



**Things to like, things to check:**

**PIAC submission to the AER's review of prices for Jemena Gas Network from 1 July 2015.**

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# Introduction

## The Public Interest Advocacy Centre

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit law and policy organisation that works for a fair, just and democratic society, empowering citizens, consumers and communities by taking strategic action on public interest issues.

PIAC identifies public interest issues and, where possible and appropriate, works co-operatively with other organisations to advocate for individuals and groups affected. PIAC seeks to:

- expose and redress unjust or unsafe practices, deficient laws or policies;
- promote accountable, transparent and responsive government;
- encourage, influence and inform public debate on issues affecting legal and democratic rights;
- promote the development of law that reflects the public interest;
- develop and assist community organisations with a public interest focus to pursue the interests of the communities they represent;
- develop models to respond to unmet legal need; and
- maintain an effective and sustainable organisation.

Established in July 1982 as an initiative of the (then) Law Foundation of New South Wales, with support from the NSW Legal Aid Commission, PIAC was the first, and remains the only broadly based public interest legal centre in Australia. Financial support for PIAC comes primarily from the NSW Public Purpose Fund and the Commonwealth and State Community Legal Services Program. PIAC also receives funding from the Trade and Investment, Regional Infrastructure and Services NSW for its work on energy and water, and from Allens for its Indigenous Justice Program. PIAC also generates income from project and case grants, seminars, consultancy fees, donations and recovery of costs in legal actions.

## Energy + Water Consumers' Advocacy Program

This program was established at PIAC as the Utilities Consumers' Advocacy Program in 1998 with NSW Government funding. The aim of the program is to develop policy and advocate in the interests of low-income and other residential consumers in the NSW energy and water markets. PIAC receives policy input to the program from a community-based reference group whose members include:

- Council of Social Service of NSW (NCOSS);
- Combined Pensioners and Superannuants Association of NSW;
- St Vincent de Paul (NSW);
- Ethnic Communities Council NSW;
- Retirement Villages Residents Association;
- Physical Disability Council NSW; and
- Affiliated Residential Park Residents Association.

# 1. Introduction

PIAC thanks the Australian Energy Regulator (AER) for the opportunity to provide comment on the five-year spending proposal submitted by Jemena Gas Network NSW (Jemena). The AER is in the process of setting prices for gas network customers in NSW from 1 July 2015 to 20 June 2020.

The review comes at a time of significant change and price uncertainty in the wholesale gas market. Consumers, including residential consumers, are facing the prospect of significant increases in gas prices over coming years. In this context, PIAC is pleased that Jemena proposes to reduce prices for residential consumers over the price determination period. Jemena has proposed reducing network prices for residential consumers by 20% in real terms over the course of the price determination period.<sup>1</sup>

PIAC supports a number of features of Jemena's proposal, including the smoother price path and reducing fees associated with gaining a special meter read. PIAC has also been pleased with Jemena's initial efforts to engage consumers, as required under recent changes to energy regulation. PIAC takes the view that because gas is a discretionary fuel for many consumers, Jemena has had to be more mindful of its consumers and what they want. This places Jemena in a much stronger initial position than electricity networks.

PIAC notes, however, that some areas of Jemena's regulatory proposal require close scrutiny by the AER. In particular, PIAC is concerned that Jemena has proposed a weighted average cost of capital (WACC) that is not fully consistent with the AER's rate of Return Guideline. PIAC takes the view that because that Guideline was developed very recently, with input from a wide range of stakeholders, all networks should use its methodology when developing their WACC proposals.

## 2. The context of this review

### 2.1 Gas prices

The AER's review of Jemena's gas network prices is occurring against the backdrop of significant increases in wholesale gas costs. These costs are being driven by the development of gas export facilities on the Australian east coast. These facilities offer gas producers access to foreign markets, where demand for energy resources is strong and consumers are willing to pay prices that are well above historical levels in Australia.

In its most recent price determination for the cap on regulated retail gas prices in NSW, the Independent Pricing and Regulatory Tribunal (IPART) agreed to proposals by retailers to increase prices by 17-21% (varying by region).<sup>2</sup> IPART stated that the development of export facilities on the east coast was the 'main driver' of the price increases.<sup>3</sup> For example, IPART agreed to an

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<sup>1</sup> Jemena, 2014, Jemena's 5-year plan: Customer overview, 8.

<sup>2</sup> IPART, 2014, *Fact sheet: Regulated retail gas prices from 1 July 2014 to 30 June 2016*, 2.

<sup>3</sup> *Ibid*, 3.

increase in AGL's regulated price cap of 17.3% in 2014/15, 11.5% of which was due to increases in wholesale prices.<sup>4</sup>

The repeal of the carbon tax has removed one component of final gas prices paid by residential consumers. However, figures recently published by IPART showed that regulated gas prices will still increase by 9-13% in 2014/15.<sup>5</sup> Many residential consumers will, therefore, face significantly more pressure in their efforts to pay for their gas consumption.

According to the Customer Overview of Jemena's regulatory proposal to the AER, gas wholesale costs currently make up 20% of a typical residential bill of around \$1000 dollars per year.<sup>6</sup> Jemena expects wholesale costs to double from \$200 to \$400 per year by 2020.<sup>7</sup>

In the context of these price rises and continuing high electricity prices, PIAC welcomes Jemena's efforts to reduce the network charges faced by residential consumers.

## 2.2 Recent reforms to network regulation

The price determination process is also the first the AER has undertaken for Jemena since significant reforms to the laws governing the economic regulation of gas and electricity networks. A key component of the reforms was the development of the Better Regulation Guidelines. The Guidelines provide guidance to network businesses such as Jemena on the AER's preferred approach to the development of regulatory proposals.

While network businesses are not bound by the Guidelines (with the exemption of the Confidentiality Guideline), where they do not follow them, the AER has greater discretion to amend spending proposals. When considering whether to approve proposals that deviate from the Guidelines, the AER also has regard to whether a network's customers were consulted about the reasons for the deviation.

PIAC devoted significant resources to participating in the development of the Better Regulation Guidelines. While not all of PIAC's positions were included in the final guidelines, PIAC was, nonetheless, satisfied with the process that developed them. This process provided extensive opportunities for input from all interested parties. PIAC also notes that as the Guidelines were largely developed in 2013, they cannot be considered out of date.

Accordingly, PIAC believes that all network businesses should adhere to the relevant Guidelines in the development of their regulatory proposals. PIAC notes that Jemena's proposed Rate of Return is not fully consistent with the relevant Guideline (see section 5, below).

## 3. Proposed prices

In developing its proposed price path of the five-year regulatory period, Jemena has taken into account the effect of rising wholesale gas prices on residential consumers. Jemena has proposed

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<sup>4</sup> Ibid.

<sup>5</sup> IPART, 2014, *Fact sheet: Removing carbon costs from regulated gas prices*, 1.

<sup>6</sup> Jemena, 2014, *Jemena's 5-year plan: Customer overview*, 4.

<sup>7</sup> Ibid, 7.

a smooth path that results in a real price decrease of almost 20% over the period.<sup>8</sup> To achieve this, Jemena has rebalanced the relative revenue it recovers from residential, commercial and industrial customers.

### 3.1 Prices for residential consumers

Many of the things residential consumers use gas for (cooking, water heating and space heating) can also be done using electricity. This means that for owner-occupiers who can afford the capital cost of converting appliances, gas is a discretionary fuel. In the context of rising wholesale prices, Jemena has, therefore, sought to design network tariffs that offset the damage to the overall appeal of gas caused by increasing wholesale prices. Jemena has proposed a real price decrease in network prices of 6.4% in 2015/16, followed by decreases of 3.7% in each of the following four years.<sup>9</sup>

PIAC welcomes Jemena's attempt to provide consumers with a smooth path over the period of the price determination. PIAC considers that such a price path is preferable to a larger decrease in year one, followed by flat or slightly increasing prices. Consumers are generally better able to respond to gradual price movements. A larger drop may also send a signal about the future prices of gas that does not reflect the likely future price trend. PIAC, therefore, recommends that the AER approve a smooth price path for Jemena for the five years. PIAC notes, however, that the AER must ensure prices are at the lowest possible level for consumers, which may mean final reductions are larger than those proposed by Jemena.

#### ***Recommendation 1***

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*PIAC recommends that the AER set a smooth price path for Jemena's network prices over the five-year price determination period.*

### 3.2 Revenue share of customer groups

One of the ways that Jemena is able to reduce prices for residential consumers is to adjust the share of total revenue it collects from different consumer groups.

Historically, Jemena has collected around 90% of its revenue from residential and commercial consumers and the remaining 10% from around 40 very large users.<sup>10</sup> In its last five-yearly proposal to the AER, Jemena kept prices stable for these large users. Jemena has stated that it did so because those users were both recovering from the recent global financial crisis and facing the impact of the carbon price. As a result of this decision, the share of Jemena's revenue that was collected from residential and commercial consumers increased from 90% to 94% over the five years of the last price determination.<sup>11</sup> In the current proposal, Jemena has proposed to return to the long-term revenue share. Accordingly, Jemena has proposed real price increases of 13% over five years for industrial consumers.<sup>12</sup>

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<sup>8</sup> McMillan, R, *Our 2015 Plan*, presentation from General Manager – Regulation to the public forum for Jemena's 2015 price determination, Four Seasons Hotel, Sydney, 15 August 2014, slide 12.

<sup>9</sup> Ibid. Based on an annual inflation rate of 2.5% over the price determination period.

<sup>10</sup> Taken from remarks made by Jemena Managing Director, Paul Adams, to the public forum for Jemena's 2015 price determination, Four Seasons Hotel, Sydney, 15 August 2014.

<sup>11</sup> Ibid.

<sup>12</sup> Above n 8, slide 11.

PIAC supports Jemena's decision to unwind the cross-subsidy between classes of consumers. In the interests of equity, residential consumers should provide no more revenue to Jemena than what is required to fund the cost of their use of the network. PIAC, therefore, recommends that the AER approve prices for Jemena that give effect to this intention.

### ***Recommendation 2***

*PIAC recommends that the AER approve prices for Jemena that allow 90% of total revenue to be recovered from residential and commercial customers over the price determination period.*

## **4. Weighted average cost of capital (WACC)**

The rate of return is a key driver of final network prices. Jemena has proposed a WACC of 8.67% per annum.<sup>13</sup> Jemena notes that this is down from 10.43% in the 2010-15 determination.

As part of the Better Regulation program, the AER developed a Rate of Return Guideline, published in December 2013.<sup>14</sup> Jemena's pricing proposal notes that in developing the Guideline, the AER 'consulted widely with consumer groups, network businesses, investors, banks rating agencies and other stakeholders'.<sup>15</sup>

PIAC made a number of submissions to the development of the Rate of Return Guideline. While the final Guideline was not totally consistent with PIAC's position, the process to develop it was rigorous and the result represents an improved outcome for consumers. Given the Guideline was developed recently and through a transparent and inclusive process, PIAC takes the view that all networks (and consumers) should accept the outcome and propose a WACC that complies with the Guideline.

Jemena's proposed WACC does not fully comply with the Rate of Return Guideline. Jemena notes that its WACC proposal 'focuses on areas where there is disagreement' with the methodology set out in the Guideline.<sup>16</sup> Jemena argues that its proposal 'best promotes the long term interests of consumers by balancing the need to attract efficient investment in the network with the risk of overpaying for investment'.<sup>17</sup>

PIAC disagrees with this assertion, and argues that the long-term interest of consumers is best served by granting network businesses a WACC that is consistent with the Guideline both in terms of approach and the value of parameters used in calculating the WACC. In its recent submission to the AER's price determination for the NSW electricity distribution network businesses, PIAC estimated that a WACC developed in line with the Rate of Return Guideline would be around 7.7%. PIAC, therefore recommends that the AER apply the approach and parameter values from the Rate of Return Guideline when calculating the allowed rate of return for Jemena.

PIAC also notes that many of the comments contained in its submission to the review of NSW electricity distribution network prices in relation to the rate of return are relevant to the

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<sup>13</sup> Jemena, 2014, *Jemena Gas Networks (NSW) Ltd 2015-2020 Access Arrangement Information*, 92.

<sup>14</sup> Ibid, 94.

<sup>15</sup> Ibid.

<sup>16</sup> Ibid.

<sup>17</sup> Ibid.

determination of a WACC for Jemena. PIAC, therefore, provides a copy of that submission as Attachment 1.<sup>18</sup>

### ***Recommendation 3***

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*PIAC recommends that the AER grant Jemena a WACC that is consistent with the approach and parameter values from the Rate of Return Guideline.*

## **5. Helping consumers engage in the competitive market**

PIAC welcomes Jemena's proposal to reduce the cost of special meter reads. Such meter reads are required if a customer wishes to switch gas retailer. PIAC takes the view that the need to pay such a fee in order to switch retailers is a barrier to consumers' participation in the competitive market. PIAC agrees with Jemena that 'lowering the charge for special meter reads will improve customer participation in the energy market'.<sup>19</sup>

Such a price reduction is possible because as the amount of customer switching in the energy market has increased, so has demand for special meter reads. Jemena notes that this increase has 'lowered the incremental cost of providing these activities'.<sup>20</sup> As a result, the cost charged to consumers can be reduced without the need to introduce a cross-subsidy from other consumers.

PIAC also notes that lowering the barriers to participation in the gas market can also impact consumers' participation in the electricity market. This is because many retailers have special 'dual fuel' offers that are, by their very nature, only available to customers who also have a gas connection. Research from the St Vincent de Paul society recently highlighted that the best gas offer in NSW was only available in conjunction with electricity.<sup>21</sup>

### ***Recommendation 4***

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*PIAC recommends that the AER accept Jemena's proposal to reduce the fee it charges for special meter reads.*

## **6. Consumer engagement**

PIAC commends Jemena on its efforts to engage consumers about its activities and regulatory proposal to the AER. PIAC has been a member Jemena's Customer Council since its inception in late 2013. In the lead up to Jemena submitting its pricing proposal to the AER, the Customer Council had three lengthy meetings that aimed to help Customer Council members better understand the issues facing Jemena and provide input on certain matters related to Jemena's proposal to the AER. PIAC also notes that Jemena made its own subject-matter experts available to Customer Council members who wished to learn more about the more technical aspects of network regulation. PIAC attended an extremely useful session with two Jemena staff about the WACC.

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<sup>18</sup> PIAC, 2014, *Moving to a new paradigm*, pp 67-93. Available at: <http://www.piac.asn.au/publication/2014/08/newparadigm>.

<sup>19</sup> Jemena, 2014, *Jemena Gas Networks (NSW) Ltd 2015-2020 Access Arrangement Information*, 117

<sup>20</sup> Ibid.

<sup>21</sup> Mautheth Johnson, M, 2014, *An update on the NSW tariff-tracking project*, Melbourne: St Vincent de Paul Society, 8.



Jemena has shown itself to be responsive to the concerns of the Customer Council and its members. For example, following statements from members of the Customer Council about the challenges in affording essential energy services facing many residential consumers, Jemena has committed to providing seed funding to a No Interest Loan Scheme (NILS). This funding will allow eligible consumers to borrow on a no-interest basis the cost of upgrading their gas appliances to higher quality (but higher cost) alternatives that have lower ongoing running costs.

Significantly, Jemena has shown a willingness to invest in consumer engagement at the suggestion of the Customer Council. Following an assertion by several members (including PIAC) that their organisations were not able to speculate about the preferences of 'everyday consumers' Jemena convened a number of deliberative forums with consumers. PIAC acknowledges that these activities impose a cost that Jemena must pass on to consumers. However, as these costs are likely to be 50 cents or less per residential customer, PIAC believes they are justifiable. This is because such events (if well run) provide Jemena with important insight into the preferences of residential consumers.

Jemena has also been responsive to the concerns raised by PIAC about concerns related to consumer information. In particular, PIAC suggested through the Customer Council that a very short document should be produced to sit in front of the summary of the regulatory proposal that is required under the National Gas Rules. This two page summary sits at the tip of a 'pyramid of information' that is available to consumers, along with the summary, the full proposal and the attachments to the proposal.

PIAC notes, however, that all businesses, including Jemena, generally seek to present their company in the best possible light in corporate publications. PIAC takes the view that in the future consumers would benefit from a more 'impartial' view of networks, their proposed prices and activities. While this may run counter to all marketing orthodoxy, PIAC takes the view that such a move would ultimately enhance the quality of consumer engagement with network planning and operations, producing better results for all stakeholders in regulated monopoly energy services.

Finally, PIAC notes that while Jemena's consumer engagement activities have been more effective than those of the NSW electricity networks, it is important that Jemena strive for continuous improvement in this area. Improving consumer engagement is just as important as improving the effectiveness of any other area of Jemena's business.

PIAC is optimistic about Jemena's commitment to make consumer engagement activities part of 'business as usual'.<sup>22</sup> If this commitment is born out in Jemena's actions, PIAC is confident that consumers will be able to make a strong and valuable contribution to the regulatory proposal Jemena will submit to the AER in 2019. PIAC looks forward to working with Jemena in this effort.

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<sup>22</sup> Reardon, S, *Our customer and stakeholder engagement*, presentation from the EGM Strategy, Regulation and Projects to the public forum for Jemena's 2015 price determination, Four Seasons Hotel, Sydney, 15 August 2014, slide 5.

## **7. Conclusion**

PIAC supports a number of aspects of Jemena's regulatory proposal. These include a reduction of 20% in real network prices for residential consumers, a smooth price path and a reduction in the fee for special meter reads.

PIAC also commends Jemena at its efforts to engage consumers in the lead up to making its submission to the AER. PIAC takes the view that Jemena was more effective in these efforts than the NSW electricity networks. If Jemena can continue to build on this strong start and incorporate improving consumer engagement into its 'business as usual', both consumers and the network will benefit in the long term.

However, PIAC notes that Jemena has proposed a WACC that is not consistent with the AER's Rate of Return Guideline. PIAC recommends that the AER reject this proposed WACC, and grant Jemena a rate of return that is wholly consistent with its Guideline.