Ref: CW:JC: A80604

18 December 2009

Mr James Cox
Chief Executive Officer
Independent Pricing and Regulatory Tribunal
PO Box Q290
QVB Post Office
SYDNEY NSW 1230

Dear Mr Cox

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

Country Energy is pleased to provide the attached submission to the Independent Pricing and Regulatory Tribunal (IPART) in response to the release of the *Review of regulated electricity tariffs and charges for gas 2010 to 2013 – Issues paper*.

Country Energy looks forward to providing additional information and clarification to assist IPART and its Officers.

Should your Officers have any questions in relation to this submission, they may wish to contact Natalie Lindsay on (02) 6589 8419 or Catherine Waddell on (02) 6338 3553.

Yours sincerely

Craig Murray
Managing Director

Att. 1

Country Energy's submission to 2010-2013 retail tariff review for gas

December 2009

Submission to IPART *Review of regulated retail tariffs and charges for gas 2010-2013*, Gas Issues Paper November 2009
December 09

EXECUTIVE SUMMARY

Country Energy is pleased to provide this response to the Independent Pricing and Regulatory Tribunal (IPART) Issues Paper regarding the Review of Regulated Retail Tariffs and Charges for Gas 2010 – 2013 (“the Review”). The issues paper provides an opportunity for Standard Retailers and other stakeholders to comment on a range of issues relevant to the Review. Importantly, the issues paper consultation process provides an opportunity to review developments since IPART completed its 2007-10 Review and the outlook for 2010-13.

Country Energy supports the NSW government and IPART objectives for retail gas regulation in NSW. These include:

- ensuring retail gas tariffs reflect efficient costs of supplying gas to small retail customers;
- encourage the development of a competitive market in gas;
- to regulate gas reticulation and supply so as to protect the interests of customers and promote customer choice;
- facilitate the continuity of natural gas supply to customers and promote the safe use of gas; and
- be consistent with regulatory best practice.

Country Energy has found that the current light handed regulation in the form of Voluntary Transitional Pricing Arrangements (VTPAs) have been effective. The special circumstances clause provided for a review of prices when revenue requirements increased above CPI as a result of unforeseen increases in wholesale costs. This mechanism is an effective tool in allowing retailers to maintain financial viability in a volatile market.

There will be a higher degree of uncertainty and volatility in the gas market over the 2010-13 period with increased demand for gas and the impending introduction of climate change mitigation strategies. This makes it more important for retailers to have a course of action for passing on these costs to customers in a timely manner.

Country Energy acknowledges the consumer impacts of rising energy prices. The risk of energy poverty is greater in the non-metropolitan areas served by Country Energy, given lower average incomes. Country Energy welcomes recent government initiatives to assist vulnerable and other at risk customers. Country Energy has in place frameworks and programs to protect at risk customers. Customer impacts specifically from CPRS can be expected to be addressed through the CPRS adjustment mechanisms outlined by the Commonwealth in its CPRS White Paper. In this submission CPRS is used to refer to any form of climate mitigation strategy that has an impact on end use customer prices.

KEY RECOMMENDATIONS

This submission details Country Energy's position on a range of issues as outlined in the Terms of Reference. A summary of the key recommendations contained within the paper are provided below.

Section	Key Recommendations
2. Approach to review of regulated retail gas tariffs	• Country Energy generally agrees with IPART's approach to conducting this review and continuing with the use of VTPAs.
3. Standard retailers proposals	• Standard retailers have, to a large extent, agreed to: o Retain WAPC form of price control; o Apply price cap to retail component of regulated tariff only; o Full pass through of network charges; o Have a mechanism to allow the pass through of unforeseen changes in retail costs, including any climate change measures.
4. How should tariffs be set	• The use of WAPC to limit the average change to regulated tariffs is an appropriate method to regulate prices while encouraging competition.
5. Risks and uncertainties	• Risk of increases in network charges would be eliminated by having them allowed as full pass through. • Risk of costs associated with the introduction of CPRS would be eliminated by having them allowed as full pass through. • The other major areas of risk around unforeseen increases in costs can also be largely contained by continuing to include a special increase provision in the VTPAs.
6. Efficient supply cost of gas	• Given there is very limited public data on wholesale gas costs, an assessment of actual contract costs is required, along with reasonableness test in allocating between contract and regulated customers.
7. Non-tariff fees and charges	• Country Energy supports the introduction of a credit card payment fee. • Late payment fees should be cost reflective and align with fees for electricity customers.

REVIEW APPROACH

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? (Question 1)

Country Energy agrees that the current form of regulation has assisted in maintaining prices at cost reflective levels and supports IPART's proposal to continue with this light handed form of regulation. VTPAs with standard retailers are an appropriate method of regulating retail gas prices and support the objective of phasing out regulation. While the current VTPAs have worked reasonably well there are some enhancements that would assist given the changes in the retail gas area since the 2007 review, as detailed below.

What (if any) other forms of regulation should we consider? (Question 2)

If there is another appropriate form of regulation then IPART would need to ensure that it would meet the objectives of this review and assist in the phasing out of retail price regulation. Where retail price regulation remains, cost reflective regulated tariffs, including appropriate adjustments for risk, are an integral requirement for an effective and competitive gas market in NSW. An aim for this upcoming Review period should be to further reduce reliance on retail price regulation.

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? (Question 3)

Customer choices depend on having available and comparable information. Provided that the review is transparent and the retailers make available their prices and VTPAs then customers in NSW do have sufficient information to allow them to exercise choice. Non-metropolitan customers will increasingly self-select competition options through forms of marketing other than door-knockers. These include telemarketing, direct mail, general advertising and websites that compare relative service offerings.

Similar to the electricity market, there is little pricing innovation in the limited competitive offers that are available to small customers. Most relate to a "discount off" the regulated price or some form of rebate. These competitive price offerings may not necessarily demonstrate that other retailers have a sustainable competitive advantage but may be more related to competitors buying market share. The "discount off" the regulated price can provide transparency on prices to customers.

If the electricity market becomes more buoyant and competition strengthens, the gas market would also experience increased competition, as retailers generally have both these services to their customers.

Are the proposed assessment criteria appropriate to guide our analysis and decision-making for this review? (Question 4)

Country Energy supports the assessment criteria IPART have proposed for this review and suggest the addition of further criteria in line with IPART's proposal.

Country Energy's proposed additional criteria are:

- facilitation of national retail market integration;
- preservation of financial viability of standard retailers;
- achievement and maintenance of cost reflective retail pricing (CRRP);

- removal of retail market rigidities that undermine the ability of energy market frameworks to respond to climate change policies, including the requirement for substantial investment in low emissions generation capacity.

STANDARD RETAILERS RESPONSES

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? (Question 5)

The standard retailers have largely agreed to retaining the WAPC form of price control but applying this to the retail component only. They have also agreed that network charges need to be fully passed through and there needs to be a "special circumstances" review mechanism in order to maintain financial viability. The impending introduction of climate mitigation strategies, in particular the CPRS, was also identified as a cost that retailers need to be able to pass through to customers, although there were some differing views on how this should be handled in the VTPAs.

SETTING TARIFFS

Does a WAPC best meet the objectives for this review? Are there enhancements that can be made to the current approach? (Question 6)

To the extent that regulated retail tariffs are required, Country Energy supports regulated retail tariffs governed under a WAPC approach. This approach gives flexibility to Standard Retailers and is, to some extent, an appropriate response to potential regulatory error.

However, enhancements to the current approach could be made to ensure compatibility with the proposed assessment criteria, in light of the substantial uncertainty over energy purchase costs over the price control period, and indicatively include:

- an extension of the N+R form of regulation that is used in retail electricity; and
- introduction of a "C" component, to ensure CPRS costs can be passed through.

Is there any evidence to suggest that a WAPC is inappropriate? Are there other approaches to setting retail tariffs that IPART should consider? (Question 7)

Objectives of this review include providing customers with a reliable and safe gas supply and to promote competition in the retail gas market. Continuing with the use of a weighted average price cap is consistant with these aims and any attempt to increase individual tariffs by much more than the overall average will be limited in an actively competitive market. As IPART have mentioned the impact on individual customer accounts should be relatively close to the total average increase given the small number of tariffs.

The use of a WAPC is appropriate and there is nothing to suggest a material change away form this approach to setting tariffs is required.

RISKS AND UNCERTAINTIES

Should IPART accept the Standard Retailers' proposal to pass network charges through to customers? (Question 8)

The natural gas distributors are currently undergoing a review process with the Australian Energy Regulator (AER) and the outcome in terms of network price increases is still not fully known. Given the increases in network charges were implicitly included in the 2007 review as a result of IPART also being the regulator for gas distribution at that time, it is reasonable that this review also allows for network charges to be passed through by using a N+R structure. This would also align regulated retail gas pricing to the pricing structure used in regulated retail electricity pricing.

What is the most appropriate way to address uncertain costs associated with national climate change measures in the new VTPAs? (Question 9)

Country Energy originally proposed including costs associated with climate change as part of the special circumstances provision. Other standard retailers have proposed having this as a separate cost element which would be automatically passed through to customers along the line of network charges, meaning that tariffs would have an R +N + C structure. Country Energy is prepared to also take this approach given it is consistant with the view presented in the current review of regulated retail electricity prices. This treatment is also in line with the AEMC review.

The cost of any scheme that may be introduced to mitigate climate change may not be transparent or readily observable in the market. Country Energy believe these costs are going to be caught up in the contracts negotiated with gas suppliers and therefore the retailers will need to set the price for the "C" component based on actual quoted costs and the cost of any CPRS permits required to be purchased. A competitive market will ensure that prices are not set at falsely high levels.

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? (Question 10)

The various components of retail prices are not currently subject to a reconciliation process. To introduce reconciliation of any CPRS component would be a step away from this and Country energy do not feel it is warranted. As stated above competition in the market place would serve to ensure the "C" component is set at cost reflective levels.

In addition to this, the timing of the introduction of CPRS may mean that a retrospective reconciliation of these costs may not eventuate in any event, given the first year of forecasting them will be the final year of the review. At this stage it is anticipated no further reviews will be necessary if the competitive market develops as expected.

Is the Standard Retailer the only party who should trigger special circumstances and a review or re-opening of a VTPA? (Question 11)

The standard retailer or IPART, the two parties to a VTPA, should be able to trigger a special circumstance review. The circumstances of winter 2007 and the resultant substantial increases to wholesale costs of gas and the transportation of that gas would have been unbearable to retailers if they had not been able to use this review mechanism to pass through the costs to customers. Country Energy recognises that there may be circumstances when IPART would also need to request a review, for example as a result of public requests put to IPART as the regulator when CPRS is introduced. Public consultation is an important part of the price setting process.

How should IPART conduct a review of an application for a special circumstance price change? (Question 12)

The current process has proved effective and should remain to a large degree. This process has assisted in maintaining light handed regulation and more constrictive measures would not be in keeping with reducing reliance on regulation and increasing competition.

Special circumstances should be assessed against the objectives of the Gas Supply Act and the criteria of this review.

Should there be a materiality threshold to trigger a special circumstances review? And if so, what should that threshold be? (Question 13)

Country Energy believes that a standard retailer would not request a special circumstance review unless there was reasonable need to do so, as any unreasonable increase to prices would be limited by competition and customers moving to another retailer. It is also acknowledged that certain components of any increase to costs may be allowed for in the retail margin and therefore should not warrant a price review. Costs of a small increase outweigh benefits so threshold not needed.

Given that the standard retailers are all operating in basically the same market, it would be expected that a review request would not be isolated to one retailer and therefore IPART would be able to perform comparisons across the retailers to assess the reasonableness of review requests.

The increases in network charges as provided for in the draft AER Access Arrangement determinations for 2010-2015 would already mean that an annual review of the retail gas charges would be required, similar to that process proposed in the draft electricity report IPART released 14 December 2009.

EFFICIENT COSTS OF SUPPLYING GAS

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? (Question 14)

IPART have documented the significant changes seen in the gas market since the 2007 review, in particular the events of winter 2007 and the increasing demand for gas for generation along with the expanding overseas market for LNG. This means that there is more volatility in wholesale prices, and the price of purchasing and securing gas supply could escalate as contracts roll off and are re-negotiated. This makes it crucial for the special provision clause to remain in future VTPAs to enable retailers to recover these costs from customers as the standard retailer's financial viability should not be compromised by this.

Is IPART's proposed approach to assessing wholesale gas costs for the 2010 review appropriate? If not, what are the alterative approaches? (Question 15)

Country Energy is comfortable with IPART's proposed method for reviewing wholesale costs and support basing the review on actual costs rather than modelled assumptions.

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? (Question 16)

Country Energy believes there have been some significant changes to business activities since the 2007 review and anticipate there will be further significant changes in the future. The introduction of climate change measures for example, will require additional administrative support and changes to the way customers are billed. The special circumstances clause may be the most appropriate method of dealing with these changes rather than as part of operating costs.

Marketing activity may well need to be stepped up in a more competitive market as well and retailer operating costs should include all expenditure relating to attaining, retaining and servicing customers in line with the operating costs for retail electricity.

Are previous retail operating cost analyses and benchmarks a valid starting point? If not what are the alternative approaches? (Question 17)

It is reasonable to use previous operating costs as a starting point, in particular the recent work done on retail electricity operating cots. Any incremental costs arising from significant events should be treated on a case by case basis through a special circumstances review, as mentioned in the response to question 16.

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? (Question 18)

Operating in the retail gas market has become more risky. Traditionally demand mainly comprised of retail demand and some major self contracting users. In recent years there has been significant increase in gas fired generation in the Eastern States (for example Tallawarra, Uranquinty and Colongara) which also competes for supply and pipeline capacity. While gas supply has softened since 2007, securing pipeline capacity can become problematic if the timing of pipeline expansions is not matched with Greenfield growth. As CE's wholesale position is to generally secure short terms supply and haulage agreements (2-3 years) to meet committed retail load, there is risk that capacity constraints may be present when CE seeks to renew its contracts. At present APA is undertaking a capital works program to expand pipeline capacity over several years, and have increased their published tariffs accordingly. However with the introduction of the Short Term trading Market in Sydney (Jun 10) both APA and Jemena are offering pipeline park services which utilises capacity and reduces the amount of firm delivery capacity available for sale. In 2007 demand for capacity in the Eastern Gas Pipeline exceeded supply. As such Jemena auctioned their remaining capacity and received prices well above the published tariffs.

A vertically integrated retailer has several operational and cost advantages over second tier retailers. For example a vertically integrated retailer may be able to utilise the complementary nature of summer gas fired generation with winter retail gas demand to secure a lower wholesale gas price based on a flatter load shape (or they may also have interests in gas production). Pipeline capacity and storage again is likely to be used more efficiently over the year as summer generation can reduce sunk pipeline capacity costs.

IPART need to find the right balance between appropriate allowances for wholesale costs and retail margin given CE has sunk haulage costs with no tangible ability to utilise pipeline capacity in warmer months.

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? (Question 19)

Gas is a fuel of choice and should be considered as having competitors given that most gas applications could be replaced with electrical appliances. Electricity however, has no real substitute and is therefore an essential service.

Retail margin for gas retailers need to be set at a level that encourages competition while maintaining the financial viability of retailers.

To what extent, if any, are the risks inherent in retailing gas in NSW different to those in other jurisdictions? (Question 20)

The Victorian market operates under a market carriage system where capacity remains with the customer. Therefore as customers churn the retailer is not required to adjust pipeline capacity booking with APA (GasNet). The retailer simply pays a throughput rate as determined under the Access Arrangement. In NSW if all firm capacity is sold, As Available services may be contracted however reliability is not guaranteed and if delivery does not occur; the retailer would have to find alternative means of supply which may be costly.

Is IPART's proposed approach to assessing the retail margin for the 2010 review appropriate? If not, what are the alternative approaches? (Question 21)

IPART have indicated that a mixture of the bottom-up approach, expected returns approach and a form of benchmarking will be used in determining an appropriate retail margin. While Country Energy is broadly comfortable with the "triangular" approach to setting the retail margin, it notes there are limitations with "top down" approaches. Such approaches calculate the allowed retail margin as a mark-up on the cost of goods sold (COGS). This means there is a risk that if COGS is under-estimated, so too is the required retail margin.

This highlights the importance of applying a truly "bottom up" approach as a cross check for "top down" approaches. Under a bottom up approach, consideration needs to be given to the quantity of capital a retailer requires, including fixed assets, adequate wholesale energy capital, and working capital. In addition, the capital base should reflect the value of the existing customer base.

A substantial portion of required retail margin is sensitive to changes in COGS. This includes working capital and wholesale energy capital. Accordingly, the scope of the retailer initiated periodic adjustment mechanism should extend to the allowed retail margin. This is a pre-requisite for maintenance of CRRP in the event supply costs materially change.

NON-TARIFF FEES AND CHARGES

Is it reasonable for the Standard Retailers to introduce a new fee for the payment of gas bills by customers using a credit card? (Question 22)

Country Energy agrees with the introduction of this fee as it encourages customers to use cheaper forms of payment. There is a cost of processing these payments and at the moment customers using a less expensive form of payment may be cross subsidising those who pay by credit card.

Is it reasonable for the Standard Retailers to change the level of the late payment fee? (Question 23)

Country Energy does not currently charge late payment fees to small retail gas customers. However, provision for late payment like other regulated retail fees should be cost reflective and should also align with the fees charged to retail electricity customers.

The current allowances for charging late fees for late energy accounts are in Country Energy's opinion too rigid and should be amended to reflect the more flexible arrangements allowed for in the Victorian and South Australian markets.

Under these arrangements, retailers can charge fair and reasonable amounts in relation to costs incurred as a result of late payments. This is an area that enables retailers to vary the price/service offering that they present to customers and should therefore be an element of any truly competitive retail market. In areas where competition is deficient in constraining the price charged for late payment, the regulator still has the ability to deem any charge unfair and not a reasonable reflection of the costs incurred. Country Energy sees no reason why an approach of this type could not be applied in NSW.

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? (Question 24)

There is a cost associated with passing on to customers the charges imposed by network operators for miscellaneous charges. However Country Energy feel these costs are not significant enough to be included as a separate charge to the customer but instead form part of the operating costs of a retailer.