1 Executive summary

The Independent Pricing and Regulatory Tribunal (IPART) is responsible for regulating retail gas prices for around 28% of residential and small business customers[1] in NSW. These are the prices the Standard Retailers in this state – AGL, ActewAGL and Origin Energy[2] – charge customers who have not signed a market contract with them or another retailer.[3]

For the past 10 years, we have regulated these prices using a relatively light-handed approach that involves making multi-year pricing agreements with each Standard Retailer (known as Voluntary Pricing Agreements). The Standard Retailers then set their own regulated prices to comply with these agreements, and we monitor their compliance.

As the current agreements will expire on 30 June 2013, the Minister for Energy and Resources has asked IPART to put in new regulatory arrangements for the period 1 July 2013 to 30 June 2016. We have invited the Standard Retailers to propose new pricing agreements for this period, and considered those agreements.

In April 2013, we made a draft decision to broadly agree to each of these proposals, although we have requested some specific changes. This report sets out our final decisions on these agreements and our reasons for making them. It also provides an estimate of the average price increase for 2013/14, and sets out how we will agree on prices for the second and third year closer to that time.

1 All customers that consume less than 1 terajoule (TJ) per year are eligible for supply under a standard form customer supply contract.

2 On 1 March 2011, the state-owned Standard Retailer - Country Energy – was sold to Origin Energy. Country Energy supplied gas to the South Western regions of NSW including Wagga Wagga and Gundagai and inland cities such as Tamworth. We have referred to these customers as Origin Energy (Wagga Wagga).

3 We set regulated retail prices paid by customers who have not signed a contract with an energy retailer or who have chosen to return to the regulated price. Customers who are currently on a contract with retailers pay unregulated prices. However, these market-based prices are influenced by changes in the regulated price, so often these prices change at the same time as the regulated price.

1.1 Regulated gas prices will rise on 1 July 2013

Under our final decision average retail gas prices will increase by 8.5% across NSW on 1 July 2013 – or by between 5.2% and 9.2% in the Standard Retailers' individual supply areas.

In reaching these final decisions, we have assessed the Standard Retailers' proposed increases in regulated retail prices, and considered stakeholder comments on our draft decisions and report. We have also taken into account the Australian Energy Regulator's (AER) recent final decisions on network charges for most small retail customers[4], and forecast inflation[5]. As a result, we consider the following total average increases to be reasonable:

- **9.2% for AGL**, which supplies gas to over 80% of small regulated retail customers in NSW, covering Sydney, Wollongong, Newcastle, Dubbo, Orange, Parkes, and parts of the Riverina region.
- **5.5% for ActewAGL**, which supplies the regions around the NSW/ACT border (including Young, Goulburn, and Yass) and South East NSW (including Shoalhaven).
- **5.8% for Origin Energy (Wagga Wagga)**, which supplies the South Western regions of NSW including Wagga Wagga and Gundagai and inland cities such as Tamworth.
- **5.2% for Origin Energy**, which supplies customers on the NSW - Victorian border, including the Albury and the Murray Valley Towns.

We have made a final decision to agree to AGL's revised proposal to increase regulated retail prices by 9.2% for 2013/14.[6] In our view, this increase in regulated retail prices is consistent with balancing the longer and shorter term objectives for this price review.

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4 The maximum prices and charges that distribution network operators can charge retailers are typically set out in an Access Arrangement which is regulated by the AER. However, ActewAGL has a small distribution network in the Shoalhaven area which is not regulated by the AER.

5 Forecast inflation is 2.5%

6 AGL initially proposed an increase in the R component of AGL's regulated retail prices of CPI + 7.7%, leading to an overall price increase of 10.7%. In May 2013, AGL provided a revised proposal to increase the R component by CPI + 5.1%, consistent with our draft decision, leading to an overall price increase of 9.2%.

We have made a final decision to agree to ActewAGL's proposal to increase regulated retail prices by 5.5%[7] for 2013/14, and Origin Energy's proposal to increase regulated retail prices by 5.2% to 5.8%[8] for 2013/14. In our view, these increases in regulated retail prices are consistent with balancing the longer and shorter term objectives for this price review.

1.2 Why are gas prices increasing again?

These increases in regulated retail gas prices follow large increases in regulated gas prices in 2012/13.[9] The sustained increases in network costs (N Component) have been the largest contributor to increases in gas prices over the last 2 years, particularly for AGL customers supplied by the Jemena gas distribution network.

Network costs reflect the charges that retailers must pay to deliver gas through the low pressure distribution network to homes and businesses. These charges are regulated by the AER and we take these regulated costs and include them in the retail prices. These costs typically make up around 50% of overall regulated retail gas prices.

As Figure 1.1 shows, the increase in network costs is responsible for around 60% of the price increase from 1 July 2013 for AGL customers, adding 5.5% to prices. These network cost increases primarily result from Jemena's successful appeal to the Australian Competition Tribunal (ACT) of the maximum prices and charges they can levy on retailers for use of the distribution network.[10] We consider that action is required to address policy settings that are leading to higher than necessary gas network prices. (Refer Section 1.8)

7 ActewAGL proposed an increase in the R component of ActewAGL's regulated retail prices of CPI + 1.5%, leading to an overall price increase of 5.5%.

8 Origin Energy proposed an increase in the R component of Origin's regulated retail prices of CPI + 4.9% and CPI + 5.7% for its customers in the Wagga Wagga and Albury/Murray Valley supply area. This leads to an overall price increase of 5.8% and 5.2%. This is lower than the estimated increases in our draft report due to lower than forecast network prices and lower forecast inflation.

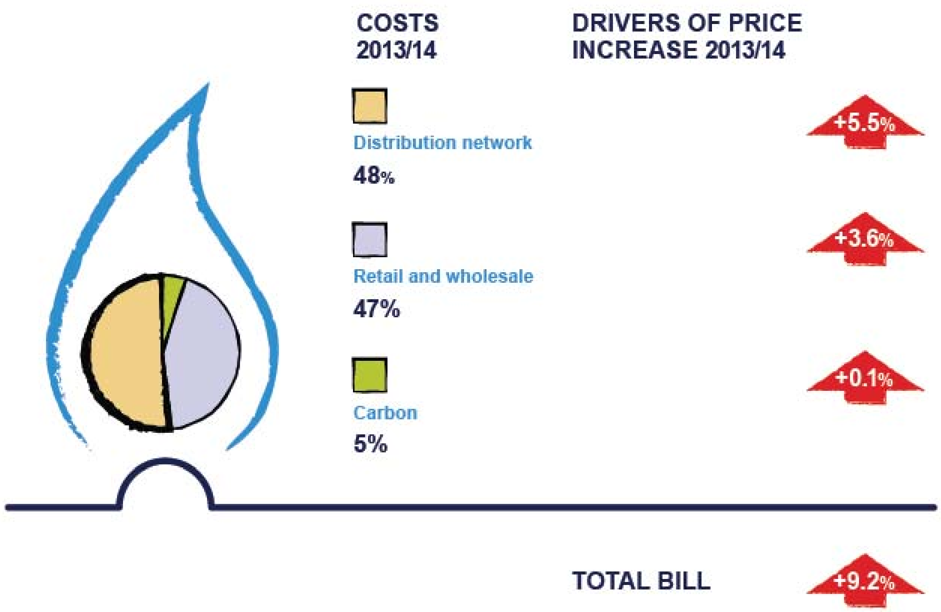
9 These price increases were primarily the result of significant increases in network costs and the introduction of the carbon price. For further detail on the price changes that occurred on 1 July 2012, click here.

10 The maximum prices and charges that distribution network operators can charge retailers are set out in an Access Arrangement which is regulated by the AER. Jemena successfully appealed the AER's final decision to the Australian Competition Tribunal (ACT). Further information on the Jemena Access Arrangement can be found here.

The increase in the R component is responsible for around 39% of the price increase from 1 July 2013 for AGL customers.[11] In our view, the increase in the R component of regulated retail prices is consistent with balancing the longer and shorter term objectives for this price review.

We have established a process for updating the prices from 1 July 2014 and 2015 given that there are too many uncertainties to reach agreements on these price changes now. However, we consider it likely that regulated retail prices will rise further over the following 2 years, partly driven by sustained increases in gas network costs under distribution pricing determinations already in place,[12] and the structural changes that are likely to emerge in the wholesale gas market. These structural changes, which mean that Australia's domestic gas markets will be increasingly influenced by the international market, are likely to put upward pressure on wholesale gas costs, which currently make up around 30% of regulated retail gas prices.

Figure 1.1 Drivers of increase in average regulated retail gas prices for AGL on 1 July 2013 (nominal, %)



[11] The Retail Component of regulated retail prices reflects the controllable costs retailers incur in supplying gas to customers, including wholesale and gas transmission costs, retail operating costs and a retail margin.

[12] AER, *Access Arrangement for JGN's NSW gas distribution networks 1 July 2010 – 30 June 2015, Amended by order of the Australian Competition Tribunal, 30 June 2011, Further amended with regard to mine subsidence expenditure*, 26 September 2011, June 2010, p 18.

1.3 Average annual gas bills for households and small business customers will rise on 1 July 2013

We cannot calculate how our final decisions will affect individual customers' annual gas bills. This impact will depend on how much gas they use, which of their Standard Retailers' regulated prices they are on, and how the Standard Retailer changes these individual prices. However to estimate the potential impact, we have calculated an indicative annual gas bill for residential and business customers with average usage in each gas supply area (Table 1.1 and 1.2).

Table 1.1 Indicative annual bill for typical residential customers of each Standard Retailer (nominal $, inc GST)

	Current bill (2012/13)	Estimated bill (2013/14)	$ increase
AGL	822	898	76
ActewAGL	1,217	1,283	66
Origin Energy (Wagga Wagga)	965	1,021	56
Origin Energy (Albury/Murray valley)	886	933	46

Note: This assumes a typical customer uses 23GJ, 45GJ, 37GJ, and 45GJ of gas per annum in the AGL, ActewAGL, Origin Energy (Wagga Wagga) and Origin Energy (Murray Valley) areas. Impact on bills includes GST.

Table 1.2 Indicative annual bill for typical business customers of each Standard Retailer (nominal $, excl GST)

	Current bill (2012/13	Estimated bill (2013/14)	$ increase
AGL	3,864	4,220	356
ActewAGL	4,423	4,665	242
Origin Energy (Wagga Wagga)	3,262	3,452	190
Origin Energy (Albury/Murray valley)	3,133	3,296	163

Note: This assumes a typical customer uses 184GJ, 229GJ, 231GJ and 209GJ of gas per annum in the AGL, ActewAGL, Origin Energy (Wagga Wagga) and Origin Energy (Murray Valley) areas.

1.4 Gas retail price regulation may no longer be necessary

Since our last review in 2010, there have been significant changes in the gas market. These include the continued development of competition in the gas retail market, as well as structural changes that are emerging in the wholesale gas market.

Based on our analysis for this report, we consider it likely that competition in the market is now effective enough to provide sufficient protection to customers, as well as offering more choices and better price and service outcomes. Only 28% of small gas customers now remain on regulated prices in NSW, below the proportion of small electricity customers remaining on regulated prices (around 40%). We also consider that a competitive market is best placed to manage the uncertainties that are emerging in the wholesale gas market and note that other States have removed formal price regulation of retail gas.

We note that the Australian Energy Market Commission (AEMC) is currently reviewing the competitiveness of the NSW energy market, for the purpose of determining whether regulation can be removed. The AEMC's draft advice is that competition is sufficient to enable all customers to benefit from the removal of price caps.[13] The AEMC will provide its final advice to the NSW Government in September this year, and the Government will decide on the future of price regulation after considering that advice.

The NSW Government has requested us to continue regulating gas prices for customers who have not entered the competitive market, in line with the objective of the *Gas Supply Act 1996* (the Act). These include protecting the interests of customers and encouraging the development of the competitive market.

1.5 Regulation should continue to be light-handed to promote competition and the long term interest of customers

We have made final decisions to agree to the Standard Retailers' proposals to largely continue the current light-handed form of regulation. This involves:

- Using a weighted average price cap (WAPC) form of price control[14] for the retail component of prices (including wholesale and gas transmission costs, retail operating costs and a retail margin).
- Passing through of the network component of prices determined by the Australian Energy Regulator, and the carbon component of prices estimated by the retailers and approved by IPART.

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13 AEMC, *Review of Competition in the Retail Electricity and Natural Gas Markets in New South Wales – Draft Report*, May 2013, p ii.

14 Under the WAPC Standard Retailers are able change their individual retail regulated prices or components of these tariffs (such as fixed service or variable charges) as long as the overall increase in average regulated tariffs does not exceed the WAPC.

- Providing a mechanism for adjusting these components to address 'special circumstances'.

In our view, this light-handed approach has been successful in meeting the objectives of the Act in the past. It has protected the interests of customers by limiting price increases to movements in efficient costs, and encouraged the development of retail competition by minimising unnecessary regulatory intervention. As our assessment of the gas market in NSW indicates that the effectiveness of competition has improved since our last review of gas prices, we are confident this form of regulation will continue to meet those objectives in the 2013 period.

We consider it important this approach continues to promote a competitive market where strong rivalry between retailers delivers products that customer's value. We consider that a competitive market offers customers the best protection from higher than efficient prices in the short term and better 'value for money' service through reduced costs and/or innovation in the longer term. Both of these are in the interest of customers.

Without a competitive market, there would be little discipline on retailers to offer cost reflective prices or improve their performance. As is the case with natural monopolies, such as gas distribution networks, customers would in effect rely on the regulator to counter the inevitable market power and to drive these efficiency improvements. It is important to recognise that regulation is likely to be an inferior way of driving these improvements compared to competition.

As with any price regulation there is also the risk that given the imperfect information available, attempting to discover the 'efficient costs and prices' that would emerge in a competitive market may not be feasible. The dynamic nature of retail energy markets only makes this more difficult, creating the potential for price regulation to distort the competitive market. Given that the NSW Government has requested us to continue regulating gas prices for customers who have not entered the competitive market; we will continue our light handed approach to minimise this risk.

In implementing this approach and making our final decision we have sought to strike a balance between efficient prices in the short term and facilitating competition and the longer term customer interests. Balancing these risks means that the regulated prices under our final decision are unlikely to be the lowest price in the market. Rather, it is a price for customers who have not taken up a competitive, unregulated market offer. IPART operates an independent, free comparator website, **myenergyoffers**,[15] to help customers identify and compare the offers available in their supply area.

15 From 1 July 2013, the independent, free price comparator website will be operated by the AER, www.energymadeeasy.gov.au

1.6 Regulation also needs to be more flexible if it is to be maintained

We have also made final decisions to agree to the Standard Retailers' proposals to make the form of regulation more flexible by providing for periodic reviews of the retail and carbon cost components in the second and third years of the regulatory period. We consider these periodic reviews are necessary and appropriate to manage the risk and uncertainty associated with forecasting these cost components more than one year in advance.

The emerging changes in the wholesale gas market mean there is an unprecedented level of risk in forecasting gas commodity costs over the 2013 regulatory period. These costs are likely to be influenced by the development of liquefied natural gas facilities on the eastern coast of Australia, which mean that Australia's domestic gas markets will be increasingly influenced by the international market. However, there is significant uncertainty in relation to the medium-term supply and demand dynamics in the Australian market.

There is also uncertainty in forecasting carbon costs over this period, as the carbon price will move from a fixed to a market-based price in 2015.

It is important that the agreements are capable of managing this uncertainty. We consider that periodic reviews are an appropriate and efficient way to do this. This will mean regulated prices are more likely to reflect movements in costs driven by regulatory, policy and market factors, and are less likely to distort the competitive market. We recognise that periodic reviews will reduce price certainty for customers, and potentially increase the administrative costs of updating regulated prices in 2014 and 2015. However, on balance, we consider that periodic reviews will support the long-term interests of customers.

1.7 Standard Retailers' proposed increases in the 'Retail Component' and 'Carbon Component' of regulated gas prices in 2013/14

The Retail Component of regulated retail prices reflects the controllable costs retailers incur in supplying gas to customers, including wholesale and gas transmission costs, retail operating costs and a retail margin.

The Standard Retailers' proposed increases in the Retail Component of average regulated prices for 2013/14. This component accounts for around 50% of a typical customer bill.

We consider that regulated retail prices over the regulatory period need to balance 2 potentially conflicting objectives:

- To encourage efficiency and protect customers from prices that are higher than efficient levels in the short term by setting regulated prices that reflect the efficient cost of supply.
- To support the interests of customers in the long term by setting regulated retail prices that create sufficient incentives for retailers to compete and customers to participate in the market.

We have made an assessment of the Standard Retailers' proposals, and exercised our own judgement to decide whether they are reasonable and balance the longer and shorter term objectives for this price review.

We have made a final decision to agree to:

- AGL's revised proposal to increase the Retail Component of regulated retail prices for 2013/14 by CPI + 5.1%.[16]
- ActewAGL's proposal to increase the Retail Component of regulated retail prices for 2013/14 by CPI + 1.5%.
- Origin Energy's proposal to increase the Retail Component of regulated retail prices for 2013/14 by CPI + 4.9% and CPI + 5.7% for its Wagga Wagga and Albury/Murray Valley customers.

In our view, this increase in regulated retail prices is consistent with balancing the longer and shorter term objectives for this price review

We have also made final decisions to agree to the Standard Retailers' proposal to increase the Carbon Component of average regulated prices for 2013/14 in line with the legislated increase in the carbon price. This component accounts for a small proportion of a typical customer bill.

A summary of our final decisions on the regulatory arrangements that will apply to the regulated retail prices and charges levied by the 4 gas Standard Retailers in NSW is provided in Table 1.3.

16 AGL initially proposed an increase in the R component of AGL's regulated retail prices of CPI + 7.7%, leading to an overall price increase of 10.7%. In May 2013, AGL provided a revised proposal to increase the R component by CPI + 5.1%, consistent with our draft decision, leading to an overall price increase of 9.2%.

Table 1.3 Summary of IPART's final decision in relation to the Standard Retailers' proposals for regulated retail gas prices for 2013/14 to 2015/16

	AGL	ActewAGL	Origin Energy (Wagga Wagga)	Origin Energy (Albury/Murray Valley)
Form of price control	Continue using WAPC based on a R+C+N structure	Continue using WAPC based on a R+C+N structure	Continue using WAPC based on a R+C+N structure	Continue using WAPC based on a R+C+N structure
Change in R component of prices for 2013/14	CPI + 5.1%	CPI + 1.5%	CPI + 4.9%	CPI + 5.7%
Change in R component for 2014/15 and 2015/16	To be updated in 2014 with flexibility to update in 2015 if necessary	To be updated in 2014 with flexibility to update in 2015 if necessary	To be updated in 2014 and 2015	To be updated in 2014 and 2015
C component of prices for 2013/14 ($ nominal)	$1.72/GJ	$1.72/GJ	$1.63/GJ	$1.56/GJ
Change in C component for 2014/15 and 2015/16	To be updated in 2014 and 2015	To be updated in 2014 and 2015	To be updated in 2014 and 2015	To be updated in 2014 and 2015
N component	Automatically pass through of regulated distribution network costs	Automatically pass through of regulated distribution network costs and unregulated network costs	Automatically pass through of regulated distribution network costs	Automatically pass through of regulated distribution network costs
Unforseen cost changes	Address through special circumstances clause	Address through special circumstances clause	Address through special circumstances clause	Address through special circumstances clause
Change in carbon related costs resulting from policy and/or regulatory change	Address through additional clause that provides for costs increases and decreases	Address through additional clause that provides for costs increases and decreases	Address through additional clause that provides for costs increases and decreases	Address through additional clause that provides for costs increases and decreases
Tariff restructuring	-	Reduce number of regulated tariffs available in each region	-	-
Miscellaneous charges	Increase by no more than CPI in each year	Increase by no more than CPI in each year	Align with charges that apply in the Albury/Murray Valley regions	Increase by no more than CPI in each year

1.8 Further action to promote the long term interests of customers

There are many regulatory and policy settings that affect the price customers pay for gas, many of which are outside the scope of our pricing decisions. Price regulation cannot protect customers from price increases driven by regulatory, policy and market factors.

We are pleased that some significant reforms to energy policy have been made over the past year. However, many actions can still be taken to improve outcomes for customers, including actions to increase the competitiveness of the NSW gas market and facilitate the removal of price regulation.

In our view, there are adjustments to energy policy that need to be made to better serve gas customers. It will take a co-ordinated effort to deliver these reforms, relying on governments, regulators, the gas industry and customers. Getting these settings 'right' is likely to be in the long term interests of customers.

1.8.1 Energy reforms should be implemented to reduce pressure on network costs

Over the past 2 years there has been considerable focus on energy policy, and the need for reform to ameliorate future price increases. While progress has been made in many areas, more action is required to implement some of the proposed reforms.

Improvements have been made to the National Gas Rules, which will allow network prices to more closely reflect efficient costs.[17] These new Rules will apply for the next network determinations from 1 July 2014, including the new network determination for Jemena from 1 July 2015 which will affect the prices paid by AGL and some ActewAGL customers.

17 http://www.aemc.gov.au/Media/docs/Information-sheet---final-rule-determination-0234dda9-acbc-4cdb-b6de-a4f3297d2d6a-0.pdf

However, further reforms in other areas are not yet complete. Commonwealth and State Governments through the Standing Committee on Energy and Resources (SCER) commissioned an expert panel to review the merits review framework under the National Electricity Law and National Gas Law. The merits review framework provides parties affected by the AER's decisions with recourse to a review mechanism. In September 2012, an expert panel recommended significant changes to the framework in ways that better serve the long term interests of customers. This included broadening the scope of the review mechanism, moving away from an adversarial review to an investigative review and to have appeals heard by an independent administrative body with increased customer participation. However, these changes are yet to be made with consultation currently being undertaken by SCER. We strongly support changing the merits review framework, as outlined in our submissions to the expert panel and SCER.[18]

Changing the merits review framework is an important measure that Governments can implement to address policy settings that are leading to higher than necessary gas network prices.

1.8.2 Encouraging customers to actively engage in the competitive market

In our view, 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. We consider that a well-functioning competitive market is in the long-term interests of customers.

While almost three-quarters of gas customers in NSW are now supplied under a market offer, further action can be taken to improve the functioning of the market, and better enable small customers to extract benefits from competition. This includes action to:

- Improve retailers' engagement with customers, so they make their offers more accessible and easier to understand and compare. Further, retailers need to take action to ensure that customers understand how their prices might change during the term of a contract to improve customer confidence in the market.
- Encourage customers to actively engage in the competitive market through education campaigns.
- Assist those specific customers that may need additional support to engage in the market.[19]

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18 http://www.ipart.nsw.gov.au/Home/Quicklinks/IPART_Submissions_to_External_Reviews

19 The vast majority of customers can access the market, albeit with assistance in some circumstances (for example, IPART's price comparator website is accompanied by a multilingual telephone line, assisting customers without access to the internet or with reading or language barriers). However there may be specific groups of customers that require additional assistance, for example, from consumer groups and/or community welfare organisations.

1.8.3 Assisting customers facing financial hardship through targeted and well-designed assistance measures

We recognise that these indicative increases in regulated gas prices are relatively high compared to previous years, and are likely to be significant for many customers. It is likely that regulated retail prices will continue to rise over the following 2 years.

Price regulation cannot protect customers from price increases driven by regulatory, policy and market factors, nor can it protect vulnerable households that may be experiencing affordability problems. Rather it is important to ensure that any specific groups of customers that might be affected are specifically considered and targeted responses are developed.

Our customer impact analysis for NSW illustrates that the most vulnerable customers are those households that have low incomes and high levels of energy consumption (see Chapter 8 for the analysis of impacts of the final decision on small customers).

Governments have a limited budget for customer assistance given the numerous demands across the range of government expenditure priorities. Commonwealth and State governments provide financial assistance to households for their energy bills. This has primarily been through income support, energy rebates, energy efficiency and emergency assistance.

The segmented nature of the available information and delivery of customer assistance make it difficult to both identify a vulnerable household that is experiencing affordability problems and to deliver the most effective and cost efficient assistance measures – that is, the appropriate mixture of emergency assistance, ongoing income support and energy efficiency measures for individual households. This ultimately affects the 'value for money' provided from government assistance funding.

We therefore recommend a review of affordability measures to ensure that the existing budgets target the most vulnerable customers in a comprehensive, complementary and cost effective manner.

1.9 What does the rest of this report cover?

The rest of this paper is structured as follows:

- Chapter 2 outlines the terms of reference and context for this review, and how it influences the objectives for the review
- Chapter 3 sets out our process for the review and the approach we used to make our final decisions
- Chapter 4 sets out our final decision on the form of regulation
- Chapter 5 sets out our final decisions and our assessment of the Standard Retailers' proposed change to the Retail Component for 2013/14
- Chapter 6 sets out our final decisions on the Carbon Component for 2013/14
- Chapter 7 sets out our final decisions on miscellaneous charges
- Chapter 8 analyses the impacts of the final decision on small customers.
- Appendices A – G provide additional information.