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Submission to the Independent Pricing and Regulatory Tribunal – Review of Regulated Retail Tariffs

Prepared for: Independent Pricing and Regulatory Tribunal

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Table of Contents

EXECUTIVE SUMMARY	3
INTRODUCTION	5
FORM OF REGULATION.....	6
<i>Key Issues</i>	6
New connections	9
Alternative options.....	9
Other comments.....	11
<i>Conclusion</i>	12
LEVEL OF COST TO BE RECOVERED.....	14
<i>Key Issues</i>	14
Retail Margin	14
Retail Operating Costs	16
Electricity Purchase Costs.....	16
Network Charges	17
Other costs	17
<i>Conclusion</i>	18
STRUCTURE OF REGULATED TARIFFS	19
<i>Key Issues</i>	19
Demand Management.....	20
Inclining Block Tariffs.....	21
Customer choice or basic tariff	21
<i>Conclusion</i>	21
NON-TARIFF CHARGES	22
<i>Key Issues</i>	22
<i>Conclusion</i>	22
APPENDIX 1.....	23

Executive Summary

This paper only addresses the regulated electricity market, as Australian Inland does not retail reticulated gas.

One of the biggest issues faced by Australian Inland is the under-recovery of network standing charges from most of the regulated retail tariffs. This under-recovery is significant as any form of regulation that caps the movement of tariffs towards cost reflective levels, severely undermines the financial health of the retail business, and its ability to charge customers cost reflective prices.

Australian Inland is acutely aware of the potential price shock to some customer categories in a sudden move to a fully cost-reflective pass through of charges.

If the form of regulation is targeted at specific customer categories, instead of broad categories, Australian Inland will have a greater flexibility to focus on the most urgent price changes. Australian Inland seeks to directly pass-through costs so that prices are able to be un-bundled and transparent for customers.

It is important to note that not only the form of constraint is important, but also where this constraint is applied. Presently it is applied to the entire bundled tariff. It would be more appropriate to apply constraints only to the un-bundled components.

Australian Inland seeks that regulation should take the form of a cost build up of component charges, including energy, network charges and other charges, and apply constraints to tariff categories.

This will allow retail tariffs to be moved towards a cost-reflective level, whilst at the same time specifically addressing categories of tariffs, and therefore customers, in regard to price-shocks and constraints. Constraints that are targeted to specific categories allow different price movements for these categories without impacting all customers.

Australian Inland's total target regulated retail revenue for 2003-04 is \$24.6m. However, actual recovery is projected to be \$21.6m. Australian Inland seeks that the Tribunal introduces realistic constraints that will allow AI to recoup the current under-recovery as well as future revenue needs within the determined timeframe.

The form of regulation needs to take into account:

- any changes in the cost of supply eg network charges, wholesale energy purchases, and any other charges such as renewable energy levies;
- the potential to consolidate and simplify existing tariffs; and,
- the introduction of new tariffs immediately at cost-reflective levels.

The following is Australian Inland's preferred form of regulation that would address our immediate issues, provide some protection against price shocks and move tariffs towards cost-reflective levels.

1. The Tribunal set a target level - this is the "cost build up" mentioned earlier;
2. Determine the timeframe for tariff increases, per customer category, eg, a three year period may be appropriate for some customers or a greater timeframe for others.
3. Introduce constraints of equal annual increases during the timeframe in order to meet target levels.
4. Direct key changes at specific customer tariffs or categories, and not across broad categories such as urban or rural, or domestic or business. Australian Inland would liaise closely with the Tribunal to determine the categories appropriate to our needs.

This is the most appropriate form of regulation for Australian Inland because it continues to set a defined target using the N+R methodology. Any tariffs that are already either over-recovering or on target will only be affected by CPI and increases in the network tariff. It also ensures that tariffs that are currently non cost-reflective have a clear path towards cost reflectivity. In addition, price shocks to customers are managed by effectively breaking the end target into stepped increases over the required timeframe which is appropriate for the size of the under-recovery.

Australian Inland suggests the "cost to serve" price set by the Tribunal previously may be out of date and require urgent review.

Australian Inland is also firm in the belief that the costs of doing business in rural NSW are no less expensive than elsewhere in the country.

A significant portion of the cost of supply is outside of Australian Inland's (retail) control. The full cost of supply must be passed through to the customer.

Australian Inland believes that for any form of demand management to occur, our existing tariff structure needs to be addressed.

If tariffs, such as inclining block tariffs, are introduced through any new network charges, they should be able to be applied appropriately through the retail tariff.

Australian Inland supports the creation of a small administration fee to be applied when a non-retail, non-tariff charge is passed through to the customer.

Introduction

Australian Inland Energy Water Infrastructure was created by the merger of Australian Inland Energy and the Broken Hill Water Board on 15 December 2000. The organisation is generally referred to as Australian Inland and this is the trading name for the new entity.

Australian Inland is the incumbent electricity retailer for Far Western New South Wales. The distribution area covers the area from the Queensland to Victorian borders, South Australian border in the west to White Cliffs, Wilcannia, Balranald and Moulamein in the east, with individual properties in both Queensland and South Australia.

Broken Hill is by far the largest centre of population with approximately 21,000 people. The next two largest towns are Balranald and Wentworth with a population of 1,400 people each. There are nine other centres with populations ranging from 1,000 to 100. There are also numerous rural properties outside of population centres spread throughout the area.

Australian Inland is the retailer for approximately 19,000 regulated customers with very low levels of growth experienced in any given year. This makes Australian Inland the smallest incumbent retailer in NSW, with less than 1% of NSW customers. We are also one of the smallest retailers in the National Electricity Market.

We have a retail presence in Broken Hill, Wentworth and Balranald, with agencies in most population centres in our area. Generally we read meters and bill customers on a monthly basis in the Broken Hill area, with other areas on quarterly billing cycles.

In Broken Hill our retail staff also service water customers, incorporating this service into our overall customer service and retail functions. There are approximately 10,000 water customers in Broken Hill.

Form of Regulation

The Tribunal seeks comment on what form of regulation will best assist the Tribunal in meeting its objectives of moving all regulated tariffs towards cost-reflective levels without exposing customers on under-recovering tariffs to unacceptable price shocks.

Key Issues

Trying to balance the avoidance of price shocks to customers, whilst encouraging a competitive environment is in some cases contradictory. Where existing tariffs are significantly not at a cost-reflective level, or where they are structured inappropriately, it may not be possible to meet both criteria. Where this conflict exists there is a tough decision to make. The strong view of regulators around the world is that the customer's long-term interests are best served by having a strong and competitive market.

The issue is then further complicated by the removal of "safety net" tariffs and the regulated customer base being fully exposed to the competitive market. At what levels of customer does this occur, and over what time frame? If there is an expectation that this is to occur for all customers at the end of the June 2007 determination period, then tariffs need to be cost-reflective by this date.

One of the biggest issues faced by Australian Inland is the under-recovery of network standing charges from most of the regulated retail tariffs. This under-recovery is significant as any form of regulation that caps the movement of tariffs towards cost reflective levels, severely undermines the financial health of the retail business, and its ability to charge customers cost reflective prices.

Australian Inland is acutely aware of the potential price shock to some customer categories in a sudden move to a fully cost-reflective pass through of charges. For some of our customers, such as domestic, an annual increase of around \$75 per customer would be required just to pass through the true cost of network standing charges. For some other customers, such as irrigation customers, the pass through of network standing charges would be around \$1400 a year.

These figures are the extreme ends of the spectrum of the network standing charge issue for Australian Inland. This is an increase on an average annual domestic customer bill of around 6-9%. For the irrigation customer this would be approximately a 20% increase on an existing annual bill. These increases also do not take into account any other increases that may be applied.

Another issue of interest to Australian Inland concerns the focus of regulation, that is, if the focus is too broad. For example, if the form of regulation results in a broad brush variation of increases, it is unlikely to fully address the significant issue we have with network standing charges at the tariff level. Alternatively, if the form of regulation is more targeted, Australian

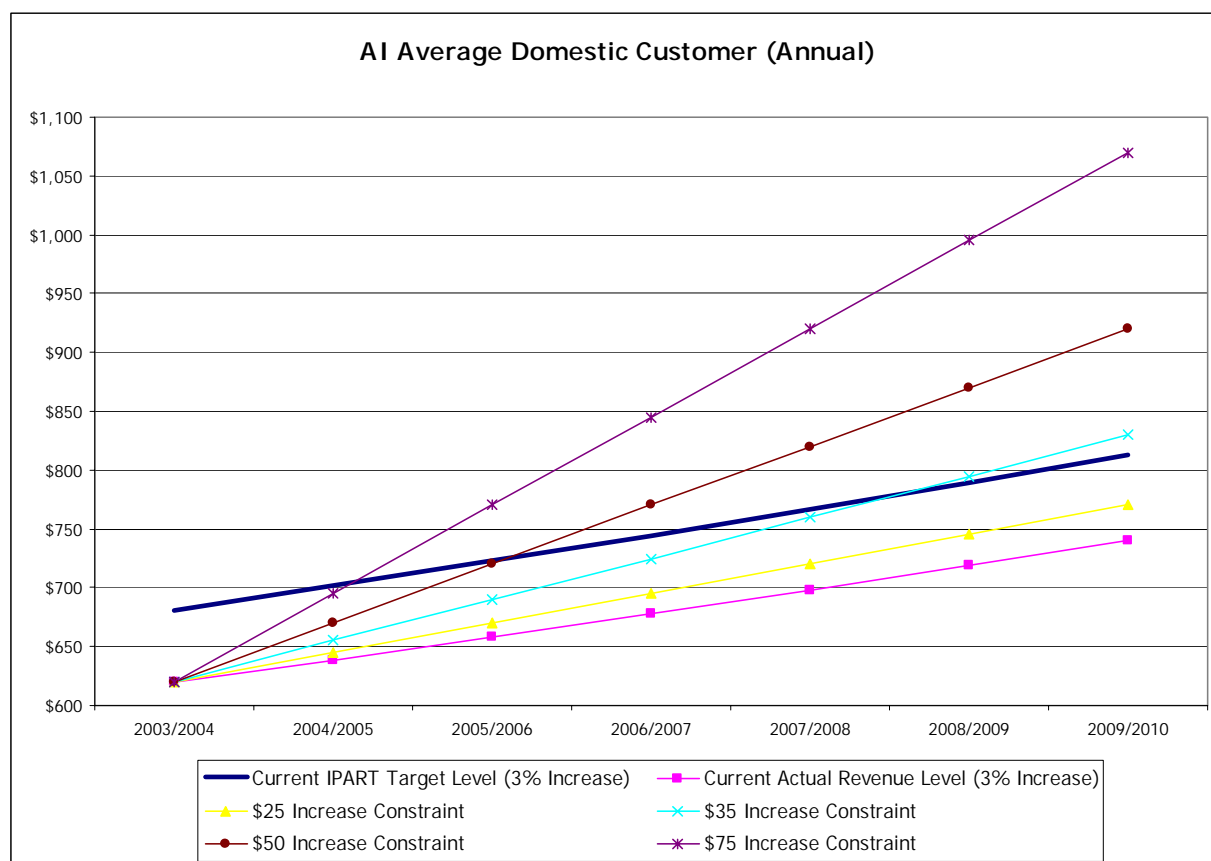
Inland will have a greater flexibility to focus on the most urgent price changes. Australian Inland seeks to directly pass-through costs so that prices are transparent for customers. Hiding the true cost of supply from customers will not benefit customers when they are exposed to the competitive market, either by their own investigations, or when regulation falls away.

Graphs 1, 2 and 3 below show sample price paths for some selected popular tariffs. These graphs demonstrate the levels of possible price increases required to meet target levels and the time frame over which increases may be appropriate.

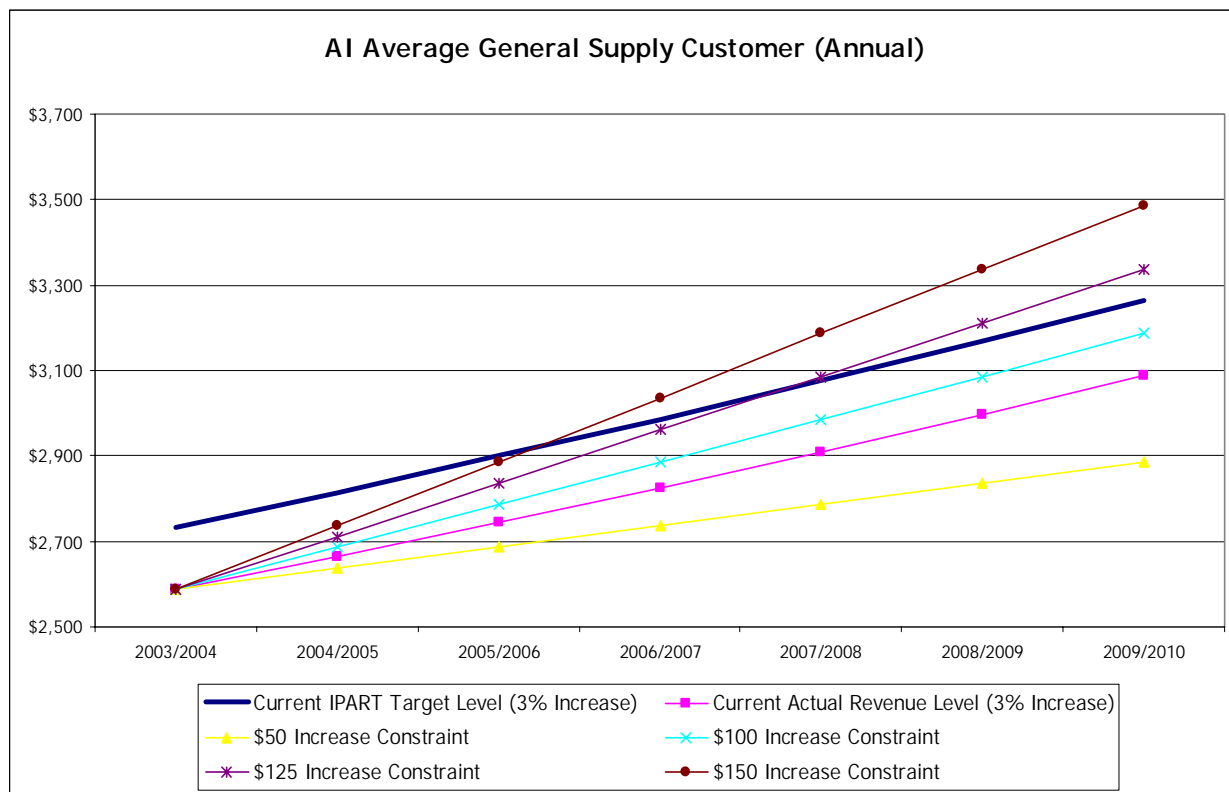
Australian Inland (retail) notes that the cost of supply for customers on regulated tariffs is greater than the overall sales revenue from these customers. As a retail business, we cannot continue to promote tariffs that are significantly non-cost-reflective.

Any broad-brush percentage or CPI based increase across all customers will end up with some customer tariffs over-recovering and others still under-recovering.

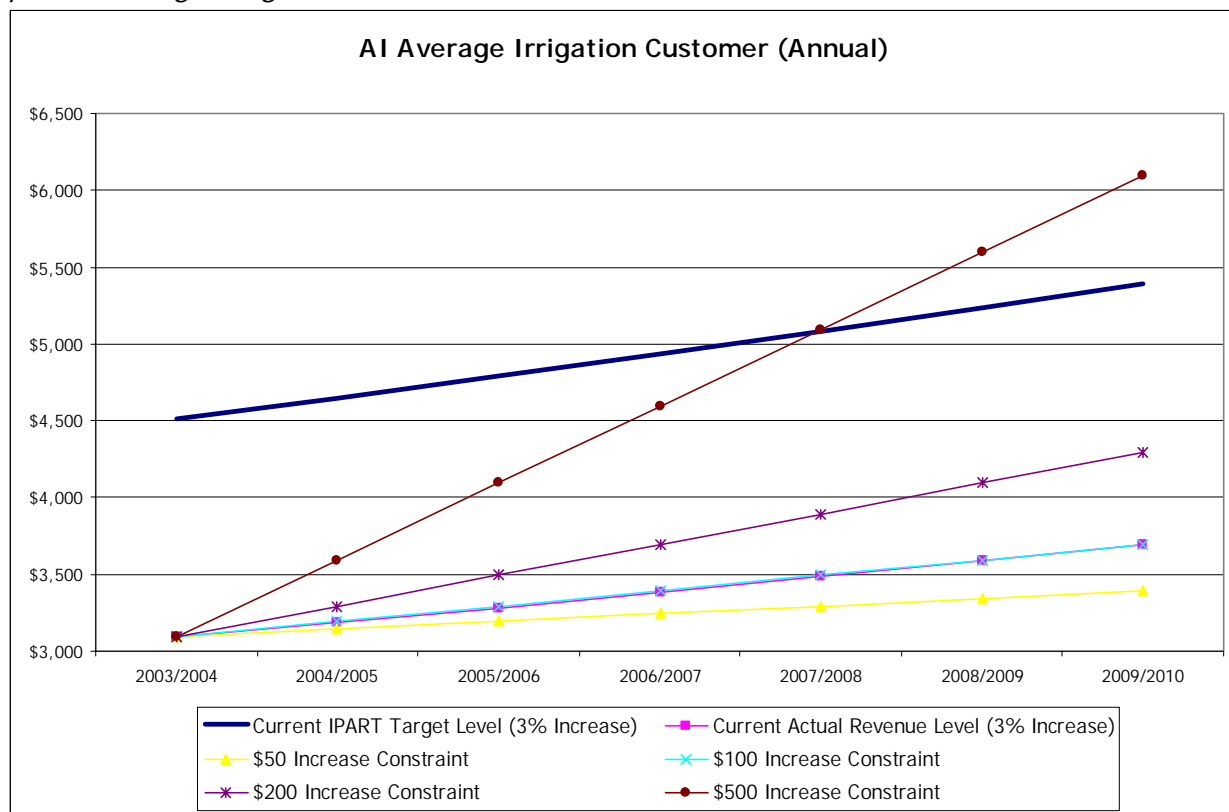
Graph 1: Average Domestic Customer



Graph 2: Average General Supply Customer



Graph 3: Average Irrigation Customer



New connections

There is a low population and very low to negative economic growth in far western NSW. This means that the number of new connections in Australian Inland's distribution area is minimal. If Australian Inland were to put new customers on new cost-reflective tariffs, the key issues would still not be addressed, as existing customers would still be charged non-cost-reflective tariffs. Any form of regulation that maintains existing tariffs with constraints, that does not allow retail tariffs to move towards cost-reflective levels, but allows the introduction of cost-reflective tariffs for new connections, has little real benefit to Australian Inland.

We would also have a concern about creating new tariffs for a small number of customers, when at the same time we are also trying to consolidate and simplify the existing tariff list.

Alternative options

The Tribunal offers some suggested options for alternative forms of regulation. We offer the following brief comments on these suggested alternatives, with specific focus around Australian Inland's particular concerns. Our analysis of advantages and disadvantages is not an exhaustive list.

1. Removing price constraints and relying on restrictions in the movement of average prices of given tariff categories relative to a target level.

Advantages

- ❑ Setting a target level gives clear path to cost reflective levels for both specific tariffs and tariff categories.
- ❑ Addressing tariff categories allows specific concerns within each category to be addressed. (Especially for AI where the network standing charges in different categories need to be addressed.)
- ❑ Different price movements can be allowed for different tariffs categories, especially non-residential tariffs, where the types of customers vary.
- ❑ This allows a more targeted approach to controlling price-increases to customers.

Disadvantages

- ❑ If tariff categories are not appropriate or too broad, that is they do not contain customers who are of a similar type, then restrictions may not be appropriate across all tariff category members. (For example, a category of business does not reflect the wide array of different customer types.)
- ❑ This methodology does create a fairly high degree of complexity in maintaining customer categories.
- ❑ If constraints are too tight, irrespective of the tariff category, then this may not allow sufficient movement towards cost-reflective levels in some cases.

2. Removing constraints on the average price of tariff categories and relying purely on per customer price constraints.

Advantages

- ❑ This method creates clear constraints for each customer.
- ❑ Simple to administer.

Disadvantages

- ❑ This does not allow for specific issues around different customers and categories to be addressed.
- ❑ This option does not allow different customer categories to increase at different rates, but imposes the same increase across all customers.
- ❑ If imposed statewide, it does not provide for possible differences between retailers.
- ❑ Assumes all customers are under-recovering at the same level.

3. Replacing all existing constraints with a single CPI-X constraint to apply to all tariff categories.

Advantages

- ❑ At a broad level it allows for possible cost differences between retailers (assuming X is different for each retailer).
- ❑ Easy to administer.

Disadvantages

- ❑ Does not allow for specific issues around different customers and categories.
- ❑ Because it is broadly imposed it does not focus on specific cases of under-recovering tariffs.
- ❑ This option may not move some under-recovering categories to target levels in sufficient time. For example some existing AI tariffs would require between 20-30 years to meet existing target levels if constraints were at 3-5%.

The UK used this approach and set X at different levels for each of its equivalent incumbent retailers. It must be noted that X was negative in the UK, as the intent was to create a ceiling as prices lowered, as opposed to NSW, where the intent of X would be to constrain price increases.

4. Altering the volume bands within which price limits or constraints are tested.

Advantages

- ❑ Allows customer consumption levels to be taken into account. Larger consumption customers would be tested and constrained differently to lower consumption customers.

Disadvantages

- ❑ Volume level constraint testing does not take into account fixed charge issues that are irrespective of customer consumption levels, and should be applied irrespective of usage.

5. *Setting a single price constraint that applies on average to all categories (rather than having specific constraints for specific categories of tariffs).*

Advantages

- ❑ Simple to administer.
- ❑ Sets a clear constraint that is easily applied to price increases.

Disadvantages

- ❑ Does not address specific issues of inappropriate or under-recovering tariffs.
- ❑ Some categories may never reach cost-reflective targets within acceptable time frame.
- ❑ Does not address significant under-recovering categories.
- ❑ Advantages larger tariff (and consumption) customers who have too small a constraint applied. Alternatively may disadvantage smaller tariff customer who may have too large a constraint applied, and thus create a price-shock.

This approach is not that dissimilar to a CPI-X option where a constraint is applied broadly across all tariff categories for that retailer.

6. *Establishing a direct pass-through of actual costs, such as wholesale electricity and gas costs, rather than using forecast costs – subject to the application of price constraints.*

Advantages

- ❑ Allows for the clear pass-through of component costs - energy, network and other costs.
- ❑ Any pass-through cost adjustments can be transparently incorporated into tariff changes.
- ❑ Exposes customers to true cost of supply.
- ❑ Retailer costs and retail margin are transparent.

Disadvantages

- ❑ Inappropriate price constraints may still restrict the movement of tariffs, keeping them below cost-reflective levels.
- ❑ This option would need complex maintenance of cost components across tariffs.

Depending on how price constraints are applied, there would probably be large price-shocks to some customer tariffs. This has been seen in SA where the removal of more formal regulated tariffs, and a move to more cost-reflective pricing, saw significant price increases to some customer classes. Experience in Victoria and SA has seen a move to a "cost-reflective" cost build up to create a standing contract price for customers. These levels of standing offers have had to be "justified" by the relevant retailers or regulators.

Other comments

It is difficult in most cases to make comparisons between NSW and other jurisdictions in relation to the form of regulation. Other jurisdictions, such as SA and Victoria, have based most of their discussion around the creation of a standing offer that is set at a justifiable level of cost recovery. SAIIR¹ states the approach in SA in seeking justifiable proposals from retailers *"provides a clear challenge to retailers to demonstrate their good will and to avoid the need for price controls by proposing fair and competitive prices."* This varies to NSW

¹ SAIIR Reviewing and Approving Electricity Retail Prices in a Competitive Market – Initial Thoughts. April 2002 (SA)

where the discussion still focuses on putting in place price movement constraints. In its follow up determination² SAIIR also found it difficult to compare NSW to SA as the position of NSW government owned and regulated businesses differed to privately owned businesses in SA and Victoria.

The UK market is seen to be a competitive environment for customers and competition generally offers the needed protection to customers. Ofgem's approach to regulation must be seen in context of a market where prices are generally going down, and regulation seen as a means of ensuring competition. Price capping was seen in the UK environment as a mechanism that could prevent or distort competition, and rejected this form of regulation of pricing by opting to move to regulation under competition law. NSW is, arguably, still some way off being a truly competitive environment.

It is important to note that not only the form of constraint is important, but also where this constraint is applied. Presently it is applied to the entire bundled tariff. It would be more appropriate to apply constraints only to the un-bundled components. With this methodology any retail constraint could be applied to the retail component only, and other price components could be addressed separately, such as in the network determination for network charges.

Conclusion

One of the biggest issues faced by Australian Inland is the under-recovery of network charges from most of the regulated retail tariffs. This under-recovery is significant as any form of regulation that caps the movement of tariffs towards cost reflective levels, severely undermines the financial health of the retail business, and its ability to charge customers cost reflective prices.

Australian Inland is acutely aware of the potential price shock to some customer categories in a sudden move to a fully cost-reflective pass through of charges.

If the form of regulation is targeted, Australian Inland will have a greater flexibility to focus on the most urgent price changes. Australian Inland seeks to directly pass-through costs so that prices are transparent for customers.

It is important to note that not only the form of constraint is important, but also where this constraint is applied. Presently it is applied to the entire bundled tariff. It would be more appropriate to apply constraints only to the un-bundled components.

Australian Inland seeks that regulation should take the form of a cost build up of component charges, including energy, network charges and other charges, and apply constraints to tariff categories.

² SAIIR Inquiry into Electricity Standing Contract Prices – Final report and determination. October 2002.

This will allow retail tariffs to be moved towards a cost-reflective level, whilst at the same time specifically addressing categories of tariffs, and therefore customers, in regard to price-shocks and constraints. Constraints that are targeted to specific categories allow different price movements for these categories without impacting all customers.

This approach is a hybrid of options numbered 1 and 6.

Australian Inland's total target regulated retail revenue for 2003-04 is \$24.6m. However, actual recovery is projected to be \$21.6m. Australian Inland seeks that the Tribunal introduces realistic constraints that will allow AI to recoup the current under-recovery as well as future revenue needs within the determined timeframe.

The form of regulation needs to take into account:

- any changes in the cost of supply eg network charges, wholesale energy purchases (ETEF³), and any other charges such as renewable energy levies;
- the potential to consolidate and simplify existing tariffs; and,
- the introduction of new tariffs immediately at cost-reflective levels.

The following is Australian Inland's preferred form of regulation that would address our immediate issues, provide some protection against price shocks and move tariffs towards cost-reflective levels.

1. The Tribunal set a target level - this is the "cost build up" mentioned earlier;
2. Determine the timeframe for tariff increases, per customer category, eg, a three year period may be appropriate for some customers or a greater timeframe for others.
3. Introduce constraints of equal annual increases during the timeframe in order to meet target levels.
4. Direct key changes at specific customer tariffs or categories, and not across broad categories such as urban or rural, or domestic or business. Australian Inland would liaise closely with the Tribunal to determine the categories appropriate to our needs.

This is the most appropriate form of regulation for Australian Inland because it continues to set a defined target using the N+R methodology. Any tariffs that are already either over-recovering or on target will only be affected by CPI and increases in the network tariff. It also ensures that tariffs that are currently non cost-reflective have a clear path towards cost reflectivity. In addition, price shocks to customers are managed by effectively breaking the end target into stepped increases over the required timeframe which is appropriate for the size of the under-recovery. For example, if existing general supply tariffs need to increase by \$230 to be at the true cost-reflective level, then this will mean a 3 step yearly increase of \$77 (excluding CPI and network charge movements). Finally, competition is served by moving under-recovering tariffs to cost-reflective levels.

³ Electricity Tariff Equalisation Fund

Level of Cost to be Recovered

The Tribunal seeks comment on the most appropriate treatment of the various cost components to ensure that retail charges are at, or close to, cost reflective levels for all small retail customers by 2007.

Key Issues

The biggest single concern for Australian Inland in relation to cost recovery is the pass through of network standing charges. The Tribunal makes the statement in the review paper:

"In setting retail prices in the past, the Tribunal has allowed retailers to pass charges directly through to customers on regulated tariffs."

The transparent pass through of charges is not a feature of Australian Inland's regulated tariffs. There is a disparity between the network standing charges applied by the distribution network service provider (DNSP), and the standing charge applied to the customer. This is obvious when comparing the network charge prices to the regulated retail tariff schedules. Appendix 1 highlights the disparities across the different tariffs. Customers are not yet paying the full cost reflective network standing charges.

This is an example of how existing tariffs are not cost-reflective, and do not encourage customers to seek competitive prices. This disparity in what the customer sees on a regulated tariff and what the competitive market could potentially offer is significant for some customer categories. Any move off the "safety net" or existing regulated tariffs to a competitive tariff would also create a large price shock for some of these customer categories.

Australian Inland is adamant that the cost of supply of regulated tariffs should be fully passed through to the customer. Where potential price shocks could occur the form of regulation should smooth this so that tariffs are at cost-reflective levels by the end of the determination period, 2007, or whatever other period is determined appropriate, depending on the size of the price increase. The ability to unbundle costs is essential for a competitive market.

Retail Margin

Ideally, when retailers pass through the direct costs of ETEF purchases and DNSP charges, there should be sufficient revenue from regulated tariffs to cover the retailing costs and other charges, as well as a retail margin.

Discussion around an appropriate retail margin makes the assumption that tariffs are recovering an appropriate amount in the first place for a retail margin to be applicable. Tariffs that are significantly under-recovering effectively have no, or a negative, retail margin.

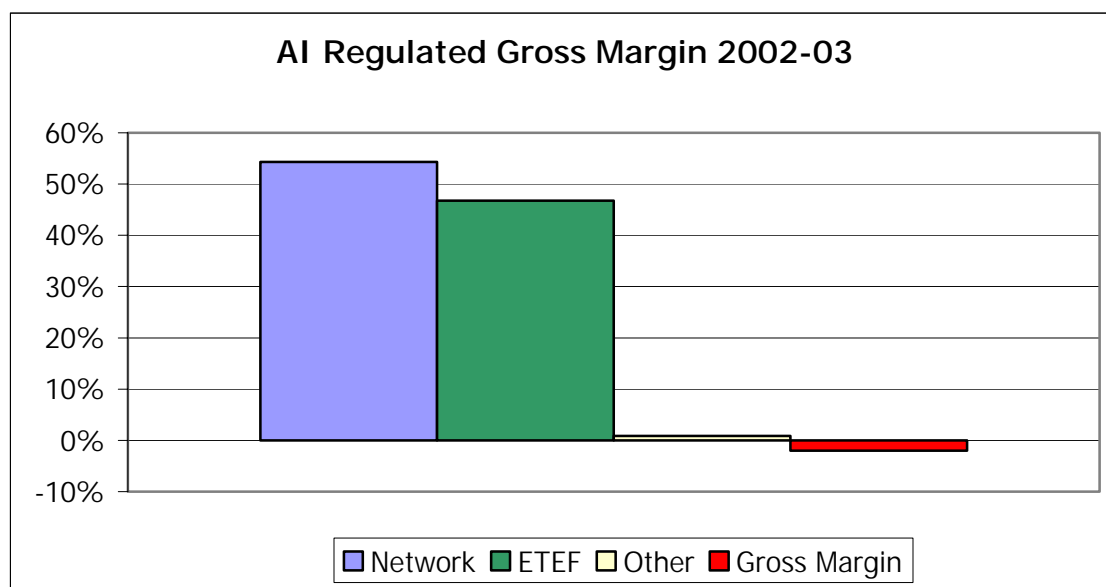
This is the case in some specific tariffs for Australian Inland, where the cost of supply is more than the actual tariff amount recovered from the customer. These under-recovering tariffs make up a significant proportion of overall regulated tariff sales. The graph below, Graph 4, demonstrates the actual gross margin, -2%, for Australian Inland's retail regulated revenue in 2002-03, highlighting the fact that current regulated tariffs are not cost reflective. The gross margin only includes direct cost of supply and does not include retail operating costs that would be included in a net margin calculation.

Much work has been done on an appropriate retail margin, with the current range of 1.5% to 2.5% probably as good as any other figure. SAIIR in their paper⁴ reviewing retail prices state,

"...there is no single 'correct' answer for the appropriate retail margin. Given the variability in the other components of a retail price, there is little point in attempting to determine and justify a more precise number."

Australian Inland is mindful that tariffs must have their cost components re-positioned to reflect appropriate cost structures. This restructuring must take place immediately so that the most appropriate rate of retail margin is achieved. The retail margin should also be transparent and capable of being readily unbundled.

Graph 4: AI Regulated Gross Margin 2002-03



⁴ SAIIR Reviewing and Approving Electricity Retail Prices in a Competitive Market – Initial Thoughts. April 2002 (SA)

Retail Operating Costs

The Tribunal has done extensive work previously on retail operating costs through benchmarking of retailer businesses. The Tribunal's current review and previous reviews have also compared benchmarks of retail operating costs across other jurisdictions.

Different retailers are fundamentally different in some areas and very similar in other areas. They have different incumbent customer bases, across differing geographical locations, population centres and densities. The reality of being a small incumbent business creates its own particular difficulties and costs associated with serving a small number of customers across a large portion of the state.

The setting of target retail operating costs per customer below the actual operating costs of retailers makes the assumption that retailers will be encouraged to reduce their operating costs. This does not, however, take into account possible variances in operational costs that are not necessarily inefficiencies, and are due to differences in operational environments, compliance impositions and cultural and historical factors.

Australian Inland has a limited ability to improve retail business efficiency because of the characteristics of its operating environment. At the same time, new developments in business technology, evolution of competition in NSW and the ever changing regulation and compliance requirements are some of the key issues which continue to impose high costs on the business.

Australian Inland suggests the fixed cost per customer set by the Tribunal previously may be out of date and requires urgent review.

Australian Inland is also firm in its belief that the costs of doing business in rural NSW are no less expensive than elsewhere in the country. The fundamental items that constitute operating costs for an electricity retail operation eg labour, consumables, systems, compliance, are incurred at the same rates as, or even higher than, elsewhere. Arguably, operating costs per customer in far west NSW are more expensive than elsewhere in the country when considering our much smaller customer base over which the costs are spread.

Electricity Purchase Costs

NSW retail businesses have the Electricity Tariff Equalisation Fund (ETEF) to manage their regulated load electricity purchases. The ETEF protects retailers from potential pool exposure during periods of high pool price, for a load they are 'obliged' to supply under regulated tariffs.

The cost of ETEF is effectively the long run marginal cost of generation applied to each retailer, taking into account its regulated load and net system load profile. The cost of ETEF does not necessarily reflect the actual position of the market, and ETEF is certainly higher than the contract market at this point in time.

This inflated cost of regulated energy purchases over the cost of the competitive market is arguably a good thing, as in theory the inflated cost of regulated electricity supply should enhance competition by encouraging customers to look to the competitive market for a cheaper price.

The cost of these energy purchases from ETEF should be directly reflected in the calculation of the cost of supply. These purchases should also be adjusted by the appropriate loss factors, both transmission and distribution, to give a true cost-reflective purchase price.

It is appropriate that the true level of cost of regulated energy purchases, including losses, is recovered from the customer.

Network Charges

This submission from Australian Inland addresses throughout the disparity between the actual published network charges and the charges that are passed onto the customer. The difference between the network standing charges applied by the network and the retail tariff standing charge is significantly different. These differences have stemmed from historical factors, such as the merging of old distribution boundaries with differing tariff schedules, and constraints on price increases across tariffs.

This is our single most concerning issue. As a business we are not passing onto the customer the true cost of supply.

As it is the network charge or network connection that effectively dictates the customer's retail tariff, it is appropriate that the retail tariff truly reflects the underlying network charge. It is appropriate that network charges are recovered from the customer.

Any changes to the structure, or increases, of network charges under the current network review should be taken into account when determining the level of cost pass through, or structure of retail tariffs.

Other costs

The other costs associated with supplying a customer, such as market fees and renewable energy levies, should be passed through.

The market fees charged by NEMMCO are separated into two categories - market fees and ancillary services. Whilst market fees are generally predictable and relatively similar across the market, ancillary services are potentially more volatile. The market for ancillary services to date has been relatively uneventful, but there is arguably the potential for this market to also demonstrate the volatility of the NEM pool price. Any potential variation in the ancillary service charges needs to be able to be captured and applied appropriately to the regulated tariffs.

The application of loss factors is important, especially to more remote parts of the state. Total losses can account for 20-25% of a customer's retail component of their bill in Australian Inland's area. In turn, this accounts for a significant portion of the regulated energy purchases from ETEF. Loss factors also need to be appropriately applied to the make-up of the regulated tariffs.

It is important to capture the increasing cost of liability to both the federal and state-based renewable energy and greenhouse gas schemes. It is also important to note the compliance periods for these schemes, and hence the increase in liability is based on a calendar year, whereas the regulated tariffs are financial year. There must also be a mechanism to capture the potential disparity in costs between these different periods, especially as the cost of liability increases each year.

There should also be an awareness of other potential charges that may need to be applied in the market. One such example is potential costs relating to B2B transactions. Whilst the move to a national B2B framework is still being developed, this potentially may be another cost that needs to be passed onto customers. These charges may be more appropriate as one off non-tariff charges, but it is important to highlight them as another potential pass through charge.

Conclusion

The biggest single concern for Australian Inland in relation to cost recovery is the pass through of network standing charges.

Australian Inland is adamant that the cost of supply of regulated tariffs should be fully passed through to the customer.

Australian Inland suggests the fixed cost per customer set by the Tribunal previously may be out of date and requires urgent review.

Australian Inland is also firm in its belief that the costs of doing business in rural NSW are no less expensive than elsewhere in the country.

A significant portion of the cost of supply is outside of Australian Inland's control. The full cost of supply must be passed through to the customer. Given that Australian Inland is under-recovering revenue, the transition to cost reflective tariffs should occur over an appropriate timeframe to avoid price shocks.

Structure of Regulated Tariffs

The Tribunal seeks comment on issues regarding the structure of regulated retail tariffs, including whether an inclining block structure is a proxy for cost reflectivity and the implications of allowing more complex price structures for the objective of rationalising the number of regulated retail tariffs.

Key Issues

Australian Inland currently has an array of tariffs that generally have block rates at varying volume levels. There is no direct retail fixed cost component on these existing tariffs. Of the tariffs that do have a fixed charge, this is the network fixed charge component. Most of the non-time of use tariffs have a high first block rate that acts in some way as a fixed charge component. There is also a minimum charge on some tariffs. Generally the non-time of use tariffs have a declining block tariff structure. The more that is used, the cheaper it gets, although the step down on some of these blocks is small.

We would agree with the Tribunal's belief that generally the cost to serve customers includes fixed and variable components. The retail cost to serve a customer generally does not increase with an increase in customer consumption, especially with ETEF as the wholesale energy purchase mechanism. The cost to serve a customer is generally the same across customer categories and billing frequencies, although there are always individual exceptions to this within categories, such as customers with high enquiry rates and credit control issues.

In conjunction with any potential change in the form of regulation, there should also be the opportunity to restructure retail tariffs. This should also be the case if there is any restructure in network charges resulting from the current network price review. As a result of the opportunity presented by this retail regulatory review, Australian Inland will seek to ensure that its existing retail tariff structure is completely reviewed.

There are a number of characteristics present which defy the objective of a transparent and simple price structure. These characteristics have resulted over a long period of time from when the tariffs were created, and in more recent years when constraints in price movements have been applied to different tariffs at different times.

Network standing charges are not being applied to the retail tariff appropriately. All Australian Inland network charges have a fixed standing charge. The retail tariffs have a mixture of no fixed standing charge or a standing charge that has no resemblance to the network standing charge. We have a minimum charge on most tariffs. The difference between these standing charges can be quickly identified with even a cursory glance at existing retail tariff and network charge schedule, Appendix 1. Australian Inland would like to introduce a fixed retail charge per customer, to replace the existing minimum charge structure. A fixed retail charge is a transparent mechanism of passing fixed costs to customers.

The appropriateness of inclining block tariffs is difficult to determine without further detailed study. Generally with the introduction of any inclining block tariffs as part of network charges, the retail tariff should also reflect this. As to inclining block tariffs on customers who have a flat network component, this may be one mechanism to encouraging demand management. Again, without further study, we would have to be cautious as to the real effect on customers.

Demand Management

The Council of Australian Governments (COAG) "Parer Report"⁵ recommends mandating the rollout of interval meters to all customers as a means of encouraging demand management. Instead of addressing demand management through inclining block tariffs, this would encourage customers to look to shifting the load from one period of the day to another. The Parer report also views this as a means of enhancing competition to customers by being able to be provided with innovative products that could encourage demand management.

The Parer report goes on to say,

"Price movements reflect the changing balance between supply and demand and enable appropriate responses. For example, inadequate price signals discourage demand side participation, as they dull the information required to adequately respond."

In their recent submission⁶ to the Tribunal regarding the current network determination, EWON offers their experiences with customers in relation to demand management and price signals. Their investigations to customer concerns over high electricity bills often relates to circumstances out of the control of the customers. Often low-income households have people who are at home more often, due to retirement or unemployment, and these factors can contribute to levels of consumption that is not at the discretion of the customer.

EWON also discuss the appropriateness of pricing signals in influencing customer behaviour in demand management. Retailer billing cycles can often mean that customers receive a bill weeks after the high consumption events, and lacks the immediacy necessary for customers to change their consumption habits. This general view was also reflected in the submissions from PIAC and Total Environment Centre.

Demand management is not just about being able to react to a specific event or series of events, but also an overall change in consumption behaviour. Changing this overall behaviour is something that needs to be addressed by increasing customer awareness. It can also be addressed by a simplistic philosophy of "the more you use the more you pay". This may be able to be achieved by price signalling in tariffs, such as inclining block tariffs.

⁵ Towards a Truly National and Efficient Energy Market – December 2002 (COAG)

⁶ Response by the Energy & Water Ombudsman NSW to the Tribunal's 2004 Network Review– October 2003

Inclining Block Tariffs

Australian Inland believes that inclining block tariffs should not just be seen as penalising high consumption users, but also rewarding low consumption users, and the tariff blocks should reflect this. The volumes levels, or steps, of inclining block tariffs are an important factor. If customer bills clearly show the consumption levels in each block step, then this may be of assistance to customers to show them how much energy overall needs to be reduced to create savings and efficiencies.

Customer choice or basic tariff

Australian Inland generally agrees with the Tribunal's current view that regulated tariffs should be a basic tariff, without the special features that could be provided by the competitive market. With this in mind it is still important to recognise that regulated tariffs are targeted to the customer appropriately and the overall structure of the tariff is cost-reflective.

The retail component of a tariff is essentially the same across all customer categories. It is the network charge or connection type that dictates what regulated tariff should be applied to the customer. Any features of a tariff, outside of the basic options such as all day energy or time of use, that could be part of a regulated tariff would need to be judged by the benefit to the customer. If the benefit that the customer gains from the feature is something that the competitive market should be providing, then it should be left to competition to make this offer.

Conclusion

Australian Inland believes that for any form of demand management to occur, our existing tariff structure needs to be addressed.

If tariffs, such as inclining block tariffs, are introduced through any new network charges, they should be able to be applied appropriately through the retail tariff.

Non-Tariff Charges

The Tribunal seeks submissions relating to the regulation of non-tariff charges including where possible the incidence and cost of different types of charges.

Key Issues

There are three retail non-tariff charges. These are the fee for late payment of accounts, the fee charged when a cheque is dishonoured by the bank and the amount charged as a security deposit. As stated in the review paper, the amount actually charged to the customer can be at the discretion of the retailer, so long as it is not higher than the regulated amount. This allows a retailer to address individual customer instances to judge if a non-tariff charge is appropriate.

Australian Inland supports the creation of a small administration fee (handling fee) to be applied when a non-retail, non-tariff charge is passed through to the customer. The retailer has invested in the business processes and systems in order to handle the charging of these fees, irrespective of the frequency of charge events. The retailer should be able to recoup over time fair funds in recognition of its investment in sophisticated billing and customer relationship systems.

Individual charge events also go beyond just billing a customer, but any associated customer enquiries relating to the event. With this in mind Australian Inland is in favour of the introduction of a small event-based administration fee.

Australian Inland does not support the incorporation of this administration fee in the retail tariff. This would most likely create a situation where the retailer ends up paying for the non-tariff charge because the tariff may not be able to be adjusted accordingly to include the fee, given constraints would be in operation. Alternatively if the tariff can be adjusted, then customers across the tariff may be effectively paying for a non-tariff charge they have not incurred (depending on the type of charge).

Conclusion

Australian Inland supports the creation of a small administration fee to be applied when a non-retail, non-tariff charge is passed through to the customer.

APPENDIX 1

Retail Tariff and Network Component Comparison.

Australian Inland

Submission to IPART - Regulated Retail Tariffs Review October 2003

PUBLIC RELEASE - Submission Appendix 1

Retail Tariff to Network Charge Component Comparison and Standing Charge Difference (2003/2004 Tariffs)

Retail Tariff	Definition	R_V Tariff c/kWh	N_V Network c/kWh	$R_V - N_V$ Retail Component	R_F Tariff Standing Charge	N_F Network Standing Charge	$R_F - N_F$ Difference
Northern Region							
Domestic	Step 1	16.79	4.82	11.97	0	3.71	-3.71
	Step 2	11.31	4.82	6.49			
	Step 3	11.21	4.82	6.39			
General Supply	Step 1	23.97	7.17	16.80	4.62	7.22	-2.60
	Step 2	13.33	7.17	6.16			
Rural Domestic	Step 1	17.28	6.49	10.79	0	9.62	-9.62
	Step 2	11.53	6.49	5.04			
	Step 3	17.02	6.49	10.53			
	Step 4	16.15	6.49	9.66			
Rural General Supply	Step 1	25.44	6.49	18.95	4.49	9.62	-5.13
	Step 2	17.02	6.49	10.53			
	Step 3	16.15	6.49	9.66			
Domestic Offpeak 1		4.62	1.08	3.54	0	0.61	-0.61
General Supply Offpeak 1		4.88	1.08	3.80	0	0.61	-0.61
Rural Offpeak 1		4.62	1.08	3.54	0	0.61	-0.61
Domestic Offpeak 2		7.1	2.43	4.67	0	0.61	-0.61
General Supply Offpeak 2		7.16	2.43	4.73	0	0.61	-0.61
Rural Offpeak 2		7.1	2.43	4.67	0	0.61	-0.61
TOU General Supply	Peak	19.43	10.82	8.61	171.92	120.2	51.72
	Shoulder	14.13	6.76	7.37			
	Offpeak	9.36	3.37	5.99			
TOU Demand LV	Peak	7.55	5.41	2.14	151.12	168.27	-17.15
	Shoulder	7.01	4.73	2.28			
	Offpeak	4.58	1.7	2.88			
	Demand All	6.32	9.62	-3.30			
	Demand Peak	12.06	9.62	2.44			
TOU Irrigation	Peak	17.02	10.82	6.20	116.34	120.2	-3.86
	Shoulder	14.35	6.76	7.59			
	Offpeak	6.53	3.37	3.16			
Water Board LV Demand	Energy	7.96	5.41	2.55	0	168.27	-168.27
	Demand	20.7	9.62	11.08			
Institution		14.2	5.28	8.92	4.49	4.8	-0.31
General Supply Irrigation	Step 1	16.4	5.28	11.12	4.62	7.22	-2.60
	Step 2	12.54	5.28	7.26			
	Step 3	10.8	5.28	5.52			
Process Heating		13.46	5.28	8.18	0	16.82	-16.82
Southern Region							
Residential	Step 1	14.63	4.82	9.81	0	3.71	-3.71
	Step 2	11.54	4.82	6.72			
	Step 3	11.27	4.82	6.45			
Rural	Step 1	14.58	6.49	8.09	5.5	9.62	-4.12
	Step 2	11.6	6.49	5.11			
	Step 3	11.34	6.49	4.85			
	Step 4	15.12	6.49	8.63			
	Step 5	12.9	6.49	6.41			
General Supply Block Tariff	Step 1	23.97	7.17	16.80	4.62	7.22	-2.60
	Step 2	13.33	7.17	6.16			
	Step 3	12.9	7.17	5.73			
Residential/Rural Offpeak 1		4.22	1.08	3.14	0	0.61	-0.61
General Supply Offpeak 1		4.88	1.08	3.80	0	0.61	-0.61
TOU GS Offpeak 1		4.34	1.08	3.26	0	0.61	-0.61
Residential/GS TOU Offpeak 2		7.48	2.43	5.05	0	0.61	-0.61
Rural Offpeak 2		7.41	2.43	4.98	0	0.61	-0.61
General Supply Offpeak 2		7.78	2.43	5.35	0	0.61	-0.61
TOU General Supply	Peak	14.39	10.82	3.57	15.35	120.2	-104.85
	Shoulder	14.39	6.76	7.63			
	Offpeak	8.63	3.37	5.26			
TOU Demand LV	Peak	9.22	5.41	3.81	71.96	168.27	-96.31
	Shoulder	8.02	4.73	3.29			
	Offpeak	3.23	1.7	1.53			
	Demand	11.54	9.62	1.92			
General Supply Irrigation TOD	Peak	17.57	10.82	6.75	4.71	120.2	-115.49
	Offpeak	7.98	3.37	4.61			
General Supply Irrigation Block	Step 1	19.81	5.28	14.53	4.49	7.22	-2.73
	Step 2	14.77	5.28	9.49			
	Step 3	14.5	5.28	9.22			
Irrigation Pumping Day Rate	Step 1	23.24	10.82	12.42	4.71	120.2	-115.49
	Step 2	17.43	10.82	6.61			
Water Pumping/Sewer Pumping	Step 1	19.07	10.82	8.25	4.98	120.2	-115.22
	Step 2	15.56	10.82	4.74			