

FINAL REPORT

**Review of the Delivered Price
of Natural Gas to
Tariff Customers
Served from the
AGL Gas Network in NSW**

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

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AGL Gas Network in NSW**

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FOREWORD

The New South Wales Government has put in place a timetable and policy framework for the introduction of full retail contestability in natural gas. This parallels similar arrangements for the introduction of competition in electricity. The Tribunal recently has put in place detailed arrangements for retail prices in electricity, with a series of regulated default tariffs applying to 2004.

Following extensive consultation with AGL Retail Energy and a range of key stakeholders, the Tribunal has negotiated voluntary pricing principles that will provide for default tariffs for residential and small business gas consumers in New South Wales. Importantly, at least up to 2004, while new gas retailers may be able to win new business with competitive offerings, no consumer will be forced to move away from existing retail tariffs. Furthermore, these default tariffs will be constrained in terms of any price increases. Annual bills for the same amount of gas consumption as the previous year will be limited to increases of \$15 or 3 per cent above the inflation rate, whichever is the greater.

The Tribunal believes it is important that competition is introduced in such a way that new retailers are able to compete effectively in the market. At the same time, the Tribunal believes that those customers who may be less likely to benefit from competition, at least in the early days, are not disadvantaged. This decision will protect consumers from any possible price shocks as the competitive gas market unfolds.

One area in which the Tribunal will need to be especially vigilant is in relation to the costs of introducing contestability. The Tribunal has agreed that prudent costs necessarily incurred in introducing contestability may be passed on to customers. This is consistent with Government policy. The Tribunal will do what it can to ensure that any such costs are prudent.

Thomas G Parry
February 2001

EXECUTIVE SUMMARY

This report presents the Independent Pricing and Regulatory Tribunal's (the Tribunal's) decision on the regulatory arrangements for gas prices charged by AGL Retail Energy (AGLRE) using the AGL gas networks in NSW. It sets out the Tribunal's approach to regulating the prices AGLRE charges its tariff customers during the transition to full contestability.

Competition and regulation in the NSW gas market

The NSW government is progressively introducing competition into the natural gas market. Market reforms have enabled new suppliers to enter the gas retail market, and larger volume users have become eligible to choose their gas retail supplier. Full retail contestability is scheduled to commence on 1 July 2001, when residential and small business gas customers will also be able to choose their supplier.¹

In December 2000, the Government issued its policy framework to support full retail competition in gas.² As part of this framework, the Tribunal is responsible for:

- the administration of retail price regulation in the tariff market under the Gas Supply Act
- the authorisation (licensing) of gas retailers and network operators from November 2000
- monitoring compliance with retail price regulation, authorisation conditions and customer protection regulations.

The Government's policy framework also provides for the Tribunal to establish 'default tariffs' during the transition to full retail competition. The purpose of default tariffs is to protect customers who:

- are already connected to gas, and therefore need assurance that they will not be stranded with gas appliances but no gas retailer
- do not have a choice of retailer, or who do not consciously exercise a choice of retailer
- no longer have a retail contract because their retail supplier has ceased to trade
- otherwise may not benefit from a competitive market.

All NSW tariff market customers (eg households and small businesses) will have the option of remaining on default tariffs.

In establishing default tariffs, the Tribunal has considered its duties and obligations under the Gas Supply Act. These are to encourage competition and to take account of the interests of customers and AGLRE. In particular, it aimed to meet the following objectives:

- to fulfil the purpose of default tariffs (as outlined above)

¹ While tariff market customers who use only a small amount of gas were originally scheduled to become contestable from July 2000, procedures and systems to support full contestability are unlikely to be in place until the second half of 2001.

² NSW Ministry of Energy and Utilities, *Policy Framework for Full Retail Competition in Gas*, 21 December 2000.

- to provide a smooth transition to a competitive market, and enable retailers and customers to have confidence in the competitive market
- to strengthen the incentives for AGLRE to operate efficiently
- to facilitate implementation and minimise the costs of regulation.

The Tribunal believes that, to encourage competition, regulated or default tariffs must reflect the costs of gas supply and operate in a 'neutral' manner in the competitive market. That is, they should not be set artificially high, so they encourage customers to switch retailer but disadvantage those less able to participate in the contestable market. Nor should they be set artificially low, so competing retail suppliers find it difficult to offer a more attractive service and competition is hindered. The Tribunal's primary objective for this review was to ensure that existing tariffs move towards cost-reflective levels, while protecting customers from undesirable price shocks.

The Tribunal's draft decision and subsequent developments

The Tribunal released a draft decision on the regulation of prices charged to tariff customers by AGLRE in May 2000. At that time, it believed some form of regulation of tariff market prices was appropriate in the lead up to effective competition. It proposed taking a 'light handed approach' by establishing a set of Voluntary Pricing Principles (VPPs) rather than issuing a gas pricing order. It believed such an approach would effectively protect customers' interests until competition was established, and would also minimise regulatory costs and encourage the development of competition.

Since the release of this draft decision, the Tribunal has reviewed its proposals in light of the feedback it received from interested parties, as well as a range of other factors. These include:

- the removal of the Price Control Formula from AGLRE's authorisation in June 2000 to enable AGLRE to pass through the net cost of the Goods and Services Tax³
- the release of the NSW Government's policy framework to support full retail competition in gas, which clarified the Tribunal's role in the competitive market and the role and objectives of default or regulated tariffs
- the Tribunal's review of regulated retail prices for electricity in NSW
- additional analysis it undertook on AGLRE's current tariffs and future costs, which shows that:
 - current tariffs are not cost reflective
 - over 70 per cent of its residential customers (including pensioners) are not meeting the cost of supply, particularly low volume users
 - most industrial and commercial tariff customers are profitable, with the exception of a limited number of low consumption customers
- additional analysis (which reinforced the difficulties of implementing average price setting⁴) and an investigation of alternative forms of regulation in the context of a competitive market.

³ Since then, tariff market prices have been regulated under interim voluntary price principles, agreed between AGLRE and the Tribunal, and largely based on the approach and parameters set out in the Tribunal's draft decision.

Tribunal's decision

The Tribunal still favours a 'light handed approach' during the transition to competition as a means of protecting customer interests while minimising regulatory costs. It has therefore decided to establish default tariffs through a set of VPPs, in line with its draft proposal. However, it will monitor the impact of the VPPs and the development of competition, and will consider issuing a gas pricing order if it believes this is necessary.

The Tribunal has also decided that AGLRE will have responsibility for setting the default tariffs. However, these tariffs will be subject to limits to price increases set by the Tribunal to manage the impact on individual customers over time and to the Tribunal's final approval. The approved tariffs will then form the VPPs.

The default tariffs will apply only to smaller customers in the tariff market—that is, to those residential, commercial and industrial customers who consume less than 1 TJ per annum (approx \$12,000pa)—as the Tribunal believes its role of protecting customers is more relevant to these smaller customers.

The default tariffs will apply until 30 June 2004, in line with default tariffs in the electricity market.⁶ However, given the uncertainty about some of AGLRE's cost components, the Tribunal intends to undertake a mid-term review of the VPP arrangement. This review will be conducted from 2002 or, under special circumstances, either at the request of AGLRE or the discretion of the Tribunal.

The Tribunal believes that these arrangements are an improvement on those proposed in its draft decision. They are transparent, and are easy to understand and administer. Most importantly, the Tribunal believes that they will ensure that tariffs will move to cost-reflective levels, while protecting customers from undesirable price shocks.

Content of the VPPs

The final VPPs (including the tariff plan) agreed between the Tribunal and AGLRE, will apply from the date they are released until 2003/04, subject to a mid-term review. They will focus on the following key objectives:

- maintaining existing tariffs for tariff market customers using less than 1 TJ, until 2003/04, as default tariffs
- allowing customers to return to default tariffs after testing the market
- setting limits on price increases for default tariffs to 2003/04
- allowing AGLRE to pass through to customers prudent costs associated with implementing full retail contestability
- implementing tariff plans as agreed with AGLRE
- defining information requirements to assist the Tribunal to monitor prices and market developments.

⁴ In particular, that a fluctuating default customer base, and therefore cost of supply, would make average price setting and regulatory compliance problematic.

⁵ In particular, that a fluctuating default customer base, and therefore cost of supply, would make average price setting and regulatory compliance problematic.

⁶ The NSW government has indicated that default tariffs will apply in the electricity sector until, at least, 2003/04.

Price limits

On the basis of the Tribunal's cost and profitability analysis, AGLRE and the Tribunal have agreed to limit the amount by which the bill of any individual *residential customer* (including pensioners) can increase. The bill of such customers will not exceed the bill for the preceding financial year (for the same pattern and volume of gas consumption) by more than \$15 or 3 per cent above CPI, whichever is the greater. These price limits are better from the customers' point of view when compared to the draft decision and the previous arrangements under the price control formula (which limited price increases to \$20 or 5 per cent above the CPI, whichever is greater).

Contestability costs will be excluded from the price limits (see below).

Default tariffs for industrial and commercial customers will not be subject to any price limits. The Tribunal believes that the competitive market will impose sufficient pressure to ensure that these customers are protected from 'price shocks'. However, the Tribunal will monitor the market to ensure that competition is effective and will issue a gas pricing order, pursuant to section 27 of the Gas Supply Act, if it believes this is necessary.

Tariff plan

AGLRE's current residential tariffs are not cost reflective and most residential customers do not pay for the cost of their gas supply. To move tariffs towards cost reflectivity while providing customers with reasonable certainty, the Tribunal and AGLRE have agreed on a tariff plan for default tariffs for residential, industrial and commercial customers. This plan sets out price movements for the period to 2003/04; however those beyond 2002 are indicative only, as they are subject to the mid-term review.

The price movements are based on analysis of the cost of supply that incorporates:

- the field price of gas, in line with AGLRE's contracts (including provisions for escalation)
- haulage costs, consistent with AGLRE's current contractual obligations
- network costs, including trunk and metering, in line with access arrangements
- retail costs, in line with competitive industry benchmarks, established in the Tribunal's investigation of the electricity sector.

The tariff plan is designed to achieve cost reflectivity by June 2004. In line with the Tribunal's tariff profitability analysis, customers with lower levels of consumption will experience higher rates of change (as they do not meet the costs of supply), while customers with higher consumption levels will experience lower rates of change.

The Tribunal believes, given that the tariff plan is based on the costs of supply, that the default tariffs arising from the plan will operate in a 'neutral' manner in the competitive market. It also believes that the tariff plan adequately balances the need for AGLRE and other new retailers to be placed on a similar competitive footing, and for customers to avoid undesirable price shocks.

Contestability costs

The Tribunal has considered the issue of contestability costs separately, given that the exact magnitude of these costs is not clear at this time. It has decided that:

- increases in tariffs due to the recovery of retail contestability costs will fall outside the price constraints
- the method of recovery (ie, who should pay, how, and when) will be considered by the Tribunal when costs are more certain.

Other issues

Miscellaneous charges

After considering submissions, the Tribunal has decided to include miscellaneous fees and charges within the VPPs. AGLRE has agreed that it will obtain the Tribunal's approval for any changes in these fees over the four years to 2004.

The Tribunal acknowledges AGLRE's initiative in developing and implementing a waiver policy on late payment fees for customers who face financial difficulties. AGLRE has agreed to report to the Tribunal on the outcome of implementing this policy.

Pensioners rebates

AGLRE intends to voluntarily increase rebates to pensioners by \$5 to \$19 a year from 1 March 2001. The Tribunal notes Government policy may overtake AGLRE's proposal.

1. INTRODUCTION

The Independent Pricing and Regulatory Tribunal of New South Wales (the Tribunal) has completed its review of the prices AGL Retail Energy (AGLRE) can charge its tariff customers for natural gas from the AGL Gas Networks in NSW for the period 2001 to 2004. This review was undertaken in the context of the progressive introduction of competition into the NSW natural gas retail market. Thus, this report sets out the Tribunal's approach to regulating the tariff market as it moves towards full contestability.

1.1. Review process

In May 1998, the Tribunal began a review of the delivered price of natural gas for tariff customers served from the AGL gas network in NSW. In accordance with the processes set out in section 32(2) of the Act and Part 4 of the *Independent Pricing and Regulatory Tribunal Act 1992*, it released an issues paper on tariff regulation and called for submissions from interested parties.

The Tribunal resolved to postpone its determination until after its review of AGL Gas Network's (AGLGN's) Access Arrangement, as the results of this review would have a significant impact on gas transportation prices, which are the major component of the delivered price of gas to the tariff market.

The Tribunal issued its draft decision on AGLGN's Access Arrangement in October 1999,⁷ and its final decision in July 2000. It then issued its draft decision on the delivered price of gas for the tariff market in May 2000, and called for submissions from interested parties.

The Tribunal considered the matters raised in these submissions, and reviewed its proposals in light of developments towards retail competition in the gas sector and its investigation on the electricity sector before reaching its final decision.

1.2. The Tribunal's decision

The Tribunal has decided to establish default tariffs⁸ through a set of Voluntary Pricing Principles (VPPs) agreed between it and AGLRE. These default tariffs will apply to small customers only—that is, to residential, industrial and commercial customers who consume less than 1 TJ of gas per year. All customers within this category will have the option of remaining on (or returning to) default tariffs during the term of this decision.

The Tribunal's overall objective for the default tariffs is to move tariffs towards cost reflective levels while protecting customers from price shocks. It has decided the best way to achieve these objectives is through a process whereby AGLRE proposes a tariff plan, subject to side constraints set by the Tribunal and with regard to the costs of supply. The tariff plan is also subject to the Tribunal's final approval, and once approved, will be incorporated into the VPPs.

The Tribunal has decided that price limits will apply to movements in default tariffs paid by residential customers only. The Tribunal and AGLRE have agreed that the annual bill of

⁷ IPART, *Draft Decision, Access Arrangement for AGL Gas Networks Limited, Natural Gas System in NSW*, October 1999.

⁸ Default tariffs are regulated tariffs to protect customers as the gas market is opened to competition.

any residential customer (including pensioners) will not exceed the bill for the preceding financial year (for the same pattern and volume of gas consumption) by more than \$15 or 3 per cent in real terms, whichever is greater.

The Tribunal has also decided that price increases to cover the costs associated with the transition to retail contestability in the gas market will fall outside the above price constraints, and that it will consider the mechanism for recovering these costs when they can be estimated with more certainty.

Finally, the Tribunal has decided to regulate AGLRE's miscellaneous charges through the VPPs.

1.3. Term of decision and mid-term review

The VPPs will apply from the date on which they are released until 2003/04. This is a longer period than was proposed in the Tribunal's draft decisions. Since the draft was released, the NSW government has indicated that default tariffs will apply in the electricity sector until 2003/04 (and may extend beyond that time subject to further review). In the interests of consistency, the Tribunal has decided that default tariffs will apply in the gas sector for the same period.

Due to the uncertainty about some of AGLRE's cost components, in particular the costs of haulage and of introducing full retail contestability, the Tribunal intends to undertake a mid-term review of the VPPs. This review will be conducted from 2002 (or under special circumstances, either at the request of AGLRE or the discretion of the Tribunal). The Tribunal will consider matters such as:

- additional costs as a result of differences between the CPI exclusive of GST and the actual escalation of AGLRE's costs
- changes in AGLRE's cost components, such as the field price of natural gas or impacts of regulatory decisions on haulage rates
- any decision on consumption profiling that deems a profile other than the market profile that has been used for cost allocation
- changes in market circumstances that the Tribunal believes warrant a review of the VPPs.

1.4. Structure of this report

This report explains the Tribunal's final decision and the rationale behind it in more detail. It sets out:

- the background to the review, and the role of regulation during the transition to competition
- the Tribunal's draft decision and subsequent developments, including matters raised by interested parties
- its final decision and the basis of that decision
- the outcomes and price implications of its decision.

In addition, it includes a number of appendices that provide information on matters that the Tribunal considered during its deliberations.

2. COMPETITION AND REGULATION IN THE NSW GAS MARKET

The NSW government is progressively introducing competition into the natural gas market. In the lead up to and early stages of competition, however, the incumbent retailer AGLRE will still be dominant and have an effective monopoly in some regions or customer segments. For this reason, the Tribunal has an important role to play in regulating the prices AGLRE can charge during this transition period. This chapter provides the context to this review, including an outline of the gas retail market in NSW and the introduction of competition into this market, the Tribunal's role, duties and powers in this market, and the objectives of default tariffs.

2.1. The gas retail market in NSW

Until fairly recently, AGL was a monopoly supplier of gas in NSW⁹ and operated as a bundled distribution and retail business. In August 1997, an Access Arrangement was put in place for AGL, establishing AGLGN as a ring-fenced gas distribution business and putting in place a third party access regime.¹⁰ This access to AGLGN's pipelines and other market reforms have enabled new retail suppliers of gas¹¹ to enter the NSW market and compete for customers.

At the same time, AGL established two separate retail businesses: AGLRE which retails natural gas to *tariff* customers in NSW, and AGL Wholesale which retail natural gas to *contract* customers:

- **Tariff customers** are those that consume less than 10 terajoules (TJ) of gas per annum. Within this category, there are low volume customers who use less than 1 TJ, or around \$12,000, of gas per annum. These customers are typically residential users, although they also include some industrial and commercial users. Large volume customers (who use between 1 and 10 TJ of gas per annum) are typically industrial/commercial users.
- **Contract customers** are those that consume more than 10 TJ of gas per annum. These customers represents less than 1 per cent of the total NSW gas customers, but account for around 75 per cent of gas consumed. Contract customers include hospitals, flour milling, brick manufacture and fertiliser production.

⁹ With the exception of gas distribution and retail in Albury and Wagga Wagga.

¹⁰ AGLGN's Access Arrangement provides operating procedures and rights in respect of third party access to the network.

¹¹ There are currently about 17 new entrants, including Citipower, Energex, EnergyAustralia, Integral Energy, Pulse Energy and TXU. Some are based within NSW and some based in other states, and most also operate in the competitive electricity market. (A full list of new entrants can be found on the Tribunal's website, at www.ipart.nsw.gov.au.)

This review is concerned only with the tariff market in NSW served by AGLGN's gas distribution network.¹² The Tribunal's decision applies only to the incumbent retailer, AGLRE.¹³

2.2. Introducing competition into the tariff market

Contestability is being introduced into the tariff market in stages. Large volume tariff customers became eligible to choose their supplier in October 1999. To date, however, few have moved away from AGLRE. Initially, this is believed to be due to uncertainty regarding network contestability costs, limitations on the availability of alternative sources of gas and some technical/contractual issues. At present, the main reason that is preventing these customers from choosing their own supplier is the lack of retail market systems necessary for the operation of the competitive market.

Low volume users were scheduled to become eligible to choose their supplier from July 2000.¹⁴ However, there have been delays in putting in place the necessary arrangements to support the operation of multiple retailers within a network or the transfer of customers between retailers. On 23 May 2000, the NSW Minister for Energy set out his expectations for the introduction of effective competition in the NSW gas retail market. He sought a commitment from the industry that it would implement the retail market systems needed to support full retail competition from 1 July 2001.¹⁵

While the 1 July 2001 deadline is in advance of other States' gas contestability timetables,¹⁶ and the current NSW electricity contestability timetable,¹⁷ the current progress appears to indicate that the necessary systems will be in place in the second half of 2001.

2.3. The Tribunal's role, duties and powers

In December 2000, the NSW Ministry of Energy and Utilities (MoEU) issued the Government's policy framework to support full retail competition in gas.¹⁸ As part of this framework, the Tribunal's responsibilities have been defined as follows:

- administering retail price regulation
- authorising (licensing) gas retailers and network operators from October 2000
- monitoring compliance with retail price regulation, authorisation conditions and customer protection regulations.

¹² There are also several small gas distribution networks including those owned by Envestra Limited and Great Southern Energy Networks.

¹³ The Tribunal has already completed reviews of how retail gas prices should be regulated for small gas consumers in the distribution areas of the two smaller incumbent retailers in NSW (Great Southern Energy and Origin Energy) for the period until 1 July 2001. See IPART, *Review of the Delivered Price of Natural Gas in Wagga Wagga and Albury*, February 2000, for further details. The Tribunal intends to review these in consultation with interested parties. The Tribunal has no responsibilities in relation to default tariffs for new entrants.

¹⁴ On 1 July 2000 third party access rights to NSW transmission pipelines and networks were extended to apply to retailers wanting to transport gas to customers below 1 TJ.

¹⁵ NSW Ministry of Energy and Utilities, *Policy Framework for Full Retail Competition in Gas*, 21 December 2000, p 6.

¹⁶ For example, Victorian residential customers are scheduled to be contestable from 1 September 2001.

¹⁷ All electricity retail customers are scheduled to become contestable by 1 January 2002.

¹⁸ NSW Ministry of Energy and Utilities, *Policy Framework for Full Retail Competition in Gas*, 21 December 2000.

In relation to retail price regulation, the Tribunal will continue to be responsible for prices to tariff customers, and will continue to regulate under the Gas Supply Act. Under Section 27 of this Act, the Tribunal may make a gas pricing order at any time. Essentially, a gas pricing order can:

- establish a methodology for setting tariff prices for delivered gas
- establish maximum tariffs or maximum average tariffs
- prohibit the imposition of certain charges.

Section 32(1) of this Act empowers the Tribunal to conduct investigations that enable it to exercise its functions under the Act. An investigation must be consistent with the Act's statutory objectives. The objectives of the Act are listed in section 3(1) and are:

- (a) 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 contained in section 6 (2) of the *Protection of the Environment Administration Act 1991*, and
- (b) to regulate gas reticulation and gas supply, so as to promote customer choice in relation to gas supply.

In carrying out its functions, the Tribunal must fulfil the duties detailed in sections 3(4) and 3(5) of the Act, which are:

- 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.

In addition, retailers are required by authorisation conditions not to impose charges on a tariff customer otherwise than in accordance with any relevant gas pricing order.¹⁹

The Tribunal can also regulate retail gas prices by voluntary pricing principles (VPPs). This is a light handed and less formal approach to fulfil the duties required by the Act although it is not specifically provided for in legislation.

¹⁹ Subject to any other condition imposed on the retailer's authorisation with respect to the implementation of government policy on community service obligations to tariff customers.

2.3.1. Current regulatory arrangements

Before July 2000, AGLRE's prices were regulated using a price control formula (PCF).²⁰ This PCF established a maximum average tariff price (MATP) per GJ of gas that AGLRE could charge tariff customers. AGLRE's authorisation required it to take all reasonable steps to ensure that the actual average tariff price (ATP) per GJ did not exceed the MATP.²¹

The PCF was removed from AGLRE's authorisation in June 2000, largely because it would not allow AGLRE to pass through the net cost of the goods and services tax (GST) to customers. Furthermore, there were practical difficulties in applying the PCF under a competitive gas retail market.

Currently, tariff market prices are regulated under interim voluntary price principles (VPPs), agreed between AGLRE and the Tribunal. These are based on the approach and parameters set out in the Tribunal's draft decision. All NSW tariff market customers (eg households and small businesses) have the option of remaining on the regulated or default tariffs. In addition there are a number of obligations and price constraints relating to tariff setting by AGLRE.

2.3.1.1. Standing charges and minimum fees

AGLRE's authorisation currently requires it to obtain the Tribunal's approval of any change to its minimum bills/standing charges²² (that is, the fee charged to supply the gas service).

In November 2000, AGLRE sought the Tribunal's approval to introduce and vary standing charges and/or minimum bills applicable to non-default tariffs.²³ Non-default tariffs are alternatives to default tariffs that are negotiated between AGLRE and customers. The Tribunal approved AGLRE's application. The requirement for Tribunal approval regarding minimum bills/standing charges relating to default tariffs continues to apply.

2.3.1.2. Pensioner rebates

AGLRE is required to provide a discount to pensioner concession cardholders.²⁴ The amount of this concession is currently \$3.50 per quarter, or \$14 per annum.

²⁰ The PCF was established as part of AGLRE's authorisation granted under the *Gas Supply Act, (NSW) 1986*. It continues to have effect under cl3(1) and 3(3) of schedule 2 of the savings and transitional provisions under the Act.

²¹ A detailed explanation of the PCF is contained in Appendix 5 of the Tribunal's draft decision.

²² The standing charge was introduced in 1995, when the former Gas Council agreed to replace the minimum bill and block rate structure with a two part fee structure – a standing charge and a dollar per megajoule charge (commodity charge).

²³ Default tariffs are regulated tariffs whereas non-default tariffs as offered by retailers in a competitive market are not subject to price regulation.

²⁴ Section 11(4) of the Act permits the Minister to impose a condition on a gas supplier's authorisation requiring the supplier to implement the Government's community service obligations policy. Section 11(4) of the Act also requires the Government to fund these rebates, amendments to the Act in July 1997 deferred this obligation until the Tribunal issues a gas pricing order. A gas pricing order has not been issued.

2.3.2. The Tribunal's role in the transition to a competitive market

The Tribunal's role will change with the introduction of competition in the retail market. Essentially, AGLRE will have a monopoly over the retail supply of gas to tariff customers until the necessary retail market systems for full retail competition are operational. The Tribunal's role during this transition period is to ensure that AGLRE does not use its dominant market power to earn excessive profits from tariff customers, to lower its service standards, or to prevent the development of effective competition.

Once effective competition is established, market forces should ensure that suppliers provide services of the quality demanded by customers, and that they do not earn excessive profits. The Tribunal's ongoing role will therefore have less focus on preventing AGLRE from earning excessive profits.

However, the Tribunal considers that effective competition is likely to take some time to develop due to AGLRE's market dominance.²⁵ The extent of competition, the likely impact on prices and services, and the likely delivery time of the benefits from competition cannot be predicted with any degree of certainty.

This is consistent with the NSW government's view:

It will take time for retail competition in gas to take full effect. In the meantime, retailers could exercise undue market power in a way that could lead to monopoly pricing behaviour. There is also potential for reductions in service levels or discontinuance of supply to customers in vulnerable market segments. Therefore an appropriate level of retail price regulation is required to protect residential and small business customers until there are sufficient competitive pressures in the gas retail market.²⁶

To enable the Tribunal to protect customers' interests in the transition from monopoly provision to effective competition in the gas market, the Government's policy framework provides for the Tribunal to establish 'default tariffs'. Default tariffs are to be incorporated in default customer supply contracts,²⁷ for the following types of customers, under the following circumstances:

- for a transitional period,²⁸ customers using less than 1 TJ of gas annually, whose premises are physically connected to a network at 1 July 2001²⁹

²⁵ See the Tribunal's draft decision for a summary of its analysis on the likely effectiveness of competition in the gas tariff market.

²⁶ NSW Ministry of Energy and Utilities, *Policy Framework for Full Retail Competition in Gas*, 21 December 2000, p 16.

²⁷ The Tribunal understands that MoEU will introduce default service contracts by regulation. These contracts will include minimum service conditions, which is a similar approach to electricity.

²⁸ This is to be reviewed within two years.

²⁹ The MoEU notes in its policy framework paper that "[t]he obligation to offer a default supply contract will extend to premises physically connected after 1 July 2001. The costs of new physical connections may be paid directly by the customer by contracting separately for the connection to be made, or paid by the retailer and recovered through an initial supply contract over a certain period. The obligation to offer a default supply contract will not apply to new customers whose premises are being physically connected for the first time and where the connection costs are to be recovered through the initial supply contract. On expiration or termination of the initial supply contract the customer will then be able to choose to be supplied under a default supply contract. However, if the customer pays separately for the physical connection, the customer would immediately be eligible for a default supply contract."

- customers who do not have a choice of retailer, or who do not consciously exercise a choice of retailer.

In addition to these customer protection mechanisms, MoEU has proposed to implement a retailer of last resort scheme. MoEU's current proposal is that the retailer of last resort, as a default service provider, would be required to offer supply at no more than the default tariff set by the Tribunal.³⁰ The Tribunal notes that this government policy is currently under consultation.

2.4. Objectives of default tariffs

Default tariffs, as part of the default supply contract, have four objectives:

- to protect customers who are already connected to gas, by ensuring that they will not be stranded with gas appliances but no retailer
- to protect customers who do not have a choice of retailer, or who do not consciously exercise a choice of retailer
- to protect customers who face an elapsed retail contract due to default by the retailer
- to protect customers who otherwise may not benefit from a competitive market.

These objective are consistent with those of the default tariffs established for the electricity sector and will provide time for small customers to consider their options.³¹

In setting default tariffs, the Tribunal will also need to adhere to its duties under the *Gas Supply Act 1996*, which, as noted above, range from ensuring that the public receives the benefit of a competitive gas market to taking proper account of the business interests of persons supplying gas to the tariff market.

It is important to note that default tariffs do not restrict AGLRE's ability to offer competitive products and prices, on unregulated terms, in the competitive market.

³⁰ NSW Ministry of Energy and Utilities, *Default supply contracts and pricing in the fully competitive gas retail market*, Issues Paper, 12 December 2000, p 9.

³¹ During the period of transition to full retail competition in the NSW electricity market, 'default tariffs' will protect small retail customers that:

- are not yet entitled to choose a retail supplier
- need time to make an informed choice about which retail supplier supplies their electricity
- may not be in the best position to negotiate a competitive deal
- no longer have a negotiated contract because their retail supplier has ceased to trade.

3. THE DRAFT DECISION AND SUBSEQUENT DEVELOPMENTS

3.1. Proposals in the draft report

The Tribunal released a draft decision on the regulation of prices charged to tariff customers by AGLRE in May 2000. At that time, it believed some form of regulation of tariff market prices was appropriate in the lead up to effective competition. It proposed taking a 'light handed approach' by removing the price control formula from AGLRE's authorisation and replacing it with a set of Voluntary Pricing Principles (VPPs). It believed such an approach would effectively protect customers' interests until competition was established, and would also minimise regulatory costs and encourage the development of competition.

The key elements of the proposed VPPs were:

- continuing to make existing tariffs available for all tariff market customers until the end of 2001 (default tariffs)
- where the price structure remained the same, limiting the increase in any default tariff from 1 July 2000 to the annual inflation rate (CPI). This price cap did not take the effects of the GST package into account
- allowing default tariffs for residential and commercial/industrial customers to be restructured provided that:
 - the increase in the average tariff for the particular customer class was capped at CPI
 - tariff increases for residential customers did not to exceed \$20 or 5 per cent in real terms per annum, whichever was greater
- providing new information to assist the Tribunal in monitoring prices
- continuing pensioner discounts.

The Tribunal also proposed a further review of the tariff market in the second half of 2001. In the lead-up to this review, the Tribunal signalled that it would continue to monitor prices and tariff market developments, and would consider issuing a gas pricing order if necessary.

3.2. Developments since the draft report

Since its draft decision was released, the Tribunal has reviewed its proposals in light of the feedback it received from interested parties. (A list of the submissions it received is provided in Appendix 5, and a summary of the issues raised is set out in Appendix 6.) It has also taken into account a range of developments and changes which have occurred in the market. These include:

- the removal of the price control formula from AGLRE's authorisation in June 2000 to enable it to pass through the net cost of Goods and Services Taxes³² (discussed in section 2.3.1)

³² Since then, tariff market prices have been regulated under interim voluntary price principles, agreed between AGLRE and the Tribunal, and largely based on the approach and parameters set out in the Tribunal's draft decision.

- the release of the NSW Government’s policy framework to support full retail competition in gas, which clarified the Tribunal’s role in the competitive market and the role and objectives of default or regulated tariffs (discussed in section 2.3)
- the Tribunal’s review of regulated retail prices for electricity in NSW
- additional analysis it undertook on AGLRE’s current tariffs and future costs
- additional analysis and further investigation into the various forms of regulation in the context of a competitive market.

3.2.1. The Tribunal’s review of regulated prices in the electricity sector

In December 2000 the Tribunal completed a review of regulation in the NSW electricity market during the transition to full retail competition in that sector.³³ It recommended that small retail electricity customers³⁴, regardless of their circumstances, should be able to choose to pay a regulated retail tariff for electricity, and that these tariffs should, where possible, adequately recover the efficient cost of supplying electricity to those customers.

Because there are more than 500 existing regulated retail tariffs in NSW—with different levels of profitability—the Tribunal established a process by which each existing retail tariff will increase or decrease gradually until it reaches a cost-reflective or ‘target’ level. It also recommended constraints on the amounts by which tariffs can move towards the relevant target levels per year, and that some regulated retail tariffs not be able to increase at all. Essentially these constraints limit price adjustments to no more than CPI or \$25 a year (whichever is greater).

The Tribunal recognises that a consistent approach to regulation in the gas and electricity sectors is desirable, and is mindful of the regulatory costs. Indeed this is a NSW government objective:

As far as is possible and practical, the Government intends to ensure that competitive arrangements and regulation in the gas and electricity markets converge as much as possible. This approach will take into account the similarities and differences between the gas and electricity industries in NSW.³⁵

However, this does not imply that regulation should be *identical* in the two sectors as:

- competition in the two markets are developing from very different historical bases³⁶
- the Tribunal’s regulatory powers differ in gas and electricity³⁷

³³ On 14 July 2000 the Acting Premier sought the assistance of the Tribunal in relation to regulated retail electricity prices for franchise and eligible default customers to apply from 1 January 2001 to 30 June 2004. This assistance was provided under section 9 of the *Independent Pricing and Regulatory Tribunal Act 1992*. The Tribunal delivered a final report on 27 December 2000. See IPART, *Regulated retail prices for electricity to 2004*, Final Report, December 2000. This report, which contains the Tribunal’s recommendations to government, is available on IPART’s website: <http://www.ipart.nsw.gov.au/pdf/S9-4.pdf>

³⁴ Including small retail customers who move premises or change retailers.

³⁵ NSW Ministry of Energy and Utilities, *Policy Framework for Full Retail Competition in Gas*, 21 December 2000, p 6.

³⁶ For example, long-term contracts, non-franchise supply, and private ownership are typical of the NSW gas market, while government ownership, franchise supply, and shorter term contracts are dominant in the NSW electricity market.

³⁷ In the gas market, the arrangements are such that the ‘threat of regulation’ has ‘teeth’— via the introduction of a gas pricing order, unlike the arrangements in the electricity market.

- the operating environments of the two industries are not identical (although they are converging).³⁸

Nonetheless, the desire for compatibility (where appropriate) has led the Tribunal to review aspects of the proposals in the draft report, including the rights of customers and obligations of suppliers.

3.2.2. Further analysis on AGLRE's current tariffs and future costs

The Tribunal believes that for competition to be effectively established in the gas retail market, regulated tariffs must reflect the cost of gas supply wherever possible in the lead up to and during full retail competition. If default tariffs are set below economic costs, competing retail suppliers may not be able to offer a more attractive service and competition may be hindered. Similarly, if regulated tariffs are set significantly above the economic cost of supply, this may 'promote' competition but will disadvantage customers who are less able to participate in the contestable market.

Given this belief, the Tribunal felt it needed to better understand the current and future cost reflectivity of AGLRE's existing tariffs, and so undertook further cost analysis. It analysed AGLRE's tariffs on the basis of the following costs:

- the field price of gas, consistent with AGLRE's contractual obligations, including provisions for escalation
- current haulage (transportation) costs for the use of Moomba-Sydney pipeline system. (Based on information provided by AGLRE, these costs increased by more than the CPI from July 2000³⁹)
- network costs (that is, local distribution pipeline and metering), consistent with the network tariffs in AGLGN's revised access arrangement
- retail costs consistent with the outcomes of the Tribunal's recent investigation in the electricity sector of \$40-\$60 per customer
- a net retail profit margin of 2-3 per cent.⁴⁰

It also looked at how these costs are likely to increase in the future. It found they are largely expected to change in line with CPI. The main exception is network charges, which are expected to decline by CPI-1%. In addition, there is considerable uncertainty in relation to:

- the future field price of natural gas paid by AGLRE
- the impact of the Australian Competition and Consumer Commission's pending decision on EAPL's haulage rates, paid by AGLRE to transport gas from the Cooper Basin

³⁸ For example the NSW government intends to establish a 'tariff equalisation fund' in the NSW electricity market, which means that the government bears the risk of changes in the cost of electricity purchases (rather than the utility or the customer).

³⁹ At present, haulage cost for the use of the Moomba-Sydney Pipeline System is charged according to a Gas Transportation Deed between the Australian Pipeline Trust and AGL Wholesale Gas Limited (AGLWG). AGLWG charged AGLRE (serving tariff customers) and AGL Energy Sales and Marketing Ltd (serving contract customers) in accordance with capacity reservation, forecast volume and pricing provisions in the Deed.

⁴⁰ AGLRE's net profit margin is estimated as about 2 per cent for the tariff business overall (ie all customers using less than 10 TJ per year).

- the size and nature of systems costs imposed on the gas network business due to the introduction of full retail contestability
- the impact of the profiling method chosen for the market, particularly with respect to cost allocations.

The Tribunal also considered future costs AGLRE is likely to incur as a consequence of the introduction of full retail competition. It found there is too much uncertainty to estimate these costs accurately at this time but acknowledges that the transition to competition may give rise to further unforeseen changes in costs. This uncertainty should be accommodated in the form of regulation.

The profitability analysis of each of AGLRE's current tariffs, for different consumption levels and given efficient forward looking costs, shows that:

- current tariffs are not cost reflective
- over 70 per cent of residential customers (including pensioners) are not meeting the cost of supply
- for the residential general and residential economy tariff, low consumption customers (less than 1 TJ per year) have a negative margin, while higher consumption customers are marginally profitable. This trend is exaggerated for the pensioner tariffs.
- most industrial and commercial tariff customers are profitable, with the exception of a limited number of low consumption customers in Newcastle and the Lower Hunter.

This analysis suggests that some restructuring of AGLRE's tariffs is needed for all tariffs to be cost reflective, particularly those for low volume users. Furthermore, given the expected future movements in costs and the current low profit margin, the Tribunal would expect a modest increase in the level of tariff revenue over the next few years. The Tribunal expects that for the majority of customers, increases of CPI are necessary. However, it acknowledges that there are circumstances where increases of more than CPI⁴¹ are needed to move tariffs toward cost recovery.

The Tribunal's analysis, and results of this analysis, are discussed in more detail in Appendix 1 and 2 of this report.

3.2.3. Further investigation of the form of regulation

The Tribunal has undertaken further analysis of the role and implementation of regulation in a market that is opening to competition. This analysis reinforced the difficulties of implementing the average price cap form of regulation, and assessed the advantages and disadvantages of three alternative forms of regulation.

3.2.3.1. Problems with the average price cap approach

There are two basic problems with an average price cap approach. The first stems from the fact that, as competition matures, AGLRE's customer base will fluctuate in terms of customer types, numbers and volumes. A fluctuating default customer base, and therefore a fluctuating cost of supply, will make average price setting and regulatory compliance problematic. To overcome this difficulty, regulatory controls would need to be set on a

⁴¹ Excludes recovery of retail contestability costs.

regular and frequent basis (say, every 12 months), or a specific default customer base would need to be deemed to be in place (for example, the default customer base that was in place in the previous financial year).

However, both these solutions also have shortcomings:

- Regular regulatory reviews will make it difficult for customers (and retailers) to understand how tariffs are derived and how they will change over time, thus making it difficult for them to assess the reasonableness of competitive offers. This situation is unlikely to promote competition or to protect customers. The direct cost of administering such an arrangement is also likely to be prohibitive. Frequent reviews are therefore unlikely to be realistic.
- An average price cap with a deemed customer base also has problems. After the first period in which a deemed customer base is in place, the price constraints are likely to be the effective control rather than the average price cap itself. For example, if AGLRE's high gas users switch to alternative suppliers, then AGLRE can easily meet any price constraint by offering reductions to the 'phantom' high users in its deemed customer base. Hence, it will only be the price constraints which are the binding control.

In addition, an average price cap approach would give AGLRE considerable discretion to allocate costs between customer groups and restructure tariffs in a way that could hinder competition. The approach can be problematic from the perspective that it gives rise to gaming opportunities.

For these reasons, the Tribunal has chosen to move away from the average price cap approach proposed in its draft decision.

3.2.3.2. Pros and cons of alternative forms of regulation

The Tribunal then assessed the relative merits of three alternative regulatory approaches:

- establishing a 'formula' to derive retail tariffs from the various cost components
- setting price constraints on the changes AGLRE can make to tariffs over time
- establishing a schedule of retail tariffs, derived either by the Tribunal or by AGLRE (with the Tribunal's approval).

The 'formula' approach would involve constructing a schedule of default tariffs from the individual cost components (such as cost of gas, haulage, reticulation, and retailing), incorporating specific assumptions about cost allocations where necessary. It can accommodate any uncertainties in future costs, as any change would be recognised by the tariff 'formula' and cost changes would automatically be incorporated into tariffs.

The Tribunal recently adopted this approach in its recommendations for default tariffs in the electricity market. One of its main advantages is that it ensures that default tariffs reflect the cost of supply, at any point in time, thus ensuring they operate in a 'neutral' manner in the competitive market. It is also fairly simple to understand and easy to administer, and requires regulatory intervention over the period it applies. Its main disadvantage, however, is that it may not provide a smooth transition to the competitive market, depending on how cost-reflective current tariffs are.

The price constraints approach is also simple to understand and administer, and ensures that individual customers are not subject to undesirable price shocks. Its main disadvantage is that it provides an incentive for the retailer to increase prices by the full amount of the price constraint (and thereby maximise revenue), which could result in some tariffs rising significantly above the cost of supply. The severity of this will depend on expected future movements in costs and the profitability of existing tariffs.

The schedule of tariffs has advantages that are similar to those of the price constraint and formula approaches. However, it may be perceived as more intrusive.

4. TRIBUNAL'S DECISION

The Tribunal still favours a 'lighter handed approach' during the transition to competition, as a means of protecting customer interests while minimising regulatory costs. It has therefore decided to establish default tariffs through a set of VPPs agreed between it and AGLRE, in line with its draft proposal. However, it will monitor the impact of the VPPs and the development of competition, and will consider issuing a gas pricing order if it believes this is necessary.

4.1. Coverage of regulation

The current regulatory arrangements in the NSW gas market cover the entire tariff market, which includes all residential, commercial and industrial customers who consume up to 10 TJ of gas a year (up to \$100,000 a year). However, the Tribunal has decided that the default tariff regime will apply *only to smaller customers*—that is, all residential and industrial customers consuming less than 1 TJ per annum (a bill of up to \$12,000 a year).

The Tribunal believes this is appropriate for several reasons. It considers its role of protecting customers is more relevant for smaller customers, as they are likely to be less sophisticated in their participation in the competitive market. It also believes that AGLRE's larger customers are more likely to be targeted by competitors in the early stages of the competitive market. In addition, the focus on smaller customers is consistent with the government's policy framework on the gas market. It is also consistent with the approach adopted in electricity, where default tariffs will apply to customers under 160MW per annum (a bill of around \$16,000).

This decision means that 99 per cent of residential customers will be covered by the regulation, and 90 per cent of industrial and commercial customers will be covered. The annual bill for a 1 TJ customer is around \$12,000.

4.2. The form of regulation

The Tribunal has assessed the three options for the form of regulation (discussed in section 3.2.3). It took into consideration its duties and obligations under the Gas Supply Act (which are to encourage competition and to take account of the interests of customers and AGLRE). In particular, it considered:

- meeting the objectives of default tariffs in relation to customer protection (discussed in section 2.4)
- providing a smooth transition to a competitive market, and enabling retailers and customers to have confidence in the competitive market
- promoting the incentives provided to AGLRE to operate efficiently
- facilitating implementation and minimising the costs of regulation.

Striking an appropriate balance between these objectives is not an easy task. Ultimately, however, the Tribunal believes that for competition to be successful in the gas retail market, it is critical that regulated or default tariffs reflect the cost of gas supply wherever possible, so that they operate in a 'neutral' manner. Therefore its primary objective was to ensure that

existing tariffs move towards cost-reflective tariffs in a way that protects customers from undesirable price shocks.

After weighing the advantages and disadvantages of the alternatives, the Tribunal decided the most appropriate approach is to adopt a process whereby AGLRE proposes a tariff plan, subject to the Tribunal's approval. In putting together its tariff proposals, AGLRE will be required to have regard to:

- the price constraints set by Tribunal to manage the impact on customers over time
- the cost parameters set out in section 3.2.2
- the objective to achieve cost reflectivity by 2003/04.

Prior to any tariff change, the Tribunal will assess the extent to which it has met these conditions before giving its approval. The approved tariffs will then form the VPPs.

The Tribunal believes that these arrangements are an improvement on those proposed in its draft decision. They are transparent, and are easily understood and administered. Most importantly, they will ensure that tariffs will move towards cost-reflective levels, while protecting customers from undesirable price shocks. They are also consistent with the Tribunal's recommendations for the electricity sector, albeit simpler given the reduced number of tariffs and retailers involved.

4.3. The content of the VPPs

A copy of the final VPPs, agreed between the Tribunal and AGLRE, is provided in Appendix 3 of this report. In summary, they focus on the following key objectives:

- maintaining existing tariffs for low volume tariff market customers until 2003/04 as default tariffs
- allowing AGL to pass through to customers prudent costs associated with implementing full retail contestability
- setting limits on price increases for default tariffs to 2003/04
- implementing tariff plans as agreed with AGLRE
- defining information requirements to assist the Tribunal to monitor prices and market developments.

4.3.1. Maintaining existing tariffs for low volume users as default tariffs

Default tariffs will be made available to all customers consuming under 1 TJ of gas, including residential, industrial and commercial customers. The Tribunal believes that customers should be able to remain with AGLRE and pay the regulated default tariff if they choose to do so. Similarly, customers who enter the contestable market and subsequently return to a regulated tariff should be able to be supplied on the basis of the same tariff as those who have remained on a regulated tariff. The Tribunal believes that this will provide for a smooth transition to competition.

4.3.2. Treatment of contestability costs

An issue that received considerable attention in submissions is the treatment of 'contestability costs'. These are the costs that will be incurred by retailers (and network service providers) as a consequence of the move to full retail competition in gas. They include costs related to:

- the provision of retail market services
- the establishment and operation of the Gas Retail Market Company⁴²
- the flow through of retail contestability costs incurred by the network service providers
- the establishment and operation of retailers' internal systems to integrate with the market business system.

The Tribunal notes that most of these costs are to be determined by the industry and will be recovered from market participants including AGLRE. However, AGLRE and AGLGN will have some discretion over their own systems that interface with the market system.

The Tribunal has considered the likely magnitude of these costs, including AGLRE's estimate. Components of retail contestability costs are outlined in Appendix 2. Because these costs are largely outside the control of AGLRE, and the exact magnitude of these costs is not clear at this time, the Tribunal has decided that:

- increases in tariffs due to the recovery of retail contestability costs will fall outside the price constraints
- the process for recovery of these costs will be similar to the policy contained in AGLGN's Access Arrangement, ie only efficient costs are to be recovered after an independent assessment
- the method of recovery (ie, who should pay, how, and when) will be considered by the Tribunal when costs are more certain.

4.3.3. Setting price limits

Default tariffs should be broadly cost reflective. AGLRE should be able to restructure prices subject to price constraints, and recover costs associated with implementing retail contestability, in addition to the price constraints.

On the basis of the Tribunal's cost and profitability analysis, AGLRE and the Tribunal have agreed to limit the amount by which the bill of any individual residential customer (including pensioners) can increase. The bill of such customers will not exceed the bill for the preceding financial year (for the same pattern and volume of gas consumption) by more than \$15 or 3 per cent in real terms, whichever is the greater.

These price limits will provide residential customers with greater benefits than either the draft decision or the previous arrangements under the price control formula (which limited price increases to \$20 or 5 per cent above CPI, whichever is greater).

⁴² In December 2000, the Gas Retail Market Company (GRMCo) was established with eight foundation industry members. GRMCo is to facilitate the work of industry to deliver the required gas retail market services to support full competition.

The Tribunal has decided that no price constraint will apply to movements in default tariffs for industrial and commercial customers. The Tribunal believes that the competitive market will impose sufficient pressure to protect these customers from price shocks. However, it will continue to monitor the market to ensure that this is in fact the case, and will issue a gas pricing order (pursuant to section 27 of the Gas Supply Act) if it believes this is necessary.

4.3.4. Implementing tariff plans

To provide reasonable certainty to customers, the Tribunal and AGLRE have agreed on a tariff plan that sets out price movements for default tariffs for residential, industrial and commercial customers over the period to 2003/04. The agreed tariff plan, and its impact on customers, is summarised in chapter 5. It should be noted that price movements beyond 2002 are indicative only, as they will be subject to the Tribunal's mid term review.

After careful analysis, the Tribunal believes that this tariff plan is consistent with its primary objectives for default tariffs. That is, the plan meets the agreed side constraints and so does not impose price shocks on customers, and moves tariffs to cost reflective levels by 2004. Given this, the Tribunal believes that the default tariffs arising from the plan will operate in a 'neutral' manner in the competitive market.

The Tribunal notes that AGLRE has also proposed to voluntarily increase the pensioner rebate and has introduced a flexible instalment/part payment plan. The measures are discussed further in chapter 5.

4.3.5. Defining information requirements

To consider future tariff proposals, the Tribunal will need access to recent customer consumption details, as well as revenue and cost information. To assess market developments once full retail competition is introduced, including the ongoing need for regulation, it will also need access to market information.

To ensure that the Tribunal has access to this information, AGLRE and the Tribunal have agreed that:

1. AGLRE must notify the Tribunal in writing at least one month prior to amending its default tariffs for residential, industrial or commercial customers, and include the following information:
 - an estimate (and associated methodology) for 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
 - existing prices did not cover costs associated with that particular tariff customer or class of customer
 - a breakdown of the costs of supply into fixed costs per customer and costs which vary with the absolute magnitude of gas consumption per customer (in \$ per GJ)
 - a customer impact analysis detailing in tabular form:
 - the number of customers in particular consumption ranges

- the current cost of gas per annum associated with consumption at the midpoint of the relevant range
 - the proposed cost per annum associated with consumption at the midpoint of the relevant range
 - the absolute and proportional change in the cost per annum associated with consumption at the midpoint of the relevant range
 - other supporting information required by the Tribunal.
2. AGLRE must provide information relating to the development of a competitive gas retail market as requested by the Tribunal, to allow the Tribunal to monitor the developments in competitive market and any price changes. This information will be an important input to future regulatory reviews.

4.4. Miscellaneous fees and charges

In its draft decision, the Tribunal proposed not to regulate miscellaneous charges, although it sought views from interested parties on this matter. It based this view on the fact that it had not received many complaints about miscellaneous charges.

However, after considering submissions, the Tribunal has decided that miscellaneous fees and charges should be covered in the VPPs. AGLRE has agreed that it will obtain the Tribunal's approval for any changes in these fees over the four years to 2004.

The Tribunal understands that AGLRE has in place a policy which it has discussed with its Customer Council. Under this policy, the late payment fee will be waived for customers who face financial difficulties if:

- the customer has entered into an instalment arrangement to pay the account
- the customer has contacted a participating welfare support service for assistance.

The Tribunal considers that this initiative by AGLRE should be sufficient to protect specific customers groups. However, AGLRE has agreed to report to the Tribunal on the implementation of its waiver policy, including providing information on number of customers who have benefited from the policy.

Appendix 4 provides further details of the reasons for this decision.

5. OUTCOMES AND PRICE IMPLICATIONS

5.1. Price outcomes

The table below sets out AGLRE’s proposed tariff path to 2003/04. As noted in section 4, the Tribunal has approved this path, and incorporated it in the VPPs. Price movements beyond 2002 are indicative only, as they will be subject to the Tribunal’s mid term review.

Table 5.1 Agreed tariff plan for tariff customers using <1 TJ (excluding pass through of full retail contestability costs) ⁽¹⁾

Tariff	2000/01 ⁽²⁾ (From 1 March 2001)	2001/02	2002/03 (Indicative only)	2003/04 (indicative only)
Residential general: Supply charge Energy rate	\$2.50/qtr -	- CPI ₁ ^{-GST}	\$3.75/qtr -	\$3.75/qtr -
Residential economy: Supply fee Energy rate	\$2.50/qtr -	- CPI ₁ ^{-GST}	\$2.50/qtr CPI ₂ ^{-GST}	CPI ₃ ^{-GST} + 3% 1st block: CPI ₃ ^{-GST} + 3% 2 nd block: CPI ₃ ^{-GST} - X% ⁽³⁾
Residential economy plus: Supply fee Energy rate 1 st block 2 nd block	3% 3% -	CPI ₁ ^{-GST} CPI ₁ ^{-GST} CPI ₁ ^{-GST}	CPI ₂ ^{-GST} + 3% CPI ₂ ^{-GST} + 3% CPI ₂ ^{-GST} - 1%	CPI ₃ ^{-GST} + 3% CPI ₃ ^{-GST} + 3% CPI ₃ ^{-GST} - 1%
Business 0-1TJ: Supply fee Energy rate	- -	CPI ₁ ^{-GST} + 3% CPI ₁ ^{-GST}	CPI ₂ ^{-GST} + 3% CPI ₂ ^{-GST} - 1%	CPI ₃ ^{-GST} CPI + 3% CPI ₃ ^{-GST} CPI - 1%

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In developing the proposal, AGLRE has had regard to the cost of supply, incorporating:

- the field price of gas, in line with AGLRE contracts (including provisions for escalation)
- network costs, including trunk and metering, in line with access arrangements
- haulage costs, consistent with AGLRE’s current contractual obligations
- retail costs, in line with competitive industry benchmarks, established in the Tribunal’s investigation of the electricity sector.

The rate of change set out in the tariff plan is designed to achieve cost reflectivity by June 2004. In line with the Tribunal’s tariff profitability analysis, the rate of change is higher for lower levels of consumption (where customers do not meet the costs of supply). For higher consumption levels, the increase will be largely in line with the CPI in later years.

No residential customer’s bill will increase by more than the greater of \$15 or 3 per cent above CPI per annum before recovery of retail contestability costs.

The Tribunal believes that the tariff plan adequately balances the need for AGLRE and other new entrant retailers to be placed at a similar competitive advantage, and the need for customers to be protected from price shocks.

5.2. Customer and financial impacts

The impact of the 2000/01 and 2001/02 price changes (excluding the impact of GST) are shown in the tables below.

Table 5.2 Residential general (non pensioners)

GJ (per annum)	Proportion of Customers	Nominal \$ change 2000/01	Real % change 2000/01	Nominal \$ change 2001/02	Real % change 2001/02
0 - 4	32%	\$5-7 pa	about 2-3%	\$6-8 pa	about 3-4%
5 - 20	45%	\$8-12 pa	about 1-1.5%	\$9-13 pa	about 1-2 %
21 - 100	23%	\$13-40 pa	about 0.5-1%	\$15-41 pa	about 0.3-1%
>100	< 1%	> \$50 pa	about 0.3%	\$50-225 pa	about 0.2%

Table 5.3 Residential economy (non pensioners)

GJ (pa)	Proportion of Customers	Nominal \$ change 2000/01	Real % change 2000/01	Nominal \$ change 2001/02	Real % change 2001/02
0-10	14%	\$5-8 pa	about 1-2.5%	\$6-10 pa	about 2-4%
11-40	67%	\$9-18 pa	about 0.5-1%	\$10-20 pa	about 1-1.5%
41-225	18%	> \$20 pa	about 0.4%	> \$20 pa	about 0.4%
> 225	< 1%	> \$90 pa	about 0.2%	> \$90 pa	about 0.1%

Table 5.4 Residential economy plus (non pensioners)

GJ (pa)	Proportion of Customers	Nominal \$ change 2000/01	Real % change 2000/01	Nominal \$ change 2001/02	Real % change 2001/02
0-10	1%	\$4-7 pa	about 0%	\$7-11 pa	2%
11-80	88%	\$8-25 pa	about 0%	\$12-34 pa	0.5-2%
> 80	11%	> \$25 pa	0.4%	>34 pa	0-0.6%

Overall the price changes in 2001 will result in a modest increase in AGLRE's tariff revenue, and a slight increase in the overall net profit margin. The average tariff price, however, will depend on future changes in AGLRE's customer profile. These changes are uncertain, given the imminent introduction of competition.

5.3. Pensioner rebates

At present, there are about 126,000 pensioners who are consumers of natural gas. AGLRE's authorisation requires the payment of rebates to pensioners worth \$14 a year. As part of its tariff plan, AGLRE has proposed to voluntarily increase these rebates by \$5 to \$19 a year, to assist pensioners facing price increases. However, the Tribunal understands that the Government is currently considering options for the payment of energy concessions to pensioners.

The Tribunal acknowledges AGLRE's proposal will mitigate any pricing impact on pensioners under the agreed tariff plan. The Tribunal has advised the Minister's office of AGLRE proposal. AGLRE's proposal may however be overtaken by government decisions on pensioner rebates.

5.4. Customer assistance plans

AGLRE has advised the Tribunal that it has introduced a policy to allow flexible instalment/part payment for customers who have difficulties paying their bill on time.

Options include:

- negotiating an instalment plan
- redirecting the bill to a third person
- receiving information about, and referral to, Government Assistance Programs
- receiving information about independent financial counselling services.

AGLRE staff are authorised to negotiate extensions of time to pay, to waive fees or charges and to make monetary allowances for customers experiencing hardship.

AGLRE also has a Customer Council, which was formed in June 1998. The Council regularly reviews AGLRE's payment plans, fee income, waiver policies and service practices, particularly with respect to low income customers.

Further details are available in AGLRE's Customer Service Charter, which can be obtained at any AGLRE service centre or by phoning and requesting a copy from AGLRE.

GLOSSARY AND ABBREVIATIONS

ACCC	Australian Competition & Consumer Commission
AGC	Albury Gas Company (now part of Origin Energy)
AGLGN	AGL Gas Networks Limited
AGLRE	AGL Retail Energy Limited
APT	Australian Pipeline Trust
ATP	Average tariff price
BGT	British Gas Trading
CoAG	Council of Australian Governments
CPI	Consumer price index
EAPL	Eastern Australian Gas Pipeline
EBIT	Earnings before interest and tax
EGP	Eastern Gas Pipeline
GJ	Gigajoule
GRMCo	Gas Retail Market Company
GSE	Great Southern Energy
GSN	Great Southern Energy Gas Networks Pty Ltd
GST	Goods and services tax
IPART	Independent Pricing and Regulatory Tribunal
MATP	Maximum average tariff price
MoEU	Ministry of Energy and Utilities
MMC	Monopolies and Merger Commission
NAO	National Audit Office (NAO)
OFFER	Office of the Electricity Regulator (UK)
OFGAR	Office of the Gas Regulator (UK)
OFGEM	Office of Gas and Electricity Markets (UK)
OTTA	Office of the Tasmanian Electricity Regulator
PCF	Price control formula
PES	Public electricity supplier
TJ	Terajoule
UAG	Unaccounted for gas
VPPs	Voluntary Pricing Principles

APPENDIX 1 CHARACTERISTICS OF CURRENT TARIFFS

Description of current tariffs

AGLRE has 5 residential tariffs (3 tariffs in NSW excluding Yass, 2 tariffs in Yass), and 3 industrial and commercial tariffs (the 'I&C' tariffs). These tariffs are:

- Residential General Tariff
- Residential Economy Tariff
- Residential Economy Plus Tariff
- Yass Residential General Tariff
- Yass Residential Economy Tariff
- I&C Tariff: NSW excluding Yass
- I&C Tariff: Yass
- I&C Tariff: Newcastle and Lower Hunter.

The actual rates of these tariffs are set out overleaf.

Pensioners currently receive a rebate on their rates of \$14 per annum.

Two of the residential tariffs account for over 80 per cent of AGLRE's total customers, and the pensioner version of these 2 tariffs account for a further 13 per cent of customers. AGLRE currently serves around 800,000 residential customers. A breakdown of the number of customers in each tariff class is provided in the table below.

AGLRE's residential customers

	All residential	Pensioners
	%	%
Residential general	39	43
Residential economy	57	54
Residential economy plus	4	3

Existing tariffs⁴³

Residential Tariffs

NSW (excluding Yass)

Rate	Supply fee (\$ per quarter)	Quantity per block (megajoule per quarter)		Charge per megajoule (cents)	
		Block 1	Block 2	Block 1	Block 2
Residential General	24.52	All		1.3233	
Residential Economy	26.86	All		1.2156	
Residential Economy Plus	39.18	4,500	Remainder	0.9053	1.666

Yass

Rate	Minimum Bill (\$ per quarter)	Quantity per block (megajoule per quarter)		Charge per megajoule (cents)	
		Block 1	Block 2	Block 1	Block 2
Residential General	26.40	750	Remainder	3.5912	2.0072
Residential Economy	31.11	750	Remainder	5.1651	1.4197

Note: In 1992, it was determined that charges to natural gas tariff customers in Yass would need to recoup the necessary infrastructure costs and therefore be higher than charges to other NSW regions.

Industrial and Commercial Tariffs

Newcastle and Hunter Valley

Rate	Minimum bill (\$ per quarter)	Quantity per block (megajoule per quarter)			Charge per megajoule (cents)		
		Block 1	Block 2	Block 3	Block 1	Block 2	Block 3
Rate 1	10.05	1,500	148,500	Remainder	2.3331	1.2892	1.0893

⁴³ Note that these prices were implemented from 1 July 2000 and include GST.

NSW (excluding Yass, Newcastle & Lower Hunter and Commercial Fruit & Seed Drying Rate)

Rate	Supply fee (\$ per quarter)	Quantity per block (megajoule per quarter)		Charge per megajoule (cents)	
		Block 1	Block 2	Block 1	Block 2
Rate 1	39.18	150,000	Remainder	1.2529	1.0083
Commercial fruit and seed drying rate ^(a)	0	All		0.9067 (monthly)	

Notes: (a) Available for gas used in a commercial fruit and seed drying process, approved by AGLRE where the consumption is a minimum of 200 GJ per month when used, and is used only in the period November to April. Gas for other purposes must be metered separately and will be billed at the appropriate Industrial and Commercial rate.

Yass Shire

Rate	Supply fee (\$ per quarter)	Quantity per block (megajoule per quarter)			Charge per megajoule (cents)		
		Block 1	Block 2	Block 3	Block 1	Block 2	Block 3
Rate 1	39.18	150,000	15,000	Remainder	1.6135	1.2860	0.7993

Profitability of current tariffs

The Tribunal's analysis suggests that AGLRE's overall gross margin (ie, retail costs plus profit margin) is currently about 9.6 per cent. Within the different residential tariff categories, the gross margin is lowest for pensioner tariffs and highest for Yass residential tariffs. In general, the gross margin is higher for the industrial and commercial tariffs than for the residential tariffs.

However, the gross margin can give a misleading view of profitability. For example, because the average residential gas bill is relatively small, retail costs are a greater proportion of the gross margin than for electricity. This means it is important to also look at the net margin too. AGLRE's estimated net margin for the whole tariff market (0-10 TJ) is about 2 per cent overall, while its net profit margin for tariff customers consuming less than 1 TJ a year is below 2 per cent.

Within each tariff category, the Tribunal has examined profitability for different consumption levels. This analysis shows that:

- for the residential general and residential economy tariff, low consumption customers have a negative margin, while higher consumption customers are profitable (Figure A1 and A2). This trend is exaggerated for the pensioner tariffs
- the profit margin is negative for pensioner tariffs, and around zero for the residential tariff

- the net margin is very high for Yass residential tariffs (0.1 per cent of customer numbers)
- most industrial and commercial tariff customers are profitable (3 per cent customers, 30 per cent of revenue, with the exception of low consumption customers in Newcastle and the Lower Hunter).

Figure A1

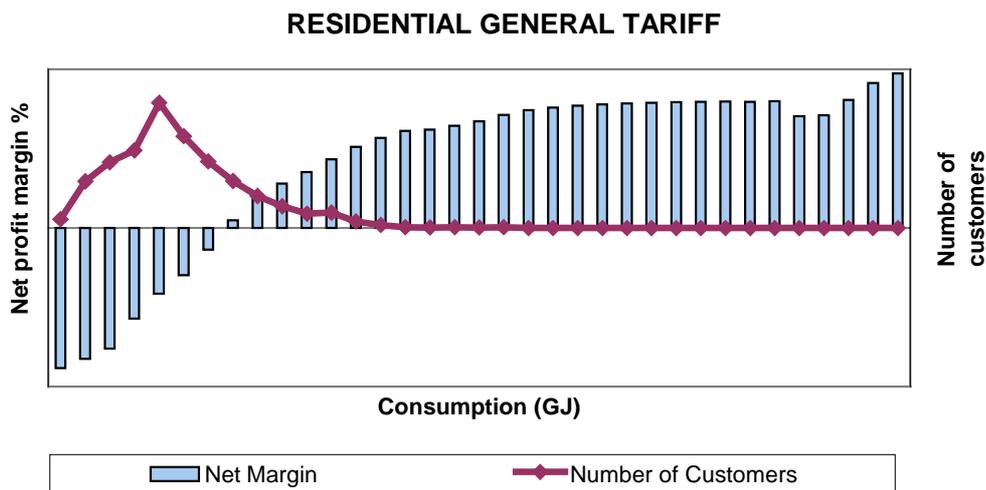
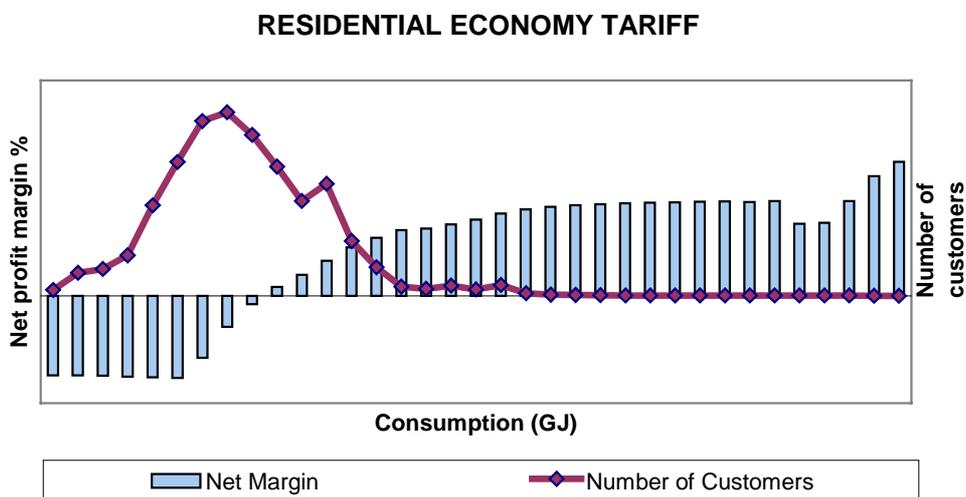


Figure A2



APPENDIX 2 ASSESSMENT OF THE COST OF SUPPLYING GAS

An objective of the default tariffs is that they be cost reflective. As noted in the main report, in deciding on the appropriate level of costs to incorporate in default tariffs, the Tribunal needs to balance the risk that too low an allowance could artificially stifle competition, while an excessive allowance could enable AGLRE to earn excess profits if competition is not vigorous.

The Tribunal has considered the following costs, which are incurred to provide a retail gas service:

- the field price of gas and the cost of haulage, ie, the cost of transporting gas from the producer to the 'city gate' (about 30 per cent)
- the cost of local transportation and metering (about 60 per cent)
- the cost of retailing, such as billing and marketing, and the net retail profit margin (about 10 per cent).

Field price of gas

The field price of gas for AGLRE is set by a long-term gas supply contract. The Tribunal has analysed AGLRE's tariffs on the basis of the content of this contract, including escalation in the price over the period to 2003/04.

The Tribunal notes that changing market circumstances may impact on the field price of gas, and AGLRE's contractual obligations.

Haulage costs

AGLRE's cost of haulage is set in accordance with a contract between AGL Wholesale Gas and Australian Pipeline Trust (APT) for the use of the Moomba to Sydney transmission pipeline. Existing contractual haulage costs are beyond the control of AGLRE. The Tribunal has analysed AGLRE's tariffs on the basis of existing obligations.

However, the future cost of haulage is subject to two significant uncertainties:

- a) APT's proposed access arrangement for the Moomba to Sydney Pipeline System is currently subject to a regulatory determination by the ACCC
- b) AGLRE currently charges tariff customers on the basis of a constant \$/GJ amount, which is appropriate where there is no load profiling in the retail market. If load profiling is introduced in the future (as is under consideration), haulage costs are likely to vary for different customer profiles.

For the purpose of this analysis, it is assumed that the continued use of haulage is through the Moomba to Sydney Pipeline. The Tribunal has assumed escalation by CPI to 2003/04.

Network charges

The access arrangements for AGLGN establish tariffs for local network services, trunk tariff services and metering in each year to 2003/04.

There is one uniform network tariff for tariff customers. Network tariffs include a fixed component, and a throughput charge which varies by each successive block of consumption. A cost-reflective retail tariff could be expected to reflect both the level and structure of these network tariffs.

Metering charges vary by the type of meter, and by the frequency of meter-reading. The Tribunal understands that most customers consuming less than 1 TJ have one metering service, while most customers consuming greater than 1 TJ have another.

The Tribunal considers that reticulation costs (as per the relevant access arrangement) are reasonable, and the Tribunal has therefore analysed AGLRE's tariffs on the basis of these costs.

Retail Costs

Retail costs are expenses incurred to operate the retail component of the gas business. These may include expenses related to 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 Tribunal's draft decision noted that only limited information was available regarding the retail costs incurred by gas retailers in Australia. In its recent investigation of the electricity sector, the Tribunal found that the retail costs of the standard retail suppliers were in the order of \$40 to \$60 per customer per year, including a \$5 allowance to cover the costs associated with full retail competition. In the context of the retail costs for gas and electricity businesses in Australia, the US, and the UK (though comparisons are difficult due to the inclusion of metering costs in some cases), the Tribunal considered that this range was 'reasonable'.

On a per customer basis, the costs incurred by AGLRE appear to be at the lower end of this range. However, for the electricity sector, the Tribunal decided that the level of retail costs recovered in regulated retail tariffs should be based on a standard industry rate, on a per customer basis, and that regulated retail tariffs should be structured so that the majority of retail costs are recovered via a fixed dollar per small retail customer charge, and the remainder through a small uplift on the variable (c/kWh) charge. The Tribunal has therefore analysed AGLRE's tariffs on the basis of an industry benchmark range of \$40 to \$60 per customer.

Costs of full retail contestability

The introduction of the competitive retail market will result in costs, including those to establish the institutions that will govern the market, additional costs passed through from the network business, and the development of IT systems that can manage customer records and billing in a contestable market.

The primary components of retail contestability costs are:

- the provision of retail market services ie customer transfer systems and participant gas balancing
- the establishment and ongoing costs of Gas Retail Market Company
- the retailer system interface costs
- the network retail contestability costs.

Retail market services

GRMC and the MoEU have developed funding principles on how they intend to recover fees from market participants (ie, authorised retailers and network operator). At this stage, it will be a combination of fixed, market share and transaction charges.

MoEU has indicated that the Tribunal will determine a pricing mechanism through which retailers can recover these charges from customers.

Establishment and ongoing costs of GRMCo

The Tribunal understands that costs of establishing and operating GRMCo are being finalised. Given its majority market share, AGLRE has indicated that initially it will bear a significant proportion of these costs.

Retailer system interface costs and costs incurred by network operators

These are the costs that will be incurred by retailers to enable them to interface with the retail market systems established by GRMC. These costs are not yet known, as the GRMC is still to determine the tender on its systems.

Customer impacts

In its review of electricity retail pricing, the Tribunal allowed \$5 per customer for some specific capital costs associated with contestability. Similar systems and procedures are being developed for retail contestability in the gas industry. Given there are a smaller number of gas customers than electricity customers in NSW, the costs per gas customer could be higher.

The actual customer impact will depend on how these costs will be recovered. The key questions are:

- the allocation of costs between customers who have 'switched' and those who have stayed with the incumbent retailer
- the allocation of costs between different customer/tariff classes
- the allocation of costs between the supply charge, the energy rate, or a combination of two.

Conclusion

As these costs are largely outside the control of AGLRE, and given that, the magnitude of these costs at this time is unclear, the Tribunal considers that:

- increases in tariffs due to the recovery of retail contestability costs will fall outside the price constraints
- the process for recovery of costs will be similar to the policy contained in AGLGN's Access Arrangement
- the method of recovery (ie, who should pay, how, and when) will be considered by the Tribunal when costs are more certain.

On this basis, the Tribunal's tariff modelling does not allow for contestability costs at this time.

Net retail margin (profit margin)

The retail profit 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 capital employed in the business and risks associated with the business. Incumbents and potential entrants alike must be able to expect to earn a net retail margin if their investment in the business is to be worthwhile. It follows that the appropriate profit margin will depend on the specific circumstances of the industry and market in which a firm is operating. For example, if the reasonable ratio of capital to sales is high for a particular firm, a higher profit margin is also reasonable.

The Tribunal estimates that AGLRE net (ie, profit) margin from the <10 TJ tariff market is currently 2 per cent. However this is recovered primarily from the industrial and commercial market.

Previous analyses of an appropriate net margin allowance include:

- In 1997 the Tribunal determined that the appropriate net retail margin was 2 per cent for both the tariff and contract markets, with the final allocation resulting in a 3 per cent margin for tariff customers.
- OFGEM in the UK proposed a 1.5 per cent net margin for British Gas Trading and noted this was consistent with electricity.
- London Economics advised the Tribunal in 1996 that the appropriate margin should be between 1 and 3 per cent.

The Tribunal concluded in its electricity investigation that a net profit margin of 1.5 to 2.5 per cent of sales turnover was a sufficient risk-adjusted return for the standard retail electricity suppliers in the lead up to and the initial phase of competition. The Tribunal noted in its report that while it was mindful that full retail competition was not due to begin for another year, it considers it unlikely that a significant change will occur in the retail suppliers' customer base—and therefore risk—over the next year or even during the first year of full retail competition. Hence, the Tribunal believed that the net profit margin would start at the bottom end of this range, and increase as standard retail suppliers' risks increase.

One would expect that the risks facing a gas and an electricity retailer in NSW are reasonably similar, and as a result these businesses should earn comparable profit margins. However, care needs to be taken in deriving like for like margins. For instance, AGLRE has argued that the net margin should be determined on a per customer basis, rather than as a proportion of revenue. The Tribunal believes that this view does have some basis.

Retail margins are generally expressed as a percentage of revenue, and this has been the consistent approach by gas and electricity regulators in Australia, the UK and the US. Nonetheless, this approach may over-simplify the assessment of appropriate margins.

The net retail margin is the return to the owner of the business for undertaking the activity and bearing risk. Some risks vary with the size of revenue, while some risks vary with the level of costs being managed or controlled by the business. We could therefore expect risk-adjusted returns to vary partly by total revenue, and partly by the level of controllable costs.

For example, the level (in total dollars) of bad debts will, other things being equal, increase as the level of revenue increases. It therefore makes sense that for this element of risk, return is related to a percentage of revenue. However, retail costs are more closely related to the number of customers served by the retailer than to the level of revenue. These are costs that are under the management of the business, and thus those on which it bears risk. It could be expected that the return to the business for managing these risks relates more closely to the number of customers than to the level of revenue. Other factors will also contribute to risk (such as the level of uncertainty in energy prices).

In conclusion, it is likely that returns should be based to some extent on factors related to the level of revenue, and to some extent on the level of costs under management (and thus the customer base). As a result, it may not be appropriate to assume that the profit margin (as a percentage of revenue) should be the same for electricity retailers as for gas retailers. Given that neither AGLRE nor the electricity retailers bear significant energy price risk, and that electricity retailers have more revenue per customer, but similar retail costs per customer, it is appropriate to allow AGLRE to earn a slightly higher net profit margin, if expressed as a percentage of revenue. The Tribunal has therefore analysed tariffs on the basis of a net retail margin of 2 to 3 per cent of sales revenue.

APPENDIX 3 VOLUNTARY PRICING PRINCIPLES

AGL Retail Energy Ltd (AGLRE) voluntarily agrees to the following pricing principles:

1. Default tariffs will be available to all tariff customers whose consumption is below 1 TJ a year until 30 June 2004.
2. A review of the VPPs arrangement will be conducted from 2002 or under special circumstances, either at the request of AGLRE or the discretion of the Tribunal, to consider matters such as:
 - additional costs as a result of any difference between the CPI exclusive of GST and the actual escalation of AGLRE's costs
 - changes in AGLRE's cost components such as the field price of natural gas or impacts of regulatory decisions on haulage rates
 - any decision on consumption profiling that deems a profile other than the market profile that has been used for cost allocation
 - changes in market circumstances that in the Tribunal's opinion warrant a review of VPPs.
3. Default tariffs should be broadly cost reflective. A transition period is required to achieve cost reflectivity during which customers should not be exposed to undesirable price shocks. AGLRE will implement tariff changes over the period 2000/01 to 2003/04 subject to the following price constraints:

Residential tariffs

The bill of an individual residential customer in a financial year is not to exceed the bill for the corresponding period of the preceding financial year (for the same pattern and volume of gas consumption) by more than \$15 (in nominal terms) or 3 per cent in real terms, whichever is the greater.
4. AGLRE's current tariff plan over the period 2000/01 and 2003/04 is shown in Table 1. Default tariffs are set out for the first two years (ie 2000/01 and 2001/02). Price movements beyond 2001/02 are to be regarded as indicative only subject to the mid term review. CPI index for adjusting prices is defined in paragraph 11.

**Table 1 Agreed tariff plan for tariff customers using <1 TJ ⁽¹⁾
(excluding pass through of full retail contestability costs) ⁽²⁾**

Tariff	2000/01 ⁽³⁾ (March 2001)	2001/02	2002/03 (Indicative only)	2003/04 (indicative only)
Residential general: Supply charge Energy rate	\$2.50/qtr -	- CPI ₁ ^{-GST}	\$3.75/qtr -	\$3.75/qtr -
Residential economy: Supply fee Energy rate	\$2.50/qtr -	- CPI ₁ ^{-GST}	\$2.50/qtr CPI ₂ ^{-GST}	CPI ₃ ^{-GST} + 3% 1st block: CPI ₃ ^{-GST} + 3% 2 nd block: CPI ₃ ^{-GST} - X% ⁽⁴⁾
Residential economy plus: Supply fee Energy rate 1 st block 2 nd block	3% 3% -	CPI ₁ ^{-GST} CPI ₁ ^{-GST} CPI ₁ ^{-GST}	CPI ₂ ^{-GST} + 3% CPI ₂ ^{-GST} + 3% CPI ₂ ^{-GST} - 1%	CPI ₃ ^{-GST} + 3% CPI ₃ ^{-GST} + 3% CPI ₃ ^{-GST} - 1%
Business 0-1TJ: Supply fee Energy rate	- -	CPI ₁ ^{-GST} + 3% CPI ₁ ^{-GST}	CPI ₂ ^{-GST} + 3% CPI ₂ ^{-GST} - 1%	CPI ₃ ^{-GST} + 3% CPI ₃ ^{-GST} - 1%

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5. Where customers have accepted a competitive offer under a contestable gas retail market, they will be able to revert to AGLRE’s default tariffs without penalty once they have met their contractual obligations.
6. AGLRE will be able to pass through to customers costs associated with implementing full retail contestability (FRC) in addition to the price constraints specified in clause (3) and the tariff plan in clause (4). Costs associated with FRC include but are not limited to costs imposed by the Gas Retail Market Board (GRMCo), and other external agencies, increases in network charges and prudent costs incurred by AGLRE. The costs will be recovered in accordance with established cost allocation and recovery mechanisms or if there is no established mechanisms, the Tribunal will determine a mechanism to recover these costs including an assessment of such costs.
7. AGLRE will not vary miscellaneous fees and charges without prior approval of the Tribunal.
8. AGLRE must notify the Tribunal in writing at least one 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) for 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
- existing prices did not cover costs associated with that particular tariff customer or class of customer.

Costs may include an allowance for an appropriate margin.

- (b) a breakdown of the costs of supply into fixed costs per customer and costs which vary with the absolute magnitude of gas consumption per customer (in \$ per GJ)
 - (c) a customer impact analysis detailing in tabular form:
 - number of customers in particular consumption ranges
 - current cost of gas per annum associated with consumption at the midpoint of the relevant range
 - proposed cost per annum associated with consumption at the midpoint of the relevant range
 - absolute and proportional change in the cost per annum associated with consumption at the midpoint of the relevant range.
 - (d) other supporting information required by the Tribunal.
9. Under this voluntary agreement the Tribunal will monitor price changes to determine whether they accord with the voluntary pricing principles set out in paragraph (1) to (8) above. Nothing in these voluntary pricing principles removes the Tribunal's ability to impose a gas pricing order pursuant to section 27 of the Gas Supply Act or indeed any other powers of the Tribunal.
 10. AGLRE will provide information relating to the development of a competitive gas retail market, if requested by the Tribunal.
 11. On 1 July 2001, tariffs may be adjusted as set out in Table 1. For the purpose of pricing adjustment, CPI_1^{-GST} means the number derived from the application of the following formula:

$$CPI_1^{-GST} = \left(\frac{CPI_{Jun2000} + CPI_{Sep2000}^{-GST} + CPI_{Dec2000}^{-GST} + CPI_{Mar2001}^{-GST}}{CPI_{Jun1999} + CPI_{Sep1999} + CPI_{Dec1999} + CPI_{Mar2000}} - 1 \right) \times 100\%$$

and

On 1 July 2002 and 1 July 2003, tariffs may be adjusted as set out in Table 1, subject to the mid term review. For this purpose, CPI^{-GST} means the number derived from the application of the following formula:

For the year 2002/03:

$$CPI_2^{-GST} = \left(\frac{CPI_{Jun2001}^{-GST} + CPI_{Sep2001}^{-GST} + CPI_{Dec2001}^{-GST} + CPI_{Mar2002}^{-GST}}{CPI_{Jun2000} + CPI_{Sep2000}^{-GST} + CPI_{Dec2000}^{-GST} + CPI_{Mar2001}^{-GST}} - 1 \right) \times 100\%$$

and for the year 2003/04:

$$CPI_3^{-GST} = \left(\frac{CPI_{Jun2002}^{-GST} + CPI_{Sep2002}^{-GST} + CPI_{Dec2002}^{-GST} + CPI_{Mar2003}^{-GST}}{CPI_{Jun2001}^{-GST} + CPI_{Sep2001}^{-GST} + CPI_{Dec2001}^{-GST} + CPI_{Mar2002}^{-GST}} - 1 \right) \times 100\%$$

where: **CPI** means the consumer price index, All Groups index number for the weighted average of eight capital cities as published by the Australian Bureau of Statistics, or if the Australian Bureau of Statistics does not or ceases to publish the index, then CPI will mean an index determined by the Tribunal that is its best estimate of the index.

CPI^{-GST} means the CPI exclusive of the net cumulative impact since 1 July 2000 of:

- a) the GST; and
- b) changes to any other Commonwealth, State or Territory taxes or charges, consequent upon the introduction of the GST

and is calculated as:

- (A) an index published by a person appointed by the Tribunal which is that person's best estimate of CPI^{-GST}; or
- (B) an index published by the Tribunal that is its best estimate of CPI^{-GST}.

CPI is as defined and where the corresponding subtext (for example _{Jun2000}) means the CPI for the quarter end of the year indicated (in the example the June quarter for the year 2000);

CPI^{-GST} is as defined and where the corresponding subtext (for example _{Jun2001}) means the CPI for the quarter and of the year indicated (in the example, the June quarter for the year 2001).

APPENDIX 4 MISCELLANEOUS CHARGES

Miscellaneous charges are imposed to signal to customers the costs of providing these 'miscellaneous' services, such as initial connections and reconnections. AGLRE's current miscellaneous charges are shown in the table below. Unlike similar charges within the electricity industry, which are currently regulated by the Tribunal, AGLRE's miscellaneous charges have never been regulated. One reason for this may be the lack of customer complaints relating to these charges.

In its draft report, the Tribunal noted that its initial view was *not* to regulate miscellaneous charges, although it sought views from interested parties on the matter.

This appendix provides further details on the basis of the Tribunal's decision.

AGLRE's current retail miscellaneous charges

AGLRE's current retail miscellaneous charges are set out below.

Description of fee	Fee exc. GST	Fee incl. GST
Account establishment fee	\$20.00	\$22.00
Establishment fee (pensioner)	\$10.00	\$11.00
Collector call	\$30.00	\$33.00
Disconnection/reconnection	\$70.00	\$77.00
High bill field visit	\$49.00	\$53.90
Late fee	\$10.00	\$11.00
Dishonoured payment	\$21.00	\$23.10
Security deposit	Residential - \$100	Residential - \$100
	Business – 2.5 times the average monthly account.	Business – 2.5 times the average monthly account.
	Refund after bills paid on time for 2 years.	Refund after bills paid on time for 2 year.

Establishment Fee: applies to 'new' customers being established onto the system for the first time.⁴⁴

Collector call Fee: applies when a contractor goes to a premise to disconnect supply but the customer decides to enter into an agreement which may include making a payment to the contractor. The contractor deposits all funds into an AGLRE account.

Disconnection/Reconnection Fee: applies on reconnection when a customer has been previously disconnected for debt or has asked for a seasonal disconnection & reconnection. Note that a comparison to electricity is not appropriate as a gas reconnection requires on site pressure tests and relights (as opposed to removing/replacing a fuse). A fee of \$55 (inclusive of GST) applies for a disconnection only, a fee of \$22 (inclusive of GST) for reconnections only, total fee of \$77.

⁴⁴ Note that if a customer moves to another premises that is also on gas, the fee is waived at the new residence.

High Bill Investigation Fee: is payable when a field officer is called out to the customer's premises following a high bill enquiry. The enquiry involves at least two clerical checks, at no charge, before a field officer is sent. The officer can spend up to two hours on site examining the installation. If no fault is found on AGLRE's side of the meter there is a charge; if a fault is discovered at AGLRE's installation there is no charge.

Late Payment Fee: is payable when a lettergram is sent (ie, a disconnection notice). This happens when a customer fails to contact AGLRE for a payment arrangement, and after the bill and reminder notices are sent and not paid. The fee is waived if the customer seeks assistance with financial councillors in line with AGLRE's agreement with the Customer Council.

Dishonour Fee: is charged if cheques and/or cards fail.

Refundable advance: is paid by a tenant or business customer who has not been responsible for a supply address before, or a domestic or business customer who does not have a satisfactory credit history.⁴⁵ Advances are refunded if customers pay their account on time for 2 years.

Matters raised by interested parties

In its submission to this review, PIAC expressed concern regarding AGLRE's miscellaneous charges, particularly the late payment fee. NCOSS has advised that when AGLRE proposed increasing the late fee to \$10 in 1999, some customer representatives opposed the increase. However the increase was supported by a majority of AGL Customer Council members with some provisions, including a provision that the fee be waived where a customer seeks assistance from a welfare agency.

Concerns regarding AGLRE's miscellaneous fees were also raised at the Electricity Retail Miscellaneous Fees Working Group meeting held in August 2000. AGLRE's policy is that the late fee is waived where a customer contacts AGLRE to negotiate a payment arrangement, and where a customer seeks assistance from financial councillors. At the electricity meeting, NCOSS commented that the late payment fee is not always waived in some circumstances where there is a poor payment history.

Another issue raised at the Electricity Retail Miscellaneous Fees Working Group was the need to differentiate between customers who won't pay on time, and those who can't. It was not considered appropriate to penalise customers who can't pay on time with a late payment fee. There are a number of conditions in place to try and avoid electricity customers who can't pay bills being charged a late fee. For example, the late payment fee is waived where bills are paid or part paid by EAPA voucher, or where the customer has contacted a welfare agency or support service.

⁴⁵ Note that no GST is added to refundable advances.

AGL's waiver policy regarding late payment fees

The Tribunal sought further information from AGLRE regarding its late payment policy. AGLRE advised the Tribunal that:

- the increase in the late payment fee was implemented from 1 July 1999 subject to a number of conditions including extension of the waiver policy to customers who have contacted participating welfare agencies
- since the increase, AGLRE has continued to work with the AGL Customer Council to identify possible concerns and actions to address those concerns
- a dedicated phone number has been installed which is only answered by senior officer trained in this policy. This is to improve outcomes for customers who are in financial difficulties
- in December 2000, AGLRE has started a research on the correlation of postcodes and the incidence of late payment fees.

Tribunal's decision

Given the information provided by interested parties, the Tribunal has some concerns regarding AGLRE's current retail miscellaneous fees, particularly the impacts on low income customers. Another issue is that as 'dual fuel' and other multi-product services are likely to become increasingly common, it would be appropriate for electricity and gas miscellaneous fees to be at similar levels and have similar guidelines.

Given the weight and content of submissions favouring regulation, the Tribunal has decided to address miscellaneous fees by including, in VPPs, an undertaking that AGLRE must obtain the Tribunal's approval for any changes in these fees over the four years to 2004.

In addition, the Tribunal has considered the issue of late payment fees. The Tribunal understands that AGLRE has developed and implemented that the late payment fee will be waived if the customer:

- has entered into an instalment arrangement to pay the account
- has contacted a participating welfare support service for assistance.

The Tribunal acknowledges AGLRE's initiative. AGLRE has agreed to report to the Tribunal on the implementation of its waiver policy, including providing information on number of customers who have benefited from the policy.

APPENDIX 5 LIST OF SUBMISSIONS

Organisation	Name	Date Submitted
AGL	Phillip James	7 June 2000
AGL	Confidential	25 August 2000
BHP Petroleum	Colin Martin	2 June 2000
Energy Australia	Nick Saphin	5 June 2000
Public Interest Advocacy Centre	Trish Benson	23 May 2000

APPENDIX 6 SUMMARY OF SUBMISSIONS

Submissions on the Tribunal's draft decision closed on 5 June 2000.⁴⁶ Submissions were received from AGLRE,⁴⁷ BHP Petroleum, EnergyAustralia, the Public Interest Advocacy Centre (PIAC) (see Appendix 4 for further details).

The main issues addressed in submissions are:

- options for the form of regulation during the transition to a competitive market, including the adoption of Voluntary Pricing Principles
- limits on tariff changes over time
- the pass-through of GST costs
- the pass-through of contestability costs
- regulation of miscellaneous charges
- the definition of the Consumer Price Index (CPI).

A summary of the arguments raised in submissions, by key issues, is provided below.

Options for regulation during the transition to a competitive market

AGLRE supported the retention of existing or default tariffs until the end of 2001. It also submitted that VPPs are an appropriate regulatory mechanism, and that the PCF should be abolished as it does not deal with the cost structure of the present and proposed regulatory regimes, or the introduction of new tax structures.

AGLRE also argued that VPPs should provide AGLRE with the right to seek amendments from the Tribunal to take account of unforeseen circumstances. AGLRE suggests that these might include:

- if quarterly rather than annual profiling is adopted under the Gas Retail Market Code, major tariff restructuring and price adjustments might be required
- field price arbitration with South Australian producers.

EnergyAustralia also supported the concept of regulation through VPPs.

BHP Petroleum however did not support the use of VPPs. It submitted that the Tribunal's proposal in effect allowed real *increases* in tariffs and that:

... only when there is true effective competition throughout the market should Regulator mandated falling real retail prices be removed.⁴⁸

BHP also commented that the fall in distribution prices should be passed through to customers, which is inconsistent with real increases in retail prices. BHP also noted that the notion of 'effective competition' should be defined by the Tribunal. It suggested that number and volume 'churn' should be considered as part of this process.

⁴⁶ Public submissions can be viewed on the Tribunal's website at www.ipart.nsw.gov.au

⁴⁷ AGLRE submitted two submissions to the Tribunal, one public submission and one confidential submission.

⁴⁸ BHP Petroleum, submission to the Tribunal, 2 June 2000, p 1.

PIAC was also of the view that a move toward VPPs and away from the PCF was unwarranted.

Limits to tariff changes over time

AGLRE's view is that the constraints proposed by the Tribunal for default tariffs were too restrictive. Rather, VPPs should provide room to reflect actual costs, for example:

- the constraints should be increased to reflect any increases to network charges above CPI
- constraints should allow network contestability charges to be passed through to customers regardless of whether or not the constraints would be exceeded
- constraints should allow retail contestability costs to be passed through to customers.

AGLRE also commented that limits to tariff changes should apply equally across all tariff customers, ie, that business and residential customers should not be treated separately. AGLRE also argued that tariffs should be allowed to change by the same amount, irrespective of whether there is a change in price structure or not.

PIAC submitted that the proposed constraints of \$20 or CPI+5% are too high. It argued that, as gas bills are approximately half the magnitude of electricity bills, the constraints on increases in gas bills should be proportionately lower than the constraints which have been applied in the electricity industry.

Definition of CPI

AGLRE submitted two concerns about the CPI adjusted to *exclude* the GST effect, as outlined in the Tribunal's draft report:

- to date no independent government body plans to calculate a GST-exclusive CPI, and it is not appropriate that the index be calculated by the jurisdictional regulator
- a GST-adjusted CPI should be based on the period for which the flow through of savings as a result of the elimination of the GST are considered – an index matched to the time period associated with the net impact of the GST should be used.

Pass-through of contestability costs

The draft report proposes that to the extent that network contestability charges are beyond the control of AGLRE, they should be excluded from the price constraints. However, the Tribunal's initial views in the draft report was that any retail contestability costs incurred by AGLRE on its own systems and procedures for the introduction of retail contestability should be included in the calculation of price constraints.

AGLRE submitted that retailers will incur substantial and unavoidable costs associated with contestability, and that it is appropriate that these costs be recoverable in default tariffs. Furthermore, AGLRE argued that if retailers are forced to bear these costs - such as operating costs of the gas industry decision making body, and purchase of load profiling and reconciliation systems - then entry to the market will be less attractive to new retailers.

PIAC submitted that contestability costs should not be passed through for a number of reasons, including the lack of benefits for some customers, the need for costs to be prudent, and because some if not all of the costs could be spread over a number of years. PIAC suggested that if contestability costs are passed through, this should not occur until 2002/03.

EnergyAustralia proposed that the treatment of retail contestability costs should be the same for electricity and gas industries.

Regulation of miscellaneous charges

The Tribunal noted in its draft decision that its initial view was not to regulate miscellaneous charges, although it sought views from interested parties on the matter.

Broadly, AGLRE and EnergyAustralia opposed the regulation of miscellaneous charges, while PIAC's view was that miscellaneous charges should be regulated. PIAC argued that these charges are regulated in the electricity industry and should therefore be regulated in the gas industry as well.