terms of gas supply (s3(4)(b)) and the proper interests of persons supplying gas to the tariff market (s3(4)(c)).

¹⁷ The incumbent retailers in Albury and Wagga Wagga respectively.

The Tribunal promotes the efficient use of gas by not allowing the prices to be artificially low so people over consume gas. However, the Tribunal has not allowed the pricing to be significantly above the cost of supply so as not to provide a disincentive to consume this relatively 'clean' energy source.

SCHEDULE 1 VOLUNTARY PRICING PRINCIPLES

The incumbent retailer voluntarily submits to the following pricing principles:

1. Customers on tariffs at the commencement of retail contestability will be given the option of remaining on those tariffs ('default tariff') for the following periods ("grace period") following the introduction of retail contestability:
 - a) for 1-10TJ pa customers, until 31 December 2000; and
 - b) for 0-1TJ pa customers until 30 June 2001¹⁸.
2. During the grace period, changes to the default tariff for residential customers will be subject to the following explicit constraints:
 - a) Subject to paragraph (b), during the relevant grace period, the amount paid by a residential customer for the pattern and volume of gas it consumes will not exceed by more than \$20 or 5 per cent in real terms, whichever is the greater ("price constraint"), the amount the customer would have paid had that pattern and volume of gas been consumed over the corresponding period of the previous year. Calculation of real changes in prices will be measured with reference to the Australian Bureau of Statistics March All Capital CPI series.
 - b) Where the full pass through of a change in **network charges** including those associated with contestability (whether under an Access Arrangement or otherwise) would result in the price constraint being exceeded, the price constraint will be increased automatically to include the full pass through of those costs.¹⁹
 - c) Net increases in costs resulting from introduction of the goods and services tax (or GST) as defined in the *A New Tax System (Goods and Services) Tax Act 1999 and associated tax changes* may be added to the price constraint in paragraph(a) from the date that the GST becomes effective. The method of determining the price increases resulting from the introduction of the GST and associated tax changes will be resolved separately.
3. Changes to default tariffs for industrial and commercial customers will not be subject to clause 2 above.
4. The incumbent retailer must notify the Tribunal in writing at least 1 month prior to amending its default tariffs for residential, industrial or commercial customers. This notification must include the following:
 - a) an estimate (and associated methodology) of the expected impact on revenue of the proposed price changes. If the estimated revenue impact is positive, evidence must be supplied showing that either costs have increased for supplying that particular tariff customer or class of customer, or that existing prices were not covering costs associated with that particular tariff customer or class of customer. Costs may include an allowance for an appropriate margin.

¹⁸ This date has been established on the basis of the current NSW timetable for full retail contestability. If the Government decides to change this timetable this date may need to be reviewed.

¹⁹ Costs incurred by the incumbent retailer on its own systems and procedures for the introduction of retail contestability are to be recovered within the constraints imposed by condition 2(a) of the proposed voluntary pricing principles.

- b) a breakdown of the costs of supply into fixed costs per customer and costs that vary with the absolute magnitude of gas consumption per customer (in \$ per GJ)
 - c) a customer impact analysis detailing in tabular form:
 - the number of customers in particular consumption ranges
 - the current cost of gas per quarter associated with consumption at the midpoint of the relevant range
 - the proposed cost per quarter associated with consumption at the midpoint of the relevant range
 - the absolute and proportional change in the cost per quarter associated with consumption at the midpoint of the relevant range.
 - d) other supporting information required by the Tribunal
5. The one-month notice period advice (as required by paragraph 4) is for the purpose of information only. Under this voluntary agreement the Tribunal monitors price changes to determine whether they are in accordance with the voluntary pricing principles set out in paragraph (2) above.
6. Nothing in these voluntary pricing principles removes the Tribunal's ability to make a Gas Pricing Order pursuant to section 27 of the Gas Supply Act or indeed any other powers of the Tribunal.

APPENDIX 1 REASONABLENESS OF CURRENT TARIFF MARKET PRICES

This appendix details the Tribunal's analysis of the reasonable costs of retail gas supply to the Albury and Wagga Wagga tariff markets.

A1 Tariff market costs and revenues

A1.1 Albury

AGC provided the Tribunal with information in regards to costs and revenues for 1999/2000 and the year 2000. The results are in the following table.

Table 1 Tariff market costs and revenues

	1999/2000 (\$m)	2000 (\$m)
Costs Components		
Transport	2.524	3.368
Gas and Haulage	2.891	2.801
Retail	1.145	1.159
Total Costs	6.56	7.328
Revenue	6.707	7.478
Net retail Margin (%)	2.19	2.01

Although the net retail margin for Energy 21 is higher than that for GSE, it can still be considered reasonable. A value of 2 per cent is the margin that is normally used in the industry as a notional retail margin. The net retail margin is slightly above this benchmark in 1999/2000. However, this figure is based on actual as well as estimated data. The 1999/2000 figures were based on 4 months of actual sales data and 8 months of forecasts using 'standard weather'²⁰ conditions. The first four months for the financial year 1999/2000 were considerably warmer than 'standard weather' and this has affected all costs and revenues for that year.

Within the information provided to the Tribunal, AGC has not taken into account costs relating to the introduction of contestability or any changes in transmission charges in 2000. Inclusion of these costs may result in the net retail margin coming more into line with that of GSE.

In the draft decision, the Tribunal compared the tariffs charged by GSE, Energy 21 and AGL. The conclusion from this analysis was that Energy 21 charged the lowest tariffs in NSW and hence its tariff prices were considered to be reasonable.

A1.2 Wagga Wagga

The reasonableness of the tariff pricing in Wagga Wagga was considered in the draft decision released in October 1999.

²⁰ Standard weather is calculated on the basis of the average of effective degree days for the last 30 years.

The Tribunal considered the aggregate tariff market revenue was not unreasonably high based on its analysis and the fact that GSE does not have control over gas field price, and haulage and transportation costs in the immediate future.

The Tribunal concluded that customers in Wagga Wagga were currently not being overcharged for gas. However, it was noted that the introduction of competition may place upward pressure on fixed charges and downward pressure on usage rates.

A2 Components of the price of gas

In the newly contestable retail market, competitive constraints will tend to force retailers to minimise the pass through of costs to customers and to allocate those costs according to the customer class for which they are incurred. If incumbent retailers do not apply cost reflective prices, competitors are likely to attract their profitable customers with lower prices, and leave them with their least profitable customers.

A2.1 Cost of gas, haulage and transportation

The field price of gas, haulage and transportation costs for GSE and Energy 21 are set by contracts already in place, or by reference to the relevant access arrangement. As such, the retailer's main opportunity to influence costs in the short term is in retail costs and margin.

Given that retailers do not have control over current field prices, haulage or transportation costs, the Tribunal regards these contractual costs as reasonable.

Haulage and transport costs have both fixed and variable components. The Tribunal considers it appropriate for tariff price structures to reflect these cost structures.

A2.2 Unaccounted for gas

Unaccounted for gas (UAG) is gas lost during its transportation through the pipeline network. In its final decisions on GSN's and AGC's Access Arrangements, the Tribunal considered that UAG is a retailer's cost rather than a cost to the network operator.

GSN and the Tribunal have agreed to an average allowance for UAG of 3.8 per cent reducing to 2.5 per cent by the end of the Access Arrangement. This has been allocated to the tariff market at 7.4 per cent in the first year of the Access Arrangement, reducing to 4 per cent in the fifth year of the Access Arrangement.

AGC proposed a lower average UAG of 1.8 per cent. The Tribunal considers this proposal to be reasonable. This is to be split between customers supplied directly off the transmission pipeline facing a UAG of 0.1 per cent and other customers supplied off the high pressure system facing a UAG allowance of 4.1 per cent.

A2.3 Retail costs and margin

As noted earlier, retail costs are expenses incurred in running the retail component of the gas business. These may include: expenses such as billing, marketing, customer advisory services, advertising, promotions, time spent handling customer inquiries and negotiating gas contracts, haulage and reticulation. Where retailers are responsible for maintaining customer service standards, these costs must be covered in their retail margin.

The net retail margin is the margin on gas sales before interest and tax, but after all other costs (including retail costs) have been accounted for. The net retail margin therefore represents a return on the capital employed in the business and the risks associated with the business. Incumbents and potential entrants alike must be able to expect to earn a net retail margin in order to make their investment in the business worthwhile. It follows that the appropriate net retail margin will depend on the specific circumstances of the industry and market a firm is operating in. For example, if the reasonable ratio of capital to sales is high for a particular firm, a higher net retail margin is also reasonable.

Another measure of the retail margin is the gross retail margin. This is the margin on gas sales before interest, tax and retail costs, but after all other costs. Benchmarking the gross retail margin gives the regulated firm an incentive to increase sales and reduce retail costs.

Great Southern Energy

GSE has stated that its gas retail costs are \$250,000 and that a further \$250,000 would represent a reasonable return on the capital and risk associated with retail operations. GSE considers that this represents something close to the incremental retail costs incurred when its gas retailing operations are added to its existing electricity retailing operations. GSE has proposed allocating these costs to the gas contract and tariff markets on the basis of 50 per cent by customer numbers and 50 per cent by gas usage. Applying these assumptions gives a net retail margin of around 2.3 per cent and a gross retail margin of around 4.6 per cent.

Retail costs of \$250,000 represent an average cost of around \$17 pa per tariff market customer. The Tribunal considers this to be a conservative estimate of retail costs.

The Tribunal considers GSE's indicative level and allocation of gross retail margin to be reasonable.

Energy 21

Given the information received from Energy 21, a net retail margin of around 2 per cent is proposed. This is consistent with the notional industry level.

Based on the data provided by Energy 21, the total retail costs are \$1,145,000. This is an average cost of \$72 pa per tariff market customer. This figure may be considered high in comparison to GSE but unlike GSE it includes the return on capital.

A2.5 Costs and quality of service

Quality of service for gas retailers includes such dimensions as the provision of customer advisory services, billing inquiries and complaint handling procedures. The quality of service requirements are regulated by the Ministry of Energy and Utilities and there is no evidence that Energy 21 or GSE are not meeting these requirements. The current level of prices should be sufficient to maintain existing service quality.

APPENDIX 2 LIST OF SUBMISSIONS

Submissions to the Issues and Consultations Papers on the Delivered Price of Natural Gas in Wagga Wagga, Albury, Moama and the NSW Murray Valley Towns.

Organisation	Name
AGC/Energy 21	T. Wallish
AGC/Energy 21	T. Wallish
AGL	B. Connery
AMCOR	D. Headberry
AGL	B. Connery
Albury Wodonga Limited	G. Oke
Australian Gas Users Group	A. Reichel
BHP Petroleum	D. Biggs
BHP Petroleum	D. Biggs
Boral Energy	J. Hayward
BTR	P. Dobney
GSE	B. Burton
GSE	P. Hoogland
GSE	M. Smith
State Member for Wagga Wagga	J. Schipp MP
NSW Treasury	J. Pierce

Submissions made to the Tribunal's draft decision on the review of the delivered price of natural gas in Wagga Wagga and Albury.

AGL	R Petersen
Great Southern Energy	P Hoogland
Public Interest Advocacy Centre	T Benson
Boral Energy Limited	T Wood
