EnergyAustralia Pty Ltd
ABN 99 086 014 968
Level 33
385 Bourke Street
Melbourne Victoria 3000

Phone +61 3 8628 1000
Facsimile +61 3 8628 1050

enq@energyaustralia.com.au
energyaustralia.com.au

21st January 2013

Peter Boxall
Chairperson
Independent Pricing & Regulatory Tribunal
Level 8, 1 Market St
Sydney, NSW

Submitted online at www.ipart.nsw.gov.au

Dear Dr Boxall

Response to the Issues Paper for Regulated Retail Prices and Charges for Gas 2013-16

EnergyAustralia welcomes the opportunity to make a submission to IPART Issues Paper for Regulated Retail Prices and Charges for Gas 2013-16 (Issues Paper).

EnergyAustralia is one of Australia's largest energy companies, providing gas and electricity to over 2.7 million residential and business customers. EnergyAustralia owns and operates a multi-billion dollar portfolio of energy generation and storage facilities across Australia including coal, gas and wind assets with control of over 5,600 MW of generation in the National Electricity Market.

We have been retailing in the NSW gas market for many years and have a long-term interest in the level of the regulated retail prices and the state of competition in this market. In addition, we strongly support the deregulation of the retail gas and electricity markets.

The NSW gas market has had a form of voluntary transition pricing arrangements in the setting of regulated tariffs since 2001. This form of regulation has been relatively successful in encouraging competitive outcomes. We note there has been an increase in gas competition over the last three years and a concurrent increase in competition in the NSW electricity market. However, we believe that it is unlikely that any additional benefits will be achieved under the current form of regulation in either the gas or electricity markets.

True competition in these markets will provide a less risky retail market environment for retailers and this will lead to better outcomes for customers (such as efficiencies in pricing and increased innovation) to a degree not seen in a price-regulated market. The NSW gas and electricity markets are ready for price deregulation now. We are willing to work with IPART and other stakeholder to develop transition plans to achieve this objective.

In setting the regulated gas price, the main challenge in next regulatory period is that forecasting the wholesale cost of gas has become much more difficult. This has meant that Standard Retailers have proposed only a one-year price path arrangement. We support this approach. To set a two or three year price path at this point would produce an unacceptable risk to retailers as it could seriously impact their viability and would reduce the attractiveness of the NSW gas market even though one year margins may be adequate.

We recognise IPART's concern around the lack of price certainty for customers under this one-year price path approach. To address this, we suggest that customers can still receive adequate price certainty if IPART and Standard Retailers publish indicative price movements for the second and third years. There are several reasons why price paths can never give customers complete certainty around prices several years into the future (this has particularly been the case for electricity tariffs in the past). Therefore, we believe that this trade-off represents the best approach under the circumstances.

If you would like more information on this submission, please contact me on (03) 8628 1242.

Yours sincerely

Melinda Green
Regulatory Manager - Pricing

EnergyAustralia response to IPART for the Issues Paper on Regulated Retail Prices and Charges for Gas, 2013-16

January 2013

Contents

1. Executive summary

EnergyAustralia welcomes the opportunity to provide comments on the issues paper for regulated retail prices and charges for gas 2013-16. This executive summary outlines our key points, which are discussed in more detail in our submission.

The current review, pricing arrangements & price control

The Network + Carbon + Retail and Weighted Average Price Cap approaches used by IPART as the basis for the Voluntary Transitional Pricing Arrangements (VTPAs) are still appropriate and should be maintained over the next regulatory period. The use of VTPAs in regulating gas tariffs for Standard Retailers is now a very mature process. We support many of the structures and approaches that IPART have used in the past and suggest that very few changes are required.

IPART should continue to support competition by ensuring that the regulated retail gas tariffs are set at adequate levels and that tariffs and that charges are reduced to a minimal number and are made as uniform as possible between gas supply areas. Competition could also be aided by lightening the form of regulation, however we would prefer to see a transition plan to price deregulation be developed as this will provide greater benefits to customers in the long-term.

Additional mechanisms to address risks and uncertainties

There are a number of developments affecting the gas market noted by IPART. The most significant changes on the horizon will affect the supply and demand for gas. In addition, AGL and ActewAGL are in the process of establishing new gas supply arrangements. Thus, all Standard Retailers are justifiably unwilling to commit to a wholesale gas cost beyond 2013/14.

We support the proposals for all Standard Retailers that the wholesale gas costs should be separately reviewed in future years. Maintaining adequate price certainty for customers can be realised by assessing and publishing likely price movements over the period, whilst not committing to a three-year price path. Over the next three years, it would introduce too great a risk for retailers to be held to price movements indexed only to the consumer price index. Setting a three-year price path could therefore negatively affect competition and longer-term price outcomes for customers.

Other than a separate reviews for wholesale costs the final two years and carbon costs in 2015/16, there appear to be no reasons to alter or enhance the mechanisms used to set the other components of the regulated tariff.

Costs underlying proposed prices

In terms of the regulated tariff components for wholesale gas costs, retail operating costs and retail margin, we largely support the proposals of the Standard Retailers. We note that wholesale costs will continue to increase and have outlined why retail operating costs should be higher to encourage competition.

Standard retailers have also proposed that retail margins and miscellaneous retail charges be made more consistent between areas. These charges appear reasonable and we agree that streamlining charges and margins is a sensible approach where costs are similar between regions.

2. The current review, pricing arrangements & price control

2.1. Review context

Question 1 - Are there any other contextual factors that we should consider that could materially affect our review?

The policy, regulatory and market developments outlined by IPART in the Issues Paper are consistent with our views. We also believe that IPART's preliminary views on meeting the objectives set out in the Terms of Reference (ToR) set by the NSW Government and in Section 3 of the *Gas Supply Act 1996* are appropriate.

2.2. The current pricing arrangements

Question 2 - Do pricing agreements continue to be an appropriate way to regulate the Standard Retailers' regulated retail prices, given the objectives and context for this review? How could we enhance the current approach?

While the NSW Government chooses to continue the regulation of gas prices in NSW for small customers via the Voluntary Transitional Pricing Arrangements (VTPAs), we agree that the regulatory approach adopted by IPART will continue to be suitable for the 2013-16 regulatory period.

Given the difficulties in forecasting the wholesale gas costs over this upcoming regulatory period, the pricing arrangement could be varied to include a new wholesale component (W) in addition to the existing components: N + R + C. Within the scope of the ToR, we don't consider that any other enhancements are necessary.

Question 3 - What (if any) other forms of regulation should we consider?

We continue to support the removal of price regulation in NSW for both gas and electricity customers and don't see any reason that this could not be put in place immediately as was recently announced in South Australia.[1] That there will be two states with full price deregulation from the 1st February 2013 shows different paths can be taken to implementing price deregulation. Lightening the form of regulation used in determining prices may help facilitate the complete lifting of price regulation. Other steps to minimise the number of customers on regulated tariffs can also assist in meeting this objective also.

A number of other approaches can be considered with a view towards moving to full deregulation of pricing:

- Increasingly removing price regulation from different components of the R part of the regulated tariff over time until full deregulation is achieved.
- If the opt-in proposal suggested by IPART for the regulated electricity tariff is implemented,[2] it could also be implemented for the regulated gas tariffs at the same time or at some other practical date.

Plans, such as the opt-in proposal, can be difficult to design and implement, as they are dependent on retailer systems and must meet certain time requirements. We are open to discussing these practical issues with IPART and helping work towards a fully deregulated gas and electricity market.

---

[1] SA Premier and Cabinet, News release, http://www.premier.sa.gov.au/images/news_releases/12_12Dec/energyprice.pdf, 18th December, 2012

[2] IPART, Review of regulated retail prices and charges for electricity 2013 to 2016: Electricity – Issues Paper, November 2012, pages 33-34

2.3. Form of price control

Question 4 - Are there any other competitive developments in the retail gas market that are relevant for our review? Are there any structural impediments to competition and customer participation, and if so, can these be addressed through the regulatory arrangements?

We agree with IPART's analysis that shows that competition in the NSW gas market has increased since the last review. Fewer customers remain on regulated tariffs and significant discounts to the regulated tariff are available and are readily accessible to customers via IPART's *myenergyoffers* site. As a second tier retailer in the NSW retail gas market we have seen a net increase in our customer numbers each year since the last review which shows that switching activity, a key indicator of effective competition, is strong and sustainable

In the submission we made to IPART's review of regulated electricity pricing over the 2013-16 period, we put forward our reasons why some customers remain on regulated pricing. There can be various reasons, but we believe that in the main, the customers who don't shop around have a lack of time or interest in actively seeking a more competitive offer. A higher proportion of gas customers in some areas of NSW are on regulated tariffs and we suggest that this could be the result of lower profitability of those tariffs for second tier retailers effectively discouraging them from actively competing. We address this further in section 4.

We always argue that where price regulation exists, competition is best facilitated by maintaining the regulated tariff at a level that allows a range of retailers to compete profitably. There are other measures that could also assist. Creating a regulated market environment that is as uniform and streamlined as possible will also help second tier retailers to keep costs down when entering and competing in new supply areas. There are several ways this can be achieved by having:

- regulated tariffs set at cost reflective levels including a margin and headroom to compete
- a minimal set of regulated tariffs with uniform structures
- similar regulated retail charges and price levels
- uniform rules and regulations (e.g. NECF)

These measures are most effective if they are achieved concurrently for both gas and electricity, as there are commercial benefits to retailers in offering both fuels to a customer. We therefore, support the proposal by ActewAGL to reduce the number of regulated tariffs in their supply area. If possible, we would like to see even fewer than six regulated tariffs in this area. In section 4.4, we suggest how IPART could manage uniformity of miscellaneous retail charges.

Question 5 - Are there enhancements that can be made to our current Weighted Average Price Cap (WAPC) approach?

Our preference is for IPART to use a WAPC approach with no side constraints. No enhancements are required to the WAPC approach to setting regulated gas tariffs. As IPART state in the issues paper, stakeholders are familiar with this approach and the level of competition and the small number of regulated tariffs make this a suitable method of allowing the required flexibility and transparency.

3. Additional mechanisms to address risks and uncertainties

3.1. Risks associate with cost components

Question 6 - Is there any reason not to accept the Standard Retailers' proposal to pass through network costs to customers?

No, there is no reason why IPART should not accept the N component as a pass through amount. The pass through of network costs is a well-established regulatory pricing mechanism and as it is the simplest and fairest way of ensuring that retailers can minimise the risks associated with managing uncontrollable costs. Any alternative method would require an additional return to retailers to accommodate the extra risks involved and this would increase prices for customers unnecessarily.

Question 7 - Are there enhancements that can be made to the proposed approach to managing uncertainty associated with the carbon pricing scheme?

Unlike the process, we proposed for the electricity regulated retail tariff, the carbon costs for gas are not determined via an assessment of a commodity-based market. Another difference for gas is that the carbon component is dealt with as a separate component (C) of the regulated tariff. This minimises some of the risk associated with carbon uncertainty.

We support the proposals of the Standard Retailers to retain the same carbon pricing approach in the next regulatory period. A separate review for the carbon component in 2015/16, due to the federal scheme moves to a market based mechanism, is also appropriate. No other enhancements are required. Carbon costs, like network costs, are uncontrollable costs for retailers and it's important that IPART continue to allow carbon costs to be fully recovered in regulated gas tariffs.

Question 8 - How material are the potential policy, regulatory and market developments affecting the gas supply chain?

Based on our experience across the Victorian and NSW gas sectors, we concur with the views taken by Origin and AGL in relation to the uncertainty of gas costs over the 2013-16 period. We understand that AGL is in arbitration to renegotiate long-term gas supply agreements, and believe that it would create a substantial commercial risk for them to pre-empt the outcome of those negotiations by having to commit to a price path for the 2014/15 and 2015/16 years. Deciding a price path before these negotiations conclude may result in higher regulated prices for customers.

In terms of policy and market developments, the opening up of both the coal seam gas (CSG) the liquefied natural gas (LNG) markets on the east coast of Australia presents a major challenge in forecasting gas demand and price in future years. IPART and Origin have already outlined the factors that lead to this uncertainty in the Issues Paper and pricing proposal respectively.[3] Increased demand and the development of higher cost gas reserves are producing upward pressure on gas prices. It is extremely difficult to determine the level that prices may reach as the east coast LNG market will introduce a link to global oil prices, and the true cost of developing other, more marginal coal seam gas fields is not known. We note that to a large extent, gas prices will be strongly influenced by geopolitical factors, exchange rates and other drivers outside the control of retailers.

IPART correctly points out that although gas wholesale costs have been seen to be 'controllable costs' in the past that 'this does not necessarily mean that they can be

[3] IPART, Issues Paper, pages 13-15; Origin Energy, Submission to IPART on the review of regulated gas retail tariffs and charges from 2013 to 2016, November 2012, pages 3-4

forecast with a high degree of certainty in the coming years.'[4] These developments will have a material and unpredictable effect on wholesale gas prices and we encourage IPART not to underestimate the potential impact to retailers' gas costs over the regulatory period.

Question 9 - Is a mechanism to update the wholesale gas cost element of regulated retail prices an appropriate way to address the uncertainty in relation to wholesale gas costs? What are the implications for customers and what value do stakeholders attach to price certainty? How should this mechanism be designed to best meet the objectives for the review?

While it is unfortunate that the changes affecting the gas market will lead to gas costs being less predictable and will have a flow on impact to the regulatory process, we agree with the proposals put forward by the Standard Retailers with respect to the handling of the wholesale gas cost component.

All Standard Retailers have proposed a one year price path for 2013/14 and have outlined a process for updates to price paths for the latter two years of the regulatory period. In terms of the reduction of certainty for customers, this could be partly mitigated by IPART informing customers of the expected significant increases in the gas costs over 2013-16. A high, medium and low scenario analysis could be helpful in outlining the expected increase ranges without requiring Standard Retailers to commit to specific price path linked to the consumer price index (CPI).

The price paths previously set for gas have an easily understandable structure; however, they do not allow even a retailer to reliably predict price movements to within a few percentage points. The main reason for this is usually that the N component is controlled by the gas distribution companies and the Australian Energy Regulator. Therefore, there is no guarantee that final gas network tariffs changes will average out at the price path level due to regulatory decisions on annual price proposals and cost pass through applications. Apart from this, retail cost pass-through events may also occur. Historically, these variations to the price path (N or R) have been smaller or less frequent for gas than for electricity, but with the increase in gas flows throughout NSW this could change.

IPART state that they may seek advice from experts to assess future gas costs. This would be useful for estimating the approximate level of increase for customers, but we recommend that IPART do not set a three-year price path including wholesale gas costs at the conclusion of this review. Instead, the wholesale cost component should be separately reviewed at the times proposed by the Standard Retailers.

There is no liquid wholesale market for gas in eastern Australia that would allow a prudent and efficient retailer to manage the risks associated with controlling wholesale costs. If a three-year price path were set for Standard Retailers in 2013 then this could easily have the effect of transferring wholesale price risk solely to retailers and be contrary to market principles. The Standing Council on Energy and Resources (SCER) has recently agreed[5] that the principles underlying gas market policy should be:

- ensuring that supply responds flexibly to market conditions; and
- promoting market development.

IPART have already stated that their preliminary views are that their role includes:

- promoting customer choice and efficient entry and investment in the retail gas market by ensuring regulated retail prices provide an appropriate return, …, and

[4] IPART, Issues Paper, page 35

[5] SCER, Gas Market Development Plan – Summary, http://www.scer.gov.au/workstreams/energy-market-reform/gas-market-development/

- ensuring financial viability of efficient retailers by taking account of the risks faced by prudent and gas efficient retailers.[6]

We recognise that IPART sometimes needs to find a balance between competing objectives when regulating prices. The potential trade-off we see here is between:

1. allowing Standard Retailers to face a major risk in exposing them to wholesale gas cost variability, which is out of their control and could endanger their financial viability, and
2. providing regulatory price certainty for customers - where this certainty is already compromised by other factors and where customers can be given information on likely price increases in other ways.

The risks faced under option 1 have more serious consequences are less able to be mitigated than option 2. Notably, the risks faced by a Standard Retailer under a three-year gas price path are greater than is required of a retailer setting market-based prices as prices may be altered every year (or even more frequently if required) and there is no obligation to commit to retail price forecasts for future years. We therefore encourage IPART allow future updates of the wholesale cost component during the regulatory period.

Various mechanisms could provide this flexibility around updating the wholesale gas costs later in the regulatory period. We believe it would be appropriate to use the process that IPART normally use at the beginning of the regulatory period and apply this to the gas wholesale cost component in the future years. For IPART to achieve objectives around cost efficiency and process transparency this would mean that public consultation is required in 2014 and 2015. This is not dissimilar to what occurs in the determination of electricity pricing. For gas, we see this impact as an unavoidable consequence of the changes to the wholesale gas market. In our view, this additional public consultation in the second and third years would only have a negligible impact on retailers' costs and so no additional costs will flow through to customers.

3.2. Special circumstances reviews

Question 10 - Should we retain the special circumstance clause in the new agreements? How would this clause sit alongside any periodic review of wholesale gas costs?

It seems appropriate to us that IPART retain the special circumstances review in the next regulatory period in a similar form. A review mechanism for unforeseen events is a more effective way of dealing with risks of than attempting to quantify and incorporate an allowance for changes that can't be accurately predicted or assessed at the beginning of the regulatory period.

As a second tier retailer for NSW gas customers we are not particularly affected by the manner in which any periodic review of wholesale gas costs or special circumstances reviews are conducted. We are generally satisfied with the way that IPART approaches gas reviews in terms of transparency and process.

Question 11 - How should we review an application for a special circumstance price change? Should there be a materiality threshold? And if so, what should that threshold be?

We don't believe it necessary to include a materiality clause in the special circumstances review as neither IPART or the Standard Retailers will have an incentive to undertake a review if the potential benefits don't compare favourably with the expected outcome.

---

[6] IPART, Issues Paper, page 10

4. Costs underlying proposed prices

4.1. Wholesale gas costs

Question 12 - What is the prudent and efficient level of wholesale gas costs for each Standard Retailer over the next 3 years? What are the key factors affecting these costs?

The carbon exclusive gas cost of $8.26/GJ proposed by AGL for 2013/14 is consistent with our expectations as a participant in the NSW gas market. Other than this, it is difficult for us to comment explicitly on efficient levels for wholesale gas costs for each Standard Retailer as:

- very little information has been made publicly available;
- for similar reasons to the Standard Retailers, we do not wish to disclose our detailed expectations of wholesale gas costs; and
- we believe that gas wholesale costs will be very difficult to forecast with any accuracy.

The factors that are leading to increases in wholesale gas costs over the next three year were discussed earlier (section 3.1).

Question 13 - How should we characterise a prudent and efficient retail gas supplier for benchmarking purposes?

When conducting assessments of efficient costs we feel it would be useful for IPART to consider the costs of existing second tier retailers and new entrant retailers as well as Standard Retailers.

To encourage and maintain effective levels of competition in the retail gas market, it is important that IPART understand how costs might differ between different types of competing retailer and ensure that the overall level of the regulated gas tariffs in NSW also allow other retailers to offer tariffs at a profitable level.

4.2. Retail operating costs

Question 14 - What is the prudent and efficient level of retail costs for each Standard Retailer over the next 3 years? Have there been any significant changes in gas retail business activities since the 2010 review?

We do not separately itemise our retail operating costs (ROC) for gas and electricity customers, but observe that there have been fewer changes in gas retailing activities than for electricity.

In relation to encouraging competition, we suggest that ROC will be higher for second tier retailers wishing to begin retailing in new gas distribution areas in NSW. Not only can it be time consuming to set up the required access arrangements, it is costly to set up the required retail tariffs and establish and maintain additional back office operations. If the overall level of the regulated tariff in some NSW gas regions is inadequate for non-Standard Retailers then is very little chance that they will enter these regions or compete actively for customers.

In our view, $112 per customer per annum figure for ROC proposed by AGL is on the low side. We expect that many of the trends observed in electricity ROC will also occur for gas. That is, the introduction of National Energy Customer Framework (NECF), the increasing digitalisation of energy sales and services will also increase gas ROC during the next regulatory period. In addition, we are working with AEMO and the gas industry on B2B (business to business) gas hub in the NSW and ACT retail gas markets to improve the automation of distributor-retailer management of customer transfers and service orders. We expect this to lead to improvements to customer service and competition; however, it does add costs through participating in forums and in making changes to systems, processes and staff training.[7] This project is anticipated to take several years to deliver and requires a commitment from retailers and distributors to overcoming competing interests in order to achieve an effective solution.

4.3. Retail margin

Question 15 - What is appropriate retail margin for each Standard Retailer over the next 3 years? Has there been any change in the level of systematic risk or other business-specific risks the Standard Retailers will face over the next 3 years and to what extent should these be compensated for in the retail margin?

The retail margins proposed by AGL and ActewAGL appear reasonable, although we would ideally like to see a move to relatively consistent retail margins being applied in all supply areas. It's hard to see why retail margins should differ significantly by supply area. We are particularly concerned with the very low margins in the Country Energy area. It is vital that IPART ensure the margins are adequate as retailers will not enter or remain in a region with low or negative margins.

The higher the level of competition the more incentive a retailer has for reducing their own margin to attract customers. If the margin is set too low then there will be less incentive for existing retailers to offer innovative deals to customers and minimal incentive for new entrants to enter the market. The end result is a stagnant market. In contrast, a higher retail margin will encourage new competitors to enter the market and gain market share via discounting and new offerings.

Question 16 - Should the retail margin continue to be expressed as a fixed proportion of costs? To which cost components should the retail margin be applied?

We believe the retail margin should be applied as a percentage of the total costs as it is for NSW regulated electricity tariffs. This method is straightforward and results in sensible outcomes if later adjustments are made to any of the cost components. There is no clear justification for holding the retail margin at a fixed dollar level over the regulatory period.

4.4. Miscellaneous charges

IPART proposes that miscellaneous retail charges will be reviewed to ensure that fees are appropriate and are not double counted. In doing this we request that IPART also consider uniformity in the price level between areas. We don't see any reason why these charges should differ significantly by region and having similar price levels between different supply areas aids competition by reducing variability in approaches required. For similar reasons, we also argue for rationalisation of regulated tariffs in all markets.

Question 17 - Is it reasonable for a Standard Retailer to introduce a new fee for payment of gas bills by customer using credit and debit cards?

Yes. Where the use of credit and debit cards results in higher costs for retailers, it is reasonable that these costs are borne by the customers choosing to pay by these methods. Other payment methods, such as direct debit, are available to customers. These allow retailers to incur lower direct costs and processing costs.

---

[7] Currently the FRC Hub (full retail contestability hub) does not operate for NSW and ACT gas markets, but AEMO are working with industry to establish this: AEMO,http://www.aemo.com.au/Gas/Resources/Information-Systems/FRC-Hub, and http://www.aemo.com.au/Gas/Resources/Working-Groups/Gas-Retail-Consultative-Forum-ACT-and-NSW