Australian Inland Energy and Water

SUPPLEMENTARY SUBMISSION TO IPART

RE

MID-TERM REVIEW OF REGULATED RETAIL PRICES

OF ELECTRICITY TO 2004

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Australian Inland Energy and Water welcomes the opportunity to make a supplementary submission to the Independent Pricing and Regulatory Tribunal (IPART) regarding the mid-term review of its current determination, *Regulated Retail Prices for Electricity to 2004, December 2000.*

This submission primarily addresses further issues not raised in the initial submission, and provides additional commentary on issues raised at the recent public forum.

Side constraint limitations

There are two constraints applying to price increases for regulated retail electricity prices, namely:

- Whether existing prices are below the relevant Target level as at 30 June each year, (Price change date) in which cases prices can increase by the relevant CPI calculation, and
- that increased prices do not result in the total amount of any bill (including GST) for residential or business customers exceeding the greater of a nominated percentage increase or nominated monetary amount for the same consumption pattern in the immediately preceding year.

  This is currently $25 (including GST) or CPI for residential customers, and $50 or CPI + 5% for business customers.

The above total increases incorporate network charge increases, which are currently capped at CPI *(1.02) or $30 (excluding GST) for residential customers only, and CPI on the total network revenue.

AIEW is facing significant increases in Transmission Use of System (TUOS) charges from 1 July 2002, due to a cessation of a Code derogation on transmission pricing. There is an allowance with the IPART Network Pricing determination to allow for >CPI increases to recover additional TUOS, where the DNSP can demonstrate to the Tribunal that it is unable to recover the increased TUOS charges from their customers.

AIEW will be submitting a proposal to IPART to increase the network charges above CPI, however the effect on both network and retail side-constraint dollar limits is unclear should the application be approved.

The net effect of the above is that under normal circumstances with current AIEW tariffs, the $30 network limit corresponds with a residential customer using approximately 1,000kWh/month, but the overall $22.70 (GST exclusive) increase corresponds to a monthly consumption of about 600kWh.

As a small customer is within the monthly consumption range up to 13,300kWh, the dollar side constraint limit is reached at the lower end of the consumption range, meaning that the percentage increase is regressive, reducing as consumption increases.
For business customers with a higher dollar limit, the same regressive percentage increase applies.

AIEW acknowledges the pressures placed on low income (and therefore assumed low energy consumption) customers, with not only annual increases in energy but food, housing, transport and other essentials, with the primary purpose of side constraints to minimize price shocks to customers.

However, the dollar side constraint is a significant limiting factor in making a satisfactory business return, as higher consumption customers effectively face a negligible increase. For business customers where electricity costs are a legitimate business expense and therefore tax deductible, the real increases are further reduced, particularly at the upper end of the small customer range.

Side constraints also limit the ability to move tariffs to their target level, as required by Section 6 of the Determination. Controlled load tariffs in particular, will never be at the target level, whilst constrained by the annual CPI percentage indexation, and the dollar side-constraint limit in conjunction with the customer's primary tariff. Considering that there are different side constraints applying to residential and business tariff increases, yet a single variable R component applicable to both customer classes for both primary and secondary tariffs causes further distortion in annual percentage increases and future price paths.

Whilst it is not suggested that there should be separate dollar constraints for primary and secondary tariffs, the existing overall dollar limits severely limit the ability of a number of tariffs to move towards target levels by the termination date.

Technically a retailer is in breach of the determination, and therefore its standard NSW retail supplier's licence, if it does not ensure that its regulated tariffs equal the target level by the termination date. However, as explained, this is often not achievable due to the side constraints, and therefore should not result in a breach of licence conditions.

This matter should be clarified in the revised determination

Environmental costs

The cost of environmental compliance, primarily relating to the Commonwealth *Mandatory Renewable Energy Target* (MRET), and NSW Emissions benchmark, were not addressed in the original AIEW submission.

It is interesting to note on p.15 of the IPART Review Report 02-1 *Inquiry into the Role of Demand Management and Other Options in the Provision of Energy Services*,

"…the Tribunal directed the consultant examining the long run marginal cost of generation to assume that each retailer met the targets for greenhouse gas reductions in full, although at the time the retailers looked likely to fall short of the benchmarks without the introduction of a penalty."

From Report S9-4, *Regulated Retail prices for electricity to 2004*, p.35, "…the CGEY analysis assumed that a least-cost approach would be adopted and therefore used gas cogeneration to supply all green purchase requirements in its modeling."

AIEW suggests that the cost of energy purchases since the commencement of the determination is greater than the LRMC of energy adopted by the Tribunal, which have to date excluded the cost of greenhouse emission costs.

AIEW makes every effort to comply with licence conditions, particularly environmental compliance, however green energy purchases have been primarily from hydro and wind generation resources, the latter being at a higher cost than gas cogeneration.

During the last week the NSW Premier allegedly gave the go-ahead for the enforcement of greenhouse benchmarks on electricity retailers, following on from the benchmark discussion paper published by the Ministry of Energy and Utilities in January this year, with the revised compulsory scheme expected to start on 1 January 2003.

Whilst it is acknowledged that retailer are required to develop and implement greenhouse gas reduction strategies, and make every effort to comply, with penalties (equaling the marginal cost of compliance) of $15/tonne $CO_{2\text{-}e}$ expected to apply from January 2003, AIEW contends that there will be an additional cost not factored in to the original energy supply cost, that must be passed through to customers.

In addition to the cost of compliance with the NSW greenhouse emissions benchmark, since April 2001 there has been the cost of meeting the Commonwealth MRET renewable energy target, which has an increasing percentage in each calendar year. The indicative cost of AIEW compliance, based on purchase of Renewable Energy Certificates (RECs) is listed in Appendix 1.

Although the renewable energy REC liability could be achieved through installation of renewable generation, including PV installations and conversion of electric hot water systems to solar, for the modeling it is expected that the market cost of RECs equals the marginal compliance cost.

As the Renewable Energy Percentage increases annually, even with constant energy purchases for small customers, the compliance cost increases significantly, even within the remainder of this determination. From January 2002 retailers are also required to surrender RECs to SEDA for “new” green energy purchases to satisfy their green power accreditation, separate from the MRET compliance.

AIEW needs the ability to pass the overall cost of environmental compliance through to its regulated customers through their tariffs.

New tariff structures

There was considerable debate at the Public Forum as to whether new tariff structures could and should be introduced.

AIEW contends that the determination should allow the introduction of new tariffs, provided that they comply with the determination, primarily to respond to market pressures and provide increased customer service. An obvious tariff category would be a Residential TOU, primarily for single-phase customers as opposed to existing TOU tariffs available to higher consumption customers usually with multi-phase supply and more expensive metering requirements.

Increased availability of affordable interval metering means that a multi-rate tariff could be offered to residential customers, where the retailer believed that customers would benefit from the ability to minimize cost due to the “pricing signals” within the tariff, and the incumbent network facilitates the new tariff.

However, to introduce a multi-rate tariff but constrained by single fixed and variable R components for the target retail level would imply fixed weighting on the peak, shoulder and energy components, that may significantly vary between retailer’s, particularly where reverse-cycle or evaporative air-conditioning was used.

It is appreciated that the existing determination expires in June 2004, with the only price change dates for introduction of new tariffs being 1 August 2002 and 1 July 2003.

Regulated tariffs a limitation to competition

One of the terms of reference was whether tariffs that are currently below the relevant target level are likely to materially undermine the effective operation of the competitive electricity retail market.

Target levels, if set correctly, should represent the cost of supply. Therefore, regulated tariffs below the target level are effectively below the cost of supply, with the true cost subsidised by other customers. Similarly, if the target level is incorrectly set too low, then existing tariffs cannot increase in real terms as they are likely to be above the target level.

AIEW believes that tariffs currently below the target level will undermine the effective operation of the competitive electricity market, with no incentive for customers to move from their regulated tariff to a competitive negotiated tariff that is likely to be at higher cost.

Considering that small customers form a large percentage of each retailers' customer base, this is likely to limit movement within the national electricity market.

Conclusion

Australian Inland Energy and Water recommends that the Tribunal re-examine the December 2000 determination relating to regulated retail electricity prices for small customers, considering that there has been material change in the following factors:

- Energy losses
- Retail gross margin
- Rural controlled load variable component
- Side constraint limitations
- Environmental compliance cost

In addition, AIEW believes that the annual CPI indexation should not have a side-constraint dollar maximum limit, with the retailer able to increase the overall tariff to recover any increase in the network component, whilst ensuring that customers do not receive price shocks and a reasonable profit can be achieved.

Finally, AIEW believes that there should be freedom to introduce new tariffs at any price change date, and not be locked in to the regulated tariffs that were in force at 31 December 2000. The new tariffs would comply with the determination, and be introduced primarily to respond to market pressures and provide increased customer service

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Appendix 1 AIEW Mandatory Renewable Energy Target compliance

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