

**Response to the Office of Energy
Gas Tariff Regulations Review
Issues Paper**



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Gas Retail Market Competition

The Department of Treasury and Finance (DTF) supports the high-level objective of improving market contestability and efficiency to facilitate the sustainable supply of reliable and competitively priced energy (be it electricity or gas), encourage private sector investment, allow consumer choice, and underpin the competitiveness of Western Australian industry.

1. *Comment is sought on opportunities for small use customers to switch to second tier retailers in the gas distribution licence areas covered by the Tariff Regulations.*

With regard to competition in the domestic gas market, though Full Retail Contestability (FRC) was introduced in May 2004, the DTF believes that the Gas Moratorium that prohibits Synergy (previously Western Power Corporation) from selling gas to small-use customers (those that consume less than 1 terajoule per annum) has reduced the opportunities for small use customers to switch gas retailers.

The DTF recognises that due to either perceived and/or real barriers to entry for gas retailers, at present there exists only two large gas retailers, Alinta and Synergy.

At the contestable levels in which Synergy can compete, competition has emerged. This is evident from the fact that Synergy has gained about 30% of the contestable gas market over 1 terajoule per annum. The reduction of the Gas Moratorium in July 2007 to customers that consume less than 0.18 terajoule per annum should further increase competition in the gas market. However, the opportunities for small use customers to switch retailers are still limited.

2. *Are there technical or other barriers to customers switching, where an alternative retailer may exist?*

See comments in section 1.

3. *Are there impediments to small use customers being able to exercise informed choices regarding their choice of retailer?*

No comment.

4. *What barriers are there, across the gas market supply chain to entry, expansion and exiting the gas retail market?*

Upstream barriers exist for the entry of new gas retailers and the expansion of existing gas retailers. A number of reports have been produced on this issue, including the DomGas Alliance's *WA Gas Supply & Demand: The Need for Policy Intervention (July 2007)* by the economic consultant Synergies, and the Chamber of Commerce and Industry of Western Australia's *Meeting the Future Gas Needs of Western Australia: A Discussion Paper (March 2007)*. These barriers include that there is no uncommitted gas supply capacity currently available – irrespective of price; that there are no new developments that would provide additional domestic gas; and that the main gas supplier to the State remains a joint venture which is allowed to collectively market gas.

If gas were available, gas transmission capacity would need to be expanded. Whilst the Dampier to Bunbury Natural Gas Pipeline continues to expand, any expansion is only in response to contracted demand, so that extra capacity is not generally available in the short-term.

A barrier to entry for new gas retailers, and to some degree for existing gas retailer expansion, is the disconnect between supply side and customer contractual terms. Supply is characterised by long-term bilateral contracts for gas and transmission capacity, while customer contracts are shorter-term (particularly the case for small use customers). Risks are further amplified by the fact that the Western Australian gas market has no formal short-term or spot trading, and as a result liquidity of gas trading is low.

The small size of the Western Australia gas market may also be a barrier and limit the number of gas retailers. Additionally the demand for small use customers is relatively small, compared with the demand of large customers. For example, the Issues Paper notes that 3% of Western Australia's gas consumption is consumed by residential sources.

Energy retailers are now retailing both electricity and gas, and are increasingly offering dual fuel products. To effectively compete, a new gas retailer may need to have an ability to also retail electricity and this may be a barrier to entry.

5. *What is the significance of these barriers and are they different for new entrant retailers in comparison to retailers seeking to expand market share?*

No comment.

6. *Comment is sought on the availability and scope for product service differentiation in relation to the reticulation of gas in Western Australia, particularly in relation to small use customers.*

Given that energy retailers are now retailing both electricity and gas, product differentiation could be achieved through dual fuel offers. However, as there is no contestability for small use customers in electricity, this is not applicable for small use customers.

7. *Comment is sought on the perceptions of natural gas as a product of choice in the small use customer market compared to other energy supply options.*

The DTF is of the view that natural gas is a greener (less carbon intensive) and more efficient alternative to other energy supply options, for example electricity. Gas is a fuel that goes directly to appliances providing area heating and water heating, which is more efficient than electricity that is derived from burning a mix of coal and gas before providing the energy to accomplish the same thing. Electricity also loses efficiency during its transmission phase.

8. *What are the impacts of competition in the gas market on the profitability of reticulating gas in the distribution licence areas covered by the Tariff Regulations?*

No comment.

Retail Tariff Caps

The DTF believes that market based mechanisms are preferable where sufficient competition has developed. In the absence of sufficient gas retail competition the DTF supports the Gas Tariff Regulations, including appropriate retail gas tariff caps. An inefficient or uncompetitive market will not accurately reflect the costs associated with gas supply and thus will provide inappropriate price signals and result in an inefficient allocation of resources. In such an environment tariffs caps ensure that customers are not exposed to unacceptable risk.

As tariffs have largely been indexed to the Consumer Price Index in an environment of significant cost increases, it is necessary to review gas tariff arrangements for small use customers.

Western Australia's strong economy and the strong international demand for energy, energy infrastructure and commodities have put substantial cost pressures on energy suppliers in the form of increased capital, labour, fuel and other costs.

In the current environment of increasing demand, increasing costs and supply constraints, economic efficiency is of particular importance as a pricing strategy.

To support competition in the gas market and support the entry of new retailers, it is necessary to ensure that tariff arrangements are at cost reflective levels. This would support an efficient market and help with the efficient allocation of resources, both of which will benefit the Western Australian economy and the wider community.

9. *Are current retail prices to small use customers reflective of supply and retail costs for the respective gas distribution licence areas covered by the Tariff Regulations? If not, to what extent are costs not covered, and by how much would tariff caps need to be increased to recover costs?*

The DTF recognises that there has been a marked increase in the costs of energy supply, particularly for the price of gas. The DTF believes that gas tariffs should be cost reflective, though there may be a good case for phasing in a move to full cost reflective pricing within the review period.

10. *What is considered to be an appropriate retail margin for retailing natural gas in Western Australia, and is this different for LPG? Is this different for alternative customer types, or for new retailers/retailers seeking to expand their business?*

The DTF supports the inclusion of an appropriate margin in the regulated tariff. This will allow tariffs to act as a price ceiling and not a price floor, which will attract suppliers into the competitive market and support the development of the market, while also protecting customers against large price increases.

11. *Input is sought from stakeholders on, but not limited to, the following areas:*

- a. *Are there significant differences to be taken into account regarding the costs of supply to residential versus non-residential classes across each of the gas trading licence areas?*

No comment.

- b. *If the existing tariff cap adjustment mechanism continues into the future, will this impact on the ability of retailers to retail to small use customers in each of the gas trading licence areas? Will impacts change over time?*

The DTF believes that if tariff caps continue into the future at cost reflective levels, inclusive of an appropriate margin, that the ability of retailers to retail to small use customers will not be affected. Impacts on retailers may change over time if tariffs are not appropriately adjusted.

- c. *What impact will price regulation have on customers and on competition in the market, in the short- and long-term?*

The DTF believes that in the short-term, when barriers to entry exist and sufficient competition has not emerged, price regulation will have positive impacts on protecting customers while also supporting competition.

In the long-term, if not appropriately adjusted, price regulation may not send appropriate price signals to both customers and retailers and result in an inefficient allocation of resources.

The DTF believes that the preferred long-term position would be the development of sufficient retail gas competition and the subsequent removal of price regulation.

- d. *Are gas retail prices consistent with customer needs and expectations?*

No comment.

- e. *What barriers or policies should be addressed to reduce pressure on the cost to supply to small use customers?*

It is the DTF's view that tariffs are not an appropriate mechanism in which to offer concessions. Any concessions offered should be specific concessions offered in addition to the tariff.

The DTF believes that if lower prices for vulnerable or disadvantaged customers are considered necessary, a specific mechanism should be introduced to ensure lower gas prices or subsidies, for example specific rebates or concessions. At the same time such a mechanism should not encourage excessive gas use.

- f. *What impacts would changes to, or the removal of, tariff caps have on small use customers, particularly vulnerable or disadvantaged customers (e.g. low income users)?*

No comment.

- g. *If adjustment to the level of the tariff caps is required to implement more cost-reflective arrangements, what transitioning process should be adopted in moving to these new tariff caps?*

If required, the DTF supports appropriate transition paths. The DTF believes that while there is a need to provide customers with an opportunity to adjust, any decision on the timing of an appropriate transition path needs to recognise that:

- the longer that tariffs are not cost reflective, the increases will eventually need to be larger; and
- cost reflective tariffs (plus an appropriate margin) are needed to support competition in the market by encouraging the entry of new retailers.

Additional Matters

12. Are there any other matters that require consideration in the Tariff Regulations Review?

Given that energy retailers are now retailing both electricity and gas, and are increasingly offering dual fuel products, the DTF supports the development of an Integrated Energy Code that will support the alignment of standards and requirements to the benefit of both retailers and consumers.

In this regard, removing the Gas Moratorium that currently prohibits Synergy from selling gas to small-use customers (those that consume less than 180 gigajoules per annum) should be done concurrently with the introduction of FRC. This would ensure effective competition in both the electricity and gas markets at the small use customer level.

Going forward, the DTF believes that the most appropriate gas tariff adjustment mechanism and review process is to have an independent authority responsible for periodically reviewing and setting tariffs. On a regular and predictable basis this body would independently analyse and set tariffs, allowing tariffs to be set on the basis of independently assessed costs.

The DTF views that the appropriate body to undertake the tariff review and reset process may be the Economic Regulation Authority. This is consistent with the process in other jurisdictions, for example the Independent Pricing and Regulatory Tribunal of New South

Wales (IPART) sets default gas tariffs for smaller users who use less than 1 terajoule of gas per annum in New South Wales.