

Ref: 8-833-17



1 December 2003

Review of Gas and Electricity Regulated Retail Tariffs
Independent Pricing and Regulatory Tribunal
PO Box Q290
QVB Post Office NSW 1230

Dear Sir/Madam,

REVIEW OF GAS AND ELECTRICITY REGULATED RETAIL TARIFFS

I refer to the Review of Gas and Electricity Regulated Retail Tariffs Issues Paper ("Paper") released by the Independent Pricing and Regulatory Tribunal ("Tribunal") for comment by energy retailers by 1 December 2003. Ergon Energy (Victoria) Pty Ltd ("Ergon Energy") thanks the Tribunal for the opportunity to comment, and asks that you accept this letter as our submission on the issues raised.

Price Increase Management

Ergon Energy understands that energy customers expect to receive simple price information. We therefore consider that it is appropriate that regulated tariffs remain bundled in accordance with the current determination that sets tariffs using the 'N+R' (Network + Retail) formula. Ergon Energy supports the managed migration of regulated tariffs towards cost reflective levels, and considers it appropriate to allow the 'N', or network, component to vary according to customer location. However, Ergon Energy considers that in migrating regulated tariffs towards cost reflective levels it is important that appropriate price constraints are used in order to prevent price shocks. In this regard, we consider that applying side constraints on tariffs, similar to those already used by the Tribunal in their previous retail tariff determination is an appropriate method of ensuring price stability for customers. Specifically, Ergon Energy suggest the continued use of smoothing mechanisms for annual price increases which prevent small retail customers' accounts (assuming no increase in consumption) from increasing by more than $CPI + X\%$, or $\$Y$, whichever is the greater.

Tariff Structure

Ergon Energy supports the use of inclining block structures as a method of providing demand side management ("DSM") signalling to customers. In addition, Ergon Energy supports the application of time-of-use tariffs as a complementary method of promoting DSM. We note that in order to allow time-of-use tariffs, the introduction of interval metering is required. Importantly, in addition to the benefits of DSM signalling, the introduction of interval metering would provide scope for tariffs to be migrated towards a more cost reflective structure over time, and also provides retailers with greater

opportunity to develop products which are more reflective of customer's specific energy requirements.

Ergon Energy agrees that the long-term structure of default tariffs should reflect the underlying cost of supplying energy and that, as many of the costs of supplying energy (from both the network and retail side) are fixed, it is appropriate that those costs are recovered via fixed charges. Hence, our overall view of tariff structure is that the retail tariff comprises a fixed and variable component, with the variable components taking on an inclining block structure.

Non-tariff charges

Ergon Energy agrees it is important that, to ensure that customer impacts and cost reflectivity issues are managed appropriately, the Tribunal should continue to regulate non-tariff charges such as security deposits and late payments fees.

Dual Fuel Synergies

Ergon Energy also notes the Tribunal's intention to conduct a retail operating cost benchmarking analysis, and queries whether the study will incorporate an investigation of the dual-fuel synergies captured by retailers who have adopted this strategy.

Wholesale Energy Cost Benchmarking

The Tribunal's Paper also proposes the onward setting of wholesale electricity costs on the basis of long run marginal cost, and states that the range used in the previous mid-term review was \$39 – 59/MWh, with actual cost adjusted for retailers in accordance with their specific load factor. This range seems extremely broad and there is a general lack of transparency about what cost is actually incorporated into the retail tariff.

Other jurisdictions prefer the use of pool price modelling or contract market benchmarking to determine wholesale electricity costs and this would seem a more robust method of estimating costs over the course of the determination period. Long run marginal cost does not necessarily reflect the costs being paid by retailers in the spot or contract market depending upon where the market is at in the supply/demand cycle. On this basis the gap between long run marginal cost and actual costs to retailers could be quite substantial.

Whilst our preference is for pool and contract market benchmarking, we query whether long run average cost is more appropriate as a benchmark compared to long run marginal cost. Given that long run marginal cost may not allow for recovery of some fixed cost components, long run average cost may be a better approximation of what generators are likely to bid, although again this methodology limits cost assessments to individual generators and does not reflect the way the pool price is set through the marginal generator bid process.

In summary, Ergon Energy supports the use of a methodology which aligns wholesale cost assessment to actual contract market costs over the course of the determination period.

Should you wish to discuss any of these matters further please do not hesitate to contact Mark Easton on (07) 3228 8149.

Yours faithfully,

Rebecca Myers
Manager Regulation