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EnergyAustralia®

17 December 2009

Mr James Cox
Acting Chairman and CEO
Chief Executive Officer
Independent Pricing & Regulatory Tribunal
PO Box Q290
QVB Post Office NSW 1230

Via email: ipart@ipart.nsw.gov.au

Dear Mr Cox,

EnergyAustralia's Submission on the Review of regulated retail tariffs and charges for gas 2010 - 2013

EnergyAustralia welcomes the opportunity to comment on IPART's Issues Paper for the Review of regulated retail tariffs and charges for gas 2010 – 2013.

We trust our submission will assist IPART with this price review. If you have any queries regarding this submission please contact Catherine Marshall, Executive Manager – Energy Pricing on (02) 9269 7256.

Sincerely,

Mike Bailey
Executive General Manager Retail

EnergyAustralia Retail

Response to IPART's Issues Paper

Review of regulated retail tariffs and charges for gas 2010 - 2013

December 2009

Response to IPART's Issues Paper

November 2009

Contents

1 Executive Summary

EnergyAustralia welcomes the opportunity to make the following submission in response to IPART's Issues Paper on the Review of Regulated Tariffs and Charges for Gas 2010 – 2013.

While EnergyAustralia would prefer to see the removal of price regulation we recognise that the NSW Government has requested that IPART continue to regulate prices for small retail customers. In light of this directive we are appreciative that IPART intends to maintain the current light-handed approach to the regulation of retail gas tariffs.

EnergyAustralia is pleased to see that the price control under the Voluntary Transitional Pricing Agreements (VTPAs) is limited to the retail component of the tariffs as we believe a direct pass through of network distribution and carbon costs will assist in meeting the objectives of the review as this helps ensure the regulated prices recover the efficient costs of supplying gas as well as being consistent with the principles of regulatory best practice. Further, we believe the use of a WAPC formula with no additional side constraints on the retail component of the tariffs best meet the objectives of the review.

EnergyAustralia, in general, supports the principles contained in the Standard Retailers' VTPAs but considers that there should be a level of consistency across the four VTPAs. Some of the areas that we consider could be made consistent include the method of calculating CPI, the timing of publishing tariffs and timing of advising/notifying IPART of increases.

The gas market in NSW is about to go through a period of substantial change as a result of the introduction of the Short Term Trading Market (STTM) in the Sydney hub. The STTM will result in increased costs to retailers as well as increased risks. The STTM also has the potential to result in unforseen impacts. It is important that the increased costs and risks are recognised as part of the gas price review.

2 Approach to the review of regulated retail gas tariffs

IPART seeks comments on the following

- Do Voluntary Transitional Pricing Agreements (VTPAs) continue to be an appropriate form of regulation for the Standard Retailers' regulated retail gas tariffs, given the objectives and context for this review? Are there enhancements that can be made to the current approach?
- What (if any) other forms of regulation should we consider?

In light of the Government's requirement for either new Voluntary Transitional Pricing Agreements (VTPAs) EnergyAustralia considers that the VTPAs continue to be the most appropriate form of regulation for the retail gas tariffs.

EnergyAustralia supports the removal of price regulation for gas but recognises that the Government requires either new VTPAs or gas pricing orders to be in place for the period 1 July 2010 to 30 June 2013.

Given this requirement, EnergyAustralia supports a continuation of the light-handed approach to the regulation of retail gas tariffs that IPART has historically applied. We believe the continuation of the current approach best facilitates a considered transition towards an environment where full retail price deregulation can become a reality.

The use of VTPAs is preferable to other forms of price regulation (including the use of Gas Pricing Order) as they provide the Standard Retailers with greater flexibility in setting regulated tariffs.

In EnergyAustralia's opinion the VTPAs have been an effective form of regulation and we do not believe that other forms of regulation need to be considered. EnergyAustralia agrees with IPART's view that moving to a more prescriptive, less light-handed form of regulation would be a backwards step especially in light of the NSW Government's commitment to phase out retail price regulation.

IPART seeks comments on the following

- Is there adequate information available for customers to make informed choices when choosing a gas supplier? If not, what measures could be implemented to address this?
- Are the proposed assessment criteria appropriate to guide our analysis and decision-making for this review?

EnergyAustralia is of the view that there is enough information currently available to enable customers to make informed choices when choosing a gas supplier. EnergyAustralia believes it is in a retailer's best interests to enable customers to easily find information on their current commonly available offers and indeed many retailers already have this information available on their websites or available from their contact centres.

However, if a formal obligation regarding disclosure requirements was to be imposed upon retailers EnergyAustralia considers that this is best done through the provision of price fact sheets on retailers' websites.

An obligation of this nature is already placed on retailers offering residential contracts in QLD (see Queensland Electricity Industry Code - clause 8.2). In line with that code, retailers are required to provide a price fact sheet on their website for each of their current product offerings. This placement of information on retailers' websites provides customers with detailed information on product offerings and more readily allows them to make their own direct comparisons to the offerings of other retailers. This is far in preference to price comparison sites set up by "independent" parties or even regulators which can be confusing, and at times misleading, given their inflexibility and inability to provide an exact apples to apples comparison. We also note that contractual prices & offers can change frequently so there is a risk that information on a comparison website may not be up to date.

The objectives of the Gas Supply Act require that both the interests of small retail customers and the business interests of those supplying gas to small retail customers be taken into proper account. EnergyAustralia believes that the assessment criteria proposed by IPART achieves a balance between these objectives. The inclusion of the desire to be consistent with best regulatory practice is fully supported by EnergyAustralia.

3 Standard Retailers' Proposals

IPART seeks comments on the following

- Do stakeholders consider that the Standard Retailers' proposals are reasonable in general? Are there any specific issues or individual components of the proposals that stakeholders wish to comment on?

EnergyAustralia believes that the Standard Retailers' proposals are, in general, reasonable and fully supports many of the principles proposed. However, we consider that there should be some consistency between proposals on some of the more "administrative" issues.

As stated elsewhere in this submission, EnergyAustralia supports the approach taken by AGL, Country Energy and Origin Energy to have a direct pass through of network costs with the WAPC formula only applying to the retail component and carbon pollution reduction scheme costs not being subject to the CPI constraint.

While recognising that each of the Standard Retailers is a separate business and have different drivers there is a level of consistency that can be achieved across the Standard Retailers' proposals which would enable more streamlined processes and industry consistency.

Areas where EnergyAustralia considers there could be consistency between the proposals are in:

- the date by which the Standard Retailer must advice IPART of special circumstances increases. Origin propose giving 3 months notice while AGL and Country Energy propose giving 4 months notice
- the CPI calculation to be applied. Country Energy has proposed using just the year on year December quarters CPI to determine the CPI variation while other retailers have proposed using the year on year average of the four quarters.
- the timing requirement to publish the approved tariffs on the retailer's websites as this currently varies between 5 business days after approval, at least 1 business day before they come into effect (Origin's proposal 3.12(f)) and no later than 15 calendar days prior to the date they come into effect (Country Energy for changes as a result of changes in the network

component). EnergyAustralia believes the Standard Retailers should be required to publish on their websites as soon as possible and no later than 5 days after approval (for those tariffs requiring IPART approval) and no later than 15 business days prior to taking effect for any change not requiring IPART approval.

- the treatment of CPRS. Further details on EnergyAustralia's preferred approach to the treatment of carbon costs can be found in Section 5.2.

It is also noted that IPART's Draft Report and Draft Determination for electricity proposes that Standard Retailers be required to lodge their annual pricing proposals by 15 May, for approval by 1 June[1]. In the event of this being adopted in the final Determination, EnergyAustralia supports this approach also being taken for the Gas Review processes to ensure a consistency across the industry.

[1] IPART, *Review of regulated retail tariffs and charges for electricity 2010 – 2013. Electricity – Draft Report and Draft Determination*, December 2009, p63

4 Setting of regulated tariffs

IPART seeks comments on the following

- Does a WAPC best meet the objectives for this review? Are there enhancements that can be made to the current approach?
- Is there any evidence to suggest that a WAPC is inappropriate? Are there other approaches to setting retail tariffs that IPART should consider?

EnergyAustralia supports the use of the WAPC formula with no additional side constraints to regulate gas retail tariffs.

We do not believe that any further enhancements to the WAPC approach need to be made beyond those currently suggested by the Standard Retailers. Further, we believe that potential "enhancements" such as the reintroduction of side constraints would actually be a retrospective step.

EnergyAustralia does not believe there is evidence to suggest that the WAPC approach is inappropriate and feels that the WAPC formula is a sensible approach. As IPART recognise the small number of regulated tariffs generally offered by Standard Retailers and the level of competition effectively act as a deterrent to prevent regulated tariffs being set significantly higher than cost-reflective levels. Additionally the proposals by the Standard Retailers to pass through network charges increases the transparency of the tariff which, in EnergyAustralia's opinion, further reduces whatever remaining potential there was.

EnergyAustralia is generally happy with the approach to determining retail gas tariffs outlined in IPART's preliminary view and does not see that there are other approaches that they should consider.

5 Risks and uncertainties

5.1 Distribution network costs

> IPART seeks comments on the following
>
> - Should IPART accept the Standard Retailers' proposal to pass network charges through to customers?

EnergyAustralia believes that IPART should accept the Standard Retailers' proposals to pass network charges through to customers as it will assist in ensuring that the objectives of the review are met.

EnergyAustralia fully supports the Standard Retailers' proposals to pass network charges through to customers and believes that IPART should accept this proposal. The tariff adjustment mechanism included in Jemena Gas Networks' Proposed Access Arrangement, which forms the network cost base for AGL's and ActewAGL's retail tariffs, is complicated and has the potential to move both up and down on an annual basis. Passing through the network charges to customers ensures customers have the benefit of any reduction in network charges and also ensures that retailers do not have to wear the cost of increases in network charges greater than CPI.

The network tariffs are an uncontrollable cost from a retail perspective and therefore should not be subject to regulation at a retail level. Additionally, the network prices are already subject to rigorous economic regulation by the AER and to include them as part of the regulation of the retail tariffs effectively double regulates them.

Further, the pass through of network charges to customers helps ensure that IPART's assessment criteria is met, as the pass through of network charges will assist in ensuring that the regulated prices recover the efficient costs of supplying gas and is consistent with the principles of best regulatory practice.

5.2 National Climate Change measures

> IPART seeks comments on the following
>
> - What is the most appropriate way to address uncertain costs associated with national climate change measures in the new VTPAs?
> - If the Standard Retailers set retail prices based on their own forecasts of CPRS permit costs, should this forecast ever be reconciled with the actual costs of permits?

EnergyAustralia believes that there is value in taking a consistent approach to the treatment of costs associated with national climate change measures and that the most appropriate way is through an annual adjustment mechanism outside of the CPI constraint which allows an automatic pass through by the Standard Retailer of a "benchmark cost".

To ensure transparency and certainty, EnergyAustralia prefers that climate change related costs are explicitly accounted for in the VTPAs rather than being left to be dealt with via the Special Circumstances provision. Relying on the Special Circumstances provision would provide little certainty to retailers of both the methodology and extent of cost recovery come the introduction of CPRS. Further the administrative workload for both the Standard Retailer and IPART would be greater if an annual special circumstances provision was applied rather than a simple pass through.

As it is only in the final year under this review that there will be market pricing of Australian Emission Units (AEUs), and in theory this year is also the final year that gas prices for small gas customers should be regulated, EnergyAustralia does not consider it feasible that the forecast CPRS permit costs be reconciled with the actual costs.

5.3 Unforeseen events

> IPART seeks comments on the following
>
> - Is the Standard Retailer the only party who should trigger special circumstances and a review or re-opening of a VTPA?
> - How should IPART conduct a review of an application for a special circumstance price change?

- Should there be a materiality threshold to trigger a special circumstances review? And if so, what should that threshold be?

EnergyAustralia believes the right to trigger special circumstances and a review or re-opening of a VTPA should be limited to the Standard Retailer only.

The process IPART uses to conduct a review of an application for a special circumstance price change should be consistent across all Standard Retailers and also, where feasible, consistent with the process undertaken in reviewing the prices for the regulatory period.

In EnergyAustralia's opinion a materiality threshold to trigger a special circumstances review is not required. In deciding whether or not to trigger a special circumstances review it is reasonable to expect that the Standard Retailers will have already weighed up the costs of the review versus the expected benefit and will only trigger a review when they consider the expected benefit to be worth the review cost. It is worth remembering that the cost of the review from the retailer's perspective is not limited to the cost of the review itself being carried out; Retailers prior to triggering a special circumstances review would also consider customers and competitive impacts.

6 Assessing the efficient costs of gas supply

6.1 Wholesale gas costs

IPART seeks comments on the following

- Have there been any significant changes to retail business activities since the 2007 review? And if so, what are the implications for wholesale gas costs?
- Is IPART's proposed approach to assessing wholesale gas costs for the 2010 review appropriate? If not, what are the alterative approaches?

The structure of the gas market within the Sydney region is about to undergo significant change as a result of the introduction of the STTM. This will have an impact on both the wholesale costs and the risks faced by retailers.

While there has been no significant change in the retail business activities since the 2007 review there have been changes to wholesale gas costs. There will continue to be further changes to wholesale gas costs during the 2010 – 2013 Regulatory Period due to the introduction of the STTM.

Since the 2007 review, there have been unusual circumstances in the wholesale gas market which resulted in constrained gas supply and transmission capacity and a significant increase in gas supply costs. IPART addressed this issue in early 2008 by approving a retail tariff price increase via special circumstances mechanisms from 1 April 2008.

Since then members of the industry have spent time and resources participating in the market design, rule formulation and procedure drafting of the STTM.

The introduction of the STTM in June 2010 is expected to create new risks on retailers that are not present under the current balancing mechanisms. As part of this review the costs of the STTM need to be factored into both the wholesale gas costs while the additional risks should be allowed for in the retail margin allowance.

IPART's proposed approach to assessing wholesale gas costs is reasonable overall, however, the assessment needs to recognise changes in wholesale gas costs not only due to CPRS (as IPART indicate) but also due to the introduction of the STTM.

The STTM introduces a significant new cost, being the costs of the Market Operator Service (MOS). Such costs are generated when gas withdrawn from the Sydney hub is different from the volume forecast to be withdrawn and hence from the gas injected by participants. Participants are allocated MOS gas commensurate with their deviations, mainly arising from load forecast error. MOS gas is allocated for all variations between scheduled and actual quantities (positive and negative). In contrast, under current balancing procedures, this only occurs when the market overall injects less gas than withdrawn.

Based on internal analysis, EnergyAustralia estimates the risks created by the STTM design will increase wholesale gas costs and that this increase may be significant, given that the price cap for the STTM is $400/GJ. This price cap is for the energy only and is in addition to the MOS service/"capacity" fee of $50/GJ. Hence the impact of the STTM needs to be considered by IPART in its review of wholesale gas costs. If required, more information on EnergyAustralia's analysis can be made available to IPART on a commercial in confidence basis.

6.2 Retail operating costs

IPART seeks comments on the following

- Have there been any significant changes to retail business activities since the 2007 review? And if so, what are the implications for retail operating costs?
- Are previous retail operating cost analyses and benchmarks a valid starting point? If not what are the alternative approaches?

While there have been fluctuations in the levels of retail business activities there have been no significant changes to the nature of gas retail business activities.

EnergyAustralia considers that previous retail operating cost analyses and benchmarks (corrected for inflation) are a valid starting point for analysis on retail operating costs provided a number of critical factors are taken into account.

Historical retail operating costs will also need to be adjusted for an increase in bad debt and collection costs that will result from the significant increases in gas prices resulting from the proposed increases in network tariffs as well as future increases due to the introduction of CPRS. This increase in costs is two fold as even if the number of non-paying customers is unchanged the level of bad debt has increased due to the price increases while there is also the potential for an increase in the number of customers not paying due to the higher prices.

It is important for any benchmarking exercise to clearly understand what has been covered in that component versus another area i.e. what is being covered by operating costs versus retail margin versus energy costs and ensure that comparisons are performed on a like basis.

6.3 Retail margin

IPART seeks comments on the following

- Have there been any significant changes to retail business activities since the 2007 review? And if so, what are the implications for the retail margin?
- Can the supply of gas be considered an essential service? If not, to what extent are the risks inherent in gas retailing different to those in electricity?
- To what extent, if any, are the risks inherent in retailing gas in NSW different to those in other jurisdictions?
- Is IPART's proposed approach to assessing the retail margin for the 2010 review appropriate? If not, what are the alternative approaches?

It is vital that the retail margin is appropriate to the risk level faced by retailers.

As previously stated EnergyAustralia does not believe there have been any significant changes to retail business activities and therefore no flow on implications for the calculation of the retail margin from that perspective. However we believe a number of changes (in particular the introduction of the STTM and the introduction of CPRS) will result in increased risks faced by retailers and that this should be factored into the margin allowance for the 2010 – 2013 Regulatory Period.

EnergyAustralia does not consider that the supply of gas can be considered an essential service. Regardless of whether the gas is considered an essential service or not, the risks inherent in retailing gas are different from those faced in retailing electricity due to the gas and electricity markets being fundamentally different. There are also differences in how customers view the fuels from an environmental perspective which changes the risk profile.

Further, the risks faced by retailers in supplying gas in NSW are different from that faced in other jurisdictions and different from that faced in the 2007 – 2010 Regulatory Period.

The risks faced across the different gas jurisdictions differ due to market design. For example, Victoria has a spot market based system with market carriage transmission, while South Australia and NSW are moving towards a STTM retaining contract carriage transmission. The STTM can expose retailers to higher levels of risk than the current structure. Being a new, untested market it is likely (and typical) that retailers will experience costs and risks not foreseen in the market design.

The approach to determining the retail margin proposed by IPART is consistent with the methodology that is being used in electricity. EnergyAustralia feels that this is generally an appropriate approach provided the correct assumptions and comparisons are made and that risks not compensated for elsewhere are considered in determining the margin. It is important that the Strategic Finance Group (SFG) analysis also recognises the risks that faced by the Standard Retailers in NSW and in particular the Sydney basin are different from those faced elsewhere and adjust the margin accordingly. Our comments made as part of the electricity review[2] regarding concerns with the appropriateness of SFG's benchmarking approach also apply here.

[2] EnergyAustralia, *Response to IPART's Draft Methodology Paper – Review of regulated retail tariffs and charges for electricity 2010 – 2013*, September 2009

7 Non-tariffs fees and charges

> IPART seeks comments on the following
>
> - Is it reasonable for the Standard Retailers to introduce a new fee for the payment of gas bills by customers using a credit card?
> - Is it reasonable for the Standard Retailers to change the level of the late payment fee?
> - Do other retailers add a premium to miscellaneous charges imposed by distribution network operators? Is it reasonable to add a premium onto network miscellaneous charges?

The introduction of a new fee for payment of gas bills by credit card is, in EnergyAustralia's opinion reasonable.

The level of the late payment fee should be adjusted to be cost reflective. At present, the late payment fee is insufficient to cover the costs associated with late payments and EnergyAustralia believes adjusting the late payment fees to be in line with the costs is consistent with the objectives of IPART's review.

Where miscellaneous charges imposed by the distribution network operator are charged to a customer by EnergyAustralia no premium is added onto those charges. However, EnergyAustralia believes it is reasonable for a retailer to add a premium onto the miscellaneous network charges.