Submission
No 23

INQUIRY INTO THE SUPPLY AND COST OF GAS AND LIQUID FUELS IN NEW SOUTH WALES

Organisation: Independent Pricing and Regulatory Tribunal

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The Director
Select Committee on the Supply and Cost of Gas
and Liquid Fuels in New South Wales
Legislative Council
Parliament House, Macquarie Street
Sydney NSW 2000

Contact John Smith

SUBMISSION TO INQUIRY INTO THE SUPPLY AND COST OF GAS AND LIQUID FUELS IN NEW SOUTH WALES

Thank you for the opportunity to make a submission to the above inquiry.

IPART is the economic regulator of retail gas prices for small customers in NSW that have not entered into a market contract with a retailer. We are well placed to comment on issues affecting the cost of gas for consumers.

Overview of our submission:

- The increase in regulated retail gas prices in 2014/15 reflects higher wholesale gas costs, as eastern Australia becomes part of a single global market for commodity gas, as well as increasing network charges.
- Domestic gas reserves in NSW currently provide only 5% of the State's gas needs. As domestic gas prices are set largely by international gas prices, the development of coal seam gas reserves in NSW would impact domestic gas prices to the extent it impacts the international market
- We consider competition in the retail gas market in NSW protects customers against market power by offering choice and better price and service outcomes, and in our view retail gas price regulation in NSW is no longer necessary.
- A domestic reservation policy would impose costs on the economy through forgone income opportunities, and might discourage producers from further investing in gas production.

Factors affecting the supply, demand and cost of natural gas and liquid fuels in NSW

More than 75% of household and small business gas customers are no longer on regulated prices and have entered into a market contract with a gas retailer. IPART regulates prices for the remaining customers by agreeing multi-year pricing agreements with each Standard

Retailer (AGL, ActewAGL and Origin Energy). The Standard Retailers then set regulated prices to comply with these agreements, and we monitor their compliance. These agreements are in place until 30 June 2016.

On 1 July 2014 regulated retail gas prices increased by an average of 11.2% (including the impact of the removal of the carbon price). There were two key contributors to these increases. The first was higher wholesale gas costs arising from a fundamental change to the wholesale gas market in eastern Australia. For the first time, the ability to export liquid natural gas (LNG) means that gas reserves previously supplied to NSW are being directed through Gladstone (in Queensland) for export. Eastern Australia is becoming part of a single global market for commodity gas, and wholesale prices are being increasingly set by international prices. In the future, it is likely that NSW gas retailers will have to compete with offshore demand and pay export parity prices for wholesale gas.

It is unclear how the development of coal seam gas reserves in NSW might affect domestic gas prices. At least in the short term, NSW would still be a small supplier in the context of the world gas market. In our view many other factors, for example domestic and international gas demand and the availability of LNG export capacity, would have a bigger impact on the price of gas in NSW.

The second key driver of regulated retail gas price increases from 1 July 2014 was higher network costs. This affected customers in the Jemena network area in NSW. Recent draft decisions by the Australian Energy Regulator indicate possible network price reductions in 2015.

The impact of tight supply and increasing cost of natural gas and liquid fuels on NSW consumers, including manufacturing, agriculture, energy production, small business, public services and household consumers

On 1 July 2014 typical annual gas bills for households paying regulated prices increased by between $80 and $130. Typical annual gas bills for small businesses on regulated prices increased by between $290 and $510. These typical bills are based on average usage within each gas supply area. The impact for individual customers will depend on where they live and how much gas they use. These estimates incorporate the repeal of the carbon price.

We note that these price increases relate to customers on regulated prices. The large proportion of customers on market contracts also face price increases, but are likely to be paying lower prices than the regulated price. The first step for customers concerned about the affordability of their gas (and electricity) prices is to shop around for a better deal. The free comparison service **energymadeeasy.gov.au** is a good place to start.

The possible regulatory responses to protect NSW gas consumers from adverse market fluctuations and failures.

In our view, competition in the retail gas market in NSW protects customers against market power by offering more choices and better price and service outcomes than a regulated market. We consider gas retail price regulation is no longer necessary in NSW and that the removal of retail price regulation is likely to:

- improve customer engagement in the market by removing confusion in relation to the difference between regulated and market prices.[1]
- remove the risk that price regulation distorts the competitive market, particularly given the dynamic nature of energy markets. This will encourage more retailers to enter the market, which should deliver better customer outcomes in the long term, including providing a better 'value for money' service through reduced costs and/or innovation.

Retail price regulation cannot protect customers from price increases driven by market factors, nor can it protect vulnerable households that may be experiencing affordability problems. There are also asymmetric risks in setting regulated prices in a competitive market. If prices are too high customers can always look for a better deal and switch suppliers; however if prices are too low retailers may leave the market and competition would diminish, leaving customers worse off.

We do not consider that a domestic reservation policy is an appropriate way to protect NSW gas consumers from higher prices. Under a domestic reservation policy, a proportion of gas production is reserved for domestic use, and sold at prices below those prevailing in the export market. Imposing a requirement that producers must reserve a fixed volume or proportion of gas, for say domestic manufacturing, is a form of industry protection. The economic benefit of the gas resources is shifted from producers to particular industry consumers. This redistribution would be achieved at a net cost to the Australian economy and is inefficient.

A further problem with a domestic gas reservation policy is that government would need to override the market and set the volume of supply. It is unlikely that a regulator would set aside the right amount, and there would be a risk that too much gas would be reserved for the domestic market. Suppliers would have less flexibility to adjust the supply of gas into the domestic market and this could discourage producers from further investing in gas production.

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1 A survey conducted by the Australian Energy Market Commission found that few participants knew if they were on a regulated or market price, suggesting there is a lack of understanding about the difference between regulated and market prices, which potentially influences effective customer engagement in the market. Roy Morgan Research, *Survey of Residential Customers of Electricity and Gas in NSW: Effectiveness of Retail Competition*, February 2013, p 53.

Please contact John Smith on if you have any queries in relation to this submission.

Yours sincerely

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Chairman