STATES OF JERSEY

GAS TARIFFS: REVIEW BY JERSEY COMPETITION REGULATORY AUTHORITY (P.32/2015) – COMMENTS

Presented to the States on 27th April 2015
by the Council of Ministers

STATES GREFFE

COMMENTS

The Assistant Chief Minister, with the full support of the Council of Ministers, initiated a review of energy and gas prices and commenced discussions on this on assuming office last October.

This pre-dates any of Deputy G.P. Southern of St. Helier's propositions or public statements. The Council of Ministers fully supports the work now underway on understanding Jersey's energy markets, and is ensuring that it is working in the interests of consumers.

The Proposition, for the second time, requests Ministers to bring forward Regulations for price regulation. However, this proposition pre-empts the work of the JCRA into the gas market as it assumes that price regulation will be necessary.

Formal price regulation is a significant step that should not be undertaken lightly, particularly as it will have costs associated with it that could ultimately be borne by the consumer.

It would be incumbent on the States to respond dynamically to changes in the market, which might affect any tariff position the States had decided to take. For example, if international commodity energy prices fluctuate, and if the States were to regulate prices using the exceptional powers contained within the law, the States could find itself in the position of having to amend Regulations because of changes due to international geo-political factors. It is not simply a case of setting a price in October 2015 and the States having no further responsibilities in this area. There would be a need for monitoring of ongoing developments in the market and future tariff changes which would mean the States from that point being committed to continuing price regulation. Members are asked to consider carefully who the right body to act as Gas Market Regulator is; moreover, what additional resources might be required.

If there are issues with the operation of the gas market, the Competition Regulatory Authority might also consider that other remedies, other than direct price regulation, are more appropriate.

The Deputy's assertion that there are no financial or manpower implications from his proposition are clearly incorrect.

It is not accepted that Deputy Southern's Proposition was responsible for the 3.5% tariff reduction.

The JCRA has indicated that Phase 1 of the fuel market review, including the gas market, will be complete at the end of Q3 2015. The JCRA will report its conclusions to the Assistant Chief Minister at that time and an update will be provided to Members.

The Council of Ministers firmly believes that the time to consider what further steps, if any, might be needed to protect the interests of consumers, is only after the JCRA have concluded their report.

The draft terms of reference for the Fuel Market Review which have been discussed with the JCRA, but are still subject to final agreement by their Board, and the Council of Ministers' Comments on Deputy Southern's earlier Proposition are attached for Members' information at **Appendices 1** and **2** respectively.

The Council of Ministers urges members to reject this proposition.

APPENDIX 1

FUEL MARKET INVESTIGATION: TERMS OF REFERENCE

Introduction

Previous reports by the JCRA have shown that there is a widening difference between UK and Jersey retail prices for fuel products. As a consequence, the Minister has asked the JCRA to conduct a market review into the supply, distribution and sale of fuel products in and to Jersey.

Previous JCRA Market Reviews include:

- Marine Fuel Market Study 2014
- Aviation Fuel Market Study 2014
- Heating Oil Review 2012
- Road Fuel 2011

The aims of the market investigation are twofold:

(1) To conduct a review of all stages of the supply chain, starting with the ex-refinery wholesale market, of fuel to Jersey and the supply chain in Jersey and identify whether there are reasonable grounds to suspect that a feature or a combination of features of market/s for the supply and acquisition of fuel for supply in Jersey are not acting in the best interests of consumers.

(2) Depending on the results of the first stage, the JCRA will focus on areas of potential concern in more detail. This may provide recommendations on changes to legislation or government policy, or suggest customer behaviour that might promote the functioning of the market.

Stage 1: Diagnostic Assessment (3–6 months)

The JCRA will conduct a high level assessment of trends in gross margins at key stages in the supply chain of the fuel markets to and in Jersey – including road fuel, heating oil, and gas. Where gross margins demonstrate unexplained trends, providers will be requested to substantiate and explain the evidence found. This will inform whether there are reasonable grounds for to suspect that a feature or a combination of features of the market/s for the supply and acquisition of fuel in Jersey are failing to work in consumers' interests. The key stages examined will be:

The JCRA will conduct an assessment of:

- Whether there is prima facie evidence in gross margins and/or unexplained trends over the past 3 years to suggest competition is not working effectively in the fuel market. This will consider the separate fuel markets as well as the conduct of particular firms.

- Consider whether any specific aspects of the supply chain suggest further examination is justified and the appropriate means to carry out more detailed market assessment.

- The review will also consider any possible structural issues and the conduct of customers.

Step 1 will help to identify more detailed work required during the second stage and ensure that resources are utilised appropriately and targeted. It is not at this stage anticipated that formal information powers will be required. With full co-operation from the companies concerned, this work is likely to take approximately 3 months to complete, but we suggest a 3–6 month time period is more realistic, formally commencing in Q2 and concluding in Q3 of 2015.

Stage 2: Detailed Investigation

It is likely that the Stage 1 Review will identify areas for more detailed investigation by the JCRA. As a result of this more focussed work, the JCRA may provide recommendations on, for example, the implications of States contractual agreements, legislation or customer action that may better support competition and choice. Any breaches of the Law will be investigated appropriately.

The length of time and resources which may be required for this stage of the review are clearly dependent on the results of the first stage.

APPENDIX 2

STATES OF JERSEY

GAS TARIFFS: REDUCTION (P.18/2015) – COMMENTS

Presented to the States on 23rd March 2015
by the Council of Ministers

STATES GREFFE

2015 Price code: A P.18 Com.

COMMENTS

The Council of Ministers, like many members, is concerned about fuel prices in Jersey and how they impact on the cost of living for Islanders. The Jersey Consumer Council has highlighted that gas prices in Jersey seem to be higher than in Guernsey and the Isle of Man. We do need to understand conditions in the Jersey gas market and what has driven trends in prices and costs, but a unilateral price cut of 5% should be rejected.

The Jersey Competition Regulatory Authority (JCRA) has been asked to commence a full-scale review of fuel supply in Jersey, including the local gas market. Jersey Gas has agreed to co-operate fully with the investigation and has already announced a 3.5% price reduction.

States Members are asked to oppose this proposition for a number of reasons –

1. It fails to understand trends in gas prices in Jersey and the factors affecting the local gas market.

2. There is no justification for such arbitrary price regulation.

3. It takes no account of the risks for the consumers of gas of imposing such price-cuts in the absence of proper analysis. Ministers wish to ensure the long-term efficiency of the gas market before making policy decisions.

4. The Assistant Minister for Economic Development has already asked officials to engage with Jersey Gas to better understand the situation in the local gas market, and has been aware since January that they were working to lower prices. The recent announcement of a tariff reduction of 3.5% with effect from 23rd March 2015 shows that arbitrary price control is not necessary and can quickly be overtaken by events.

5. The new Council of Ministers has given high priority to competition and a programme of work to ensure competitiveness in consumer markets, including gas. The Assistant Minister for Economic Development is finalising with the JCRA a fuel price review that will be conducted in coming months and that will ultimately provide recommendations, where appropriate, on how we can make fuel markets work better in consumer interests. It is encouraging that Jersey Gas has agreed to work on an open-book basis with the JCRA as part of this review to ensure that we have a full understanding of trends in the local market. We need to fully understand the issues in the local market before we can start to prescribe the solutions.

The proposition tries to explain trends in Jersey gas prices through selected quotes from coverage in the Jersey Evening Post. This is insufficient information on which to base a States' decision. A comparison of Jersey and UK gas prices (as included in the Retail Prices Index) shows that since 2000, UK gas prices have risen at a faster rate than those in Jersey. In addition, over the last 3 years, prices in Jersey have risen by 14% and those in the UK by 12%. However, such price trends do need to be treated with caution, given the different nature of gas sold in Jersey and the scale of the local market. Only through more detailed work by JCRA can we really determine whether the market is working in consumers' best interests and whether competition remedies are required.

Comparing price increases in Jersey with those in the UK is not sufficient to form conclusions, as it does not take into account differences in the local gas markets. The attached **Appendix** has been provided by Jersey Gas to explain some of the issues they feel are relevant when looking at trends in gas prices in Jersey. Some of this information has already been shared with the Assistant Minister for Economic Development after his public comments, as covered in the Jersey Evening Post on 16th January 2015. Officers met with Jersey Gas later in January to understand some of the issues facing the business. In particular, Jersey Gas have a hedging policy which means that the relationship between feedstock prices and those for Jersey customers is less straightforward than might first appear.

This information is something that the proposition of Deputy G.P. Southern of St. Helier fails to recognise, and which would have been shared with him if he had engaged with the Assistant Minister for Economic Development, his Officers or Jersey Gas on this matter.

Article 89 of the Jersey Gas Company (Jersey) Law 1989 has been copied by Deputy Southern for States Members' information. Members will see that in making decisions about tariffs, they need to satisfy themselves that the company remains commercially viable. On the evidence available, it would be difficult for States Members to be confident that they are properly taking into account the commercial reality of supplying gas in Jersey.

Deputy Southern states that Ministers are powerless in the face of price increases, but the Assistant Minister for Economic Development has shown that this is not the case by engaging with Jersey Gas at an early stage, and by working with the JCRA to agree a wide-ranging review of fuel prices in Jersey. This review will look at all stages of the fuel supply chain in Jersey to identify whether there are reasonable grounds to suspect markets are not acting in the best interests of consumers. These are the right routes through which to develop policy and protect the interests of consumers.

Arbitrarily imposed price cuts could undermine the future supply of gas and/or simply lead to higher prices in the future. **It is much better to have the JCRA working with Jersey Gas on an open-book basis, so that they can fully understand trends in the costs and prices of gas in Jersey and what, if any, remedies might be justified.**

The Council of Ministers urges members to reject this proposition, irrespective of whether the amendment of Deputy S.Y. Mézec of St. Helier is adopted.

APPENDIX

Jersey Gas comments on trends in gas prices

With respect to current (2015) tariffs –

- Jersey Gas were fully hedged (that is 80% of our outputs) for all of 2015.
- The hedges were taken out in July 2014 at competitive prices at the time.
- Hedging at this time was considered appropriate, as there were a number of conflicts in oil- and gas-producing regions (Ukraine/Syria) which, in the view of the market, could have resulted in higher prices.
- Hedging our gas purchases has served our customers well in avoiding tariff shocks, and it allowed us to budget to not increase prices in 2015. This seemed a significant challenge at the time as prices had risen continuously since 2009.
- The risk with hedging is that if the market moves down within the hedged period, it is usually very costly to "unwind" the hedge.
- Jersey Gas is a very small player in the market and as a result is a price-taker, and so the spot wholesale price quoted in the media is not the price paid for gas.

As a gas supplier, Jersey Gas faces competition for customers from competing fuel sources. We are heavily dependent on 2 key factors which are beyond our control, and mean gas tariffs are subject to fluctuation and cannot be guaranteed at a particular level. These are feedstock prices (LPG) and weather –

- Feedstock price forecast is based on hedges that we have in place, which never exceeds 80% of our requirement, plus an assumption of what we might pay for the balance, based on specialist market forecasts.
- Weather significantly affects sales, and we base our forecast on a simple average of the last 5 years' sales, plus or minus new or lost loads.
- When we develop our budgets, we have to make critical assumptions about how the future will turn out, given these uncertainties, and then try to set a tariff on that basis.
- We can advise that we will be reducing tariffs by 3.5% with effect from 23rd March 2015. This represents a saving of £57 per annum for an average central heating customer.
- From 1st October 2015, we will be introducing a new banded standing charge depending on the volume of gas that is used. The new banded standing charge does not increase the revenue that we receive, but the changes will make it easier for customers to budget for gas throughout the year, and will help us separate the cost of supplying gas to homes and businesses from the cost of gas itself, providing a fairer pricing structure.