



18 December 2009

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

Dear Mr Cox

Review of regulated retail tariffs and charges for gas 2010-13

Please find attached ActewAGL Retail's (ActewAGL) submission on the Independent Pricing and Regulatory Tribunal's (IPART) issues paper *Review of regulated retail tariffs and charges for gas 2010-13*. ActewAGL appreciates the opportunity to comment on the issues paper.

ActewAGL supports IPART's approach to the review in general, particularly the continuation of a VTPA approach in a regulatory environment and that the VTPAs should include a pass through of network costs

ActewAGL is concerned that IPART has not expressed a view on the appropriateness of retailers' proposed approaches for dealing with the costs arising from the possible introduction of the Federal Government's Carbon Pollution Reduction Scheme (CPRS). ActewAGL believes that all CPRS costs should be passed through to customers, in line with the amended Council of Australian Governments (COAG) *Australian Energy Market Agreement*.

ActewAGL looks forward to continuing to work closely with IPART during the remainder of the review process.

If you would like to discuss any aspects of our submission, please contact David Graham, Director Regulatory Affairs and Pricing on (02) 6248 3605.

Yours sincerely

Ayesha Razzag
Acting General Manager Retail

Review of Regulated Retail Tariffs and Charges for Gas 2010-13

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Contents

1. <i>Introduction</i>	3
2. <i>Form of Regulation</i>	5
3. <i>Setting of regulated tariffs</i>	7
4. <i>Managing risks and uncertainties</i>	8
4.1 Distribution network costs	8
4.2 Costs associated with national climate change measures	8
4.3 Costs arising from unforeseen events or changes	9
5. <i>Assessing the efficient costs of gas supply</i>	11
5.1 Wholesale gas costs	11
5.2 Retail operating costs	12
5.3 Retail margin	12
6. <i>Non-tariff fees and charges</i>	15
<i>References</i>	17

1. Introduction

The New South Wales (NSW) Minister for Energy issued a Terms of Reference (TOR) on 19 August 2009 instructing the Independent Pricing and Regulatory Tribunal (IPART) to continue regulating standard tariffs for small retail gas customers in NSW for the period 1 July 2010 to 30 June 2013. On 27 August 2009, IPART invited gas retailers in NSW to submit revised voluntary transitional pricing arrangement (VTPA) proposals. ActewAGL Retail (ActewAGL) provided its revised VTPA proposal on 2 October 2009.

This submission responds to IPART's Issues Paper *Review of regulated retail tariffs and charges for gas 2010-13* (Issues Paper) released on 6 November 2009.

ActewAGL believes competition levels in NSW are sufficient to support full deregulation of retail gas prices. ActewAGL believes that lessening the role of the regulatory review process and allowing the competitive market to bear more of the burden in delivering commercial and customer appropriate outcomes would assist in reducing consumer reliance on the regulated tariff. This would be consistent with IPART's proposed assessment criteria with the "aim of reducing customer's reliance on regulated retail tariffs"¹ and provide customers with increased choice. Accordingly, ActewAGL believes it is unnecessary for intrusive cost based regulatory reviews into retail gas pricing in NSW, as this review process is more effectively managed by the competitive market which also avoids incurring excessive regulatory cost.

However, in light of the NSW Government requiring IPART to continue retail gas price regulation, ActewAGL supports IPART's intention "to continue using a light-handed approach to regulating retail gas tariffs by reaching a new VTPA with each of the Standard Retailers."² To the extent VTPAs are to continue being used, it is appropriate that retailers are subject to a weighted average price cap (WAPC) with no side constraints on individual tariffs.

ActewAGL welcomes IPART's view that the revised VTPAs should explicitly allow for the full pass through of network costs, given the significant portion of retail tariffs these costs represent.

However, ActewAGL is concerned by IPART's failure to identify a preliminary position on the pass through of costs associated with the Federal Government's Carbon Pollution Reduction Scheme (CPRS) and other national climate change policies. In this regard, ActewAGL notes the Council of Australian Governments (COAG) Australian Energy Market Agreement (AEMA) which requires all additional climate change policy costs to be passed through to customers, where prices are regulated.³ ActewAGL reiterates that these costs should be passed through to consumers via an annual adjustment mechanism. ActewAGL also supports the continued use of the special circumstances provision.

¹ IPART 2009, p11

² IPART 2009, p2

³ COAG 2009, cl14.17

ActewAGL notes IPART's proposed approach for assessing the efficient costs of gas supply will rely on both IPART's internal expertise and the use of external consultants. These studies should not be necessary in a light handed regulatory framework, given a competitive retail gas market is able to more efficiently ensure prices are based on commercial cost margins.

However, ActewAGL views the general assessment criteria proposed in the Issues Paper as appropriate for assessing the efficient cost of gas supply, but reiterates its opposition to detailed cost reviews, as noted above. When assessing the efficient costs of gas supply, ActewAGL emphasises the importance of transparency during the review of input data and potential assumptions while balancing the extent of detail requested.

In summary, ActewAGL:

- believes the use of VTPAs and a WAPC with no side constraints at this stage best support a light-handed regulatory approach;
- welcomes IPART's view that changes to network charges should be passed through;
- seeks confirmation that costs associated with the CPRS will be passed through;
- emphasises the importance of transparency in the review process for assessing the wholesale gas costs and the retail margin; and
- notes the important role played by the competitive gas market in ensuring that VTPAs prices are commercially appropriate.

ActewAGL looks forward to working with IPART in the review process of the upcoming VTPA. ActewAGL also looks forward to the Australian Energy Market Commission's (AEMC) review into the effectiveness of retail gas competition in NSW, scheduled for 2011. Considering current levels of competition in the market, ActewAGL has an expectation this review will result in a recommendation for deregulation of the retail gas pricing in NSW, should prices be set at market reflective levels.

2. Form of Regulation

Do 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?

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?

In the Issues Paper, IPART proposes the continued use of VTPAs because they:

- are an effective form of light-handed regulation;
- protect the interests of consumers and promote competition by encouraging retailers to propose cost-reflective prices;
- represent a sound transition on the path to retail gas deregulation; and
- have been proposed by all the Standard Retailers as the preferred form if there is to be continuing regulation of retail gas prices.⁴

As noted in its 2 October 2009 submission⁵, ActewAGL's preference is for the deregulation of the retail gas market in NSW. ActewAGL believes the transition to a competitive market in NSW has already taken place, noting there are genuine benefits that will accrue to customers arising from deregulation, including competitive pricing and increased choice. ActewAGL strongly believes that regulated arrangements offer sub-optimal outcomes to customers compared to effective competition and opposes any stronger form of regulation, particularly gas pricing orders. In accordance with the Issues Paper, ActewAGL believes IPART should closely consider recommending the NSW Government remove retail gas price regulation once the proposed 2010-13 VTPAs expire.

However, to the extent retail gas prices continue to be regulated, ActewAGL broadly agrees with IPART's views on the merits of VTPAs. Further, given that retail gas price regulation in NSW will continue until at least 2013, ActewAGL accepts that VTPAs represent a reasonable transitional solution on the path to price deregulation. Any other form of regulation would be a retrograde step undermining the further development of competition.

⁴ IPART 2009, p9

⁵ ActewAGL 2009, p1

In response to IPART's question as to whether or not there is adequate information available to consumers to make informed decisions when choosing a gas retailer, ActewAGL believes there is sufficient publicly available information for customers to make informed choices about their gas retailer. Information is freely available on retailers' websites and customers have the freedom to contact other retailers. Additionally, ActewAGL notes the existence of utility provider comparison services that identify the best utility prices available. ActewAGL also notes IPART's 2006 survey of residential energy users finding that, on average, more than 94 per cent of gas customers were aware of competition in the market.⁶ Therefore, ActewAGL does not believe additional measures are necessary. Where IPART chooses to prioritise customer protection, it is important that the Standard Retailers are adequately compensated for all associated costs, including compliance with any potential information reporting and publishing requirements.

ActewAGL also notes IPART's comments on the level of customer churn in the NSW market. Whilst high customer churn rates can be used as an indicator of the level of competition (reflecting the availability of attractive offers or the effectiveness of retailer marketing) in the market⁷, ActewAGL believes caution must be used in interpreting churn rates. A low level of churn does not necessarily reflect a lack of competition. Rather, it may reflect a high level of customer satisfaction with their existing retail offering.

ActewAGL also agrees that regulatory certainty is important and encourages IPART to enable a transparent pass through of changes in network charges and any other outside retailers' control.

Finally, ActewAGL believes the general assessment criteria IPART have chosen to guide their analysis and decision making are appropriate for this review. However, ActewAGL believes intrusive cost based reviews are contradictory to the light handed regulatory approach which is the intention of having VTPAs in place. ActewAGL also notes that IPART recognises the importance of setting a regulated tariff in a manner which is "consistent with the aim of reducing customers' reliance on regulated retail tariffs."⁸ It is important that the price is set at an appropriate level. A commercially focussed retail tariff will result in increased competition in the market, which in turn results in innovation and more choice for customers. However, a price set too low would cause competition to diminish, impose undue risks on retailers and potentially result in some retailers leaving the market, thereby further diminishing competition.

⁶ IPART 2007, p66

⁷ QCA 2008, p61

⁸ IPART 2009, p11

3. *Setting of regulated tariffs*

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?

With regards to the continued use of a WAPC for this review, ActewAGL agrees with IPART's comments that a WAPC best meets the objective for this review and is an effective approach for setting regulated tariffs which allows both flexibility and certainty for customers and retailers.⁹ ActewAGL notes that network charges and any changes in costs due to the introduction of national climate change initiatives should be passed on to customers.

As already noted in its 2 October 2009 submission¹⁰, ActewAGL considers a WAPC, with no side constraints on individual tariffs, to be appropriate for this review if price regulation is to continue, and is not aware of any evidence suggesting a WAPC is inappropriate. ActewAGL believes that any departure from a WAPC should only be to assist a move to full deregulation of retail tariffs.

⁹ IPART 2009, p20

¹⁰ ActewAGL 2009, p7

4. Managing risks and uncertainties

4.1 Distribution network costs

Should IPART accept the Standard Retailers' proposal to pass network charges through to customers?

ActewAGL supports IPART's preliminary view that "the new VTPAs should explicitly allow retailers to automatically pass through" distribution network costs to customers.¹¹ As previously noted by ActewAGL¹², and also recognised by IPART in the Issues Paper¹³, network distribution costs represent a significant portion of final retail tariffs and are not within the retailers' control. Accordingly, not allowing full pass through of variation in network distribution costs would impose an additional forecast risk on retailers, and result in a potential unjust regulatory outcome with resulting threat to the level of competition.

To enable ActewAGL to transparently pass through network costs, it may be necessary for ActewAGL to consider adjustments of retail prices to align with network tariff structure. This would simplify the pass through of future network price changes and provide improved price signals to customers. ActewAGL will have better insight as to the most appropriate tariff structure following the Australian Energy Regulator's (AER) review of gas network tariffs in NSW and ACT, due to be completed by April 2010. ActewAGL is aware of IPART's intention to seek more information from the Standard Retailers on any potential restructuring of regulated tariffs.¹⁴

4.2 Costs associated with national climate change measures

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?

ActewAGL notes IPART has not identified a preliminary view on the Standard Retailers proposals for dealing with the costs of national climate change measures. This is despite NSW being a signatory to the COAG AEMA, which states that "where retail prices are regulated, energy cost increases associated with the Carbon Pollution Reduction Scheme and

¹¹ IPART 2009, p23

¹² ActewAGL 2009, p9

¹³ IPART 2009, p23

¹⁴ IPART 2009, 17

the Renewable Energy Target shall be passed through to end use customers.”¹⁵ ActewAGL believes any decision IPART reaches on the pass through of costs associated with national climate change measures, including the CPRS and RET, must be consistent with the COAG commitment.

There is currently a high degree of uncertainty surrounding the implementation and impacts of the Federal Government’s CPRS. ActewAGL believes it is important that the regulatory framework contains sufficient flexibility to allow for both the possibility that the CPRS will commence as planned or be subject to modification.

ActewAGL proposes that market costs associated with the CPRS should be passed through to customers through an annual adjustment mechanism as proposed in its 2 October 2009 submission.¹⁶ Use of an annual adjustment mechanism represents an efficient way of passing through CPRS costs with minimum administrative and regulatory costs. Also, use of an annual adjustment mechanism will ensure NSW satisfies the COAG amendment to the AEMA requiring the pass through of CPRS costs to customers.¹⁷ ActewAGL conceptually outlined how the costs for the CPRS could be calculated in its 2 October 2009 submission.¹⁸

In response to IPART’s question of whether or not Standard Retailers’ forecast and actual permit costs are ever reconciled (assuming Standard Retailers set their prices based on their own forecasts of CPRS permit costs), ActewAGL believes that an ex-post review of the calculation of CPRS costs could be conducted, with adjustments in subsequent years for material differences.

4.3 Costs arising from unforeseen events or changes

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

Special circumstances provisions are important in providing retailers with sufficient flexibility to adjust prices in response to unforeseen changes impacting retailer costs. The inclusion of a special circumstances provision allows retailers to recover the costs. ActewAGL believes the retailers are generally in the best position to trigger the use of the special circumstances provision and a review or re-opening of a VTPA.

¹⁵ COAG 2009, clause 14.17

¹⁶ ActewAGL, 2009, p7

¹⁷ COAG 2009, clause14.17

¹⁸ ActewAGL, 2009, p15-16

How should IPART conduct a review of an application for a special circumstance price change?

Any review process IPART considers needs to be based on a framework which provides for a smooth and transparent review process. When conducting a review of an application for a special circumstance price change, ActewAGL believes it is very important that the process be as efficient as possible and that it does not excessively place a cost or administrative burden on the resources of relevant parties. A review process should be conducted in an efficient manner and facilitate effective information exchange. Where appropriate this could for example be performed through the use of a standardised process involving high level guidelines to facilitate information exchange. Any review process of special circumstance price change applications also needs to be flexible, given that special circumstance events often involve uncertain price impacts.

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

ActewAGL believes there should be no materiality threshold introduced in relation to the application of the special circumstances provision. There is an implicit materiality threshold in the form of a retailer's prudent commercial behaviour. ActewAGL suggest it is unlikely a retailer would trigger the special circumstances condition if the amount is not material due to the internal costs of conducting an application for a special circumstance price change.

However, if IPART prefers the introduction of a materiality threshold, then ActewAGL suggests that any threshold must be set on a relative basis so as not to discriminate against smaller retailers.

5. Assessing the efficient costs of gas supply

5.1 Wholesale gas costs

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 alternative approaches?

ActewAGL notes that wholesale gas costs have generally increased since 2007, partly due to increased costs for transporting gas. In addition, the introduction of the Short Term Trading Market (STTM) in 2010 is expected to affect the gas market and price volatility. The introduction of the STTM could add additional risks to retailers' operations. ActewAGL also notes the introduction of the CPRS in 2011/12 could add additional risks to retailers' operations.

ActewAGL believes IPART's general proposed approach for assessing wholesale gas costs is appropriate. However, ActewAGL notes that difficulties can arise in allocating wholesale gas costs to a particular customer segment because retailers take a portfolio approach to their gas supply and contracting arrangements. That is, retailers do not enter into specific supply arrangements to service a specific customer segment.

ActewAGL also notes the importance of having a transparent and open process, in which both IPART and its consultant's methodologies for determining the wholesale gas costs are well understood by stakeholders. As previously noted in this submission, ActewAGL believes detailed cost based reviews are no longer required given the levels of competition in the market. In assessing the wholesale gas costs, the outcome will be subject to the quality of the input parameters, which should be sourced from publicly available data where possible.

5.2 Retail operating costs

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?

The most significant changes that will impact retailers are the introduction of the STTM and CPRS and the associated system modifications and operational changes that will be required.

In addition, over the past three years there has been a stronger focus on customer service and retailers have experienced a greater level of competition in the retail gas market. This has resulted in increased marketing expenditures to retain customers.

ActewAGL notes IPART's intention to make use of the benchmarking and bottom-up cost approach methods in its 2010 review of regulated retail electricity tariffs in NSW, as well as seeking information from stakeholders and the Standard Retailers. ActewAGL believes IPART's previous retail operating cost analyses and benchmarks are a valid starting point and are suitable for the purposes of this review. However, it is important when using benchmarks and analysis from previous review periods and other industries that they be updated to adequately reflect and account for industry differences, market developments, and changes from when they were first constructed.

5.3 Retail margin

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?

It is expected that the introduction of STTM will change retail business activities and increase gas costs and price volatility, increasing the risks for gas retailers in NSW. In addition, the introduction of the CPRS will add further complexity to the retail operation and is expected to both increase the administrative costs and the volatility of gas wholesale prices. These additional risks need to be compensated for through 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?

Unlike electricity which can be used for all household requirements, gas can only be used in place of some household utility requirements, namely space and water heating and cooking. Space cooling and lighting still require electricity, along with all household appliances, which means that gas retailing is arguably a riskier business than electricity due to the increased exposure to customer preferences, including customer sensitivity to price changes. Therefore, ActewAGL believes gas cannot be considered an essential service on par with electricity.

Where gas retailers are exposed to large numbers of customers who rely on gas for their space and water heating, gas demand is often peakier, meaning that retailers have to manage larger fluctuations in daily demand than for electricity. This in turn has implications for a gas retailer's risk management practices, which must be able to cope with the large fluctuations in demand.

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

ActewAGL notes that it is the retailer of last resort for networks in locations with stronger winter peaks than in other parts of NSW and Australia, which adds unique risks to ActewAGL's operations. The dominance of domestic customers in ActewAGL's customer base results in peakier and riskier demand (as it is driven by space heating), compared with jurisdictions where there are more large commercial and industrial customers.

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

ActewAGL notes that the approach described in the Issues Paper is very general. Given the importance of the retail margin in ensuring the long term viability of retailers, the investment in upstream supply, and the development of competition in the market, ActewAGL believes it is important for retailers in particular to understand what IPART and its consultant, Strategic Financing Group Consulting (SFG), are proposing for their review of the retail margin. Accordingly, it is important that stakeholders have the opportunity to discuss with SFG the different approaches they choose to use, including the input data, the quality of inputs, the extent to which the risks are properly addressed and the assumptions underpinning each

method. ActewAGL believes this is of particular importance with regards to SFG's expected returns and bottom-up approach to calculating the margin, where ActewAGL understands that parameters such as the retailer's weighted average cost of capital (WACC) and assumptions about an assumed investment base are critical inputs in estimating the retailer's retail margin.

6. *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?

In its revised VTPA, ActewAGL has not proposed to introduce any new non-tariff fees and charges, including a new fee for the payment of gas bills by customers using a credit card. Nonetheless, from a commercial perspective, ActewAGL believes it is reasonable for a retailer to introduce such a fee to the extent it reflects actual extra costs incurred by the retailer and is legally permissible as long as it could be legislatively permissible. The costs for retailers of credit card fees have increased proportionally more in the last 5-10 years and ActewAGL therefore believes it would be reasonable to consider such fees.

Is it reasonable for the Standard Retailers to change the level of the late payment fee?

ActewAGL believes that in a competitive market, retailers should be allowed to set the level of fees. Competition and the freedom of customers to choose their provider will ensure that retailers are not able to set the level of their fees above market levels. When determining the appropriate level of late payment fee, it is necessary that the fee be cost reflective, thereby striking an appropriate balance between the costs incurred by the retailer and providing an incentive for customers to pay on time. ActewAGL notes that late payment fees are completely avoidable by the customer.

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?

ActewAGL has not proposed to add a premium to network miscellaneous charges. However, ActewAGL believes it is important that IPART allow the retailers to pass through the full amount of managing the application of network miscellaneous fees and charges to customer.

Managing network charges imposes additional costs to on the retailers and ActewAGL believes it is reasonable to add a premium onto network miscellaneous charges.

Finally, ActewAGL suggests IPART should consider allowing the revised VTPAs to permit the pass through of changes in network miscellaneous charges. This would provide a more efficient process than conducting a regulatory review to approve such changes.

References

ActewAGL Retail, 2 October 2009, *Submission to the Independent Pricing and Regulatory Tribunal – Review of Regulated Retail Tariffs and Charges for Gas 2010-13* (ActewAGL 2009)

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