

14 May 2004

Mr James Cox
Acting Chairman
Independent Pricing and Regulatory Tribunal
Level 2, 44 Market Street
SYDNEY NSW 2000

Dear Mr Cox,

EnergyAustralia (EA) welcomes the opportunity to provide comments on the draft determination on regulated retail electricity to 2007, released by IPART on 30 April 2004.

The draft report contains areas of significant concern to EnergyAustralia, the effects of which could result in distortions in the market that are counter to the long-term interests of customers and other industry stakeholders.

EnergyAustralia welcomes the flexibility to introduce new tariff structures and a new time-of-use tariff, however it urges IPART to reconsider key issues where IPART has not properly addressed the Government's aims as set out in the terms of reference and indeed, its own aims in making the draft determination.

EnergyAustralia's aim in urging IPART to reconsider these key issues is so that it can truly achieve a \$1 per week price increase on average in each year of the determination period. This will result in tariffs reaching cost reflective levels during the determination period and meet the Government's objectives for this review.

EA would be pleased to discuss these comments at your convenience. Should you require further information or assistance, please feel free to contact Graeme Lees on 9269 2317.

Sincerely

Nick Saphin
General Manager – Retail and Marketing

EnergyAustralia's Response to IPART's Draft Determination

The terms of reference for this review states that "the Tribunal must consider the Government's policy aim of reducing customers' reliance on regulated prices and the effect of its determination on competition in the retail electricity market." While the draft determination contains some positive developments in the regulation of retail prices, EA believes many aspects of the draft determination work against the Government's policy aim and will have detrimental effects on competition and business viability in NSW.

I. Price Increases

In the draft determination IPART states that the maximum increase for residential customers in EnergyAustralia's area will be approximately \$1 per week. EnergyAustralia's modelling shows that the average increase as a result of the draft determination will be approximately 60c per week in each year of the determination. This difference is caused by inappropriate cost figures used by IPART which EnergyAustralia believes are too low. The draft determination as currently written will result in little improvement in the cost reflectivity of regulated retail tariffs and in some cases a deterioration of cost reflectivity.

EnergyAustralia believe that price increases of \$1 per week are necessary in order to result in tariffs approaching truly cost reflective levels and its comments in this response to IPART are based on the achievement of this aim.

EnergyAustralia believe the achievement of \$1 per week increases in its regulated tariffs is the only acceptable outcome of the determination if truly cost-reflective prices are to be achieved.

II. Target Tariffs and LRM

Real Reduction in Target Tariffs

The terms of reference for the review state that "in order to promote retail competition, regulated retail tariffs which are below the cost of supply should be moved towards full cost reflectivity, as far as practicable." Despite this, the draft determination includes target R components that are a real 1.5% reduction from those contained in the current determination, as demonstrated below.

	Fixed R		Variable R (all time tariff)		Total Targe for a 7MWh customer (in 04/05 \$)	
	2003/04	2004/05	2003/04	2004/05	2003/04	2004/05
EA	48.27	55.25	6.01	5.99	482	475

(Note: 2003/04 targets are shown in 2003/04 dollars, and 2004/05 targets are shown in 2004/05 dollars. The difference in CPI is 2.8%)

This appears to be a re-calculation of the costs of supply that is inconsistent with the realities of the market.

EnergyAustralia seeks that the reduction of the R components be reversed and that the variable R components be increased by CPI+2.4% in order to reflect the true costs of supply.

Lack of Retailer-Specific LRM

EnergyAustralia believes the use of retailer-specific Long Run Marginal Costs (LRMCs) is critical to the achievement of cost-reflective prices. The Variable R targets set by IPART for each retailer clearly do not reflect the unique LRMC's for each retailer's supply area.

According to the IES report, individual retailer LRMC's vary by as much as 12% from the NSW average LRMC, therefore the use of the NSW average creates a significant distortion in the target levels presented in the draft determination. The effect of this will be the continuation of tariffs that do not reflect the underlying costs of supply, which does not meet the Government's policy aim as it increases the dependency of customers on artificially low regulated retail tariffs. The effect this will have on competition, which IPART is required to consider, is to make certain retailers' area more favourable for competition and suppress the competition in retailer areas whose LRMC is being subsidised.

Such a disregard for the true costs of supply would have a negative impact on demand management and greenhouse gas obligations, as these will be dramatically undermined by the existence of arbitrary tariffs that bear little relation to their true costs.

EnergyAustralia believes that the use of retailer-specific LRMCs should be adopted to achieve cost-reflective regulated retail prices and that the use of a NSW-average would negatively impact demand management and greenhouse gas obligations.

No Margin in Fixed Target

As commonly recognised in price decisions in all jurisdictions, the driver behind retail operating costs are largely fixed. Based on that understanding, IPART has allocated 15% of operating costs to be recovered through variable R and 85% from fixed R. Invariably, this creates the risk of cost-recovery mismatch, considering the trend of faster reduction in volume than customer numbers.

IPART has only applied the retail margin to the variable R target and not the fixed R target. This contradicts the definition of retail margin as a percentage of total retail revenue and results in a \$3.6m reduction in retail margin. EnergyAustralia believes that a proportion of the retail margin should be applied to the fixed R target in order to avoid the cost-recovery mismatch mentioned above.

EnergyAustralia seeks the appropriate apportionment of the retail margin of at least 2% to the fixed R target.
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Targets for Time-of-Use Tariffs

As previously demonstrated EnergyAustralia believes IPART has not applied the Variable R targets correctly to time of use tariffs. IPART's ToU targets imply a retailer can purchase peak/shoulder energy at the average ETEF price (which includes cheaper off-peak energy). EA disagrees with this being cost-reflective. The artificial suppression of ToU prices will have dramatic consequences for the success of demand management initiatives being introduced in NSW.

The standard variable R is used for all-time tariffs, where the consumption is spread across peak, shoulder and off peak periods. With these tariffs, approximately 50% of the consumption is in off peak periods and 50% is in peak/shoulder periods. The consumption patterns of customers who have a time-of-use meter are broadly the same as customers on all-time tariffs, however the draft determination gives time-of-use tariffs a significantly different target level, which is calculated as 50% of the standard target and 50% of the off peak target.

EnergyAustralia believes the problem can be solved by applying the standard variable R target to the entire consumption of time-of-use tariffs and only apply the off-peak and extended off-peak targets to controlled load consumption.

EnergyAustralia seeks the application of the standard R target to the entire consumption of time-of-use tariffs, in order to achieve cost-reflectivity in time-of-use tariffs and ensure the viability of demand management initiatives in NSW.

Profile Risks

The pressure of increased demand and peaky regulated load shape has been partly recognised through the increased need for network asset investment, hence a price increase. IPART has presumed that the increased risk in energy cost, responsible for more than 70% of the total retail cost, has been eliminated by ETEF. Although ETEF eliminates the volatility risk, the peakier load profile risk remains. This is clearly not being sufficiently accounted for by IPART.

Despite the retailers' insistence that competition brings on profile shape and volatility risks, IPART's draft report continues to ignore these risks on the assumption that ETEF will exist in the long term. The longer IPART refuses to include the risk premium in the safety net prices, the greater the price shocks will be once the ETEF scheme ceases. Profile shape and volatility risks are part of the cost reflectivity equation.

IPART may consider the risk premium as monopoly rents to the incumbents as there is "no real risks" to match with in ETEF. However, this is a short-term view and customers will face a price shock once cost reflectivity occurs.

EnergyAustralia requests that IPART take account of load profile risks in its calculation of cost benchmark for variable R.

III. Price Constraints

EnergyAustralia believes that the price constraints outlined in the draft determination are not consistent with the terms of reference given to IPART for this review.

Inconsistent Constraints amongst Retailers

In its draft determination IPART has included a price constraint on the R component of CPI + 3% for Country Energy and Australian Inland, and a price constraint of CPI + 1% for EnergyAustralia and Integral Energy, which are not sufficient to ensure its tariffs are at cost-reflective levels by 30 June 2007. As demonstrated in EnergyAustralia's confidential submission a price constraint on the R component of CPI + 3% would ensure most tariffs are at cost reflective levels by 30 June 2007.

EnergyAustralia seeks the application of the CPI+3% price constraint on the retail component of the tariff to be applied to all retailers.

Constraints applied inappropriately

EnergyAustralia's support of the formula proposed by Country Energy (detailed in section 7.3 of the determination) was based on the assumption that it would be applied, as originally intended by Country Energy, on an average tariff basis. IPART's application of the formula on an individual customer bill basis is more restrictive, administratively complex and goes against the principle of ensuring that network charges are a pass-through cost for retailers.

Another problem with applying the formula at the individual customer level is that customers often have more than one tariff applicable to their consumption and this necessitates a large number of combinations and permutations to show that **not one** customer is facing an increase higher than the formula allows. This is an unnecessary cost of regulation that could be overcome if the formula were applied more sensibly.

In addition, applying the formula at the individual customer level has a prohibitive effect on attempts by standard retailers to rationalise obsolete tariffs. This is in direct opposition to the terms of reference for this review, which state that "the setting of any 'price constraint' should allow the further rationalisation of regulated retail tariffs". If the constraint was to be applied at the tariff level, customers could be transferred from obsolete tariffs to current tariffs as long as the current tariffs themselves were not breaching the constraint. The price constraint contained in the draft determination will perpetuate the existence of customers on obsolete tariffs, as even if tariffs are equivalent on average, individual customers will always breach such a restrictive constraint.

EnergyAustralia urges IPART to apply the price constraint detailed in 7.3 of the draft determination at the tariff level and not the individual customer bill level.

IV. Tariff Structures

EnergyAustralia is pleased with IPART's decision to allow flexibility in the structure of regulated retail tariffs, including the inclining block structure tariff. This will ensure tariffs are structured appropriately to reflect the underlying costs of supply and customers will receive appropriate price signals regarding their consumption.

V. Notification

The draft determination requires that standard retailers give the Tribunal at least 30 days notice in writing of proposed amendments to regulated retail tariffs. This is problematic, particularly for 2004/05, as the Tribunal is not required to notify DNSP's of their pricing compliance until 15 June 2004 and if revisions are needed final notification may not occur until 28 June 2004. In subsequent years this may also be problematic, as final notification may not occur until 31 May.

EnergyAustralia requests that IPART provide, in the final determination, a detailed timeline for the retail price changes and an explanation of how this will interact with the network timeline. If the notification requirement still applies, EnergyAustralia will seek relief from compliance to what is practical under the circumstances.

EnergyAustralia requests that IPART changes the notification timeline for price changes to one that is more reflective of the network price change timeline.

VI. Retail Charges

EnergyAustralia is disappointed by IPART's decision not to allow an increase to the maximum late payment fee specified in the draft determination. IPART stated that:

"The Tribunal notes that a \$5.00 fee may be less than cost (as argued by EnergyAustralia and Integral Energy) and may not provide sufficient incentive for customers to pay on time. However, the Tribunal notes the Public Interest Advocacy Centre and the Energy and Water Ombudsman of NSW's concerns about these charges have the effect of increasing hardship for low-income and disadvantaged consumers. On balance the Tribunal considers that an increase is not justified."

In its initial submission, EnergyAustralia reinforced its commitment to be sensitive to customers who are genuinely having difficulty in meeting payments by the due date. This includes not applying the late payment fee during the period of an extension, where there is an unresolved complaint in relation to the bill, or during the period of an instalment arrangement; and waiving the late payment fee where the customer has contacted a welfare agency for assistance, where payment or part payment is by an EAPA voucher, or on a case by case basis as other circumstances warrant. EnergyAustralia will also refund the late payment fee with extra \$10 in compensation if the fee was incorrectly applied.

EnergyAustralia sees IPART's deliberation as insufficient to argue against the increase of the late payment fee. As IPART is aware, competition will proportionally increase the bad debt costs for the standard retailers - a cost never recognised by IPART. Further, and as a result of the procedures mentioned above, it is EnergyAustralia's belief that the late payment fee can be increased without increasing hardship of low-income and disadvantaged customers.

EnergyAustralia requests that IPART increase the maximum late payment fee to \$10 on the basis that EnergyAustralia will compensate customers where it is incorrectly applied.
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