

Regulated retail tariffs for gas

Decision and statement of reasons – Country Energy’s 2008 application for a special circumstances price increase

Gas — Final Decision and Statement of Reasons
May 2008

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The Tribunal members for this review are:

Dr Michael Keating, AC, Chairman

Mr James Cox, Chief Executive Officer and Full Time Member

Inquiries regarding this document should be directed to a staff member:

Anna Brakey (02) 9290 8438

Fiona Towers (02) 9290 8420

Independent Pricing and Regulatory Tribunal of New South Wales

PO Box Q290, QVB Post Office NSW 1230

Level 8, 1 Market Street, Sydney NSW 2000

T (02) 9290 8400 F (02) 9290 2061

www.ipart.nsw.gov.au

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1 Decision

IPART has decided that Country Energy may increase the average prices for regulated gas customers by \$1.97/GJ from 1 June 2008. For a typical residential customer in NSW, with annual consumption of 35 GJ this translates into a 12.2 per cent increase in the customer's annual bill. This increase replaces the CPI increase that would have otherwise occurred on 1 July 2008.

2 Background

On 30 June 2006 the then Minister for Energy wrote to IPART requesting it to continue regulating default tariffs for small retail customers by ensuring that either new voluntary pricing principles or a gas pricing order under section 27 of the *Gas Supply Act 1996* operate until 30 June 2010.

In June 2007 IPART finalised voluntary transitional pricing arrangements (VTPA) with the standard gas suppliers in NSW for the regulated retail prices.¹ IPART developed a specific agreement with each of the standard suppliers, including Country Energy. The agreements provide for annual price increases of the consumer price index (CPI) or less. In special circumstances a supplier may apply to IPART to vary prices outside of this limit.

2.1 Country Energy's application for a price increase resulting from special circumstances

On 5 May 2008 Country Energy submitted a proposal for average price increases to regulated tariffs of \$1.97 per GJ or by an average of 12.2 per cent (for residential and business customers using less than 1 TJ each year) to apply from 1 June 2008, which is different to the standard arrangements of a CPI price increase on 1 July of each year that is provided for in the VTPA.

Country Energy submitted that the special circumstances under which it sought approval to increase gas prices by more than CPI arose for two reasons:

1. Wholesale gas costs have increased for 2007/08 and 2008/09.
2. Gas Transportation costs have increased for 2007/08 and 2008/09

Country Energy submitted this has resulted in a substantial increase in costs from January 2008 and that part of these additional costs should be recovered from tariff customers.

¹ IPART, *Promoting retail competition and investment in the NSW gas industry, Regulated gas retail tariffs and charges for small customers 2007 to 2010, Gas - Final Report and Voluntary Transitional Pricing Arrangements*, June 2007.

2.2 Process for this review

The VTPA requires the supplier to give IPART four months notice of price increases resulting from special circumstances. However, in the report that accompanied the VTPA, IPART said:

The notice period for suppliers to inform the Tribunal of special circumstances can be varied with the agreement of the Tribunal and the supplier. This provides flexibility where the change in circumstances is relatively straightforward (and so can be assessed in less than 4 months), or where it requires more complex analysis (entailing a longer lead time before prices changes are approved).²

In response to Country Energy's request, IPART agreed to undertake a review of whether the additional costs that Country Energy identified are reasonable and should be passed onto tariff market customers. IPART called for public submissions regarding the increase, but none were received. IPART then engaged Frontier Economics to provide expert advice to assist its decision making. The advice focussed on the following issues:

1. verifying the claim that Country Energy would not be able to meet its forecast maximum demand over winter in the absence of securing additional gas supply and transportation contracts
2. assessment of the costs of the winter gas, including examining whether as a prudent and efficient retailer, Country Energy sought the most competitive gas supply contracts
3. assessment of the increased transportation charges, including examining whether as a prudent and efficient retailer, Country Energy sought the most competitive gas transportation contracts
4. whether the methodology used to calculate cost-reflective tariffs is reasonable
5. the allocation of the increased costs for winter 2008 between the tariff and contract markets

² IPART, *Promoting retail competition and investment in the NSW gas industry, Regulated gas retail tariffs and charges for small customers 2007 to 2010, Gas Final Report and Voluntary Transitional Pricing Arrangements*, June 2007, p 3.

3 The price increase and statement of reasons

Decision

- 1 IPART has decided that Country Energy may increase the average prices for regulated gas customers by \$1.97/GJ from 1 June 2008. This represents a 14 per cent increase in the fixed charges to customers, and a variable charge increase of 11-12 per cent. For a typical residential customer in Wagga Wagga, with annual consumption of 35 GJ, this translates into a 12.2 per cent increase in the customer's annual bill. This increase replaces the CPI increase that would have otherwise occurred on 1 July 2008. IPART's reasons for this decision are set out in this chapter.

In assessing this price application, IPART reviewed the additional costs in accordance with Country Energy's building block approach. While an independent assessment of all costs was not undertaken, IPART regards the assumptions in the building block model as reasonable, and therefore increased tariffs are required.

3.1 The supply of gas for winter 2008

Country Energy submitted that it will not be able to meet its forecast maximum demand over winter 2008 without securing additional gas supplies and transportation. IPART accepts that Country Energy does require the additional gas to supply its customers.

3.2 Winter gas (commodity) costs for 2008

To assess the additional winter gas costs IPART examined what costs would an efficient and prudent retailer incur to secure supply for the New South Wales market over the 2008 winter.

3.2.1 The cost of the winter gas

Prior to winter 2007, Country Energy bought significant quantities of gas from the Victorian pool and transported it through the Victorian Principal Transmission System (VTPS) and the Interconnect at Culcairn. However, following VTPS compression problems during winter 2007, Country Energy formed the view that it would need to secure alternative supply arrangements. At this time, the wholesale gas market in NSW was experiencing significant increases in prices. Country Energy considered several alternative sources of supply and was able to secure supply at a price that compared favourably with other options.

Country Energy provided evidence of the offer for the additional gas over the 2008 winter period.³ The details of this offer are commercial in confidence. IPART allowed the value of that gas.

3.3 Transportation charges for 2008

To assess the additional transportation charges IPART examined the additional costs to secure haulage capacity.

3.3.1 Transportation Charges

Country Energy submitted that it faced increased transportation costs and added the average costs of the additional capacity to its existing transportation costs in 2008/09. The increased transportation costs are due to contracting increased capacity to meet winter demand in 2008. IPART has examined the revised transportation charges and has concluded the increase proposed by Country Energy is reasonable.

3.4 Allocation of costs across tariff and contract customers

The gas retail market consists of two types of customers:

- ▼ Tariff customers – customers that consume less than 10 TJ each year. These customers are not metered on a daily basis.
- ▼ Contract customers – consuming more than 10 TJ each year.

Competition has been progressively introduced in the NSW market. Since 2002, all NSW gas customers have been able to choose their retailer, with around 17 licensed retailers supplying the market.⁴ Tariff customers consuming less than 1 TJ each year can either:

- ▼ enter into a market contract with a licensed supplier or
- ▼ remain on a regulated tariff, established under the VTPA.

Country Energy submitted that the appropriate allocation of the costs of securing gas to meet winter demand is to recover the additional costs of securing capacity for 2008/09 from all customers equally. This means that tariff and contract customers will face the same additional \$/GJ price increases. IPART considers that this allocation methodology is appropriate.

³ This data was verified by Frontier Economics.

⁴ Not all licensed retailers offer supply contracts across all customers or all geographic areas within NSW.

3.5 Price change date for 2008

The VTPA established price changes for 1 July each year. IPART has agreed to Country Energy's request for a 1 June 2008 price change instead of the 1 July 2008 price change. IPART considers that cost recovery from June is reasonable, taking into account that Country Energy has incurred higher wholesale prices since January 2008. The additional costs incurred between January and May will be borne by Country Energy.

There will not be a further price change on 1 July 2008 – the 1 June 2008 price change includes the CPI adjustment (amended to reflect its early implementation).

4 The cost of supplying gas in winter

This price increase arose from special circumstances relating to the supply of gas to the New South Wales market for winter of 2008. IPART does not expect these circumstances to be replicated in 2009.

However, it does consider that the cost of supplying gas to the New South Wales market could be more expensive than it has been over the earlier part of this decade, due to increased demand for gas and its transportation. This increased demand stems in part from more demand from gas-fired power stations.

Anecdotally IPART has been informed (and seen evidence) of a reduction in active competition in the retail gas market for both contract and tariff customers.