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Review of regulated retail prices and charges for gas 2013 to 2016 – Issues Paper

The Energy Supply Association of Australia (esaa) welcomes the opportunity to make a submission to the Independent Pricing and Regulatory Tribunal's (IPART) Review of Regulated Retail Prices and Charges for Gas (2013-2016) Issues Paper.

The esaa is the peak industry body for the stationary energy sector in Australia and represents the policy positions of the Chief Executives of 36 electricity and downstream natural gas businesses. These businesses own and operate some $120 billion in assets, employ more than 51,000 people and contribute $16.5 billion directly to the nation's Gross Domestic Product.

Over the past decade, IPART has regulated retail gas prices by reaching an agreement with each Standard Retailer on a regulated price path for the period. As outlined in the Issues Paper, this approach is light-handed and generally regarded as a stepping stone towards the removal of retail price regulation. Unlike previous years, the Standard Retailers have proposed average regulated prices for 2013-14 only, citing that there are significant risks associated with establishing a fixed price path beyond this timeframe (i.e. for 2014-15 and 2015-16). These risks are primarily due to significant uncertainty over future wholesale gas prices and compliance with the carbon pricing mechanism.

The esaa remains firmly of the view that the most appropriate way to address such risks is to remove retail price regulation. Where this is not achieved, it is essential that regulated prices are cost-reflective and set at a level that promotes competition within the retail gas market. In this respect, the Association considers that the Standard Retailers proposal is a sensible approach that will minimise the risk of any material changes to components of the regulated tariff. Further, it will also allow for the timely removal of retail price regulation should the New South Wales Government declare that regulation is no longer required based on the outcomes of the Australian Energy Market Commission's (AEMC) review of competition in NSW.

NSW has undertaken significant reform to improve the efficiency and competitiveness of the retail gas market. These reforms include the introduction of retail competition for all gas customers in January 2002 and the application of a transparent and light-handed consultative process to set the standing contract price path for small-use customers. Accordingly, there are now around 20 companies authorised to retail natural gas in NSW, five of which currently retail natural gas to small customers. Further, as at 30 June 2012, approximately 70 per cent of small use customers in NSW were on market offer contracts compared with below 50 per cent in June 2009.

Despite these commendable achievements, the process of reform is not complete. Retail price regulation remains the key outstanding reform preventing a genuinely competitive retail gas market from flourishing in NSW. With the AEMC currently reviewing retail competition and regulation in NSW, IPART's review provides a timely opportunity to reflect on the current policy approach on retail competition.

The esaa agrees with IPART's view that effective retail competition – where retailers strive to offer customers products and services they value – is the best way to ensure that gas prices are driven towards the efficient cost of supply. Competition in retail gas markets, as in other sectors of the Australian economy, incentivises businesses to improve service, develop products that meet consumer needs and find ways to lower their costs and to pass those costs onto consumers. As a result, retail prices are set as low as is sustainably possible while businesses can still make an appropriate return.

The Association considers that open competitive markets free from distortions such as retail price regulation naturally encourage prices to be efficient. Regulated retail prices, in effect, form price caps in the market. As a result, retail price regulation in contestable electricity markets is an inherently fallible and risk-laden exercise that can be self-fulfilling. Regulating prices in potentially competitive markets whereby regulated tariffs may be set below the cost of supply impedes the efficient operation of the market. It creates financial pressure for industry participants forced to absorb costs that cannot be passed on and removes incentives for retail businesses to enter the market and compete for small-use customers. Conversely, in the event that prices are set above the cost of supply – including an appropriate retail margin – competition will erode margins back to efficient levels. The risks are thus asymmetric, with greater adverse consequences arising from setting the regulated price too low.

As outlined in the Issues Paper, the task of setting appropriate retail prices that are competitive but still allow retail businesses to meet their costs and manage risks is becoming increasingly complicated, largely as a result of regulatory and market changes. With respect to the wholesale gas market, impending linkages to international markets for liquefied natural gas (LNG) have introduced new complexities and opportunities into the east coast gas market. As a result, it's likely the competitive environment will change for two main reasons:

- Opening up the east coast to export markets also opens it to world prices, meaning domestic gas prices have the potential align with international gas prices over time.

- Contract terms (including length of coverage) may vary from previous market norms as the competition for supply is increasing with the entry of LNG proponents, who will be seeking adequate supply to ensure they can meet their LNG export commitments over time.

It is currently unclear as to how these and other factors (e.g. the development of coal seam gas reserves in NSW) will ultimately impact upon the dynamics of the east coast gas market, particularly with respect to wholesale gas prices. Given that the wholesale gas price component represents a substantial proportion of the regulated tariff, this uncertainty has significant implications for regulated tariffs also. Indeed, any material change in wholesale gas prices over the regulatory period would need to be reflected in regulated tariffs, or risk exposing retail businesses to costs that cannot be recovered.

The esaa considers that the NSW Government can avoid the risks of setting a price either too high or too low by removing gas retail price regulation and allowing the competitive market to find the efficient price. In this respect, should the AEMC recommend deregulation of the retail gas market in its final report (due September 2013), this should be used as a catalyst to immediately pursue the removal of retail price controls.

As the NSW Government has chosen to regulate retail gas prices in the interim, flexibility in the setting of regulated retail prices is imperative. In particular, given the significant uncertainties outlined above in relation to wholesale gas prices, it would seem prudent to implement an approach that avoids setting a fixed price path over the three-year regulatory period and allows for periodic adjustments. While the esaa accepts such an approach may add to the complexity of the tariff setting process and reduce price certainty to some degree, the Association considers that the benefits of setting tariffs in a manner that facilitates competition far outweigh any potential costs.

Any questions about our submission should be addressed to Kieran Donoghue, by email to kieran.donoghue@esaa.com.au or by telephone on (03) 9205 3116.

Yours sincerely

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