ICRC
INDEPENDENT COMPETITION AND REGULATORY COMMISSION

FINAL DETERMINATION

Review of natural gas prices

May 2001

INDEPENDENT COMPETITION AND REGULATORY COMMISSION

Final Determination

Review of Natural Gas Prices

May 2001

The Commission is headed by:

Mr Paul Baxter

Inquiries regarding this review should be directed to:

Ian Primrose ☎ 02 6205 0779

Public information about the Commission's activities

A range of information about the role and current activities of the Commission, including copies of latest reports and submissions can be found on the Commission's website at www.icrc.act.gov.au

Independent Competition and Regulatory Commission
Level 7, 197 London Circuit, Canberra ACT 2600
☎ 02 6205 0799 Fax 02 6207 5887

All correspondence to: GPO Box 975, Civic Square, ACT 2608

TABLE OF CONTENTS

FOREWORD

This is the Commission's final decision on retail prices for gas supply in the ACT. The Commission makes its decision in response to a reference issued by the Minister for Urban Services, calling for retail gas prices to be determined and effective from 1 July 2001.

In reaching its final decision, the Commission has considered ActewAGL's response to the draft decision released in April 2001. The final decision builds upon the Commission's approval of the gas access arrangement proposed by ActewAGL earlier in 2001 and the setting of network pricing for the period to 30 June 2004.

The final decision sets a maximum retail price for gas for customers under the current regulated regime and takes into account the need for a default tariff, or safety net price, to underpin contestability during the period of the network pricing decision. While the Commission recognises that there are currently constraints on the development of a contestable market for gas in the ACT, there is an expectation that those constraints will reduce in the medium term and that the potential for new entrants to enter the retail gas market will increase.

The final decision delivers lower prices, in real terms, to consumers over the period of the price path, and retains the benefits provided by ActewAGL for pensioners.

The Commission has considered the issue of contestability costs separately. Given that the exact magnitude of these costs is not clear at this time, the Commission has decided that prudent costs necessarily incurred in introducing contestability will be passed on to customers when they become certain.

Paul Baxter
Senior Commissioner
May 2001

EXECUTIVE SUMMARY

Introduction

This report presents the Independent Competition and Regulatory Commission's (the Commission's) final decision on the regulatory arrangements for gas prices in ACT. It sets out the Commission's approach to regulating the prices ActewAGL charges its tariff customers during the transition to full contestability.

Competition and regulation in the ACT gas market

The ACT government is progressively introducing competition into the natural gas market. As the gas market moves towards full retail contestability, residential and business gas customers will be able to choose their supplier. This requires development of customer transfer and market administration systems. The ACT government is currently considering alignment of the market structure, system design and development with that are now being established in NSW. The expectation is that effective retail competition will occur around the same time as NSW.[1]

The terms of reference of this investigation provide for the Commission to establish 'default tariffs or safety net prices' during the transition to full retail competition. The purpose of default tariffs is to protect customers who:

- are already connected to gas, and therefore need assurance that they will not be stranded with gas appliances but no gas retailer
- do not have a choice of retailer, or who do not consciously exercise a choice of retailer
- no longer have a retail contract because their retail supplier has ceased to trade
- otherwise may not benefit from a competitive market.

All ACT tariff market customers (eg households and small businesses) will have the option of remaining on default tariffs.

In establishing default tariffs, the Commission has considered its duties and obligations under its legislation and the new Utilities Act. These are to encourage competition and to take account of the interests of customers and ActewAGL. In addition, it also aims to meet the following objectives:

- to fulfil the purpose of default tariffs (as outlined above)
- to provide a smooth transition to a competitive market, and enable retailers and customers to have confidence in the competitive market
- to strengthen the incentives for ActewAGL to operate efficiently
- to facilitate implementation and minimise the costs of regulation.

---

1 In the Speech for the Second Reading of the *Gas Supply Amendment (Retail Competition) Bill 2001* on 4 April 2001, the NSW Minister for Energy announced that full retail competition in gas will be introduced from 1 January 2002 to coincide with the commencement of full competition in the electricity industry.

The Commission believes that to encourage competition, regulated or default tariffs must reflect the costs of gas supply and operate in a 'neutral' manner in the competitive market. That is, they should not be set artificially high, so they encourage customers to switch retailer but disadvantage those less able to participate in the contestable market. Nor should they be set artificially low, so competing retail suppliers find it difficult to offer a more attractive service and competition is hindered. The Commission's primary objective for this review is to ensure that existing tariffs move towards cost-reflective levels.

The Commission's final decision

The Commission favours a price path approach to establish default tariffs (ie safety net prices) during the transition to competition, as a means of protecting customer interests while providing certainty to ActewAGL. The price path is based on the costs of supply. The default tariffs arising from the price path will operate in a 'neutral' manner in the competitive market.

On the basis of information and analysis undertaken during its investigation and consideration of ActewAGL's submission, the Commission has decided to adopt the following regulatory approach during transition to contestability:

1. Default tariffs to all tariff customers whose consumption is below 10 TJ will apply from 1 July 2001 to 30 June 2004. These default tariffs are "maximum prices". ActewAGL will have the ability to offer alternative tariffs under a competitive market.
2. Default tariffs should be broadly cost reflective and will be based on ActewAGL's existing tariff structure. A price path has been determined for the next 3 years.
3. A review of the price path will be undertaken under special circumstances, either at the request of ActewAGL or the discretion of the Commission, to consider matters such as:
    - changes in ActewAGL's cost components such as the field price of natural gas, impacts of regulatory decisions on haulage rates, or impacts from capacity enhancement
    - any decision on consumption profiling that deems a profile other than the market profile that has been used for cost allocation
    - significant changes to ActewAGL's obligations and costs under new regulation and codes
    - changes in market circumstances that in the Commission's opinion warrant a review of price path.
4. Where customers have accepted a competitive offer under a contestable gas retail market, they will be able to revert to ActewAGL's default tariffs without penalty once they have met their contractual obligations.
5. ActewAGL will be able to pass through to customers costs associated with implementing full retail contestability (FRC) in addition to default prices set out under the price path. Costs associated with FRC include but are not limited to costs relating to market systems, increases in network charges, gas balancing charges and prudent costs incurred by ActewAGL. The Commission will determine a mechanism to recover these costs including an assessment of such costs.

6. ActewAGL will be able to pass through to customers costs associated with changes to authorisation fees, taxes and imposts.
7. ActewAGL will provide information relating to the development of a competitive gas retail market, if requested by the Commission.

The Commission has decided a price path as set out below.

ICRC price direction 2001/02 to 2003/04

Tariff	2001/02	2002/03	2003/4
Residential general:			
Supply fee	CPI^{-GST}	CPI^{-GST}	CPI^{-GST}
Energy rate	CPI^{-GST} -8.7%	CPI^{-GST} -1%	CPI^{-GST} -1%
Residential economy:			
Supply fee	CPI^{-GST}	CPI^{-GST}	CPI^{-GST}
Energy rate	CPI^{-GST} -5.2%	CPI^{-GST} -1%	CPI^{-GST} -1%
Residential economy plus:			
Supply fee	CPI^{-GST}	CPI^{-GST}	CPI^{-GST}
Energy rate 1	CPI^{-GST}	CPI^{-GST} -1%	CPI^{-GST} -1%
Energy rate 2	CPI^{-GST} -3.7%	CPI^{-GST} -1%	CPI^{-GST} -1%
Business 0-10 TJ:			
Supply fee	CPI^{-GST}	CPI^{-GST}	CPI^{-GST}
Energy rate 1	CPI^{-GST} -11.7%	CPI^{-GST} -1%	CPI^{-GST} -1%
Energy rate 2	CPI^{-GST} -5.7%	CPI^{-GST} -1%	CPI^{-GST} -1%
Comparison with ActewAGL's proposal	ActewAGL's proposed prices are expressed in nominal terms. They are translated to CPI-X factor assuming an inflation of 3.7%	ActewAGL proposal: CPI cap	ActewAGL proposal: CPI cap

Note:

1. The CPI index for adjusting price is CPI exclusive of GST.
2. On 1 July 2001, tariffs will be adjusted using an inflation of 3.72% ie the adjusted inflation excluding the net impact of GST for the year to 31 March 2001.

Other matters considered by the Commission

Tariff market prices in ACT

In the past four years 1996-2000, the residential market has seen real price increase. Prices in ACT were pegged to those in NSW until October 2000. Therefore, the price increase in ACT is largely as a result of cost reflective price changes implemented in NSW.

Over the same period, real average tariff prices for business customers have fallen slightly. The analysis also suggests that ActewAGL's revenue growth has been driven by strong market expansion and customer growth.

Profitability analysis of ActewAGL's current tariffs

The profitability analysis of each of ActewAGL's current tariffs, for different consumption levels and given ActewAGL's cost assumptions, shows that:

- approximately 25 per cent of residential customers (including pensioners) are not meeting the cost of supply. They are low consumption customers. However, the amount of under-recovery, in dollar terms, represents less than 1 per cent of revenue from these customers. This suggests that subsidies in the market is not a major issue.
- two pensioner tariffs (general and economy) have a negative margin. In dollar terms, the amount of under-recovery is approximately 2% of pensioner revenue.
- all industrial and commercial customers are profitable.

This analysis suggests that ActewAGL's tariffs are largely cost reflective.

Retail margin

While taking account of the limitations of the available data relating to retail margins for ActewAGL and gas suppliers, the Commission notes:

- ActewAGL's profit margin on its whole tariff business is approximately 3% under its pricing proposal
- On a dollar per customer basis, ActewAGL's retail costs are at the upper end of a benchmark range $40-$60 for energy suppliers considered by the NSW regulator. This may be caused by a smaller customer base in the ACT.
- ActewAGL has allowed for additional retail costs from 2001/02 associated with compliance with the Utilities Act, bad debts and potential costs it may incur under a competitive market. Assessment of these new costs is subject to the timing and effectiveness of a full contestable market.

The Commission has adopted ActewAGL's retail cost forecasts for the purpose of this decision. The Commission will further examine ActewAGL's cost efficiency at the next review.

Recent changes to the ACT gas regulatory framework

There will be changes to the licence obligations of gas suppliers under the Utilities Act. ActewAGL has allowed for additional costs of compliance with the Utilities Act. ActewAGL submits that changes to authorisation fees, taxes, imposts and balancing charges should be passed through to customers. The Commission has accepted ActewAGL's proposal.

Alternative gas supply

ActewAGL Distribution has advised that the Eastern Gas Pipeline Connector project is on schedule and will be completed by 1 July 2001. The Interconnect will allow alternative supply of gas from the Bass Strait Basin. This will remove a major impediment to entry to the ACT gas market.

Gas tariffs in Queanbeyan and Yarrowlumla

The Commission supports ActewAGL's intention to align tariffs in Queanbeyan and Yarrowlumla with those in ACT. AGL Retail Energy (the incumbent retailer in NSW) will seek approval from the NSW pricing regulator.

ActewAGL's compliance with ring-fencing requirements

ActewAGL Distribution has advised that it is working towards compliance with the ring fencing obligations in the National Gas Code.

Miscellaneous charges

The Commission has decided to regulate miscellaneous fees and charges.

Pensioners rebates

ActewAGL intends to voluntarily increase rebates to pensioners by $5 to $19 a year from 1 July 2001. The Commission supports this initiative.

1 INTRODUCTION

1.1 Purpose of this review

The Independent Competition and Regulatory Commission (ICRC) is conducting an investigation into natural gas pricing within the Australian Capital Territory (ACT) for domestic, commercial and industrial consumers from 1 July 2001. The terms of reference establish the various matters to be considered by the Commission for this investigation (see Appendix 1)

The introduction of contestability to the tariff market has necessitated a review of the regulatory arrangement. In this investigation, the Commission has considered the form of price regulation during transition to full retail contestability in the gas market.

1.2 Investigation timetable and process

The term of reference requires the Commission to report to the Minister for Urban Services by 31 May 2001.

During the investigation, the Commission has received and assessed a pricing proposal from ActewAGL and has held discussions with the Department of Urban Services.

On 20 April 2001, the Commission released a draft price direction for public consultation. ActewAGL submitted its response on 21 May 2001. The Commission has now made a final decision and determined a price direction (see Schedule 1) for ActewAGL's gas pricing. The price direction will be effective from 1 July 2001 to 30 June 2004.

Event	Date
Reference to the Commission for investigation	22 March 2001
Release of draft report and price direction	20 April 2001
Public submissions due (including ActewAGL)	21 May 2001
Release of final report and price direction	31 May 2001

1.3 Issues for the final decision

To arrive at its final decision on ActewAGL's gas retail prices, the Commission has considered ActewAGL's submission and developments in the gas retail market since the draft decision. A summary of ActewAGL's submission is provided in Appendix 2. Key aspects of the Commission's final decision are:

- the retail gas price path and default tariffs
- retailer of last resort obligations
- coverage of regulation (whether default prices should be applied to customers using up to 10 TJ a year)
- assessment of retail costs
- definition of CPI
- regulation of miscellaneous fees.

These matters are addressed throughout this final report. The Commission has modified some of its decision in light of ActewAGL's submission and further analysis.

1.4 Structure of this report

This report explains the Commission's final determination and the rationale behind it in more detail. It sets out:

- the background to the gas market in the ACT, and the role of regulation during the transition to competition (chapter 2)
- matters investigated by the Commission as set out in the terms of reference (chapter 3)
- ActewAGL's pricing proposal and the Commission's assessment (chapter 4)
- the final determination on the form of regulation, the outcomes and price implications of its price direction.

In addition, it includes a number of appendices that provide information on matters that the Commission considered during its investigation.

2 COMPETITION AND REGULATION IN THE ACT GAS MARKET

The ACT government is progressively introducing competition into the natural gas market. In the lead up to and early stages of competition, however, the incumbent retailer ActewAGL will still have an effective monopoly. For this reason, the Commission has an important role to play in regulating the prices ActewAGL can charge during this transition period. This chapter provides the context to this review, including an outline of the gas retail market in ACT and the introduction of competition into this market, the Commission's role, duties and powers in this market, and the objectives of default tariffs.

2.1 The gas retail market in ACT

Until fairly recently, AGL Gas Company (ACT) Limited was the monopoly supplier of gas in ACT.[2] In November 2000, ACTEW Corporation and AGL Limited entered into a joint venture arrangement. This followed the ACT Legislative Assembly decision to pass the *ACTEW/AGL Partnership Facilitation Bill 2000* in March 2000. The joint venture included the amalgamation of ACTEW Corporation's ACT electricity network and retail operations, and AGL's ACT gas network and retail operations, and gas network operations in Queanbeyan. The ACT's water and wastewater assets remain public with ACTEW retaining 100 per cent ownership of these assets.

Under the joint venture, the gas and electricity retail businesses of the two utilities have been combined in the ACT as ActewAGL Retail (ActewAGL) whereas the distribution network businesses have been combined as ActewAGL Distribution.

ActewAGL supplies natural gas to both *tariff* and *contract* customers:

- **Tariff customers** are those that consume less than 10 terajoules (TJ) of gas per annum. Within this category, there are low volume customers who use less than 1 TJ of gas per annum.[3] These customers are typically residential users, although they also include some industrial and commercial users. Large volume customers (who use between 1 and 10 TJ of gas per annum) are industrial/commercial users.

  Residential, industrial and commercial customers consumed approximately 4,700 TJ of gas in 1999/2000. Although residential customers account for 97 per cent of the total number of tariff customers, they consume only 70 per cent of the total tariff load. Commercial and industrial customers account for 3 per cent of customer numbers and consume about 30 per cent of gas sold.

- **Contract customers** are those that consume more than 10 TJ of gas per annum. There are 41 contract customers which represent less than 0.1 per cent of the total ACT gas customers, but account for around 17 per cent of gas consumed.

This review is concerned only with the tariff market in ACT served by ActewAGL's gas distribution network. The Commission's final decision applies only to the incumbent retailer, ActewAGL.

---

2 Whilst AGL Gas Company (ACT) Limited operated as a bundled distribution and retail business, work was under way to legally separate distribution and retail business.

3 For a typical residential household consuming 45-50 GJ a year, the current gas bill is around $650-700 a year. The bill for customers using 1 TJ of gas a year is around $12,000.

2.2 Introducing competition into the tariff market[4]

Reforms have paved the way for new suppliers of gas to enter the ACT gas market. A third party access regime has been developed for natural gas pipelines. The Commission has approved a revised Access Arrangement submitted by ActewAGL Distribution in January 2001, following its final decision in November 2000.

At present, there are limitations on the availability of alternative source of gas. Retail market systems necessary for the operation of the competitive market are yet to be implemented. However, the Commission notes that:

- ActewAGL Gas Networks is required to connect to the Eastern Gas Pipeline (EGP) and allow for third party access by 1 July 2001.[5] The EGP connection project is undertaken to provide a long term solution to meet winter demands for the next 20 years. The interconnection will allow supply of natural gas from the Bass Strait basin in Victoria.
- under current contestability timetable, customers will become eligible to choose their suppliers. This timing is expected to be in early 2002, subject to the availability of business systems to deal with customer churns.[6]
- the ACT government has participated in the NSW Steering Committee on Retail Contestability.[7] ACT will align its market administration system to that of NSW, ie ACT will be part of the NSW gas retail market business systems and will apply similar business rules.
- in NSW, the Gas Retail Market Company (GRMCo) was established in December 2000. The Company will fund and engage a provider of IT & T retail market services for the gas industry and will administer the business rules which will govern transactions between gas retailers and network operators in the competitive market. A long term contract between GRMCo and an IT & T services provider is being put in place. This will deliver the systems which are required to support full retail competition.[8]

At present, ActewAGL is the only gas retail supplier in ACT. However, the Commission considers that new retailers will enter the ACT market when there is alternative supply of gas.

---

4 The contract market in ACT is not regulated.

5 ICRC final decision on Access Arrangement for ActewAGL Natural Gas System in ACT, Queanbeyan and Yarrowlumla, November 2000, Amendment 6. However, the date of 1 July 2001 may be extended by ActewAGL notifying the Commission that delay has been caused through factors beyond ActewAGL Distribution's control, and the nature of these factors.

6 In ACT, full retail contestability is scheduled to commence on 1 July 2001, same as that for NSW. However, the NSW Minister for Energy recently announced that full retail competition in gas will be introduced from 1 January 2002 to coincide with the commencement of competition in the electricity industry.

7 The NSW Ministry of Energy and Utilities established the Gas Retail Project in May 1999 to facilitate the gas industry's efforts to develop rules, codes and arrangements to support full retail competition in gas. The Steering Committee was established with participation by key stakeholders.

8 Progress Report by the Ministry of Energy and Utilities, January 2001.

2.3 Regulation of gas utilities

2.3.1 New regulatory framework

The *Utilities Act 2000* commenced on 1 January 2001. This Act establishes a new regulatory framework for electricity, gas and water and sewerage utilities in the ACT.

The Act deals with the following:

- licensing of utilities
- licence compliance
- utilities' powers and duties
- codes of practice
- customer contracts (negotiated and standard)
- complaints handling and applications for relief from hardship
- community service obligations.

Primary responsibility for regulating utilities rests with the Commission. In addition to issuing licences and monitoring licence compliance, the Commission has responsibility for managing industry codes of practice (including the Consumer Protection Code) and for approving standard customer contracts for franchise customers. The Commission will also continue to be responsible for regulating utilities' prices. Technical matters will be regulated by the Department of Urban Services.

Under the new Act persons providing a utility service will be required to hold appropriate operating licences. Gas utilities currently licensed or authorised under the *Gas Supply Act 1998* were given a temporary exemption from the requirement to hold a licence under the Utilities Act. The exemptions will remain in force until applications for the grant of a licence can be considered and new licences issued and, in any event, no later than 1 June 2001.

Despite the start of the Utilities Act on 1 January 2001, its provisions will not apply to utilities until they are licensed under that Act. This means, for example, that utilities do not have to comply with either industry or technical codes until they are licensed. In the meantime the licences and authorisations currently issued under the *Gas Supply Act* will remain in force until 1 July 2001 and utilities will need to continue to operate in accordance with the terms of those instruments.

2.3.2 Existing price regulation in the tariff market

Gas tariffs in ACT were pegged to those charged in NSW. Under the *ACT Gas Act 1992*, gas prices for the tariff market in ACT were regulated by reference to prices in NSW set under a price control formula.

In July 2000, increase in gas tariffs in ACT was implemented in line with those in NSW. The increase was 1.9 per cent in addition to the pass through of the net impact of the Goods and Services Tax (GST). In order to ease the price impact, the 1.9 per cent increase was deferred for pensioners in ACT to 1 October 2000. However, the 1.9 per cent increase was not implemented for pensioners in ACT in October 2000. As a consequence, tariffs for pensioners in ACT are slightly lower than those for residential customers.

Changes to the NSW tariffs were implemented in March 2001, following the decision of the Independent Pricing and Regulatory Tribunal (IPART) on the tariff review of AGL Retail Energy. The NSW tariff changes were to achieve cost reflectivity. As the cost of gas supply (including network distribution cost) is different in ACT, it is no longer appropriate to apply NSW tariffs to ACT.

2.4 The Commission's role, duties and powers

Under section 7 of the *Independent Competition and Regulatory Commission Act 1997* (ICRC Act), the Commission has the following objectives in relation to regulated industries:

a) to promote effective competition in the interests of consumers

b) to facilitate an appropriate balance between efficient and environmental and social considerations

c) to ensure non-discriminatory access to monopoly and near-monopoly infrastructure.

Section 15 of the ICRC Act provides for the Commission to conduct investigations. Among other matters, the terms of reference for the current investigation require the Commission to review gas retail pricing in ACT, and to consider the impact of retail contestability and the time for which a price path or other regulatory mechanism that should be determined. The Commission has therefore considered:

- the appropriate form of price regulation during transition to full retail competition
- a price direction.

2.4.1 Price direction

Section 20 of the ICRC Act empowers the Commission to make a price direction in a regulated industry at the conclusion of an investigation. The Commission is required to have regard to a number of matters as set out in section 20(2). The Commission's consideration of these matters are set out in chapter 4.

Under section 20 (4), a price direction may specify, in relation to the supply of natural gas, any or all of the following:

a) a price

b) a maximum price

c) a maximum price and a minimum price

d) a formula for calculating a price referred to in paragraph (a), (b) or (c)

e) a method, by reference to price indices or otherwise, by which a price referred to in paragraph (a), (b) or (c) is to be ascertained

f) a period or periods during which the direction, or any provision of the direction, is to apply.

2.4.2 Commission's role in the transition to a competitive market

The Commission's role will change with the introduction of competition in the retail market. ActewAGL will have a monopoly over the retail supply of gas to tariff customers until the necessary retail market systems for full retail competition are operational. The Commission's role during this transition period is to ensure that ActewAGL does not use its dominant market power to earn excessive profits from tariff customers, to lower its service standards, or to prevent the development of effective competition. In determining prices for natural gas, the Commission considers that allowing sufficient 'headroom' on the retail margin is important if potential competitors are to be encouraged to enter the gas market.

Once effective competition is established, market forces should ensure that suppliers provide services of the quality demanded by customers, and that they do not earn excessive profits. The Commission will therefore have less focus on preventing ActewAGL from earning excessive profits. The Commission notes that in the final proposals for British Gas Trading's (BGT's) price control, Ofgem (the regulator for the energy market in the UK) decided to remove price control on BGT tariffs. However, Ofgem sought a public commitment from BGT that would maintain the relative differentials between its tariffs until at least April 2002. Ofgem's decision is made in recognition of how competition has developed in the three years that the market has been fully open.[9]

However, the Commission considers that effective competition is likely to take some time to develop in the ACT. Currently, factors such as limited alternative gas supply sources and systems to support contestability are hindering its development. While these structural impediments are expected to diminish over the medium term, the extent of competition, the likely impact on prices and services, and the likely delivery time of the benefits from competition cannot be predicted with any degree of certainty.

2.5 Objectives of safety net prices (or default tariffs)

One of the specific requirements in relation to this investigation is the determination of a suitable safety net price that addresses an appropriate balance in the period of transition to retail contestability between customer protection and the encouragement of the longer term benefits of contestability. Such safety net price is akin to the approach of default tariffs adopted in NSW electricity and gas industries.

The Commission notes that under the NSW government framework for full retail contestability, default tariffs, as part of the default supply contract, have four objectives:

- to protect customers who are already connected to gas, by ensuring that they will not be stranded with gas appliances but no retailer
- to protect customers who do not have a choice of retailer, or who do not consciously exercise a choice of retailer
- to protect customers who face an elapsed retail contract due to default by the retailer
- to protect customers who otherwise may not benefit from a competitive market.

[9] Ofgem, Review of British Gas Trading's price regulation – Final Proposals, February 2001.

The Commission considers that default tariffs should be established for the gas sector which will provide time for small customers to consider their options. In setting default tariffs, the Commission will also need to adhere to its duties under the ICRC Act.

It is important to note that default tariffs do not restrict ActewAGL's ability to offer competitive products and prices, on unregulated terms, in the competitive market.

3 MATTERS INVESTIGATED BY THE COMMISSION

The Commission has considered specific matters set out in the terms of reference. In addition, the Commission has also considered the regulation of miscellaneous fees and the quality and standard of service.

3.1 Assessment of current tariff prices

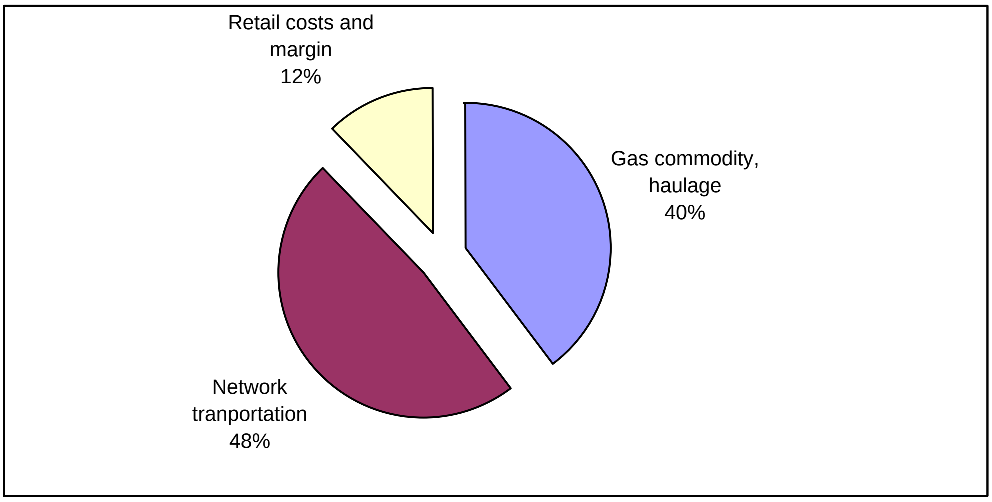
3.1.1 The cost of gas supply

In deciding gas prices for the tariff market, the Commission has attempted to assess trends in ActewAGL's costs, average tariffs and revenue. The Commission has had regard to information and data provided by ActewAGL during its investigation.

The delivered price of gas has several components:

- *gas commodity and haulage costs* – purchasing the gas from the field and transporting it from the field to the city gate through a transmission pipeline
- *transport costs* – transporting the gas through the reticulation system[10]
- *retail costs and margin* – running the supply business, including a profit margin.

Figure 3.1 ActewAGL's supply costs



Source: ActewAGL.
Note: Excludes the net cost impact of GST.

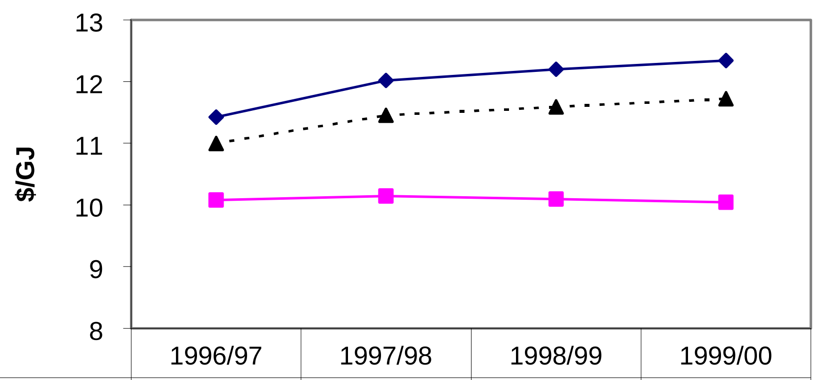
Gas field prices and haulage costs are subject to contractual arrangement between ActewAGL and AGL. Network transportation costs, which form the majority of the cost of gas supply, are now separately regulated under an Access Arrangement as a result of national gas reform. The remaining costs are those incurred by ActewAGL and its profit

10 ActewAGL Gas Network's distribution charges are regulated by the Commission under the National Gas Code.

margin on the retail business. As may be seen from Figure 3.1, this is the smallest of the three components.

3.1.2 Recent price movements

Figure 3.2 shows the real average tariff price (ATP) movements over the period 1996/97 – 1999/2000.



	1996/97	1997/98	1998/99	1999/00
Residential	11.42	12.02	12.20	12.34
Business	10.08	10.14	10.09	10.04
All tariff customers	10.99	11.46	11.59	11.72

Figure 3.2 – Real average tariff price by customer classes - $/GJ – (1999/2000 dollars)

Source: ActewAGL

The Commission's analysis shows that over the period 1996/97 to 1999/2000:

- real ATP for residential customers have increased by 2.6 per cent per annum
- real ATP for non-residential customers have fallen by 0.1 per cent per annum
- real ATP for tariff customers have increased by 2.2 per cent per annum
- ActewAGL's gas tariff customers grew by 17 per cent over the four year period 1996-2000, or 5.4 per cent per annum
- growth in gas sales is consistent with customer numbers with annual growth of 5.2 per cent per annum
- there have been a strong revenue growth which has been driven by a combination of market growth and tariff increases.

Given the history of gas pricing in ACT, the price movements in ACT were effectively driven by various tariff restructures in NSW implemented in recent years.

3.1.3 Retail margin

The retail margin represents those costs controlled by ActewAGL, being the costs of providing retail services to customers (ie gas supplier's retail costs) and a profit margin. Other costs, such as gas purchase costs, haulage, network prices and the net cost of the GST package, are passed through by retailers to end customers.

Prior to the ActewAGL joint venture, AGL Gas Company (ACT) Limited operated as a bundled gas retail and distribution business. Information on retail margin for the gas retail business is not directly available.

The Commission notes that only limited information was available regarding the retail costs incurred by gas retailers and profit margin in Australia. During this review, the Commission has considered the level of retail margin of energy retail businesses in NSW:

- in its draft report on AGL Retail Energy (AGLRE), IPART's analysis shows that retail margin for the tariff market in NSW was 9.9 per cent of sales turnover in 1998/99[11]. However, the Commission notes that AGLRE's retail margin outcome was achieved in the context of 70 per cent of customers not meeting the cost of supply.
- in its final report on the tariff review in NSW, IPART analysed AGLRE's tariffs on the basis of retail costs consistent with the outcomes of IPART's investigation in the electricity sector of $40-$60 per customer and a net retail profit margin of 2-3 per cent.[12]

By comparison, profit margins allowed by the UK regulator for energy suppliers are around 1.5% of sales revenue. ActewAGL submits that it does not believe that selected international comparisons of profit margins are valid for determining prices.

One would expect that the risks facing a gas retailer in NSW and ACT are reasonably similar, and as a result these businesses should earn comparable profit margins. However, care needs to be taken in deriving like for like margins. For instance, in the NSW tariff review, AGLRE has argued that the net margin should be determined on a per customer basis, rather than as a proportion of revenue.

In its draft determination, the Commission raises the issue of synergies arising from the ACTEW Corporation/AGL merger and the need to capture these benefits in the initial period to 2004. ActewAGL submits that:

> … it is concerned with the Commission's approach on this matter for a number of reasons:
>
> - Synergy benefits, say relating to operating costs, cannot be considered in isolation. Such benefits would need to be considered in the full context of a multi-utility business. Such consideration would, amongst other things, require a view on the optimal business strategy and structure of a multi-utility businesses. There is a risk that regulatory intervention may inadvertently start to signal business strategy and structure with the potential consequence of limiting innovation in the supply of multi-utility services.

11 IPART, Draft report "Review of the Delivered Price of Natural Gas to Tariff Customers Served from the AGL Gas Network in NSW", May 2000, p26.

12 IPART, Final report "Review of the Delivered Price of Natural Gas to Tariff Customers Served from the AGL Gas Network in NSW", February 2001, p11.

- The approach would reduce the incentive to realise synergy benefits. ActewAGL will bear the costs of synergy realisation (eg. restructuring costs) but will not receive the proper share of benefits. In a competitive market, benefits accruing from synergy will be passed through to customers in the form of lower prices in response to competitive pressures. Mandating the pass through of synergy benefits across the entire market may not be efficient and in doing so, the Commission may restrict ActewAGL's ability to pass through such benefits to the relevant customer groups.

- From a competitive market perspective, the approach would mean that only multi-utility retailers would be able to compete in the ACT market where they could utilise the benefits of synergy. This is not consistent with the Commission's desire to allow sufficient headroom to encourage competitors, who may not be multi-utility operators, to enter the market.[13]

At present, ActewAGL is at the early stage of implementing the joint venture. Initially, part of any synergies will be offset by the cost of restructuring. Any cost savings are expected to vary between the distribution and retail businesses. The treatment of these synergies needs to be considered in the context of incentive regulation.

On a per customer basis, the cost incurred by ActewAGL falls within the $40-$60 range considered by IPART but is higher than those reported for AGLRE in NSW. In response to the draft decision, ActewAGL submits the customer base in the ACT market is around one tenth of that in NSW and for this reason it is not unexpected that cost per customer will be higher.[14]

The Commission concludes that:

- there is scope for cost improvements (eg synergy associated with the combined gas and electricity retail business) but this should be considered in the context of ActewAGL's restructuring costs, the level of savings that may flow to the gas retail business and the implication for incentives.
- it is possible that the difference in retail costs in NSW and ACT is caused by size of operation.

In determining the appropriate level for a retail margin, the Commission considers that allowing sufficient 'headroom' on the retail margin is important if potential competitors are to be encouraged to enter the gas market. On this basis, the Commission has used ActewAGL's retail cost to formulate the price path. However, the Commission will examine ActewAGL's cost efficiency and sharing of such benefits between customers and retailers from the next regulatory period in 2004.

3.1.4 Profitability of current tariffs

The Commission's analysis suggests that ActewAGL's overall gross margin (ie, retail costs plus profit margin) is approximately 12 percent. Within the different residential tariff categories, the gross margin is lower for pensioner tariffs than non-pensioners.

13 ActewAGL's submission, 21 May 2001.
14 ActewAGL's submission to ICRC, 21 May 2001.

However, the gross margin can give a misleading view of profitability. For example, because the average residential gas bill is relatively small, retail costs are a greater proportion of the gross margin than for business customers. This means it is important to also look at the net profit margin. The profit margin is higher for the industrial and commercial tariffs than for the residential tariffs.

Within each tariff category, the Commission has examined profitability for different consumption levels. This analysis shows that:

- for the residential tariffs, low consumption customers have a negative margin, while higher consumption customers are profitable. On the basis of ActewAGL's cost assumption, approximately 25% of residential customers (including pensioners) do not meet the cost of gas supply. In dollar terms, the amount of under-recovery represents less than 1 per cent of revenue. The level of subsidies in current tariffs is also sensitive to the assumption of retail costs. The Commission's view is that the extent of cross subsidies between low and high consumers in ACT is not a significant issue.
- the profit margin is negative for pensioner general and economy tariffs.
- all industrial and commercial tariff customers are profitable.

3.1.5 Conclusions

In the past four years, there have been real price increase in the residential tariffs. As there are limited historical cost information relating to cost of gas supply for ActewAGL, the Commission is not able to undertake a detailed comparison of price and cost movements in past years.

The Commission notes that data on retail margins for energy suppliers are limited and has taken a conservative view in assessing ActewAGL's retail margin.

The Commission finds that ActewAGL's retail margin is slightly above AGLRE and its retail cost per customer is towards the upper range of a benchmark $40-$60 as adopted by IPART in the NSW tariff review.

In broad terms, ActewAGL's current tariffs cover the costs of supply, though there are some cross subsidies within each tariff class in residential tariffs. However, the extent of cross subsidies, in dollar terms, represents a very small percentage of revenue. The profit margin is negative for pensioner general and economy tariffs which is largely due to the pensioners rebates arrangement.

Overall, the Commission's assessment is ActewAGL's tariff market is profitable and the extent of cross subsidies is not significant.

3.2 Form of regulation

3.2.1 Pros and cons of alternative forms of regulation

The Commission has considered the role and implementation of regulation in a market that is opening to competition. The Commission then assessed the relative merits of four alternative regulatory approaches:

- setting average price cap approach as previously adopted under the former price control formula in NSW up until 30 June 2000
- establishing a 'formula' to derive retail tariffs from the various cost components
- setting side constraints on the changes ActewAGL can make to tariffs over time
- establishing a price path (ie a schedule of retail tariffs), derived either by the Commission or by ActewAGL (with the Commission's approval).

There are two basic problems with an average price cap approach. The first stems from the fact that, as competition matures, ActewAGL's customer base will fluctuate in terms of customer types, numbers and volumes. A fluctuating default customer base, and therefore a fluctuating cost of supply, will make average price setting and regulatory compliance problematic. To overcome this difficulty, regulatory controls would need to be set on a regular and frequent basis (say, every 12 months), or a specific default customer base would need to be deemed to be in place (for example, the default customer base that was in place in the previous financial year).

In its tariff review, IPART has highlighted that both these solutions have shortcomings:[15]

- Regular regulatory reviews will make it difficult for customers (and retailers) to understand how tariffs are derived and how they will change over time, thus making it difficult for them assess the reasonableness of competitive offers. This situation is unlikely to promote competition or to protect customers. The direct cost of administering such an arrangement is also likely to be prohibitive. Frequent reviews are therefore unlikely to be realistic.
- An average price cap with a deemed customer base also has problems. After the first period in which a deemed customer base is in place, the side constraints are likely to be the effective control rather than the average price cap itself. For example, if the incumbent retailer's high gas users switch to alternative suppliers, then the incumbent retailers can easily meet any side constraint by offering reductions to the 'phantom' high users in its deemed customer base. Hence, it will only be the side constraints which are the binding control.

The Commission considers that an average price cap approach would give ActewAGL considerable discretion to allocate costs between customer groups and restructure tariffs in a way that could hinder competition. The approach can be problematic from the perspective that it gives rise to gaming opportunities. The Commission concludes that there are difficulties of implementing the average price cap form of regulation.

The 'formula' approach would involve constructing a schedule of default tariffs from the individual cost components (such as cost of gas, haulage, reticulation, and retailing), incorporating specific assumptions about cost allocations where necessary. It can accommodate any uncertainties in future costs, as any change would be recognised by the tariff 'formula' and cost changes would automatically be incorporated into tariffs. One of its main advantages is that it ensures that default tariffs reflect the cost of supply, at any point in time, thus ensuring they operate in a 'neutral' manner in the competitive market. It is also fairly simple to understand and easy to administer, and requires regulatory intervention

15 IPART, Final Report "Review of the Delivered Price of Natural Gas to Tariff Customers Served from the AGL Gas Network in NSW", February 2001.

over the period it applies. Its main disadvantage, however, is that it may not provide a smooth transition to the competitive market, depending on how cost-reflective current tariffs are.

The side constraints approach is also simple to understand and administer, and ensures that individual customers are not subject to undesirable price shocks. Its main disadvantage is that it provides an incentive for the retailer to increase prices by the full amount of the side constraint (and thereby maximise revenue), which could result in some tariffs rising significantly above the cost of supply. The severity of this will depend on expected future movements in costs and the profitability of existing tariffs.

The price path (ie schedule of tariffs) has advantages that are similar to those of the side constraint and formula approaches. However, it may be perceived as more intrusive. The Commission notes that ActewAGL has supported a price path approach.

3.2.2 Coverage of regulation

The current regulatory arrangements in the ACT gas market cover the entire tariff market, which includes all residential, commercial and industrial customers who consume up to 10TJ of gas a year (up to $100,000 a year). The issue is whether the default tariff regime should apply *only to smaller customers*—that is, all residential and business customers consuming less than 1TJ per annum (a bill of up to $12,000 a year).

At present, all but one residential customers consume less than 1 TJ a year. Of the existing business customers, about 22% consume between 1-10 TJ.

The Commission has considered the following:

- customers using up to 10 TJ have traditionally been "tariff" customers and have had access to regulated tariffs -- this contrasts with the group over 10 TJ whose tariffs are never been regulated.
- despite current legislative provisions and policy statements, no *effective* competition for customers who are at present eligible for competition
- it may take some time after alternative gas supplies to become available and new retailers are licensed to make a call as to whether competition is then effective
- it could be argued that the role of protecting customers is more relevant for smaller customers, as they are likely to be less sophisticated in their participation in the competitive market. ActewAGL's larger customers are more likely to be targeted by competitors in the early stages of the competitive market.

In its submission, ActewAGL proposes the Commission reconsider its decision on the threshold of 10 TJ. It submits that:

> The 1 TJ threshold had been proposed for consistency with arrangements in NSW and development in Victoria. The ACT Utilities Act 2000 also defines a franchise customer as one using less than 1 TJ. The various customer protection regulations and industry codes (translated into standard form customer contracts) are designed for the supply of gas to customers using less than 1 TJ. Consistency in price regulation, standard form

> customer contracts, and business rules across jurisdictions will also help reduce costs and confusion in the market.[16]

The Commission considers the gas retail market in ACT is quite different from that in NSW and Victoria. The customer base for 1-10TJ users in ACT is small. At present, there is no other authorised retailers. ActewAGL is the incumbent retailer for both gas *and* electricity. Potential for developing retail competition for customers using 1-10 TJ is likely to be higher in the NSW/Victoria markets than that in ACT.

On balance, the Commission maintains its decision to apply default tariffs for customers using up to 10 TJ.

3.2.3 Maintaining existing tariffs as default tariffs

As discussed above, default tariffs will be made available to all customers consuming under 10 TJ of gas, including residential, industrial and commercial customers. The Commission believes that customers should be able to remain with ActewAGL and pay the regulated default tariff if they choose to do so. Similarly, customers who enter the contestable market and subsequently return to a regulated tariff should be able to be supplied on the basis of the same tariff as those who have remained on a regulated tariff. The Commission believes that this will provide for a smooth transition to competition.

However, existing tariffs should be cost reflective. Since February 2001, network charges have fallen significantly following the implementation the approved Access Arrangement for ActewAGL's gas distribution system. The Commission considers that real reduction in network tariffs should be passed onto customers from 1 July 2001. The Commission has decided to establish a price path based on existing tariff structure to reflect costs of supply.

3.2.4 Time period of price direction

The Commission considers that a medium price path is appropriate as it will provide price certainty to retailers and customers.

3.3 Impact of retail contestability costs

At issue is the treatment of 'contestability costs'. These are the costs that will be incurred by retailers (and network service providers) as a consequence of the move to full retail competition in gas. They include costs related to:

- the provision of retail market services
- the flow through of retail contestability costs incurred by the network service providers
- the establishment and operation of retailers' internal systems to integrate with market business system.

The Commission notes that there is considerable uncertainty about the quantum of such costs. If ACT joins the NSW FRC market system, most of these costs are to be determined by the industry and will be recovered from market participants including ActewAGL.

16 ActewAGL's submission, 21 May 2001.

However, ActewAGL and ActewAGL Distribution will have some discretion over their own systems that interface with the market system.

The Commission has considered ActewAGL's estimate. Because these costs are largely outside the control of ActewAGL, and the exact magnitude of these costs is not clear at this time, the Commission has decided that:

- increases in tariffs due to the recovery of retail contestability costs will fall outside the price path
- only efficient costs are to be recovered after an independent assessment
- the method of recovery (ie, who should pay, how, and when) will be considered by the Commission when costs are more certain.

The Commission has decided that ActewAGL be allowed to pass through to customers prudent costs associated with implementing full retail contestability.

3.4 Recent changes to the ACT gas regulatory framework on gas prices

As discussed in section 2.3, a new regulatory framework has been put in place for utility regulation. For gas suppliers, the main changes are:

- obligation to supply gas customers (section 82 of the Utility Act)
- requirement to establish standard customer contracts
- establishment of Essential Services Customer Council which may affect recovery of customer debt.

ActewAGL has provided an estimate of $160,000 to comply with the Utilities Act on the basis of:

- development and annual review of customer contracts and charter
- monitoring and reporting in respect of industry codes and complaints
- interpreter service and training of internal staff.

The Commission's view is that ActewAGL's estimate is not unreasonable. The Commission also anticipates that there will be changes to the level of authorisation fees.

3.5 Retailers of last resort obligations

Retailers of last resort (RoLR) means that a retailer is obliged to step in to provide emergency supplies to contestable customers whose retailer has ceased to trade.

In its draft decision, the Commission does not expressly make any decision on tariffs for customers in the event of ActewAGL has to offer a "retailer of last resort" (ROLR) service.

In response to the draft decision, ActewAGL submits that:

> ActewAGL supports the Commission's objectives for safety net prices and the ability for ActewAGL to offer non-default prices to customers in order to be able to compete effectively in a contestable market.
>
> ActewAGL is however concerned by the implied requirement to supply customers at the default prices in the event of default by a retailer – where a retailer has ceased to trade. This suggests that ActewAGL will be required to offer a "Retailer of Last Resort" (ROLR) service at the default prices established under the Draft Determination.
>
> ActewAGL is not averse to assuming the responsibility of a default retailer under arrangements proposed in the Draft Determination in the event that customers are stranded without a contract. However in the event that a retail supplier has ceased to trade, ActewAGL may have to procure supply for a significant number of customers at short notice which may accrue significantly higher costs of supply. As competition increases, this risk will become onerous.
>
> ActewAGL is of the view that the default prices will not be sufficient to meet cost of supply under ROLR situations and as such believes that it should not be required to make supply available at default prices. Supply under ROLR situations will need to reflect any additional costs that are either passed onto the specific group of customers supplied under ROLR obligations or passed through in the default prices.

The Commission has consulted the government on this issue. The view is that this matter needs to be considered when there are competitive retailers licensed and operating in the ACT. This is a policy issue and may also be subject to the arrangements for the operation of the Gas Retail Market Company in NSW.

The Commission considers that this issue should be reviewed at a future date after the commencement of full retail competition. The Commission notes that it is possible for ActewAGL to request a special review of this matter.

3.6 Factors affecting competition

3.6.1 Alternative gas supplies

ActewAGL Distribution has advised ActewAGL that the EGP connector project is on schedule. It is expected that the pipeline construction will be completed by the end of May and that a connection to the EGP will be made by 1 July. However, the flow of gas through the connection will be subject to commercial arrangements being in place between the relevant parties - ie retailers, Duke Energy (EGP pipeline owner), wholesalers and producers.

Upon commissioning of the EGP interconnect, the barrier to competition due to the lack of alternative gas supply will be removed.

3.6.2 Ring-fencing

Section 4.1 of the National Gas Code sets out the minimum obligations of a service provider in respect of a covered pipeline to ensure proper ring-fencing between itself and its associate retailer. This is to ensure the associate retailer does not have any competitive advantage to other retailers, in terms of access to the gas networks.

ActewAGL Distribution met with the Commission in February 2001 to discuss a range of matters including ring-fencing. ActewAGL Distribution advised that it was is in the process of ensuring compliance with gas ringfencing provisions per the Gas Code.

ActewAGL Distribution has advised the Commission that it is working towards compliance with the ringfencing obligations. The Commission will examine ActewAGL Distribution's compliance with the requirements of the Gas Code.

3.7 Extent of any cross subsidies between the ACT and NSW sections of the gas distribution system

ActewAGL's gas distribution system covers Canberra, Queanbeyan and Yarrowlumla in NSW. The pipeline system in Queanbeyan and Yarrowlumla Shire is regulated by the Commission under a cross vesting arrangement between the ACT and NSW government. As a consequence, the network cost component in Queanbeyan and Yarrowlumla is the same as that in ACT but is different from other NSW areas which are supplied from AGL Gas Network's distribution system.

Until October 2000, tariffs for Queanbeyan/Yarrowlumla tariff customers were aligned with those charged in NSW and ACT. The Commission understands that the increase in tariffs in NSW from March 2001 has not been applied to Queanbeyan and Yarrowlumla.

ActewAGL proposes that tariffs in Queanbeyan and Yarrowlumla be aligned with those in ACT, given the same gas network costs in these areas. Whilst the Commission considers this is a reasonable approach, regulation of tariff customers in Queanbeyan and Yarrowlumla is a matter for the NSW regulator (IPART) to consider.

3.8 Regulation of miscellaneous charges

Current miscellaneous fees and charges in the ACT are shown in Appendix 4. Miscellaneous charges are imposed to signal to customers the costs of providing these services. Unlike the electricity industry charges that are regulated by the Commission, ActewAGL's miscellaneous charges in gas supply are not regulated.

It is noted that in NSW, AGLRE has agreed that it will obtain IPART's approval for any changes in these fees over the four years to 2004.

In its submission, ActewAGL states that:

> ActewAGL believes that the cost of additional customer specific services, such as disconnections and reconnections should be borne by those customers utilising the services. The rest of the market should not be required to bear such customer specific costs.
>
> ActewAGL is currently in the process of reviewing all its miscellaneous fees and charges and will seek to adopt a consistent approach across its businesses to the extent possible. ActewAGL accepts that any variations to existing fees and charges will require approval by the Commission.[17]

[17] ActewAGL's submission, 21 May 2001.

The Commission has decided that ActewAGL's miscellaneous charges be regulated as long as they relate to the supply of gas services and until competition in the market is effective. ActewAGL is required to seek the Commission's approval prior to any changes in these fees.

3.9 Quality of service

Economic regulation of gas pricing requires the quality and level of service to be considered. The key issue is the service provider's ability to maintain or improve its profit without adverse effect on service standards whilst achieving efficient prices.

Under the Utilities Act, an industry code may set out practices, standards and other matters about the provision of a utility service. The Commission will be responsible for administration of industry code.

Further, the Commission has power to require provision of data on customer service and performance indicators under conditions of ActewAGL licence.

The Commission will review its information requirement of ActewAGL's service standards in consultation with ActewAGL and interested parties.

4 ASSESSMENT OF PRICE PATH

This chapter presents the Commission's assessment of and decision on ActewAGL's pricing proposal. The Commission has decided to make a price direction. Its consideration of matters under section 20 of ICRC Act is presented in chapter 5.

4.1 ActewAGL's pricing proposal

ActewAGL has proposed a price path with real price reduction in 2001/02 and that prices to customers will not increase in real terms in 2002/03 and 2003/04. Key components of ActewAGL's pricing proposal are:

- in 2001/02, prices to residential customers will fall by up to 8 per cent and business up to 11 % in real terms (see Table 4.1)
- prices to residential, commercial and industrial customers will not increase in real terms in the outer years 2002/03 and 2003/04
- prices set for a period covering the transition phase to contestability
- pensioners rebate increase by $5 pa to $19 pa
- full pass through of contestability costs
- mechanism for review in unforeseen circumstances and specific provisions
- initial default tariffs from 1 July 2001 which will be applied to customers using less than 1 TJ of gas
- Queanbeyan and Yarrowlumla customers to be offered standard ACT tariffs, subject to the approval of the Independent Pricing and Regulatory Tribunal of NSW.

Table 4.1: ActewAGL's proposed price path (nominal terms) (1)

Tariff	2001/02	2002/03	2003/4
Residential general:			
Supply fee	CPI	CPI	CPI
Energy rate	-5%	CPI	CPI
Residential economy:			
Supply fee	CPI	CPI	CPI
Energy rate	-1.5%	CPI	CPI
Residential economy plus:			
Supply fee	CPI	CPI	CPI
Energy rate 1	CPI	CPI	CPI
Energy rate 2	0	CPI	CPI
Business 0-1TJ:			
Supply fee	CPI	CPI	CPI
Energy rate 1	-8%	CPI	CPI
Energy rate 2	-2%	CPI	CPI

Note: The information in ActewAGL's proposed price path has been prepared in good faith by ActewAGL for the limited purpose of facilitating the determination of prices for that tariff market. The information contained in the above table should not be relied on for any other purpose.

ActewAGL's proposed price path is made on the basis of the following costs:

- the field price of gas is consistent with ActewAGL's contractual obligations, including provisions for escalation
- current haulage transportation costs for the use of Moomba-Sydney pipeline system
- network costs (that is, local distribution pipeline and metering) are consistent with the network tariffs in ActewAGL Gas Network's revised access arrangement
- retail costs on a per customer basis, plus additional costs including such costs as bad debts, compliance costs and quantification of risks in a competitive market.
- a net retail profit margin of about 3 per cent.

ActewAGL submits that under its proposal:

- prices to customers are efficient and do not lead to price shocks to customers
- customer protection (safety net) during transition to full retail contestability
- stability of prices over the longer term
- prices promote competition in the supply of gas
- recognition of a market based discipline
- adaptation of traditional monopoly regulation with sufficient flexibility to allow for the risks and uncertainties of competitive market.

The ActewAGL believes its proposal is a total package that seeks to address the issue of safety net pricing in a market open to competition:

- costs and the level of prices are part of this equation
- the pricing adjustments over time should take account of the risks and uncertainties
- the need for price path flexibility in the transition period to a competitive market
- it needs to have the ability to offer non default prices in the market.

4.2 Commission's assessment

In assessing ActewAGL's pricing proposal, the Commission has considered:

- current and future costs of gas supply, including ActewAGL Gas Network costs in its Access Arrangement
- profitability analysis of current tariffs (see section 3.1)
- cost efficiency
- customer impacts
- the need for customer protection and promotion of competition
- matters under section 20 of the ICRC Act (see section 5.2).

4.2.1 Future costs of gas supply

The Commission has undertaken a review of ActewAGL's cost assumptions.

Gas commodity cost

The Commission understands gas field costs are currently under contractual arrangement between ActewAGL and AGL Wholesale Gas. Future movements may be subject to negotiation between the parties.

Haulage cost

Transmission network charges for the use of Sydney to Moomba transmission pipeline (ie haulage cost) are regulated by ACCC.

In its draft decision, ACCC supports EAPL's proposal to have higher charges for the 3 laterals, including the Dalton to Canberra lateral. However, ACCC considers that this approach would lead to tariffs on the Dalton to Canberra lateral in excess of DORC plus operating costs. Accordingly, the ACCC is proposing an amendment to the effect that tariffs on any pipeline should not exceed that pipeline's DORC plus its operating costs. One feasible solution would be to apply the mainline tariffs to the Dalton to Canberra pipeline leaving only the Young to Lithgow and Junee to Griffith laterals being charged the lateral tariff structure.

Pending ACCC's final decision, the Commission has assumed current haulage costs in the analysis.

Distribution network cost

The Commission has considered the impact of network costs on gas tariffs in ACT in accordance with the approved Access Arrangement for ActewAGL Gas Networks:

Table 4.2 Impact of future network costs on gas tariffs

	2000/01	2001/02	2002/03	2003/04
ICRC final decision on network costs (1)	CPI-19.2%	CPI-3.7%	CPI-3.7%	CPI-3.7%
Estimated impact on gas retail prices (2)	CPI-9%	CPI-1.8%	CPI-1.8%	CPI-1.8%

Note:

1. ICRC, Final Decision on Access Arrangement for ActewAGL Natural Gas System in ACT, Queanbeyan and Yarrowlumla, p112.
2. The estimate is based on network costs represent 45-50% of total cost of supply.

The Commission notes that under ActewAGL's proposal, the majority of reduction in network costs is reflected in the lower tariff prices in 2001/02. However, real network price reduction is not incorporated in ActewAGL's proposed price path for 2002/03 and 2003/04.

Retail costs

ActewAGL has allowed for additional operating costs in 2001/02, 2002/03 and 2003/04 due to uncertainties and potential of new costs driven by risks in a competitive market. For example, ActewAGL submits that if it loses market share, it will bear take or pay risks for the remainder of its fixed term contract.

The Commission believes that ActewAGL should have the capacity to manage or mitigate risks in a competitive market. However, for the purpose of the final determination, the Commission has taken a conservative view and has based its analysis using ActewAGL's assumptions. This is to ensure sufficient margin to be allowed in order to encourage new entrants to the market, given the lack of new authorised retailers in ACT.

4.2.2 Pricing outcomes under ActewAGL proposal

ActewAGL's pricing proposal excludes the recovery of costs associated with full retail contestability. Under ActewAGL's proposal, the pricing outcomes in 2001/02 are:

- a majority of domestic customers will enjoy 3-5 per cent real price reduction
- typical small businesses will have 10 per cent real price reduction
- large businesses will enjoy 6-8 per cent real reduction in their bills.

Under ActewAGL's proposal, prices to domestic or business customers will not increase in real terms for the years 2002/03 and 2003/04.

4.2.3 Alternative price path scenarios considered in the draft decision

The Commission's overall view is that ActewAGL's proposed price for 2001/02 is acceptable. However, the proposed price path in 2002/03 and 2003/04 does not reflect future cost of network costs. The Commission has considered alternative price path scenarios using network costs as set out in ActewAGL Gas Network's Access Arrangement.

The Commission notes that under the Access Arrangement for ActewAGL Gas Network, the fixed charge component will increase by CPI whereas the throughput charge component will decrease in real terms. Provision of meter reading charge will also decline in real terms. On this basis, the Commission has considered the following price paths for ActewAGL in 2002/03 and 2003/04:

1. Supply fee will increase by CPI; energy rates will be capped at CPI-1.5%
2. Supply fee will increase by CPI; energy rates will be capped at CPI-1%.

The Commission has considered the outcomes of gross margin and profit margin on the basis of ActewAGL's retail cost assumptions. The projected profit margin under scenario 1 is lower than scenario 2. The Commission notes that:

- there should be sufficient headroom in the margin to attract new entrants
- the default tariffs under the price path are the maximum prices. It is possible that some customers will be offered better terms if competition is effective. Under these circumstances, the actual profit margin outcome may be lower than the projection.

In the draft decision, the Commission proposed option 2 which would establish a schedule of default tariffs which are generally cost reflective but would also encourage competition by allowing adequate headroom on the retail margin.

4.3 ActewAGL's response to the draft decision

ActewAGL supports the light handed approach adopted by the Commission in providing an environment which fosters competition while alleviating community concerns that could arise about price movements and levels during the transitional period to effective competition. However, ActewAGL expresses a concern that the price path of CPI-1%, whilst reflecting a reduction in network charges, does not adequately take into account increased costs associated with pricing subsidies, increases in operating costs and risks in a competitive gas market. For these reasons, ActewAGL proposes that its original request for a CPI pass through be endorsed for 2002/03 and 2003/04.

The Commission has considered ActewAGL's submission, risks as the market develops and the assumptions about future retail costs as proposed by ActewAGL. The Commission considers that the timing of a full retail competition market has been further extended to 2002. As a result, the risks as suggested by ActewAGL is unlikely to occur until such time competition in the gas market is effective.

On balance, the Commission has decided to adopt the price path as proposed in the draft decision.

4.4 Summary and conclusions

Based on the above consideration, the Commission concludes that:

- a price path over a medium term 2001/02 to 2003/04 should be adopted as the form of price regulation during transition to contestability.
- ActewAGL's proposed prices in 2001/02 incorporate real price reduction, reflecting real reduction in network costs under the revised Access Arrangement for ActewAGL Gas Network. This is considered acceptable.
- ActewAGL's proposed price path in 2002/03 and 2003/04 is considered "soft" which does not incorporate real price reduction in network charges.

The Commission has decided that the following price path for 2002/03 and 2003/04 is a more equitable outcome for customers:

- gas supply fee should be capped at CPI
- gas energy rates should be capped at CPI-1% per annum.

5 THE COMMISSION'S FINAL DECISION

The Commission favours a price path approach to establish default tariffs (ie safety net prices) during the transition to competition, as a means of protecting customer interests while providing certainty to ActewAGL. The price direction and outcomes under its final determination are provided below.

5.1 Form of regulation during transition to contestability

On the basis of information and analysis undertaken during its investigation, the Commission has decided to adopt the following regulatory approach during transition to contestability:

1. Default tariffs to all tariff customers whose consumption is below 10 TJ will apply from 1 July 2001 to 30 June 2004. These default tariffs are "maximum prices". ActewAGL will have the ability to offer alternative tariffs under a competitive market.
2. Default tariffs should be broadly cost reflective and will be based on ActewAGL's existing tariff structure. A price path will be determined for next 3 years.
3. A review of the price path will be undertaken under special circumstances, either at the request of ActewAGL or the discretion of the Commission, to consider matters such as:
    - changes in ActewAGL's cost components such as the field price of natural gas or impacts of regulatory decisions on haulage rates, or impacts from capacity enhancement
    - any decision on consumption profiling that deems a profile other than the market profile that has been used for cost allocation
    - significant changes to ActewAGL's obligations and costs under new regulation and codes
    - changes in market circumstances that in the Commission's opinion warrant a review of price path.
4. Where customers have accepted a competitive offer under a contestable gas retail market, they will be able to revert to ActewAGL's default tariffs without penalty once they have met their contractual obligations.
5. ActewAGL will be able to pass through to customers costs associated with implementing full retail contestability (FRC) in addition to default prices set out under the price path. Costs associated with FRC include but are not limited to costs relating to market systems, increases in network charges, gas balancing charges and prudent costs incurred by ActewAGL. The Commission will determine a mechanism to recover these costs including an assessment of such costs.
6. ActewAGL will be able to pass through to customers costs associated with changes to authorisation fees, taxes and imposts.
7. ActewAGL will provide information relating to the development of a competitive gas retail market, if requested by the Commission.

5.2 Price direction

The Commission has decided to make a price direction in relation to gas supply services provided by ActewAGL (Table 5.1).

Table 5.1: ICRC price direction 2001/02 to 2003/04

Tariff	2001/02	2002/03	2003/4
Residential general:			
Supply fee	CPI^{-GST}	CPI^{-GST}	CPI^{-GST}
Energy rate	CPI^{-GST} -8.7%	CPI^{-GST} -1%	CPI^{-GST} -1%
Residential economy:			
Supply fee	CPI^{-GST}	CPI^{-GST}	CPI^{-GST}
Energy rate	CPI^{-GST} -5.2%	CPI^{-GST} -1%	CPI^{-GST} -1%
Residential economy plus:			
Supply fee	CPI^{-GST}	CPI^{-GST}	CPI^{-GST}
Energy rate 1	CPI^{-GST}	CPI^{-GST} -1%	CPI^{-GST} -1%
Energy rate 2	CPI^{-GST} -3.7%	CPI^{-GST} -1%	CPI^{-GST} -1%
Business 0-10 TJ:			
Supply fee	CPI^{-GST}	CPI^{-GST}	CPI^{-GST}
Energy rate 1	CPI^{-GST} -11.7%	CPI^{-GST} -1%	CPI^{-GST} -1%
Energy rate 2	CPI^{-GST} -5.7%	CPI^{-GST} -1%	CPI^{-GST} -1%
Comparison with ActewAGL's proposal	ActewAGL's proposed prices are expressed in nominal terms. They are translated to CPI-X factor assuming an inflation of 3%	ActewAGL proposal: CPI cap	ActewAGL proposal: CPI cap

Note:

1. The CPI index for adjusting price is CPI exclusive of GST.
2. The CPI-X factor in 2001/02 is based on the inflation outcome of 3.7% for the year to March quarter 2001.

In establishing gas prices under the above price path, national CPI (exclusive of the net impact of GST) is to be used. This is to maintain consistency with the indexation of gas network costs in the ACT.

CPI means the consumer price index, All Groups index number for the weighted average of eight capital cities as published by the Australian Bureau of Statistics, or if the Australian Bureau of Statistics does not or ceases to publish the index, then CPI will mean an index determined by the Commission that is its best estimate of the index.

CPI^{-GST} means the CPI exclusive of the net cumulative impact since 1 July 2000 of:

a) the GST; and

b) changes to any other Commonwealth, State or Territory taxes or charges, consequent upon the introduction of the GST

The Commission's GST adjustment to CPI is explained below.

The Commission notes that a hierarchy of possible sources for advice on a possible adjustment to the CPI was available. Under this hierarchy, the Commission identified the Australian Bureau of Statistics (ABS) as a first preference as a source of independent advice on this matter. With this in mind, the Commission has examined the analysis undertaken by the ABS and reported in Australian Economic Indicators of December 2000 (ABS Cat No 1350.0). The Commission has decided that the results from this analysis be used as a means of adjusting the CPI series.

The Commission will adjust the CPI series (weighted average of eight capital cities) by the average of the two estimates provided by the ABS of the points contribution to the CPI net of the GST effect. The average of the two estimates of the contribution to the CPI net of GST reported by the ABS, namely 1.8 points and 2.5 points, would be 2.15 points. Thus, in effect the CPI series (weighted average of eight capital cities) for the September quarter 2000 would be calculated as the June quarter result of 126.2 plus the 2.15 points increase in the September quarter net of the GST, giving 128.35. For subsequent quarters the CPI series would be adjusted from the 128.35 September base to reflect the percentage quarterly movement in the unadjusted series (for example, the December quarter is calculated as 131.3 ÷ 130.9 x 128.35 = 128.74).

The following table outlines the Commission’s approach.

Table 5.2 GST adjustment to CPI

	June	Sept	Dec	Mar	Sum	Inflation Rate
All capital cities CPI 1999/00	122.30	123.40	124.10	125.20	495.00	
All capital cities CPI 2000/01	126.20	130.90	131.30	132.70		
Sep quarter Increase (points)		2.15				
All capital cities CPI 2000/01 Adjusted	126.20	128.35	128.74	130.11	513.40	3.7%

As a result of this calculation, the adjusted CPI for use in the pricing formula for 2000/01 is 3.7%.

For purposes of calculating the adjusted CPI series for the remaining period of the current price determination, ActewAGL is required to apply the quarterly movements in the national CPI series as published by the ABS to the adjusted quarterly CPI series as calculated for the previous quarter. Thus, for example, if it is assumed that the national CPI series grows by one percent in the June quarter 2001, the adjusted CPI series will be:

130.11 (the adjusted March quarter figure) x 1.01 = 131.41

The sum of the adjusted CPI series for the four quarters to March 2002 would be divided by the sum of the adjusted series to March 2001 (that is, 513.40) to derive the percentage CPI movement for the year 2002/03. This process will be continued up until the end of the current price determination ie 2003/04.

5.2.1 Requirements under section 20 of the ICRC Act

Under s20 of the ICRC Act 1997, the Commission shall have regard to a number of matters to give a price direction. These have been grouped under four main headings and the following discussion indicates to what extent the Commission has had regard to them.[18]

Costs and efficiencies

** the need for greater efficiency in the supply of regulated services to reduce costs to consumers and taxpayers (s20(2)(c))*

** the cost of providing the regulated service (s(2)20(e))*

** any arrangements that a person providing regulated services has entered into for the exercise of its functions by some other person (s20(2)(k))*

The Commission has assessed ActewAGL's costs of gas supply, efficiency levels and the opportunity for additional productivity gains (see section 3.1 and 4.2.1).

Consumer protection

** The protection of consumers from abuses of monopoly power in terms of prices, pricing policies (including policies relating to the level or structure of prices for services) and standard of regulated services (s20(2)(a))*

** Standards of quality, reliability and safety of the regulated services (s20(2)(b))*

** The social impacts of the decisions (s20(2)(g))*

** The effect on general price inflation over the medium term (s20(2)(j))*

The first two factors have been canvassed by the Commission in chapter 3. Customer impact analysis is a key consideration in price determination. The Commission's customer impact of ActewAGL proposal is discussed in section 4.2. Further analysis under the Commission's price direction is discussed in section 5.2.2.

Gas services makes up a small, but important, component of the overall outlays by households. The significance of these charges will vary between households based on disposable income. The price path (with real price reduction) proposed by the Commission will have a favourable impact on general inflation.

Financial viability

** An appropriate rate of return on any investment in the regulated industry (s20(2)(d))*

** The borrowing, capital and cash flow requirements of persons providing regulated services and the need to renew or increase relevant assets in the regulated industry (s20(2)(i))*

The Commission has assessed the profit margin of ActewAGL. Under the Commission's price direction, ActewAGL will be able to maintain a profit margin of 2-3 per cent.

18 ICRC Act 1997, s20(3).

Environmental considerations

* *The principles of ecologically sustainable development (s20(2)(f))*

* *Considerations of demand management and least cost planning (s20(h))*

Pricing policy has a role to play in ensuring desired environmental outcomes are achieved. Pricing policies should encourage activities that general the best overall outcome for the community. Cost reflective pricing can help ensure scarce resources are not wasted and can promote more efficient investment in infrastructure.

Natural gas has the appeal of lower environmental effect. Lower gas tariffs will encourage use of natural gas.

5.2.2 Outcomes under price direction

The customer impact of the price path in 2001/02 is shown in Table 5.3.

Table 5.3 Real price reduction under the final decision – 2001/02

Residential customers

Real price reduction	RG customers		RE customers		RE+ customers		Total residential	
	%	No	%	No	%	No	%	No
< 3%	39%	859	7%	3,844	98%	7,818	20%	12,521
3-5%	9%	194	92%	48,192	2%	190	70%	48,576
5-8%	52%	1158	0.3%	137	-	-	2%	1,295
Total	100%	2,211	100%	52,173	100%	8,008	100%	62,392

Pensioners

Real price reduction	RG customers		RE customers		RE+ customers		Total pensioners	
	%	No	%	No	%	No	%	No
< 3%	0%	-	8%	493	100%	723	18%	1,216
3-5%	28%	51	92%	5,434	0%	-	80%	5,485
5-8%	72%	134	-	-	0%	-	2%	134
Total	100%	185	100%	5,927	100%	723	100%	6,835

Industrial and commercial customers

Real price reduction	% of I&C customers	No of I&C customers
< 3%	3%	55
3-5%	2%	39
5-8%	20%	324
8-11%	75%	1,229
Total	100%	1,647

Note:
RG: Residential General tariff
RE: Residential Economy tariff
RE+: Residential Economy Plus tariff.
The analysis is based on ActewAGL's customer and consumption profile in 1999/2000, and an inflation assumption of 3.7% (exclusive of the net impact of GST) in 2000/01. The customer impact excludes the pass through of contestability costs.

Examples of customer impact under ICRC's final decision is shown in Table 5.4.

Table 5.4 Examples of customers' gas bills in 2001/02

	Consumption per annum	Current bill in 2000/01 $	Projected bill in 2001/02 $	Nominal $ change	Real % change
Small residential	10 GJ	230	227	-3	-4.8%
Average household	50 GJ	714	709	-5	-4.4%
Large residential	100 GJ	1,274	1,286	+12	-2.8%
Small pensioner	10 GJ	212	208	-4	-5.4%
Pensioner	45 GJ	627	630	+3	-3.2%
Small business	175 GJ	2,346	2,176	-169	-10.9%
Average business	700 GJ	8,669	8,054	-615	-10.8%
Large business	1 TJ	11,689	11,014	-675	-9.5%

Note:
The above table is prepared on the basis of the following:
1. Residential General tariff for small residential customers and pensioners
2. Residential Economy tariff for average households
3. Residential Economy Plus tariff for large residential customers
4. Inflation for the year 2000/01 is calculated based on the Commission's adjustment to the inflation outcome for eight capital cities for the year ended March 2001 to exclude the net impact of GST, ie 3.7% per annum.
5. The above examples exclude the pass through of contestability costs which will be determined after these costs are known.

Subject to the pass through of contestability costs, customers' gas bills are expected to fall slightly below inflation in 2002/03 and 2003/04

Overall the price changes in 2001/02 will result in a modest reduction in ActewAGL's tariff revenue, and a decrease in the overall net profit margin. The average tariff price, however, will depend on future changes in ActewAGL's customer profile. These changes are uncertain, given the imminent introduction of competition.

5.3 Pensioners rebates

At present, there are about 6,800 pensioners who are consumers of natural gas. At present, ActewAGL funds the payment of rebates to pensioners worth $14 a year. As part of its tariff proposal, ActewAGL has voluntarily proposed to increase these rebates by $5 to $19 a year.

The Commission acknowledges ActewAGL's proposal is made as a result of:

- its proposed alignment of pensioners tariffs to those for residential customers in ACT
- alignment of the rebate to the level put in place in NSW.

The Commission has advised the Minister's office of ActewAGL proposal. ActewAGL's proposal may however be overtaken by government decisions on community services obligations.

5.4 Miscellaneous charges

After considering ActewAGL's submission, the Commission has decided that miscellaneous fees and charges will be regulated.

GLOSSARY AND ABBREVIATIONS

ABS	Australian Bureau of Statistics
ACCC	Australian Competition and Consumers Commission
ActewAG	ActewAGL Retail under the joint venture arrangement
AGLGN	AGL Gas Networks Limited
AGLRE	AGL Retail Energy Limited
ATP	Average tariff price
CoAG	Council of Australian Governments
EAPL	Eastern Australian Gas Pipeline
EGP	Eastern Gas Pipeline
GJ	Gigajoule
GST	Goods and services tax
CPI	Consumer price index
IPART	Independent Pricing and Regulatory Tribunal
MoEU	Ministry of Energy and Utilities of NSW
Ofgem	Office of Gas and Electricity Market – the UK energy industry regulator
TJ	Terajoule

SCHEDULE 1 – PRICE DIRECTION FOR ACTEWAGL'S NATURAL GAS PRICING

This Price Direction specifies the price path for the supply of natural gas by ActewAGL for the period from 1 July 2001 to 30 June 2004. The price path sets out the maximum prices on the basis of CPI-X price regulation.

1. Price of natural gas

The following conditions will apply to ActewAGL's natural gas pricing effective from 1 July 2001 to 30 June 2004:

1. Default tariffs to all tariff customers whose consumption is below 10 TJ will apply from 1 July 2001 to 30 June 2004. These default tariffs are "maximum prices". ActewAGL will have the ability to offer alternative tariffs under a competitive market.
2. Default tariffs should be broadly cost reflective and will be based on ActewAGL's existing tariff structure. A price path has been determined for the next 3 years.
3. A review of the price path will be undertaken under special circumstances, either at the request of ActewAGL or the discretion of the Commission, to consider matters such as:
   - changes in ActewAGL's cost components such as the field price of natural gas, impacts of regulatory decisions on haulage rates, or impacts from capacity enhancement
   - any decision on consumption profiling that deems a profile other than the market profile that has been used for cost allocation
   - significant changes to ActewAGL's obligations and costs under new regulation and codes
   - changes in market circumstances that in the Commission's opinion warrant a review of price path.
4. Where customers have accepted a competitive offer under a contestable gas retail market, they will be able to revert to ActewAGL's default tariffs without penalty once they have met their contractual obligations.
5. ActewAGL will be able to pass through to customers costs associated with implementing full retail contestability (FRC) in addition to default prices set out under the price path. Costs associated with FRC include but are not limited to costs relating to market systems, increases in network charges, gas balancing charges and prudent costs incurred by ActewAGL. The Commission will determine a mechanism to recover these costs including an assessment of such costs.
6. ActewAGL will be able to pass through to customers costs associated with changes to authorisation fees, taxes and imposts.
7. ActewAGL will provide information relating to the development of a competitive gas retail market, if requested by the Commission.
8. Maximum prices are defined by the price path as shown in the following table:

ActewAGL's price path 2001/02 to 2003/04

Tariff	2001/02	2002/03	2003/4
Residential general:			
Supply fee	CPI^{-GST}	CPI^{-GST}	CPI^{-GST}
Energy rate	CPI^{-GST} -8.7%	CPI^{-GST} -1%	CPI^{-GST} –1%
Residential economy:			
Supply fee	CPI^{-GST}	CPI^{-GST}	CPI^{-GST}
Energy rate	CPI^{-GST} -5.2%	CPI^{-GST} -1%	CPI^{-GST} -1%
Residential economy plus:			
Supply fee	CPI^{-GST}	CPI^{-GST}	CPI^{-GST}
Energy rate 1	CPI^{-GST}	CPI^{-GST} -1%	CPI^{-GST} -1%
Energy rate 2	CPI^{-GST} -3.7%	CPI^{-GST} -1%	CPI^{-GST} -1%
Business 0-10 TJ:			
Supply fee	CPI^{-GST}	CPI^{-GST}	CPI^{-GST}
Energy rate 1	CPI^{-GST} -11.7%	CPI^{-GST} -1%	CPI^{-GST} -1%
Energy rate 2	CPI^{-GST} -5.7%	CPI^{-GST} -1%	CPI^{-GST} -1%

Note:
CPI^{-GST} is the inflation rate exclusive of the net impact of GST

2. Miscellaneous fees and charges

ActewAGL's miscellaneous fees and charges are to be regulated as long as they relate to the supply of gas services and until competition in the market is effective. ActewAGL is required to seek the Commission's approval prior to any changes in these fees.

3. Definition of CPI and GST adjustment to the CPI index

The Commission has determined to apply the Consumer Price Index, All groups index number for the weighted average of eight capital cities as published by the Australian Bureau of Statistics (ABS).

CPI means the consumer price index, All Groups index number for the weighted average of eight capital cities as published by the Australian Bureau of Statistics (ABS), or if the Australian Bureau of Statistics does not or ceases to publish the index, then CPI will mean an index determined by the Commission that is its best estimate of the index.

CPI^{-GST} means the CPI exclusive of the net cumulative impact since 1 July 2000 of:

a) the GST; and

b) changes to any other Commonwealth, State or Territory taxes or charges, consequent upon the introduction of the GST

The Commission will adjust the CPI series (weighted average of eight capital cities) by the average of the two estimates provided by the ABS of the points contribution to the CPI net of the GST effect. The average of the two estimates of the contribution to the CPI net of GST reported by the ABS, namely 1.8 points and 2.5 points, would be 2.15 points. Thus, in effect the CPI series (weighted average of eight capital cities) for the September quarter 2000 would be calculated as the June quarter result of 126.2 plus the 2.15 points increase in the September quarter net of the GST, giving 128.35. For subsequent quarters the CPI series would be adjusted from the 128.35 September base to reflect the percentage quarterly movement in the unadjusted series (for example, the December quarter is calculated as 131.3 ÷ 130.9 x 128.35 = 128.74).

The following table illustrates the Commission's approach.

	June	Sept	Dec	Mar	Sum	Inflation Rate
All capital cities CPI 1999/00	122.30	123.40	124.10	125.20	495.00	
All capital cities CPI 2000/01	126.20	130.90	131.30	132.70		
Sep quarter Increase (points)		2.15				
All capital cities CPI 2000/01 Adjusted	126.20	128.35	128.74	130.11	513.40	3.7%

As a result of this calculation, the adjusted CPI for use in the pricing formula for 2000/01 is 3.7%.

For purposes of calculating the adjusted CPI series for the remaining period of the current price determination, ActewAGL is required to apply the quarterly movements in the national CPI series as published by the ABS to the adjusted quarterly CPI series as calculated for the previous quarter. Thus, for example, if it is assumed that the national CPI series grows by one percent in the June quarter 2001, the adjusted CPI series will be:

130.11 (the adjusted March quarter figure) x 1.01 = 131.41

The sum of the adjusted CPI series for the four quarters to March 2002 would be divided by the sum of the adjusted series to March 2001 (that is, 513.40) to derive the percentage CPI movement for the year 2002/03. This process will be continued up until the end of the current price determination ie 2003/04.

APPENDIX 1 – TERMS OF REFERENCE

AUSTRALIAN CAPITAL TERRITORY

INDEPENDENT PRICING AND REGULATORY COMMISSION ACT 1997

REFERENCE FOR AN INVESTIGATION UNDER SECTION 15

AND

SPECIFIED REQUIREMENTS IN RELATION TO INVESTIGATION UNDER SECTION 16

Reference for Investigation Under Section 15

Pursuant to subsection 15(1) of the Independent Pricing and Regulatory Commission Act 1997 ("the Act"), I refer to the Independent Competition and Regulatory Commission (the "Commission") the matter of an investigation into natural gas prices within the Territory for domestic, commercial and industrial consumers using less than 10 terajoules of natural gas per annum.

Specified Requirements in Relation to Investigation Under Section 16

Pursuant to subsection 16(1) of the Act, I specify the following requirement in relation to the conduct of the investigation:

- A report in relation to prices for domestic, commercial and industrial consumers using less than 10 terajoules of natural gas per annum is to be provided to the Minister for Urban Services by 31 May 2001.

- The Commission in conducting its investigation into gas prices shall take into consideration but not be limited to:

  - a review of the delivered price of gas to ACT gas consumers that includes an assessment of the costs of producing and delivering natural gas to the ACT market and the retail margin for the supply of gas

  - the impact of retail contestability, including the determination of a suitable safety net price that addresses an appropriate balance in the period of transition to retail contestability between customer protection and the encouragement of the longer term benefits of contestability

  - the impact of recent changes to the ACT gas regulatory framework on gas prices

  - the impact of alternative gas supplies

- the extent of any cross subsidies between the ACT and NSW sections of the gas distribution system

- whether ring-fencing requirements of the National Gas Pipelines Access Code are met by ActewAGL

- the appropriate period of time for which a price path or other regulatory mechanism should be determined.

- any other issues the Commission considers relevant to the investigation.

Dated this 22 day of March 2001

Brendan Symth MLA
Minister for Urban Services

APPENDIX 2 – SUMMARY OF ACTEWAGL'S SUBMISSION

The main points submitted by ActewAGL are:

- it supports the Commission's light-handed approach in establishing a price path during the transitional period to effective competition
- the Commission's proposed CPI-1% to the energy rates in 2002/03 and 2003/04 does not adequately take into account increased costs associated with pricing subsidies and increases in operating costs and risks in a competitive gas market. ActewAGL proposes that its original request for a CPI price path be endorsed.
- the obligation to provide a retailer of last resort service, at default tariffs, does not adequately take into account the costs associated with providing such a service
- the price direction should only be applied to customers using less than 1 TJ of gas per annum
- A retail profit margin of 2-3% are unlikely to be sufficient to attract new entrants
- it expresses concern about the Commission's approach to the issue of synergies arising from the Actew Corp/AGL merger.
- it accepts that any variations to existing miscellaneous fees and charges will require approval by the Commission.

APPENDIX 3 – CURRENT TARIFFS

Description of current tariffs

ActewAGL has three residential tariffs and two industrial and commercial tariffs (the "I&C" tariffs). Tariffs for pensioners are slightly lower than residential customers. These tariffs are:

- Residential General Tariff
- Residential Economy Tariff
- Residential Economy Plus Tariff
- I&C Tariff.

Pensioners currently receive a rebate on their rates of $14 per annum.

Residential economy tariffs account for over 80 percent of ActewAGL's total customers. ActewAGL currently serves around 70,000 residential customers. Average consumption per residential customer is about 50 GJ a year.

A breakdown of the number of customers in each tariff class is provided in the table below.

ActewAGL's residential customers

	All residential	Pensioners
Residential general	3%	3%
Residential economy	84%	87%
Residential economy plus	13%	11%

There are around 1,650 business customers.

Existing tariffs - ACT[19]

Residential Tariffs

Rate	Supply fee ($ per quarter)	Quantity per block (megajoule per quarter)		Charge per megajoule (cents)	
		Block 1	Block 2	Block 1	Block 2
Residential General	24.49	All		1.3213	
Residential Economy	26.82	All		1.2136	
Residential Economy Plus	39.13	4,500	Remainder	0.9040	1.1648

Pensioner rates

Rate	Supply fee ($ per quarter)	Quantity per block (megajoule per quarter)		Charge per megajoule (cents)	
		Block 1	Block 2	Block 1	Block 2
Residential General	24.02	All		1.2966	
Residential Economy	26.32	All		1.1911	
Residential Economy Plus	38.39	4,500	Remainder	0.8870	1.1430

Industrial and Commercial Tariffs

Rate	Supply charge $	Charge per megajoule (cents)	
		first 50,000 MJ per month	Consumption thereafter
Monthly	13.04/month	1.2509	1.0067
Quarterly	39.12/quarter	1.2509	1.0067

19 Note that these prices were implemented from 1 July 2000 and include GST.

APPENDIX 4 – MISCELLANEOUS CHARGES

Income derived from the fees and charges by ActewAGL in 1999/2000 is just under $400,000. ActewAGL's current retail miscellaneous charges are set out below.

Description of fee	Fee exc. GST	Fee incl. GST
Account establishment fee	$20.00	$22.00
Establishment fee (pensioner)	$10.00	$11.00
Collector call	$30.00	$33.00
Disconnection/reconnection	$70.00 (standard hours)	$77.00
High bill field visit	$49.00	$53.90
Late payment fee	$10.00	$11.00
Dishonoured payment	$21.00	$23.10
Security deposit (reflects the provisions under the AGA Customer Service Code)	Residential – up to 1.5 times quarterly average bill or 2.5 times the monthly average bill Business – 2.5 times the average monthly account or sufficient to secure customers current natural gas usage Refund after bills paid on time for 2 years.	Residential – up to 1.5 times quarterly average bill or 2.5 times the monthly average bill Business – 2.5 times the average monthly account or sufficient to secure customers current natural gas usage Refund after bills paid on time for 2 years.

Business customers may, instead of a security deposit, choose to pay an annual security insurance levy. The levy varies depending on the risk covered. An insurance levy is non-refundable, but the size of the levy is reassessed annually.

The above miscellaneous charges do not include charges related to connection offers to new customers.

Establishment Fee: applies to "new" customers being established onto the system for the first time.[20]

Collector call fee: applies when a contractor goes to a premise to disconnect supply but the customer decides to enter into an agreement which may include making a payment to the contractor. The contractor deposits all funds into an ActewAGL account.

Disconnection/Reconnection fee: applies on reconnection when a customer has been previously disconnected for debt or has asked for a seasonal disconnection & reconnection. Note that a comparison to electricity is not appropriate as a gas reconnection requires on site pressure tests and relights (as opposed to removing/replacing a fuse). A fee of $55 ($50 fee plus $5 GST) applies for a disconnection only, a fee of $22 ($20 fee plus $2 GST) for reconnections only, total fee of $77.

High Bill Investigation fee: is payable when a field officer is called out to the customer's premises following a high bill enquiry. The enquiry involves at least two clerical checks, at no charge, before a field officer is sent. The officer can spend up to two hours on site

20 Note that if a customer moves to another premises that is also on gas, the fee is waived at the new residence.

examining the installation. If no fault is found on ActewAGL's side of the meter there is a charge; if a fault is discovered at ActewAGL's installation there is no charge.

Late Payment Fee: is payable when a lettergram is sent (ie, a disconnection notice). This happens when a customer fails to contact ActewAGL for a payment arrangement, and after the bill and reminder notices are sent and not paid. The fee is waived if the customer seeks assistance with financial councilors.

Dishonour fee: is charged if cheques and/or cards fail.

Security deposit/refundable advance: is paid by a tenant or business customer who has not been responsible for a supply address before, or a domestic or business customer who does not have a satisfactory credit history.[21] Advances are refunded if customers pay their account on time for 2 years.

[21] Note that no GST is added to refundable advances.