

11 May 2006



Dr Michael Keating
Chair
Independent Pricing and Regulatory Tribunal
PO Box Q290
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Dear Dr Keating

Review of Retail Gas Prices in NSW 2007-2010

The Public Interest Advocacy Centre (PIAC) is pleased to provide the following comments to IPART's review of retail gas prices in NSW 2007-2010.

The amendments allowing for retail contestability were introduced in 2001 to the *Gas Supply Act 1996*. In his Second Reading Speech, the (then) Minister for Energy, Minister Yeadon said of gas price regulation and competition:

In the fully competitive gas retail market, small gas customers will be free to choose from competing gas retailers. Some of them will choose to move to a new retailer. It is likely that those who do choose to move to a new retailer will do so because of advantages in terms of price or standards of service offered by the new retailer. On the other hand, other small gas customers may choose to stay with their current retailer. The Government is determined to protect the interests of those small gas customers.

For these reasons, the Bill allows small gas customers to choose whether to obtain supply from the competitive market, or whether to obtain supply at a price regulated by the Independent Pricing and Regulatory Tribunal [IPART].

Importantly, the Minister went on to point out that:

The Government will ensure that customer protection is not compromised in the pursuit of competition reforms.

(Source: NSW, *Parliamentary Debates*, Legislative Council, 4 April 2001, Minister Yeadon, Second Reading, Gas Supply Amendment (Retail Competition) Bill 2001 (Kim Yeadon, Minister for Energy)).

The Terms of Reference issued by the Minister for Energy in June 2006 should ensure that customer protection goes hand in hand with pricing regulation, in accordance with the objectives of the *Gas Supply Act 1996*:

3(1)(b) to regulate gas reticulation and gas supply, so as to protect the interests of customers and to promote customer choice in relation to gas supply

In the past, this balance has been achieved through side constraints on individual bills and price increases limited to CPI. It is PIAC's expectation that the regulation of those prices should continue to provide adequate consumer protections to those customers who remain on a regulated tariff.

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Form of Regulation

The Terms of Reference leave to the Tribunal the decision about a voluntary transitional pricing agreement (VTPA) or a formal gas pricing order. There are costs and benefits associated with both forms of regulation.

The Tribunal reported in its Explanatory Note that there was broad support for VTPAs from those who made submissions.

Of the three submissions received by the Tribunal last year, one was from PIAC. In its submission, PIAC argued that consumer protection needed to be central to the regulatory decision-making process. The Energy and Water Ombudsman NSW (EWON) presented a similar view in her submission to the Tribunal.

PIAC supported VTPAs (referred to as VTTPs) with the following caveat:

PIAC has historically endorsed the use of light-handed regulation where it is bounded with the requisite consumer protections. In the case of Voluntary Transitional Pricing Principles (VTTPs) this balance has been achieved through CPI limits on average price increases and side constraints on individual bills. With these protections, VTTPs have worked well to deliver price protections for standard customers. That is, customers have seen robust price developments, efficient cost pass-through events and minimal price shocks.

The form of regulation used in the 2007-2010 price determination should not weaken or lower the price protection currently enjoyed by customers in the retail gas industry.

VTTPs will continue to be an acceptable form of regulation where the interests of consumers are clearly recognised. The use of VTTPs to regulate the retail gas industry is therefore contingent of the application of side constraints and CPI price limits on average prices throughout the duration of the price determination period. In the absence of such protections, direct price controls would more appropriately protect the interests of consumers.

(PIAC Submission, 13 October 2006)

PIAC's support of a light-handed form of regulation is dependent on strong and effective consumer protections.

The proposed VTPAs do not address the ongoing need for customer protections in an environment of light-handed regulation. They provide no limitation on the retailer's ability to introduce new tariffs to the detriment of classes of consumers, and provide no incentive to manage tariff consolidation and/or rebalancing within a reasonable limit.

Recommendation 1: *PIAC seeks the inclusion of customer protection mechanisms in the regulatory arrangement.*

Bill and Tariff Constraints

The Weighted Average Price Cap (WAPC) grants considerable discretion to retailers regarding how their revenue is generated. The Tribunal is correct in saying that overall revenue is constrained at the macro level. However, this does not deal with how an individual's bill is constrained nor account for the impact on consumers of tariff reform.

In the absence of a side constraint, the WAPC offers almost unlimited discretion in how tariffs can be structured. A side constraint ensures that tariff rationalisation occurs within a band of reasonableness. It ensures that consumers are not unreasonably burdened by the rationalisation or innovation of tariff products.

No evidence has been presented that there is any substantial problem with the current form of regulation including side constraints. To the contrary, retailers report that they have been able to achieve cost reflectivity in tariffs within the constraint.

The WAPC in electricity proposes a ban on introducing new tariffs. This ensures that retailers do not use their market power to discriminate between classes of consumers in the introduction of new tariffs.

The model proposed in the regulated electricity tariff includes a threshold test at the tariff level for tariffs still moving towards cost reflectivity. In the case where retailers have a large number of tariffs, it further ensures that tariff consolidation is reasonably undertaken.

Consumer protection in the form of side constraints meets the regulatory objective. Without a side constraint, the form of regulation cannot be said to protect the interests of customers.

Unfortunately, no information has been made publicly available about the number of tariffs each retailer operates, the volume of customers on these tariffs and the degree to which tariffs may be under-recovering.

In the absence of such information, PIAC believes that the following customer protections should be a part of the Voluntary Transitional Pricing Arrangement.

Recommendation 2: *PIAC recommends retaining the side constraint on individual bills at the current level of CPI+3% or \$15 (whichever is the greater).*

Recommendation 3: *PIAC recommends introducing a threshold test at the tariff level for tariffs that are currently under-recovering*

Recommendation 4: *PIAC further recommends disallowing the introduction of new tariff during the regulatory period.*

Miscellaneous charges

PIAC supports the analysis undertaken and recommendations proposed by EWON into miscellaneous charges. PIAC notes that the practice of imposing high late payment fees considerably disadvantages low-income customers. It is poor customer protection practice that limitations on late payment fees do not apply to the gas industry.

PIAC lends its full support to reducing the quantum of fee and restricting the application of such a fee where a customer has a complaint pending with EWON, has sought emergency assistance, or is seeking to establish a payment plan for the debt.

Recommendation 4: *PIAC supports the alignment of customer protections in miscellaneous charges*

Evidence presented by the Tribunal

It is PIAC's view that any weakening of price protections must be accompanied by a detailed and transparent investigation into the costs and intensity of competition. PIAC notes that switching data, such as that included in the Explanatory Note is a crude measure of competition. Evidence from other jurisdictions suggests that customers who are switching may not be moving to better deals. Outcomes based research is required to understand competitive pressures in the market place. PIAC draws the Tribunal's attention to yet more research that argues the outcomes of the marketplace are skewed towards retailers with large incumbency. Clearly the NSW gas market is characterised by a large reliance on a single retailer. Any analysis of the marketplace should focus on the outcomes for vulnerable households and the power of incumbency.

Future analysis

Lastly, PIAC seeks a commitment from IPART to undertake further analysis of the cost structure of the regulated gas companies. No information has been made publicly available about the cost incurred by the regulated entities. PIAC believes that customers may be missing out on productivity improvements.

In the event that no productivity improvements have been achieved, PIAC seeks a review into the types of regulatory incentives that may be necessary in the future to ensure that NSW households provided with gas under a regulated contract enjoy the best possible prices.

Yours sincerely



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