



# Submission to the Independent Pricing and Regulatory Tribunal

## Review of electricity regulated retail tariffs 2007 - 2010

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## Table of Contents

<b>1</b>	<b>INTRODUCTION.....</b>	<b>1</b>
<b>2</b>	<b>POLICY CHANGES THAT AFFECT THIS REVIEW .....</b>	<b>3</b>
2.1	NSW Government's decision to phase out the ETEF .....	3
2.2	COAG endorsement of Ministerial Council on Energy's agenda to phase out retail price regulation.....	5
2.3	COAG's agreement to roll out time-of-use meters.....	7
<b>3</b>	<b>FORM OF REGULATION AND PRICE CONSTRAINTS .....</b>	<b>10</b>
3.1	Broad options for the form of regulation.....	10
3.2	Price constraints.....	17
3.3	Assessing the options .....	21
<b>4</b>	<b>COSTS TO BE RECOVERED .....</b>	<b>23</b>
4.1	Long run marginal cost of electricity generation .....	23
4.2	Hedging, risk management and transaction costs .....	24
4.3	Mass market new entrant retail operating costs .....	25
4.4	Mass market new entrant retail margin .....	27
4.5	Network charges .....	27
4.6	Cost of compliance with green energy obligations.....	28
4.7	Retailer NEM fees .....	29
4.8	Energy losses.....	29
4.9	Optional Green Power component to all new (or moving) residential tariffs.....	30
4.10	Mechanism to capture costs of new schemes .....	30
<b>5</b>	<b>MISCELLANEOUS CHARGES .....</b>	<b>32</b>
5.1	Security deposits.....	32
5.2	Late payment fees.....	32
5.3	Dishonoured bank cheque fees .....	32



## 1 INTRODUCTION

Country Energy is pleased to provide this response to the Independent Pricing and Regulatory Tribunal (the Tribunal) Issue Paper regarding the Terms of Reference for the Review of Regulated Electricity Tariffs 2007 – 2010. The Review provides an opportunity to analyse the framework under which regulated retail prices are managed to ensure cost reflectivity.

Country Energy supports a form of regulation which aims to phase out retail price regulation. We believe that our proposed form of regulation discussed further in section 3 – Form of Regulation and Price Constraints will provide a mechanism to achieve the aim of the Terms of Reference. As stated previously, cost reflective regulated tariffs is a precursor to a buoyant and effective, competitive market for electricity in NSW.

In 2003 Country Energy proposed the Tribunal adopt a form of regulation that would allow the inequities arising from many outdated regulated tariffs to be resolved, and significant equity gains have since been achieved (including the recent removal of the overly complex distinctions between 'rural' and 'urban' customers). In 2007 we are seeking further changes to the form of regulation, taking the next steps to see the inequities finally eliminated over the next four years. This will ensure a strong path to full retail competition not retail price regulation. This, along with full and fair recognition of wholesale energy costs and other relevant costs, will also support a more commercially competitive retail energy market.

Whilst competition has been observed in the NSW market, the extent of competition between regional and metropolitan areas varies significantly. International and national experience shows that the level of regulated tariffs relative to market prices is the key determinant of how many eligible customers remain with regulated arrangements. If retailers are unable to commercially sustain sufficient discounts under competitive contracts, then their ability to acquire customers under competitive arrangements will be constrained.

Structural tariff reform is a priority for Country Energy. Without significant changes to current tariff structures, varied price impacts on customers will persist and the ability to achieve cost reflective pricing will be difficult. Country Energy's price levels are around three per cent below target levels with some current prices failing to recoup costs.

The current form of regulation has been successful in allowing majority pass through of network increase and the removal of certain inequities in Country Energy's regulated retail prices. During the current determination, cost reflectivity has also improved. However the various layers of price limits have impeded the ability to achieve the objectives of the target tariff.

Country Energy's intent is not to undermine the current retail price regulatory framework. In fact Country Energy believes that the 'target tariff' framework has been successful in starting to address the inequities, and has moved tariffs towards their target. Country Energy believes it is possible to retain, but significantly simplify, the target tariff framework.

Country Energy has commented on the items raised in the Issues Paper concerning the appropriate level for each of the costs mentioned in the issues paper. Our view

concerning the level, inclusions and exclusions, and volatility are discussed in Section 4 and we look forward to further consideration of these matters with the Tribunal and their consultants.

This submission details Country Energy’s position on a range of issues as outlined in the Terms of Reference. A summary of the key recommendations contained within the paper are provided below.

Section	Key Recommendations
<b>2. Policy changes that affect this Review</b>	<ul style="list-style-type: none"> <li>■ Country Energy recommends that the ETEF phase out be assumed at the start of the Determination and has provided a process that would allow a transition without intra-year price increases.</li> <li>■ We agree with the need to phase out price regulation as soon as is practical to ensure that the energy market in NSW matures, but do not support the view that this is possible until cost reflectivity of tariffs is attained.</li> </ul>
<b>3. Form of regulation and price constraints</b>	<ul style="list-style-type: none"> <li>■ Country Energy is in favour of maintaining the N + R model modified to allow the retailer greater flexibility in the move to cost reflectivity.</li> <li>■ We also favour the removal of the customer bill constraint and believe that this will assist the Tribunal in addressing the key objectives of this review.</li> <li>■ It is also a further tangible step in phasing out price regulation.</li> </ul>
<b>4. Costs to be Recovered</b>	<ul style="list-style-type: none"> <li>■ Country Energy is of the view that the appropriate cost recovery for electricity purchases should be based on the wholesale risks involved for a retailer to trade in the competitive market.</li> <li>■ Country Energy is of the view there will be increased load and price volatility to which we will be exposed during and after the phasing out of the ETEF.</li> </ul>
<b>5. Miscellaneous charges</b>	<ul style="list-style-type: none"> <li>■ Country Energy supports the approach that exists currently for a dishonoured cheque fee. Country Energy feels, however that it is only appropriate that similar charges are allowed to be levied for direct debit dishonours. This would take on the nature of a dishonoured payment fee.</li> </ul>

## 2 POLICY CHANGES THAT AFFECT THIS REVIEW

### 2.1 NSW Government's decision to phase out the ETEF

*The Tribunal seeks comment on:*

- ▶ *Whether, for the purposes of establishing cost reflective tariff levels, it should consider the phasing out of the ETEF over a period of time or assume that the ETEF immediately ceases.*

The phasing out of the ETEF provides some challenges for the management of regulated retail prices over the period of its removal. It is difficult to predict the changes that may occur with the significant growth of hedging instruments, risk management and transaction cost requirements.

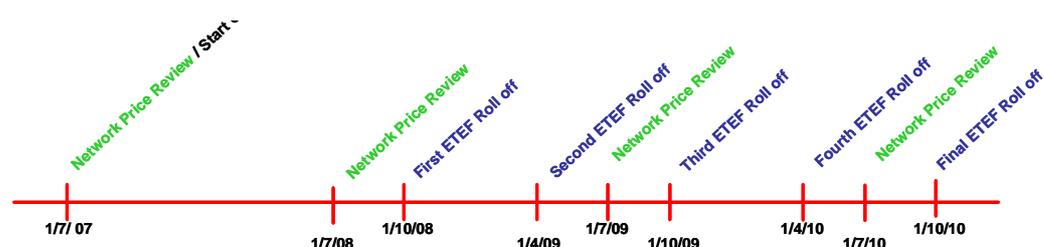
Country Energy believes that the expected cost reflective price determined for 30 June 2010 should be established as the initial target levels at the commencement of the regulatory period. The transition to these target levels should undertake a phased approach during the period of the determination in the form of a smooth price path. This approach will achieve cost reflective prices whilst also limiting potential price shocks for customers.

There also needs to be a mechanism built in to ensure that movements which occur in the cost of electricity as the ETEF rolls off are included in the price movements. These movements may include significant increases in hedging instruments, risk management and transaction cost requirements.

The timetable for phasing out of ETEF requires a reduction of 20 per cent of regulated retail load supported by ETEF every six months from September 2008. Country Energy believes that to match these purchase cost changes to customer price changes is inappropriate and would represent a cumbersome process for Country Energy and its customers.

To adjust prices every six months as the ETEF load diminishes would place an unnecessary regulatory and administrative burden on retailers and would result in customers facing six price movements within three years. In addition the phasing out of ETEF is mismatched to other known changes in costs of the regulated retail tariff such as network prices. If prices were moved at each significant change in costs, consumers could be facing nine price movements in three years as shown below in Figure 1. This is clearly unacceptable.

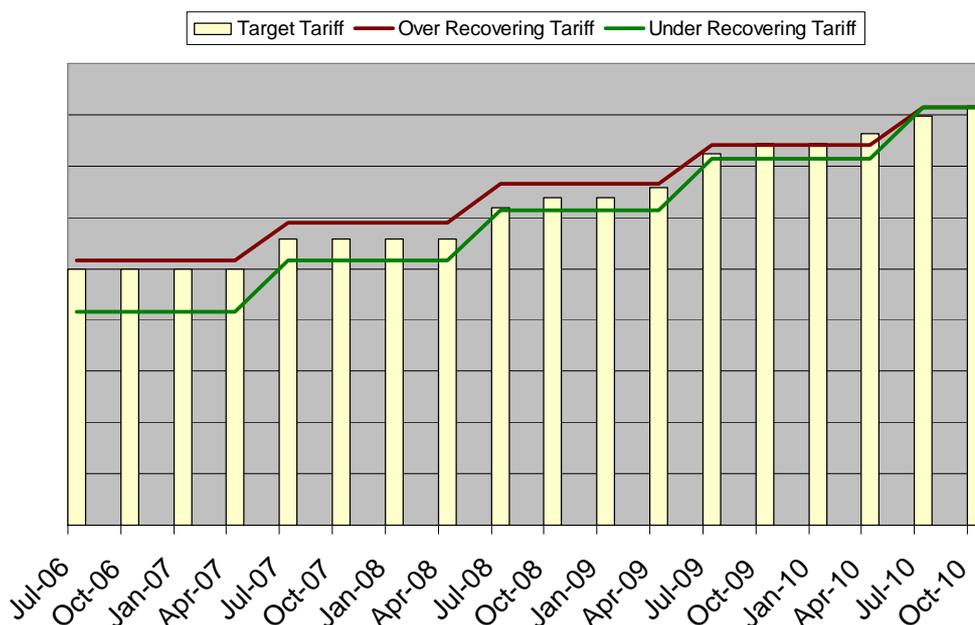
**Figure 1: Potential regulated Price review Timing**



Country Energy is of the view that the mechanism for calculating regulated price movements during the period to 2010 should be designed to predict the total cost of electricity at 30 June 2010 and move prices annually to that level as evenly as possible. In addition, Country Energy believes that a mechanism which allows for pass through of unexpected increases in costs should be included which ensures the goal of cost reflectivity is not compromised by unforeseen circumstances or events.

Figure 2 below shows the path that an under recovering tariff and an over recovering tariff should take during the transition to cost reflective prices. The columns represent the build up of the cost reflective target, whilst the lines represent the transition path of regulated retail prices.

**Figure 2: Recommended tariff path to cost reflectivity**



We believe that this approach would allow a smoothed price path through the turbulence of the phasing out of the ETEF and, unless there were major movements in the cost of purchasing electricity, there would be adequate coverage of the marginal intra-year cost changes. If there were major cost movements, Country Energy recommends that they would be subject to the mechanism described below in section 4.10 – mechanism to capture costs of new schemes.

- ▶ *How the phasing out of the ETEF will affect retailers’ hedging, risk management and transactions costs over the course of the determination and whether these costs are different between a standard retailer and a mass market new entrant retailer.*

The phasing out of ETEF will create considerable uncertainty for retailers in the NSW market and possibly beyond. The ETEF currently protects Country Energy from risks of movement in wholesale energy prices as well as risks associated with variability in load.

We believe that there will be upward pressure on the cost of hedging due to the increased demand by retailers for hedging products as the market expands to take

up the ETEF load. Increased demand in NSW without the introduction of additional capacity will also work to reduce liquidity in the wholesale contract market.

This may, in the longer term, be mitigated by new generation being available to the hedge market, but during the period of the determination it is not expected that a significant amount of new generation will be available. In addition we believe that there will be increased staffing requirements and also an increase in transactions and cost due to the increased load hedged. Independent from the actual cost of energy purchases, this will increase the cost of purchasing wholesale electricity.

Given the status of the current market for electricity in NSW, Country Energy is of the view that there will not be a significant difference in the cost of purchasing energy and the associated hedging, risk management and transaction costs between a new entrant retailer and those already in the market, other than as mentioned below.

- ▶ *How it should recognise the forecasting risks that retailers will face in the absence of the ETEF and whether these risks are different between a standard retailer and a mass market new entrant retailer.*

The impact of the risk of inaccuracy in forecasting load becomes more problematic post ETEF. Currently the ETEF removes all volume risk. As the ETEF is phased out, Country Energy will be required to hedge that volume previously covered. This introduces significant volume risk to the energy purchases for regulated retail customers. Traditionally, regulated retail customers have a highly variable load driven by changes in energy consumption in response to heating and air-conditioning and so on.

The variability in the customer's consumption leads to a position of either being over-hedged and therefore relatively higher costs of hedging; or exposed to the market and high pool price events which lead to relatively higher costs of electricity. Country Energy believes the cost of hedging to a "reasonable level" that takes account of the significant associated uncertainty and risk, should be included in the Tribunal's assessment of wholesale energy costs, and hence final prices.

Country Energy believes that a new entrant would face higher costs flowing from a lack of experience and historical market data. Whilst this is mitigated by information such as the Net System Load Profile being available from NEMMCO, the new entrant would still be at a disadvantage due to the lack of consumption data. This is reflected in the risk premium a new entrant would pay (i.e. higher than "market" costs)

## **2.2 COAG endorsement of Ministerial Council on Energy's agenda to phase out retail price regulation**

*The Tribunal seeks comment on:*

- ▶ *the extent of competition in the NSW retail electricity market.*

Since the introduction of Full Retail Contestability (FRC) to NSW residential customers in 2002, all customers can opt to be supplied by any licensed retailer in NSW at a negotiated price. The NSW Department of Energy, Utilities and Sustainability has estimated that up to the end of May 2005, 1.1 million NSW gas and electricity customers who are entitled to supply at regulated prices have entered into negotiated contracts.

Based on our internal analysis, churn rates within the market (the propensity for customers to move to FRC) varies significantly between the various States of Australia. Our analysis indicates that approximately 40 percent of customers have churned in Victoria and South Australia, 16 percent of customers have churned in NSW and 3 percent in the ACT.

Whilst competition has been observed in the NSW market, the extent of competition between regional and metropolitan areas varies significantly. In May 2004, PricewaterhouseCoopers, based on confidential data supplied to them by electricity retailers, observed that “the extent to which customers have entered into negotiated contracts appears to be greater in the Sydney area than in areas outside Sydney.”<sup>1</sup> This would imply that the rate of customer churn from regulated tariffs to negotiated contracts within Country Energy’s franchise area is less than the NSW average.

As reported in Country Energy’s submission to the Tribunal in 2003, international and national experience shows that the level of regulated tariffs relative to market prices is the key determinant of how many eligible customers remain with regulated arrangements.

A recent report prepared by the Boston Consulting Group <sup>2</sup>commissioned by the Queensland Government reported that:

“... experience from other markets indicates that customers will be willing to shift to another retailer if offered a discount of 5-12%”.

It follows that while net margins remain lower than 5%, limited churn will occur. If retailers are unable to commercially sustain sufficient discounts under competitive contracts, then their ability to acquire customers under competitive arrangements will be constrained.

Country Energy believes that there is currently an insufficient commercial opportunity for retailers to offer competitive contracts, especially in regional NSW, because regulated tariffs have yet to fully reflect the ‘cost to supply’ and ‘costs to serve’, particularly relative to commercial opportunities available in other jurisdictions.

► *the appropriate form of regulation given Governments’ aim to phase out energy retail price regulation.*

Country Energy believes the foundations already established under the current form of regulation provide an established framework to move towards the Government’s aim to phase out energy price regulation. The components of the current form of regulation that make it the right methodology should be retained to move forward into the next regulatory period.

The current form of regulation has been successful in allowing a majority pass through of network increase and the removal of certain inequities in Country Energy’s

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<sup>1</sup> Report to the Independent Pricing and Regulatory Tribunal, NSW: Information on Negotiated Contracts offered to Small Electricity & Gas Customers in NSW, PricewaterhouseCoopers, May 2004.

<sup>2</sup> Queensland Energy Structure Review, The Boston Consulting Group, March 2006

regulated retail prices. During the current determination, cost reflectivity has also improved. However the various layers of price limits have impeded our ability to achieve the objectives of the target tariff.

Country Energy believes that the current form of regulation with some modification will further improve cost reflectivity to a level where the majority of price inequities are removed and prices accurately reflect future movements in costs.

The form of regulation should be based on the current target revenue concept but be modified to allow greater scope to restructure and rationalise prices in a cost reflective manner. The modified form of regulation would include:

- The establishment of the requirement to transition to total target revenue rather than individual target levels.
- Pass through of network charges directly at the individual tariff level.
- The introduction of a constraint on the retail component at the individual tariff level which allows a smoothed transition to cost reflectivity in 2010.
- The removal of individual customer side constraints.

Country Energy supports a form of regulation which aims to phase our retail price regulation. We believe that our proposed form of regulation discussed further in section 3 – Form of Regulation and Price Constraints will provide a mechanism to achieve the aim of the Terms of Reference. As stated previously, cost reflective regulated tariffs is a precursor to a buoyant competitive market for electricity in NSW.

## **2.3 COAG's agreement to roll out time-of-use meters**

*The Tribunal seeks views on:*

- ▶ *What problems have arisen during the current determination as a result of network roll out of time-of-use meters.*
- ▶ *How the new determination could be used to facilitate the transition to time-of-use tariffs.*

Country Energy acknowledges the potential demand management benefits that time of use pricing can deliver. We support the adoption of interval metering for large commercial customers above certain usage levels, and recognise that new regulated pricing structures, including step pricing, may better reflect the underlying costs of energy supply.

Country Energy recognises the increasing interest from State and Commonwealth regulatory bodies and the Council of Australian Governments in issues relating to interval metering and time of use pricing, and is strongly supportive of initiatives to develop and deliver new pricing mechanisms to our customer base. However the costs associated with the roll out of such technology also need to be considered.

Country Energy was the first utility in Australia to develop and implement a comprehensive trial of smart metering and dynamic pricing in the residential context. Country Energy's Home Energy Efficiency Trial (HEET) in the Queanbeyan region has demonstrated the potential benefits to customers and utilities through greater access to consumption and cost information, and Country Energy will continue to

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assess the performance of the project prior to making any decision on a wider implementation of the technology and the pricing product.

Complex pricing structures, including time of use and dynamic pricing, should exist in the context of competitive contracts. Our experience to date – both with time of use and during the HEET project – has shown that customers are more likely to transition to a time of use pricing structure if they are given the opportunity to do so in a flexible environment.

However, our experience has also shown that regulated customers may choose time of use pricing in certain circumstances, and Country Energy will continue to support customers seeking to transition to time of use pricing.

The Tribunal seeks views on how this determination could be used to facilitate the transition to time of use pricing. Country Energy advocates a transition path that remains voluntary, rather than a mandated path to time of use pricing for all regulated customers.

This view recognises that there is no ‘one size fits all’ approach that can be applied to time of use pricing, and also allows regulated customers to retain choice between tariff structures.

It is important that any time of use pricing structure introduced through this determination is cost reflective, allowing correct price signals to be delivered to the customer while encouraging demand management. For example, the retail component of any time of use tariff should be set at a level equivalent to the standard component based on a standard usage profile.

Under this scenario, a customer transitioning to time of use pricing will be no worse off, but will have the opportunity to reduce energy costs by moving consumption to shoulder and off-peak periods.

Country Energy has identified issues between time of use pricing structures and settlement processes in the National Electricity Market (NEM) that require further examination by regulatory bodies. These issues relate to the requirement to settle based on net system load profile (NSLP), and we would be willing to work with the Tribunal to overcome these issues.

► *How the Tribunal should consider the impact of its determination on demand management.*

Under current regulatory arrangements, Country Energy views the ability of retailers to have a significant impact on demand management as constrained.

Traditional demand management initiatives and programs have the potential to advantage distribution network service providers (DNSPs) as well as retailers. While retailers can take advantage of demand management to better manage wholesale energy trading positions in the National Electricity Market, these opportunities are primarily limited to negotiating interruptibility clauses in large contestable customer contracts.

Retailers have a unique and direct relationship with regulated customers, and therefore are best placed to engage customers in programs to encourage demand management and energy efficiency outcomes.

Country Energy suggests that the current determination examine ways to provide incentive to retailers to provide demand management programs on behalf of DNSPs, either through a program of cost recovery or through some other mechanism that ensures retailer's costs are met and that demand management outcomes are recognised for the benefit they provide the DNSP.

Such a mechanism would allow retailers to contract to a DNSP to provide an agreed level of demand management through the implementation of programs and initiatives that a DNSP may not have the resources to conduct.

Country Energy would be willing to work with the Tribunal to further develop this concept.

Of concern to Country Energy is a recently published decision from the New South Wales Greenhouse Gas Abatement Scheme Administrator to reduce the Default Abatement Factor (DAF) for 'giveaway' projects under the Demand Side Abatement Rule.

Reducing the Default Abatement Factor from 0.9 to 0.4 will effectively halve the value in retailers undertaking (or contracting specialist providers to undertake) energy efficiency programs that involve freely available energy efficiency products.

Whilst Country Energy supports efforts to maintain the integrity of the NSW Greenhouse Gas Abatement Scheme, it is directly at odds with the aim of this determination to reduce the potential incentive for retailers to undertake energy efficiency and demand management projects under the Demand Side Abatement Rule.

We would urge The Tribunal to ensure that appropriate incentives remain in the Scheme to encourage retailers to participate in demand management programs.

### 3 FORM OF REGULATION AND PRICE CONSTRAINTS

#### 3.1 Broad options for the form of regulation

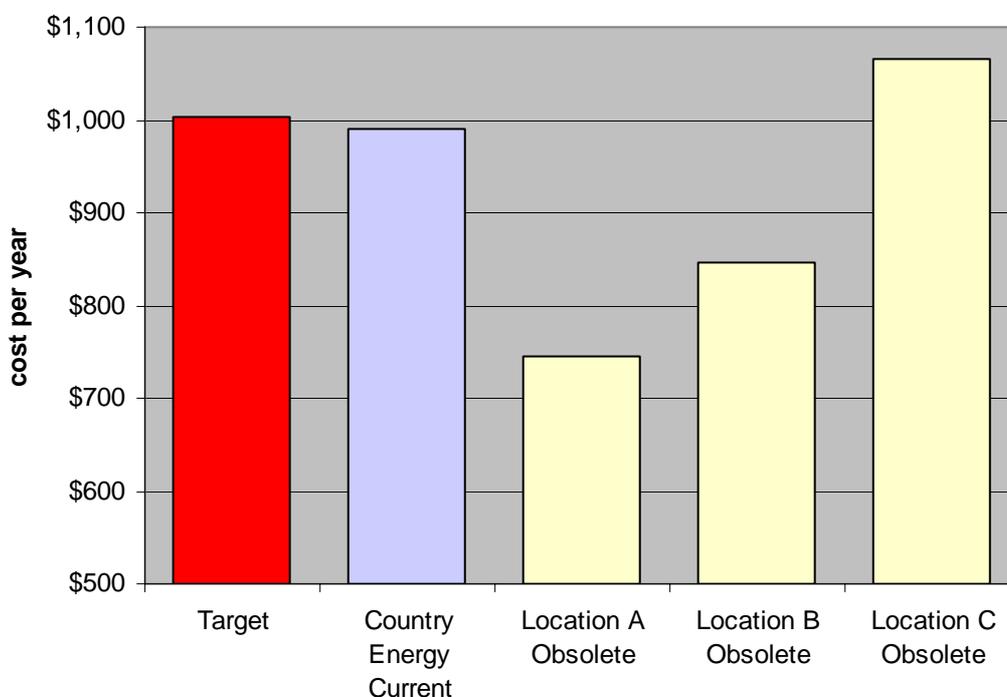
*The Tribunal seeks comment from stakeholders on the regulatory approach that best meets the objectives for the review, the pros and cons of the options, and whether there are additional broad options or variations within the options that the Tribunal should consider.*

Country Energy is managing a large number of regulated retail prices, a proportion of which will be below target levels at the end of the current regulatory period. This is the result of Country Energy’s predecessors maintaining complex and varied suites of tariffs. Amalgamating these tariffs into a consolidated tariff framework has been a key focus of Country Energy since its formation.

In July 2006 Country Energy also began an initiative to further reduce the complexity and variability of prices by removing the differentiation between rural and urban customers, providing an opportunity to reduce tariff complexity and remove many obsolete tariffs.

During the course of the current determination Country Energy has been successful in unwinding significant cross subsidies between customer classes. In addition we have taken a number of steps to standardise regulated retail pricing options which have benefited the removal of some inequities. However inequities are still apparent within Country Energy’s regulated retail prices as shown in Figure 3, below.

**Figure 3: Customer Inequities**



The current regulatory framework has allowed Country Energy to provide the foundations of a standardised suite of regulated retail prices. However further rationalisation and increased cost reflectivity of prices is required. Country Energy

believes this can be achieved through a modified form of the current form of regulation.

The current form of regulation provides an established framework to move towards standardised and cost reflective prices. The components of the current form of regulation that make it the right methodology should be retained to move forward into the next regulatory period. These aspects are further discussed below.

Attaining full cost reflectivity is one of the key objectives specified in the Terms of Reference for this review. The objectives set out in the Terms of Reference would be achievable under a variety of regulatory regimes and Country Energy can see merit in both N + R and the weighted average price cap (WAPC) models outlined in the Tribunal's issues paper.

In Country Energy's view, the outcomes achievable under a WAPC compared to those under a basic N + R approach are the same, assuming a modified form of the N+R approach as proposed by Country Energy. Under such circumstances, both enable considerable flexibility in the setting of individual tariffs and would deliver positive outcomes in relation to the key objectives of the review.

However, considering that there is an active commitment within the broader context of the Ministerial Council on Energy towards the removal of price regulation, significant switching costs would be incurred if a new model (such as the WAPC approach) were to be instituted at this late stage. In addition, a WAPC imposes higher monitoring and compliance costs on the regulator and retailers. Country Energy is therefore in favour of the Tribunal maintaining a modified form of regulation based in the N+R model.

### **The proposed form of regulation**

Country Energy has proposed a form of regulation based on a modified form of the existing framework. Key aspects are summarised below and discussed further throughout the remainder of this section.

<b>Current determination (N+R)</b>	<b>Country Energy Proposal (modified N+R)</b>
Target levels determined for each tariff with strict requirements to move towards target	Total target revenue determined to allow CE scope to structure and rationalise prices in an unrestricted manner within total revenue
Pass through of network charges and constraint on retail component CPI+3 at total revenue level	Pass through of network charges and constraint on retail component at individual tariff to allow restructuring and rationalisation
Limits on increase of individual customer accounts of the greater of CPI+5 or \$35	No customer side constraints

### 3.1.1 Setting target or maximum tariffs based on N+R

*The Tribunal seeks stakeholder views on:*

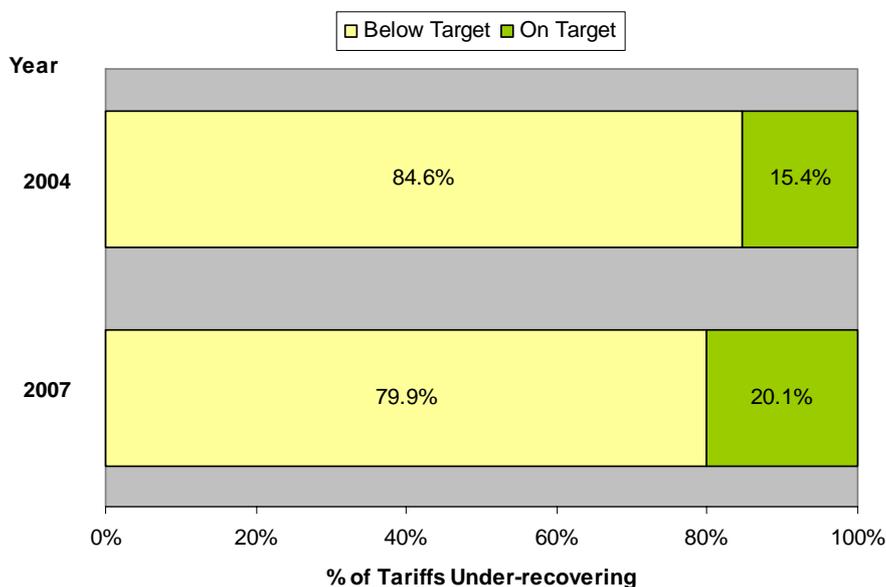
- ▶ *Whether the N+R approach should be retained.*
- ▶ *Whether there are variations within the N+R approach which should be considered.*
- ▶ *What modifications could be made to the current N+R framework and/or incorporated in a revised N+R approach to meet the objectives implied in the terms of reference.*
- ▶ *How the N+R approach could be designed and implemented to better accommodate network tariff reform.*

It is Country Energy's preference that the basic N+R model be retained. As discussed above aspects of the current form of regulation have been successful, and these components should provide a solid foundation to assist in attaining the objectives of the review. However, Country Energy strongly recommends that in setting the regulatory controls for retail pricing for the upcoming period, the Tribunal should take this opportunity to remove those elements of the existing N + R model that have shown to be inhibitive in achieving the stated aims of the Terms of Reference. We would consider the major areas for reform to be:

- The establishment of the requirement to transition to total target revenue rather than individual target levels
- Pass through of network charges directly at the individual tariff level in order to preserve network pricing signals
- The introduction of a constraint on the retail component at the individual tariff level which allows a smoothed transition to cost reflectivity in 2010
- The removal of individual customer side constraints
- The removal of individual tariff comparisons to target levels and the strict price movements this imposes
- The ability to remove tariffs or to create new tariffs in reflection of changing network tariff structures

As discussed above during the course of the current determination, Country Energy has succeeded in moving many of our regulated retail prices towards cost reflective levels, but a proportion remain as under-recovering as shown below in Figure 4.

**Figure 4: Regulated retail prices compared to current target levels**



This was expected at the time of the previous determination being released and as such is not a reflection of any failing in either the determination itself or its implementation over the regulatory period. We note that a central aim of the current determination was to strike an appropriate balance between moving prices towards cost reflective targets and protecting customers from unacceptable price shocks. To this end, the current determination has achieved this goal.

However, given a key objective of this review is for all prices to be at cost reflective levels at the end of the period, Country Energy believes that simply carrying over the forms of price constraint as they exist currently would prevent the realisation of this goal by 30 June 2010. Modifications to the existing frameworks are needed to provide an appropriate level of flexibility in the rationalisation of regulated retail prices in a cost reflective manner.

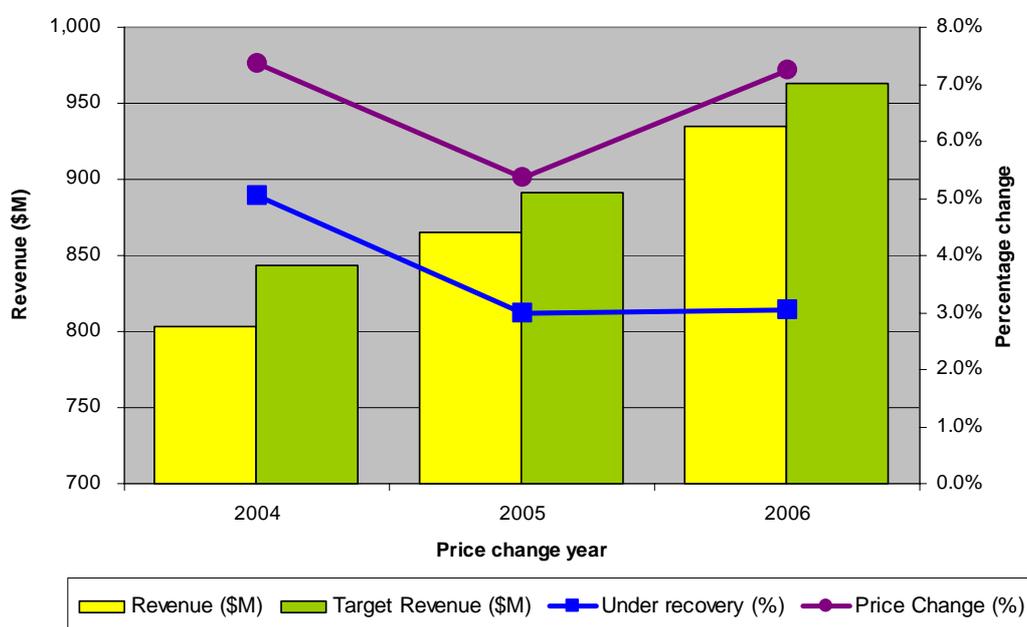
As discussed above, the foundations of the current form of regulation provide an appropriate base to move forward to the next regulatory period. The N+R model provides a robust mechanism which signals cost reflectivity of prices and provides a transition path for regulated retail prices. However Country Energy has been limited in its ability to fully address all issues inherent in regulated retail prices. Specifically, underlying issues that have restricted the success of the current determination are:

- Country Energy’s inability to rationalise prices that are below target in concert with those that are above target due to the disallowing of a reduction in tariffs.
- Although the majority of network price increases have been passed through during the period of the current determination, the customer side constraint has prevented a full pass through of these increases.

- The customer side constraint also makes tariff rationalisation difficult, particularly in the case of varying tariff structures, the \$35 side constraint prevents restructuring of prices.
- The customer side constraint has limited the transition to cost reflectivity which has been demonstrated by the inability of Country Energy to fully utilise the CPI+3 constraint on total retail component revenue in two of the three price changes under the current framework.

This is demonstrated in the following graph which shows that, whilst the percentage under-recovery improved in 2005, we have been unable to make any further improvement.

**Figure 5: Price changes under current determination**



### Arrangements for significantly under-recovering tariffs (obsolete tariffs)

Cost reflectivity for all regulated retail prices will not be achievable if the existing side constraints are maintained. Maintaining regulated retail prices at levels below cost reflectivity, has resulted in customers receiving electricity at a considerable discount against cost. This is not a desirable situation from an equity or efficiency position, and measures in the upcoming determination should cater for these circumstances.

Country Energy is of the opinion that these tariffs must be carefully managed and customers transitioned to more cost-reflective tariffs in a once off tariff restructure coupled with a smoothed price path to cost reflectivity. We accept that there is a need for a small proportion of customers on significantly under recovering tariffs to be assisted through our Country Support program which has great success since its implementation. Country Support and its key successes are further discussed below.

It is clear that the situation where these customers continue to be transitioned by way of limited price increases must be modified if the goal to see efficient, cost reflective

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pricing is to be achieved for such customers by 2010. In addition the availability of other regulated retail pricing options may provide a suitable path to cost reflectivity.

### **Structure of target levels**

The current determination sets target levels for the variable R component of the following categories:

- Standard;
- Off Peak; and
- Extended Off Peak.

In submissions to the Tribunal on the current regulatory period, Country Energy previously proposed that these targets should be expanded to include a target for peak and shoulder components. In our final submission, it was stated that:

Country Energy has developed a number of scenarios surrounding the transition of single rate customers to time of use prices. This analysis concluded that the current standard targets are not cost reflective, and the impact on revenue, and in particular gross margin, would be in some instances severe. (p 28)

If the key objective of reaching cost reflectivity across regulated retail prices is to be achieved, then the current continuous target tariff structure needs to be expanded to incorporate a peak rate. Country Energy considers the benefits of such an expansion to include the following:

- Regulated retail prices would more closely reflect the underlying costs of supply.
- Regulated retail prices would compliment the underlying objectives of introducing network time of use tariffs.

It is for these reasons that Country Energy strongly recommends to the Tribunal that a peak component be allowed for in the upcoming determination. This will ensure that increasing numbers of customers can utilise time of use network tariffs in a way that benefits themselves, the retailer and the network.

### **Creating and deleting tariffs from the regulated tariff base**

Currently, new tariffs are not allowed to be created under the existing determination. Similarly, tariffs that existed at the beginning of the regulatory period cannot be deleted, even if they have no consumption against them. This rigidity in the current framework adds complexity to regulated retail prices whilst preventing it from adapting to the introduction of new underlying network prices.

Of most concern is the inability to introduce regulated retail prices that reflect the addition of new prices at the network level. Currently the introduction of new network prices is allowed under the current network determination. The use of a weighted average price cap in regulating network prices allows, as discussed previously, an inherently flexible approach to be taken in setting network tariffs. With the current constraints in the retail determination, this cannot be replicated and hence regulated retail prices are not able to accurately reflect additions to network cost structures.

### 3.1.2 Applying a weighted average price cap

*The Tribunal seeks views on:*

- ▶ *Any implementation issues associated with introducing a weighted average price cap.*
- ▶ *How the framework can be used to promote cost reflectivity and demand management objectives.*
- ▶ *Whether a weighted average price cap should be applied to the retail component of tariffs only, and any issues associated with this approach.*

As stated, Country Energy is not in favour of the adoption of a weighted average price cap (WAPC) model for the next determination period. Country Energy believes that a modified N+R model would be equally effective in achieving the benefits identified under a WAPC approach.

A WAPC model allows an important level of flexibility in the setting of prices at an individual tariff level. This flexibility would also be allowed under Country Energy's proposed form of regulation. However, the key difference between the two models is that the implementation of a WAPC model would involve considerable costs to industry, both in establishing the optimum framework, as well as ongoing monitoring and assurance requirements. Implementing a WAPC model would involve costs above and beyond that of alternative models.

If the objectives of the Terms of Reference are achieved by 30 June 2010, it may be likely that ongoing regulation of retail prices will be phased out, as agreed in principle through the Ministerial Council on Energy. Thus adopting an entirely new approach to the regulation of retail prices at this late stage would, given the likely administrative costs, not seem justified.

The benefits of a WAPC could equally be achieved through a revised N+R model. If such a model relaxes constraints at the tariff level, then the appropriate level of flexibility is available in movements to target levels and thus the desired outcomes in relation to the Terms of Reference are attainable.

Essentially, an N+R model with no customer constraints and relaxed constraints at the individual tariff level represents a form of WAPC. The constraint operating on the retail component in isolation from changes to the Network component at an individual tariff level will allow full flexibility in movements of regulated retail prices towards a rationalised, cost reflective base. Country Energy supports this model and believes that such a model is administratively less complex than a fully developed WAPC operation.

We therefore cannot see any additional benefit from incurring the considerable transition costs that would arise from a change of N+R to WAPC. The amendments to the N+R model as outlined in this submission would deliver the outcomes of the Terms of Reference at less cost in implementation and operation than that under a WAPC model.

### 3.1.3 Establishing new opt-in regulated tariffs

*The Tribunal seeks input from stakeholders on:*

- ▶ *Whether it is appropriate to apply a regulatory approach that requires customers to 'choose' to be supplied on a regulated tariff and the implications of doing this.*

- ▶ *What measures could be taken to resolve the customer protection issues associated with such an approach, and who should take responsibility for taking them.*
- ▶ *Whether customers could continue to be supplied on a standard form contract if they do not choose to be supplied on the new regulated tariff.*

Given the current Terms of Reference have as a major objective the movement of regulated retail prices to cost reflectivity by 2010, then it is implied in such an objective that any move to an opt-in regulated retail tariff regime may be premature.

Customers currently on a regulated retail price have the option to move to a market rate offered by Country Energy or any other retailer. Where the regulated retail price is at cost reflective levels, then a customer may receive a benefit through entering the competitive market. Such situations may in theory lend themselves to an opt-in regime since the customer would likely be better off on a negotiated contract as opposed to a standard form contract.

However, many of Country Energy's regulated retail prices are below target levels. In these cases, customers have little or no incentive to shift to a negotiated contract simply because they would face higher prices. In these situations, there would be no benefits to be gained by consumers in implementing an opt-in regime. Instead, the regime would add to the cost of entering into a standard form contract by increasing the complexity of the application process, namely because all of these customers would now face an additional step.

Any appropriate regulatory regime under these circumstances would effectively be a 'two-tiered' regime. That is, the arrangements for an opt-in regime may only be suitable for customers on regulated retail prices at cost reflective levels, with another regime needing to be applied for those customers to whom an opt-in arrangement is not currently viable.

The costs for a retailer such as Country Energy operating under a two-tiered framework would be significant, both in terms of establishing the appropriate processes for an additional opt-in approach as well as in ongoing delivery of compliant outcomes. Similarly, an approach that sought to extend the standard form contract to customers who did not opt-in to the regulated tariff would also impose a cost on business.

The benefits of such an approach in the current retail pricing environment are far from clear and it is for this reason that Country Energy does not support an opt-in regulatory model for the upcoming determination.

### **3.2 Price constraints**

*The Tribunal seeks views on whether and at what level it should set price limits, how price limits interact with the form of regulation, and whether it is appropriate to remove price limits on obsolete tariffs.*

As discussed above aspects of the current form of regulation should be retained, however in a form which relaxes the price limits. In summary we believe the appropriate price limits to interact with the proposed form of regulation are:

- The establishment of the requirement to transition to total target revenue rather than individual target levels.

- Pass through of network charges directly at the individual tariff level.
- The introduction of a constraint on the retail component at the individual tariff level which allows a smoothed transition to cost reflectivity in 2010.
- The removal of individual customer side constraints.

These are discussed further below.

### 3.2.1 Limiting increases to customers' bills

*The Tribunal seeks comment on:*

- ▶ *Whether it should impose limits on increases to customers' bills.*
- ▶ *Whether there are alternative approaches that the Tribunal should consider.*
- ▶ *Experiences with the customer bill price limit in the current determination.*
- ▶ *Whether different limits should be applied to different customer classes, and why.*

In the current determination increases to customers' bills should not exceed CPI+5% or \$35, whichever is the greater of the two. This was established in order to protect customers from unacceptable price shocks while still providing retailers with some ability to undertake tariff reform. Country Energy accepts that such measures were necessary and have been largely effective in achieving this.

A key concern with the current approach is, however, the limitations that it places on Country Energy's ability to rationalise the number of tariffs in a cost reflective manner. This has perpetuated a level of complexity in the billing and administration of the retail business that is unnecessary, and also impacts the transparency and simplicity of the competitive market.

The constraint on individual customers' bills has prevented rationalisation. A small number of customers can prevent such rationalisation even though the discrepancy between the allowed increase and the increase to achieve cost-reflective levels are small.

Another key concern is that the existence of multiple layers of constraints, including the limit on movements in individual customer bills. In the context of an N+R regulatory framework, the constraints in individual customer bills at times serves to undermine the our ability to fully recover increases in network charges. Given that the current network determination allows for greater than CPI increases in network charges, many increases to network tariffs have been in excess of the side constraint allowed against customer bills. This has in some instances exacerbated rather than diminished the extent to which tariffs are under-recovering.

This would not occur in an N + R model that imposed constraints solely on the retail component rather than on both the network and retail component combined as is the effect of a side constraint on customer bills. Such a side constraint would seem inconsistent with the stated aims of the revised Terms of Reference that is to ensure network charges are fully recovered.

Looking forward, Country Energy believes that a modified version of the current form of regulation which incorporates a relaxation of limits on price movements would achieve both cost reflective pricing and significant tariff rationalisation. Country Energy's indicative modelling has demonstrated that the average movement in price that customers would see in achieving these twin goals would not be significantly

greater than the constrained amounts currently allowed for the majority of tariff adjustments. This is also an important transitional step towards phasing out all retail price regulation.

Whilst there will be a need to manage the very few customers who are far below cost reflectivity, there is little need for such a protective constraint to be carried forward across the tariff base. In addition Country Energy's Country Support program provides customers with additional options to assist those facing short or long term periods of hardship.

Country Energy believes these arrangements are manageable and could be implemented in a way that would not cause serious customer concerns.

### **Country Support**

Underpinning the argument for the ultimate aim of no regulation of retail prices, or full retail contestability, is a robust program for customers in hardship. *Country Support* is an initiative that focuses on assisting our customers in times of hardship, with long term payment solutions - not just short term fixes. Through the program we provide support during times of drought, unemployment, family changes, in fact, during any circumstances when hardship affects a customer.

Through *Country Support* Country Energy works with customers to tailor solutions to their individual needs. Developing a solution is a mutual process between the customer and Country Energy and is treated with the utmost confidentiality.

Country Energy has assisted more than 7,000 families and businesses experiencing financial hardship through *Country Support*. The establishment of the unique industry assistance program, *Country Support*, has seen a continued downward trend in the number of customers having their power disconnected, with disconnections reduced by 50 per cent. Just 0.47 per cent of Country Energy's 800,000 plus customers were disconnected for non payment in 2006.

*Country Support* offers help in accessing support and concessions, affordable payment plans, automatic payment channels such as Centrelink's Centrepay facility, energy efficiency advice and incentives to reduce repayments.

The underpinning focus of the *Country Support* program has been a commitment to work in partnership with individual customers and the broader community to design flexible and responsive account management solutions.

Country Support is not a 'one size fits all' program - each customer has a solution tailored to their needs. This program has been crucial to Country Energy's success in halving disconnections for non payment. Due to the persistence of the drought we have expanded the program to include Busiplan for small businesses and Farmplan for farming families which tailors payments to rural business income cycles.

Taking the next step in assisting customers to manage their accounts, Country Energy will soon introduce a project that will use internal indicators to identify customers in hardship, allowing the provision of early advice and assistance, even if it is just to identify what payment method may be the best option for them.

The success of Country Support is not only clearly evident in the reduced numbers of disconnections, but also a low level of complaints. Country Energy's approach to managing customers is working.

### 3.2.2 Limiting increases to individual tariffs

*The Tribunal seeks comment on:*

- ▶ *Whether it should impose limits on increases to individual tariffs.*

Under the current determination, Country Energy reports on and considers some 300 individual retail prices. The current determination imposes no specific limits on price movements on individual tariffs however there is a requirement that tariffs below cost reflectivity must move towards target levels and those above must not increase or reduce below target levels. Country Energy's experience has shown that these strict movements towards target levels have impeded the ability to rationalise and restructure tariffs.

Country Energy believes that rather than each individual regulated retail price strictly adhering to a specific target level, that total target revenue be determined based on the existing N+R framework. For each standard retail supplier the total target revenue would be determined by the sum of each individual target level of each price. This approach would allow:

- The ability for total revenue from tariffs to reach cost reflectivity;
- Rationalisation and restructuring without additional limits on tariff movements; and
- Minimal change from the existing form of regulation.

Standard retail suppliers have an incentive to ensure that each regulated retail price within the total regulated revenue is at cost reflective levels due to the inherent forces of competition. Tariffs that are priced significantly above cost reflective levels may be targeted by competitors, leaving the standard retail supplier with the remaining customers on tariffs below cost reflective levels.

Although Country Energy believes the existing requirement to move individual regulated retail prices to target tariffs should be removed and introduced at total regulated retail revenue, a limit on the total movement in each regulated retail price could be imposed.

Country Energy proposes changes in revenue of individual regulated retail prices should be limited in the form of the full pass through of the network component plus an increase for each tariff's retail component. Therefore, for each tariff the increase would be limited to the retail component for that price. This approach is not dissimilar to the current retail determination where the total estimated revenue from the retail component is limited to  $(1+CPI) \times (1+R)$ . Country Energy believes that this constraint is best placed at an individual price level rather than total retail component revenue.

Country Energy suggests that the constraint on regulated retail prices may be imposed as follows:

*A standard retail supplier must ensure that the total estimated revenue from the R component of each regulated retail price for a year commencing on a*

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*price change date does not exceed the total revenue from the R component of the revenue from the R component from that tariff in the year immediately preceding the price change by  $(1+CPI) \times (1+R)$ .*

R would be set at a level which would allow:

- Full cost reflectivity to be achieved by 2010.
  - Tariff restructuring and rationalisation within total target revenue by way of sufficient head room.
- ▶ *Whether there are alternative forms of price limits it should consider.*

Country Energy believes additional price limits will mitigate our ability to reach cost reflectivity. Therefore we do not believe further price limits should be considered other than those outlined above.

- ▶ *Whether different limits should be applied to different tariffs or tranches of tariffs, and why.*

The current determination effectively imposes a control on all regulated retail prices in that the regulated retail revenue is compared to the target revenue for each individual price. Regulated retail prices above target levels must not increase in nominal terms and those that are below must be increased subject to price constraints.

The target price should be set at a level which reflects the underlying costs and be used to determine a price path, but individual regulated retail price changes should be determined by the retailer. The current approach effectively limits the level of rationalisation that can be achieved, due to the inability to change prices that are above target levels.

Country Energy gives preference to a form of regulation which provides scope to address tariff rationalisation and cost reflectivity issues. It should be at a retailer's discretion how increases to regulated retail prices are applied. As discussed above, it is in a retailer's best interest to reduce the number and level of under recovering prices, and to also address issues with over recovering prices.

### **3.3 Assessing the options**

*The Tribunal seeks comment on the most appropriate form of regulation, having regard to the terms of reference.*

The primary purpose of a side constraint should be to minimise price shocks to consumers. However, large increases in costs can be detrimental to both standard retail suppliers and to retailers in the competitive market who may not be able to compete with artificially low regulated retail tariffs. Relaxation in limits on price movements should be considered.

Country Energy believes that the form of regulation and limits in price movements proposed will deliver:

- A phased approach to reaching full cost reflectivity by 2010.
- The ability to restructure and rationalise prices on a more timely, but managed fashion.
- Demonstrate the Tribunal's commitment to eventually phase out retail price regulation.

Country Energy is of the view that significantly moving away from the current form of regulation would be counterproductive. We believe that our proposed form of regulation increases flexibility to allow the provision of cost reflectivity by 2010.

## 4 COSTS TO BE RECOVERED

*The Tribunal seeks views on the appropriate level for each of the relevant costs and on how the Tribunal should directly or indirectly consider that cost in determining regulated tariffs.*

Country Energy has formed a view on the appropriate level for each of the costs mentioned in the issues paper and our view concerning the level, inclusions and exclusions, and volatility follow.

### 4.1 Long run marginal cost of electricity generation

*The Tribunal seeks views on:*

- ▶ *The appropriate level of LRMC to be included in regulated retail tariffs.*

The regulated energy cost is currently based on the Long Run Marginal Cost (LRMC) and is annually indexed by CPI. Country Energy is not in a position to determine if the current long run marginal cost is appropriate, however we must have the ability to pass on increases in electricity purchases to customers. As discussed, increases in revenue are consistently below the increases seen in costs to the retail business.

It is important to note that the electricity purchase costs are the predominant contestable component of a retail price. The remaining costs components are either:

- identical for all retailers, for example network and market charges; or
- closely related, for example gross margin and green energy costs.

Therefore it is important that the LRMC is not set too low, as much of the incentive for customer choice lies within the electricity purchase cost. The appropriate cost recovery for electricity purchases in principle should be based on not only the LRMC but also the wholesale risks involved for a retailer to trade in the competitive market. These risks include but are not limited to, regulatory risk, forecast risk, volume risk, credit risk and operational risk.

Additionally, investors in generation capacity need to be assured that Retail prices are cost reflective to give certainty to future upstream investments.

Country Energy will provide further comments once the Tribunal's consultants report is available.

- ▶ *How and whether the Tribunal should recognise projected future changes in net system load profiles and what these profiles are likely to look like in 2010.*

Country Energy believes that our Net System Load Profile (NSLP) is likely to change during the course of the next regulatory period. This change is likely to be driven by the following factors:

- Further changes in weather patterns which have shown to be unpredictable at times.
- Increased penetration of air conditioners, as the cost of such appliances further reduces making the installation a more affordable option for many consumers.

- As more interval metering is installed this potentially changes the shape of the NSLP considerably. We believe that this would increase our risk and drive up cost.

It is important that, if such a change happens, we are able to claim full pass through as per Section 4.10 to ensure cost reflectivity.

## **4.2 Hedging, risk management and transaction costs**

*The Tribunal seeks comments on:*

- ▶ *The appropriate level of hedging, risk management and transaction costs for inclusion in regulated retail tariffs.*

Country Energy is of the view there will be increased load and price volatility to which they will be exposed during and after the roll off of the ETEF.

It is possible to evaluate the risk premium required by the standard retailers to compensate for the additional risk that they face and Country Energy looks forward to the report from the Tribunal's consultant in this area.

- ▶ *Whether the concepts of LRMC and hedging are compatible and how any relationships should be considered.*

Country Energy is of the view that LRMC is not an appropriate measure to be included in the determination of the cost of electricity as the retailers face a market that is essentially reacting to short term changes and is based on the short term marginal cost. This is especially relevant given the stated aim to phase out retail price regulation.

- ▶ *Whether the Tribunal should consider hedging costs against the pool price or only allow costs for hedging above the LRMC estimate.*

LRMC has little bearing on the market other than to give a view of whether or not new generation is viable. We believe that the only meaningful measure in predicting the cost of electricity is to relate it to the hedging costs against the pool price, not the LRMC.

- ▶ *Retailers' experience in hedging load for customers less than 160MWh per annum in NSW and hedging in other relevant markets*

Country Energy has experience in hedging load for customers less than 160MWh per annum in several jurisdictions. We are willing to share our experience in NSW and other jurisdictions on a confidential basis. We believe that it is important that the determination ensures the recognition of the forecasting risk inherent with customers less than 160MWh per annum.

- ▶ *What impact the phasing out of the ETEF is likely to have on hedging and risk management costs over the determination period.*

Country Energy is of the view there will be increased load and price volatility to which we will be exposed to during and after the phasing out of the ETEF. With the additional load to be hedged during the phasing out of ETEF, we expect the cost of

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electricity including hedging, risk management and transaction cost to rise, for the following reasons:

- Generators traditionally do not hedge to their full capacity. Increasing demand in NSW without the introduction of additional capacity will work to reduce liquidity in the wholesale contract market.
- The removal of the ETEF will increase the demand by retailers for hedging products. We believe the availability of hedging will shrink and prices will increase.
- The use of market hedging products by standard retailers as opposed to the ETEF will lead to an increased exposure for the retailers to load and price volatility. Retailers must be compensated for the increased load and price volatility to which they will be exposed post the ETEF.

### **4.3 Mass market new entrant retail operating costs**

*The Tribunal seeks comments on:*

- ▶ *The appropriate level of mass market new entrant retail operating costs for inclusion in regulated retail tariffs.*

Country Energy believes the appropriate level of mass market new entrant retail operating costs to be included in regulated retail tariffs should include as a minimum the key components of regulated retail operating costs. These would essentially not differ from that of an established new entrant retailer. In addition appropriate operating costs for a new entrant retailer should also include as a minimum acquisition, marketing and customer transfer costs.

The key components of regulated retail operating costs are:

- Costs associated with operating call centres and customer centres, including customer care systems;
- Billing, revenue collection and credit control systems;
- Provision for bad debt and debt management;
- Marketing and advertising, including regional sponsorships;
- Information systems;
- Regulatory compliance;
- Finance and Energy Trading costs;
- Corporate costs and overheads, including administration, legal services and human resources; and
- Complaint management.

The costs facing a new entrant will differ depending on the new entrant's experience in the energy industry and the maturity of its systems to add significant business for

marginal, rather than fully absorbed cost. If the new entrant was a significant energy player in another State of Australia with similar products to offer, their cost of entry into the NSW mass market would be lower when compared to someone new to the energy industry.

Considering the above, Country Energy believes that the definition of the mass market new entrant is the key to the expected level of retail operating costs that will be incurred entering the NSW market. Country Energy believes there are already companies of the scale that could, if competitive, absorb a significant part of the NSW energy market. It is this size and shape of company that should be used to gauge the appropriate level of regulated retail operating cost.

The costs predicted to be incurred would be marginal insofar as the entrant would not need to build new IT systems, but their existing systems would need to be changed to account for any differing requirements in the NSW jurisdiction.

However the cost of acquiring customers will essentially not differ between new entrant retailers of similar scales. Country Energy, based on its experiences as a national retailer operating in a number of jurisdictions, has identified the following costs as those essential to be identified as incremental operating costs of a new entrant retailer actively participating in the deregulated energy market:

#### ■ Acquisition

The cost of acquisition involves the process involved in communicating and inviting the customer to join Country Energy. Acquisition costs typically include advertising and marketing, proactive call-centre communications, direct mail and the employment of third party door to door companies.

#### ■ Enrolment

Enrolment costs relate to “processing” an acquired customer through market and internal systems enabling the commencement of billing on an ongoing basis. These costs generally occur very early in the customer life cycle, and include the establishment of the customer in retail marketing systems, the transfer of the customer through NEMMCO’s Market Settlements and Transfer System (MSATS) and the establishment of the customer in the customer billing and information system.

#### ■ Serve

The cost to serve a customer who has signed a negotiated contract revolve around the cost of the processes and collateral involved in serving customers, to a base level of expectation on an ongoing basis.

#### ■ Retain

The cost to retain customers is also an important part of new entrant retail operating costs. Once a customer has been acquired on a fixed contract, the expiration of this contract eventuates at some point of the customer life cycle. There are further costs associated with the retention of customers once acquired and can not be ignored when assessing the operating costs of a new entrant retailer.

## ■ Lose

The cost to lose a customer is an important part of new entrant retail operating costs. These costs cover the processes involved in processing customers which have chosen to sign a contract with a different retailer. These costs would incorporate costs associated with the transfer of customers through MSATS and the decommissioning of the customer in the customer billing and information system.

- ▶ *The experience of mass market new entrant retailers, both in NSW and other relevant markets.*

Country Energy has extensive experience in all jurisdictions where Full Retail Competition has been introduced and will provide this detail in a separate submission to the Tribunal due to the commercially sensitive nature of the information.

### **4.4 Mass market new entrant retail margin**

*The Tribunal seeks views on the appropriate mass market new entrant retail margin to be included in regulated retail tariffs.*

NSW retailers, under the current determination, are allowed the lowest net retail margin of regulated tariffs in Australia. At 2 percent, the net margin is unlikely to encourage a new entrant in gaining a foothold in the NSW market when risk and the need for a viable return on capital are considered.

We are modelling various levels of retail operating margin to recommend the level that a bona fide long term new entrant would require, and look forward to the report of the Tribunal's consultant on this matter.

### **4.5 Network charges**

*The Tribunal seeks views on how best to ensure that network charges are fully recovered by retailers.*

In the past there has been a disconnect between the allowable network increases passed through to the retail business and the increases that the retail business are able to pass through to the customer. This disconnect means that retail has not always been able to fully pass through network price changes.

The effect of the inability to pass through network charges, which at times are CPI plus increases, negatively impacts the gross margin. If this trend continues, coupled with the current side constraints, the retail component will be eroded due to the inability to pass through this uncontrollable cost. This also increases the gap between target and actual prices.

Although the target tariff effectively allows direct pass through of these costs, larger increases in the network component rarely translates to an equivalent increase in the regulated retail tariff. Ultimately, this has an impact on customer choice, as the incentive for a customer to enter the competitive market gradually diminishes as the retail margin is squeezed.

Over time this situation would be exacerbated further if greater than CPI increases are consistently seen in network prices. This is due to the ability of retailers to pass through network increases in the competitive market

Network price increases last year have absorbed by far the bulk of the price increase allowed due to side constraints, leaving only a 1.8 percent increase in the total retail component revenue which is well below the levels allowed in the determination. The limited ability to pass through network increases has resulted from the multiple levels of price control which has inhibited at times the attainment of cost reflectivity for Country Energy's regulated retail tariffs.

#### **4.6 Cost of compliance with green energy obligations**

*The Tribunal seeks comment from stakeholders on the appropriate allowance for such costs and how they might change during the course of the determination.*

Retail licence holders that operate in NSW are required to comply with two key environmental requirements. These include the NSW Governments Greenhouse Gas Abatement Scheme and Federal Governments Mandatory Renewable Energy Target.

In response to these environmental obligations, Country Energy has developed Board approved compliance policies that reinforce our commitment to address greenhouse issues and has recommendations that every endeavour will be made to meet the target imposed by each scheme. Green energy obligations pose a significant financial and administrative cost on Country Energy and our efforts are constrained by the availability and cost of energy sources. These environmental obligations are elaborated on further below.

##### **Compliance with Greenhouse schemes**

The NSW Greenhouse Gas Abatement Scheme commenced on 1 January 2003. The Scheme currently has targets in place until 2012. The benchmark for 2003 was set at 8.65 tonnes of carbon dioxide equivalent (CO<sub>2</sub>-e) per capita. Annual targets follow a linear path to achieve the benchmark of 7.27 CO<sub>2</sub>-e per capita in 2007. The target will be maintained at that level until 2012.

A penalty is imposed on retailers, based on the excess of their greenhouse gas emissions above their greenhouse gas target for each year. In 2007 this penalty is forecast to be \$17 and ramping up towards \$19.50 in 2010 at post tax penalty rates.

The Federal Governments Mandatory Renewable Energy Target places a legal liability on wholesale purchasers of electricity to proportionately contribute towards the generation of an additional 9,500 GWh of renewable energy by 2010.

Where a liable entity does not have enough certificates to surrender, the participant will have to pay a Renewable Energy Shortfall Charge. This charge is calculated by multiplying the liable entity's Renewable Energy Certificates (RECs) shortfall for the year, by the rate of charge specified under the Renewable Charge Act. During the determination period this penalty will be \$57 per Renewable Energy Certificate shortfall and is not indexed.

There is a tremendous amount of uncertainty in the market for participants in trying to comply with these scheme requirements. These uncertainties relate to:

- Complex Interaction with state based schemes
- Extensions, reviews of existing scheme structures and the introduction of new schemes
- Rule changes affecting compliance
- Ascertaining which projects will be available to meet future supply
- Ascertaining how an emissions trading scheme will interact with existing schemes; and
- The sensitivity of the Compliance Formulas
- The lack of a robust market around the trading of renewable instruments

The uncertainty associated with compliance means that Retailers will need to recover post tax penalty rates in order to ensure effective passthrough of green costs. Critical to the potential effectiveness and efficiency of any and all climate change policy options is cost reflectivity in the energy market.

End-users must receive the carbon signal created by a policy option to the fullest extent possible (in order that demand side management and fuel substitution can take effect). In an ideal market there would be no retail price regulation and therefore market forces would make the most of a carbon signal eliminating any concerns about appropriate pass through.

#### **4.7 Retailer NEM fees**

*The Tribunal seeks comment from stakeholders on the appropriate allowance for retailer NEM fees, and on whether these fees are expected to change significantly from their current levels.*

Country Energy does not foresee any significant changes in the operation of the National Electricity Market (NEM) that would require a change in the existing allowance for retailer NEM fees. Country Energy would expect that existing fees could be indexed in line with inflation.

#### **4.8 Energy losses**

*The Tribunal seeks comment on the appropriate allowances to account for energy losses in supplying electricity.*

To ensure tariffs reach cost reflective levels, it is important that any allowance for losses is reflective of actual losses. The target retail component should initially be set reflective of underlying costs, however if at the time of price change an increase in losses occurs, retailers should have the ability to recover these unforeseen increases not only in losses but also other key components of the retail tariff.

In addition, losses do not only form an important part of the retail component in terms of electricity purchases but are also important components of market fees and green compliance costs. The target retail tariff is applied to consumption excluding losses,

therefore an allowance for green energy obligations and market fees should also include:

- an allowance for distribution losses on market fees. These charges are imposed on retailers at the transmission node, therefore any allowance for market fees should also include distribution losses; and
- Mandatory schemes such as the Commonwealth Mandatory Renewable Energy Target and the NSW greenhouse gas abatement scheme define a certain level of compliance in relation to retail suppliers' total purchases. Therefore an allowance for the product of distribution losses and transmission losses should be included in addition to green compliance costs.

#### **4.9 Optional Green Power component to all new (or moving) residential tariffs**

*The Tribunal seeks comment on the most appropriate way to account for the requirement of energy retailers to offer a 10 per cent Green Power component to all new (or moving) residential tariffs.*

The current determination does not regulate green power and Country Energy believes that this principle should remain. It is, however, important for the new determination to recognise that the recovery of costs associated with the implementation and ongoing running of the proposal should be allowed.

Country Energy believes the implementation of the proposal, will increase costs related to the requirement that customers must opt out of green power, rather than the current opt in arrangements.

#### **4.10 Mechanism to capture costs of new schemes**

*The Tribunal seeks views on:*

- ▶ *The appropriate form of the mechanism that should be included.*

Country Energy is of the view that a mechanism should be available, not only to capture the costs of new schemes, but also to enable retailers to recoup or repay major movements in the cost base of the regulated price calculation. In a competitive market these changes would be passed through to consumers in a timely manner thus providing the right demand signals.

As the retailers are no longer protected by the ETEF from price shocks in the supply cost of electricity, an unseen major movement in the cost of electricity will need to be recouped at a rate higher than the LRMC to mitigate the impact during a current year, rather than in preparation for the next year. If not consumers would be protected from the price impact for a time which could easily lead to decisions by consumers contrary to the intentions of the Government.

It is expected that this mechanism would form part of the annual reviews of the Determination, but if material, would allow for recouping of significant matters during the year in question.

► *Whether ‘material’ should be defined in terms of a particular threshold.*

Country Energy believes that to avoid complexity and unreasonable effort both on the part of the retailers and the Tribunal that “material” should be defined. This mechanism should only be invoked under extenuating circumstance, not as a normal part of the review process.

Country Energy is of the view that whilst the mechanism should focus on the impact of new schemes, the probability of significant change to assumptions concerning the cost of electricity (green or black) is high when considering the roll off of the ETEF and other aspects of the electricity market. Country Energy supports the ability to pass through these increases or incorporate them into the calculation of the annual increases that flow from the determination.

## 5 MISCELLANEOUS CHARGES

### 5.1 Security deposits

*The Tribunal invites views on the appropriate level for security deposits, and on the circumstances in which a security deposit may be collected and refunded.*

Country Energy believes that the current arrangements for the collection and refunding of security deposits in New South Wales are appropriate. These should be carried forward into the new determination period unchanged.

### 5.2 Late payment fees

*The Tribunal invites views on the appropriate level for the late payment fee and information on the costs incurred by retailers where a customer does not pay a bill by the due date.*

Although Country Energy does not currently charge the late payment fees, from a cost reflectivity perspective current allowances for charging late fees for late electricity accounts are in Country Energy's opinion too rigid and should be amended to reflect the more flexible arrangements allowed for in the Victorian and South Australian markets.

Under these arrangements, retailers can charge fair and reasonable amounts in relation to costs incurred as a result of late payments. This is an area that enables retailers to vary the price/service offering that they present to customers and should therefore be an element of any truly competitive retail market. In areas where competition is deficient in constraining the price charged for late payment, the regulator still has the ability to deem any charge unfair and not a reasonable reflection of the costs incurred. Thus Country Energy sees no reason why an approach of this type could not be applied in New South Wales.

### 5.3 Dishonoured bank cheque fees

*The Tribunal invites views on the level of the dishonoured bank cheque fee.*

Country Energy supports the approach that exists currently for a dishonoured cheque fee, i.e. a retailer can charge two times the regular GST-exclusive fee charged by the bank or other financial institution to which the cheque is presented. However, given that the use of cheques for payment are in relative decline while payment via direct debit has increased significantly, Country Energy feels that it is only appropriate that similar charges are allowed to be levied for direct debit dishonours.

The charging for dishonoured payments to customers is allowable in Victoria and South Australia, at the rate incurred by the retailer. We feel that there are additional charges incurred upon dishonoured payments, including the cancelling and re-establishment of direct debit plans, customer contact and mail outs. These should also be reflected in the allowed rate. As such, we would argue that a similar approach to that argued for above in relation to late payments is provided for in the forthcoming determination, that is, retailers are allowed to levy the fee at a fair and reasonable amount in relation to the costs incurred.

Country Energy understands that the current miscellaneous charges which standard retail suppliers can charge regulated customers is restricted by the definitions of these charges within the Electricity Supply Act. However, consideration needs to be given to commencing the process of amending the current definitions within the Electricity Supply Act to expand the definition of cheque dishonour fees to simply dishonour fees. In addition other fees related to payment options, such as the ability to pass through credit card surcharges should also be considered.