



Annual wholesale price review

17 March 2008 – Public forum presentation

Overview

- Requirement for and basis of annual energy cost review
- Review of modelling approach
- Forward curve movements since 2007 determination
- Energy purchase cost movements
 - efficient frontier
 - conservative point
- Questions and comments

Annual review

Requirement for annual review

- Retailer's energy costs are more uncertain as ETEF rolls off
- This roll-off coincides with a tightening of supply and demand, drought, fuel price changes, uncertainty about greenhouse policies
- This makes it very difficult for regulators to determine a reasonable and durable energy cost allowance
- The large change in energy costs immediately prior to the release of Draft Determination at beginning of April 2007 demonstrated the difficulties of fixing an energy cost allowance
- IPART decided to introduce some flexibility mechanisms
 - higher retailer margins to compensate for risks
 - conservative estimate of energy costs
 - allowance for managing additional cashflow risks
 - cost pass through on some items
 - annual energy cost review
 - Pass through mechanism for regulatory and taxation events
- Government can always issue new Terms of Reference to reflect change in policy approach and/or environment

Annual review

Nature of annual energy cost review

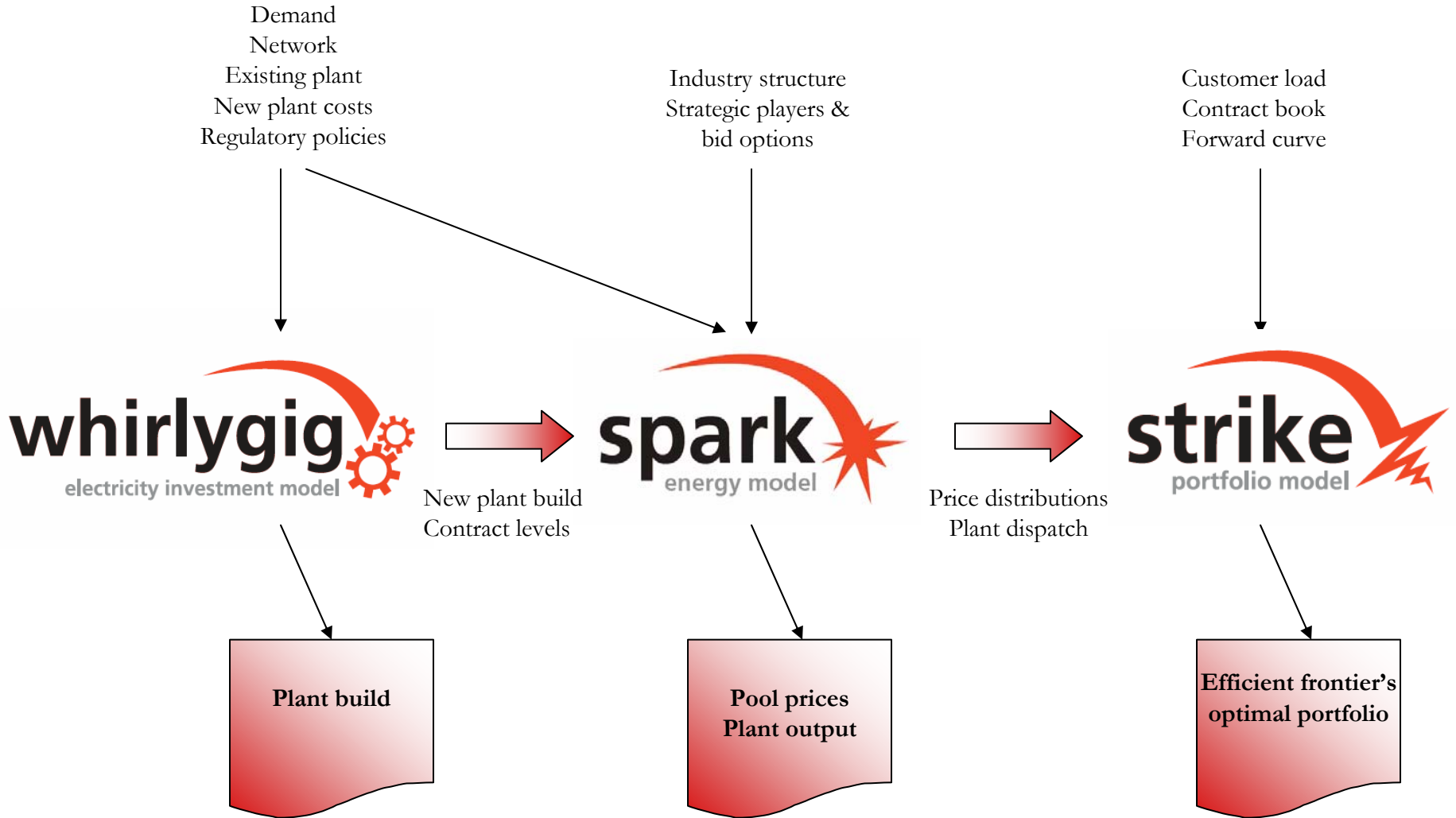
- Being an annual review it is not a full-blown review of all elements, as this would effectively mean that price is under constant review and would generate uncertainty
- The review is limited to black energy costs only, it does not consider:
 - green costs
 - market fees
 - impact on retailer margin
- The review is forward looking at the time the review is conducted (from February). It is not a review of retailers' actual energy costs.
- The prices that are used to form the cost estimates are to be based on the views of IPART's expert reviewer
- The review is to be conducted using the same approach as applied in the Determination using all the same load assumptions as used in the Determination

Modelling approach

Frontier has adopted the same three-staged modelling process as was used for the purposes of IPART's Final Determination:

- *WHIRLYGIG* determines efficient mix of investment
- *SPARK* determines price distributions
- *STRIKE* determines efficient mixes of hedging products to meet load profile

Frontier energy modelling framework

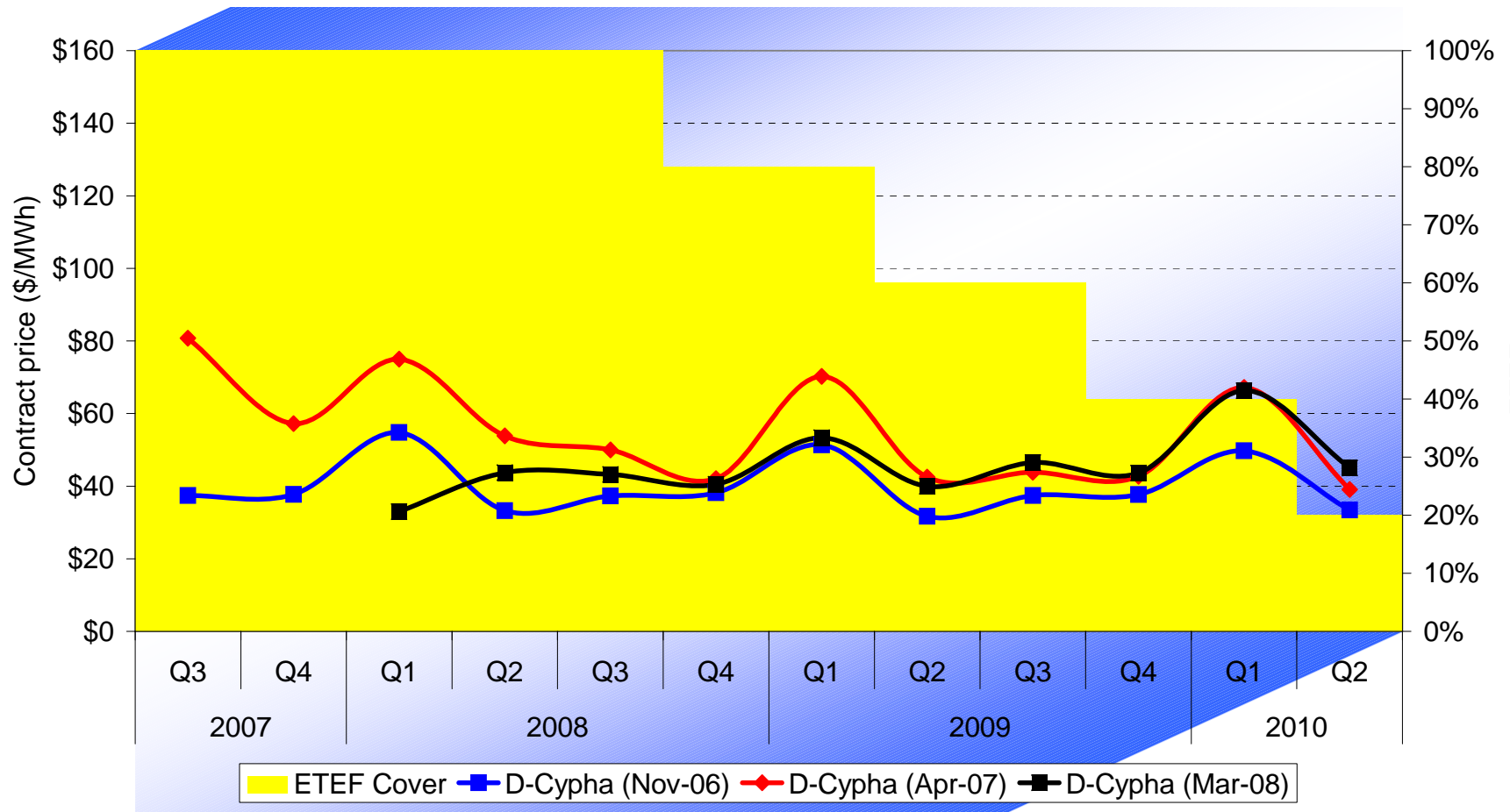


Recent changes in prices

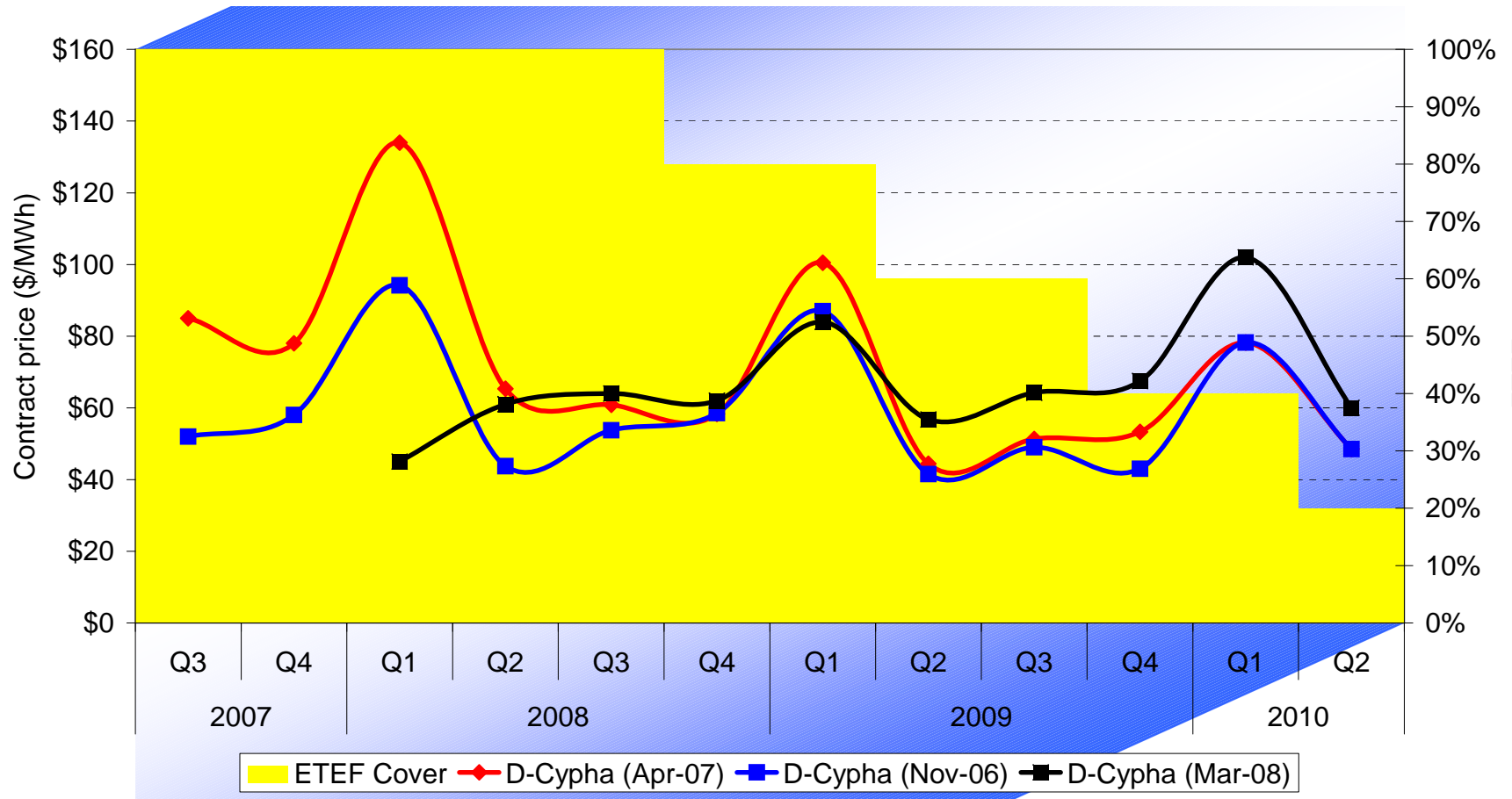
Prices have fallen significantly since April 2007

- Higher rainfall as predicted by BOM, but key hydro facilities still drought affected and this is taken into account
- Return to service of Tarong and Swanbank
- Change in bidding behaviour in NSW which has substantially reduced prices
- Slightly lower NEMMCO forecast demand and energy

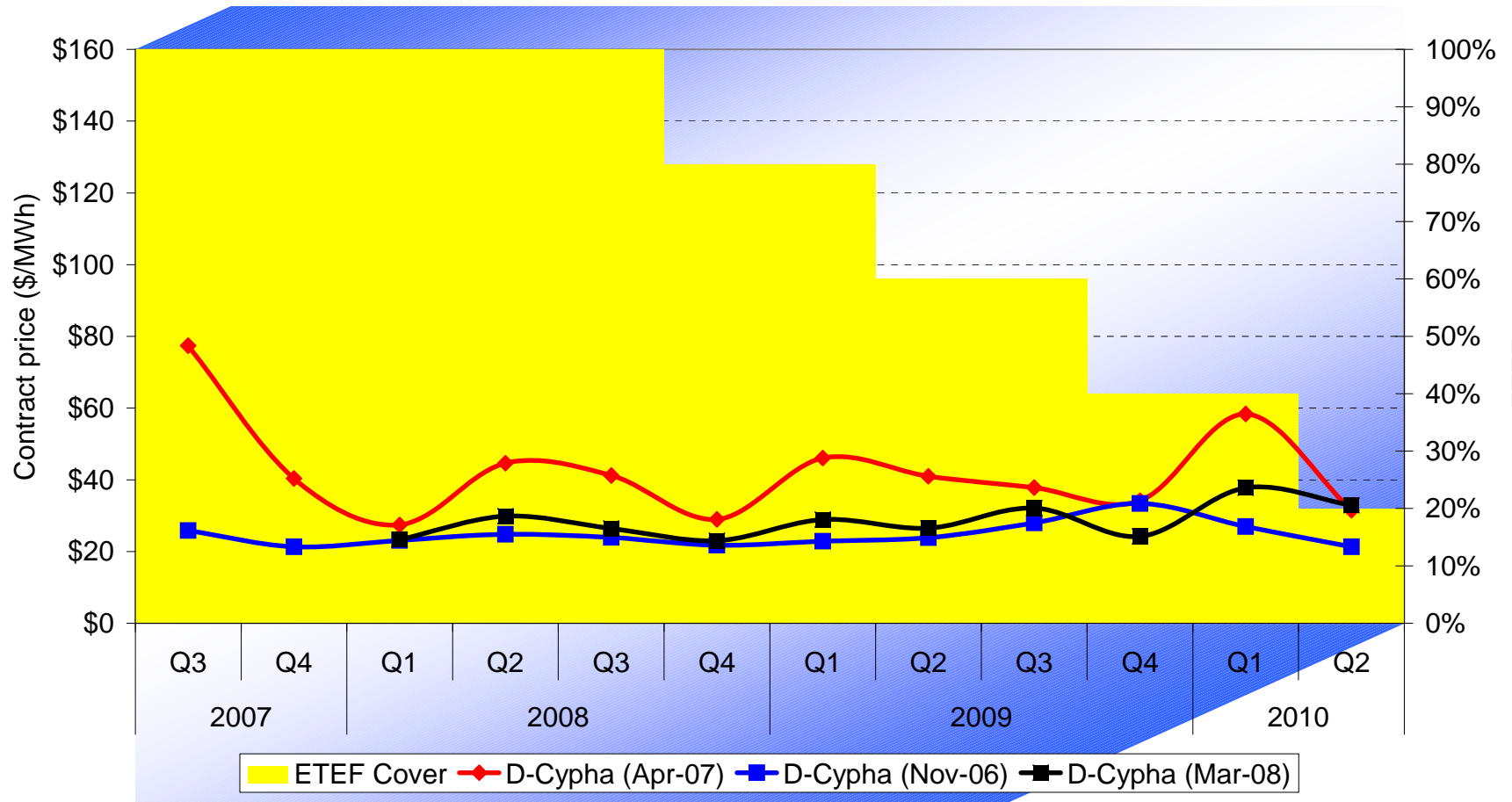
D-Cypha – baseload swap contracts



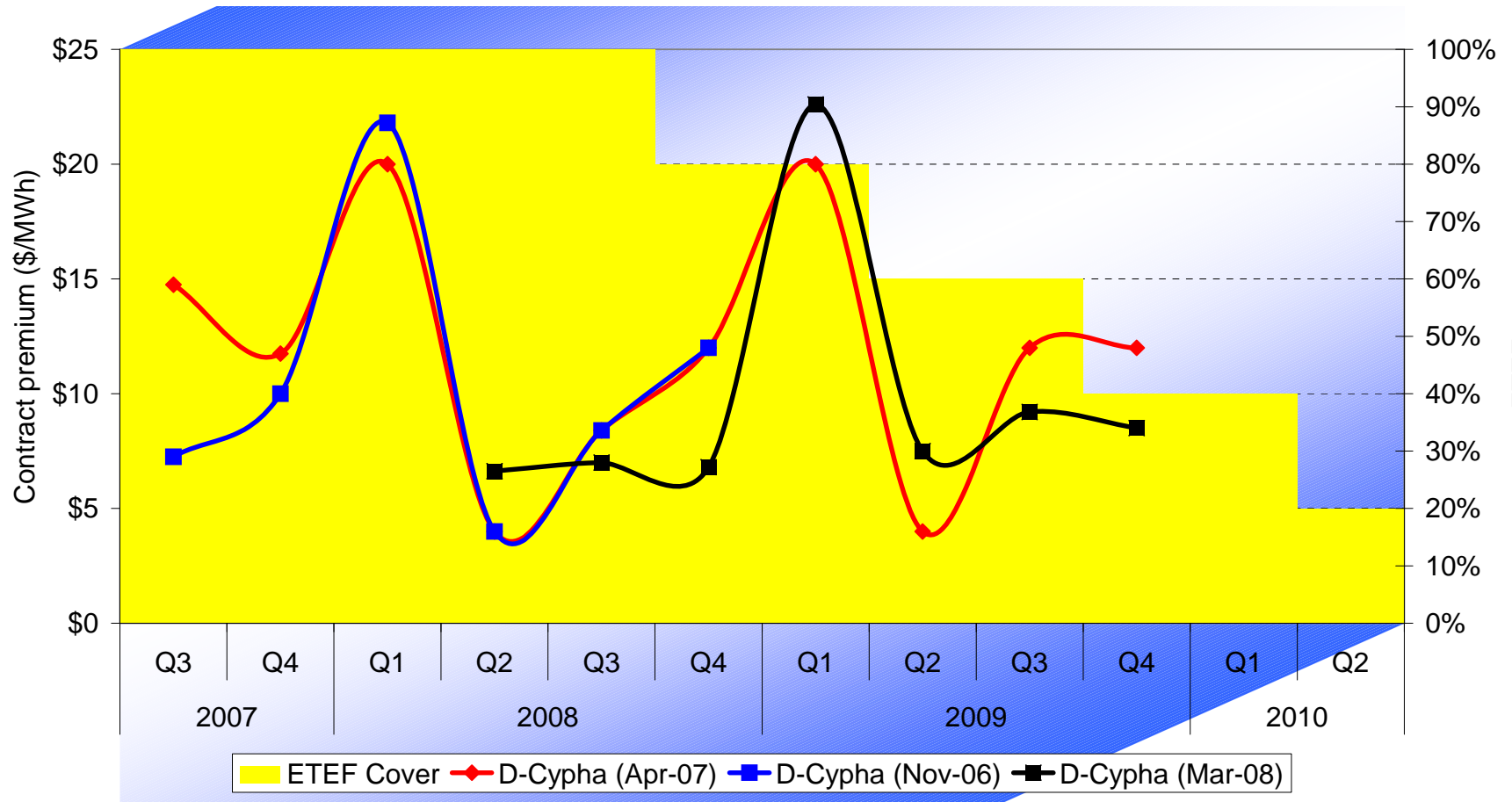
D-Cypha – peak swap contracts



D-Cypha – offpeak swap contracts

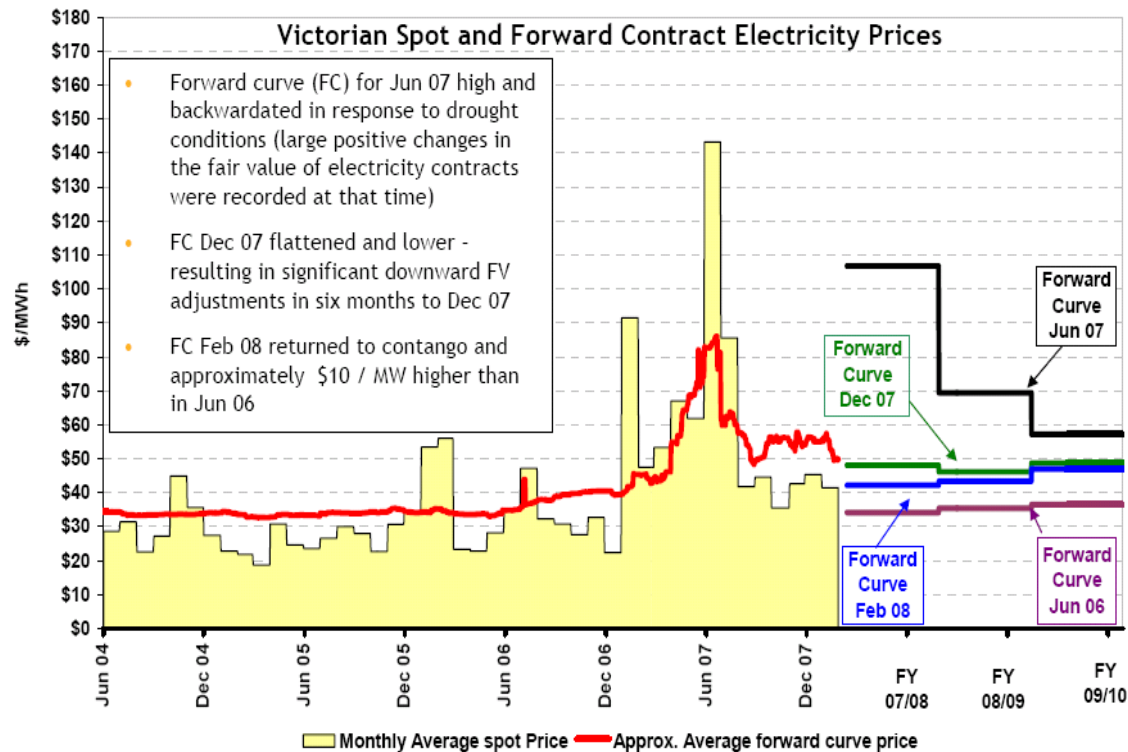


D-Cypha – \$300 cap contracts



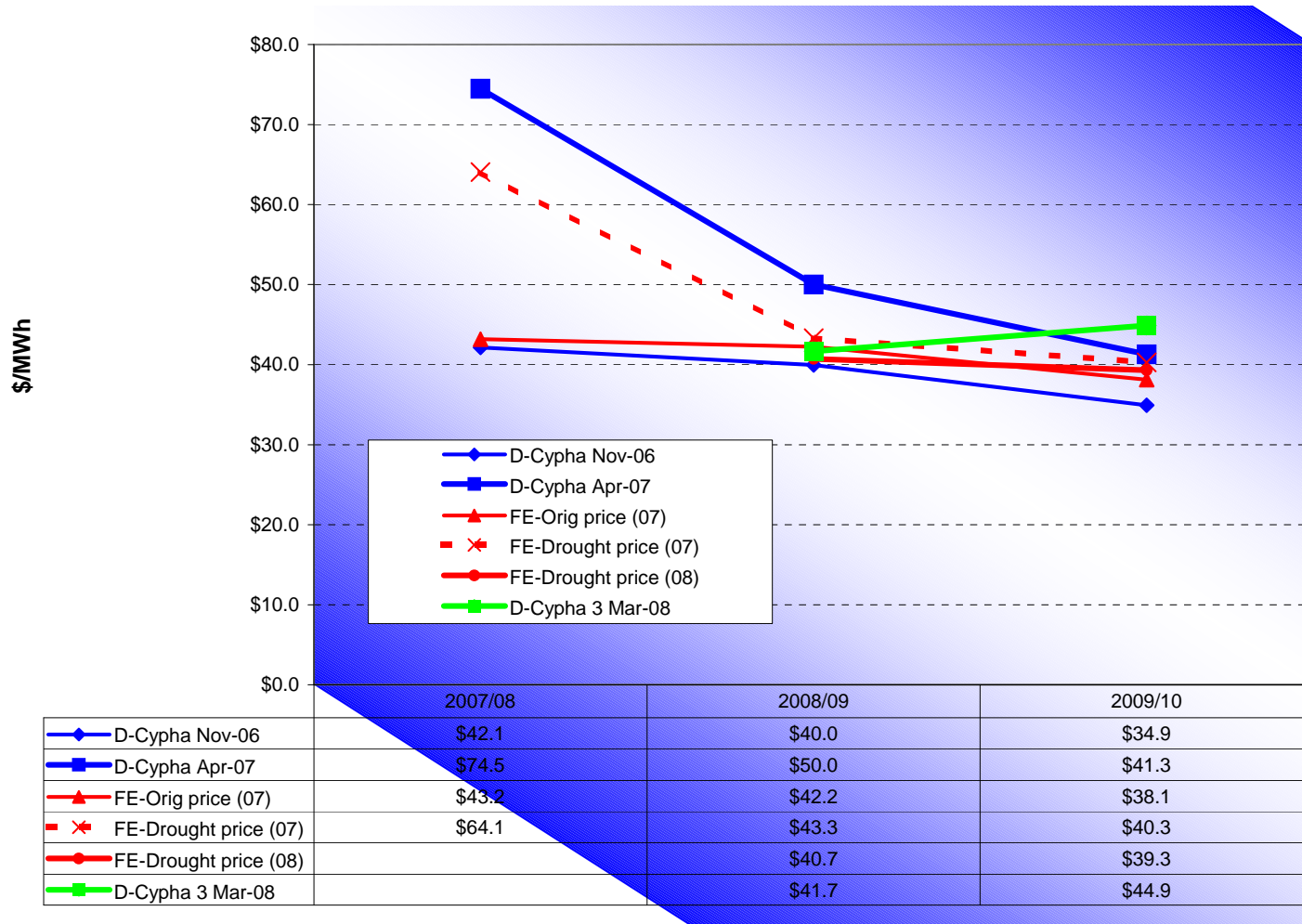
Other industry views

Large movements in the forward curve have caused significant movements in mark-to-market values

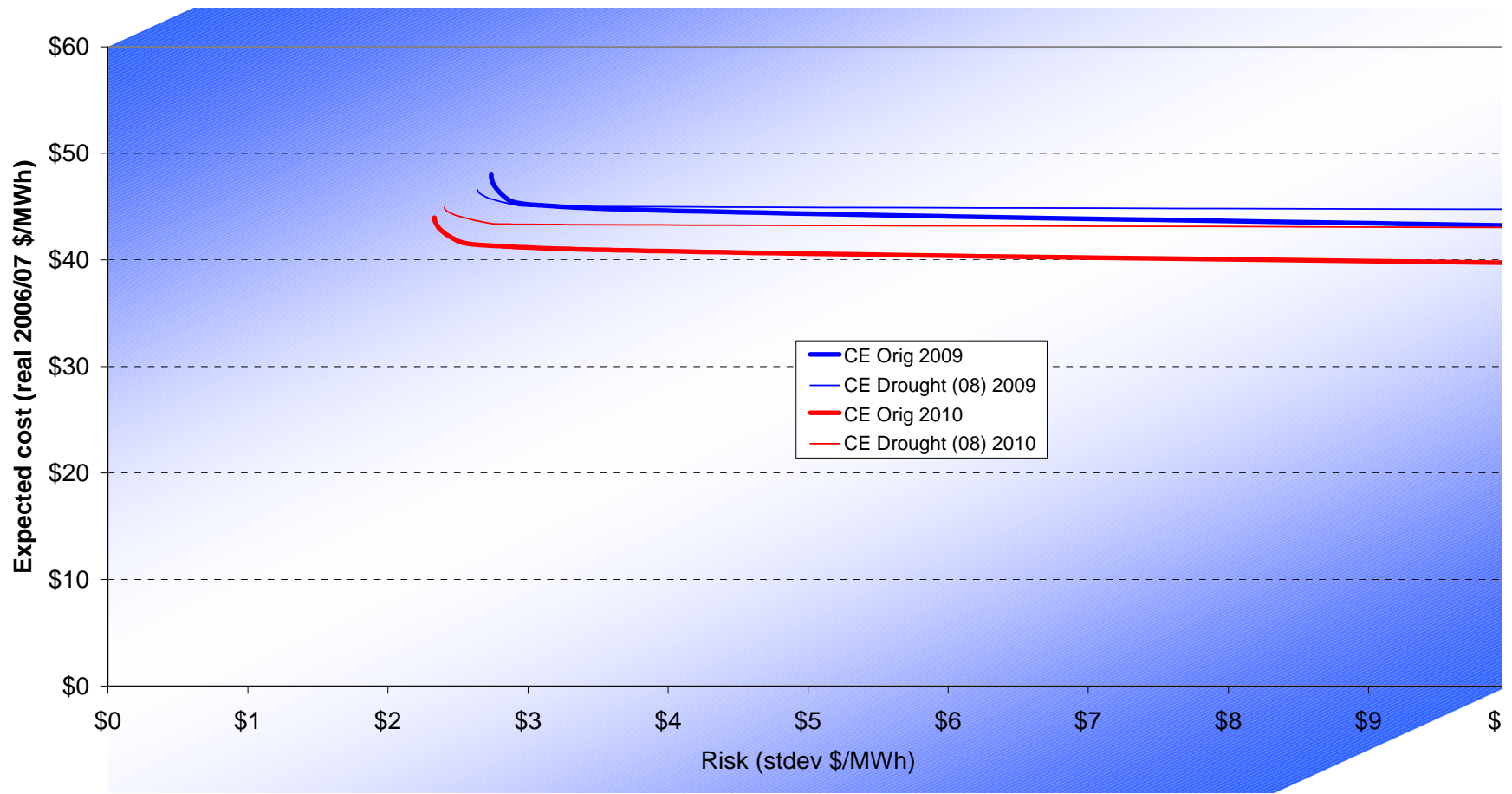


While forward curve has fallen significantly since June 07 it continues to signal higher wholesale prices than the prior year

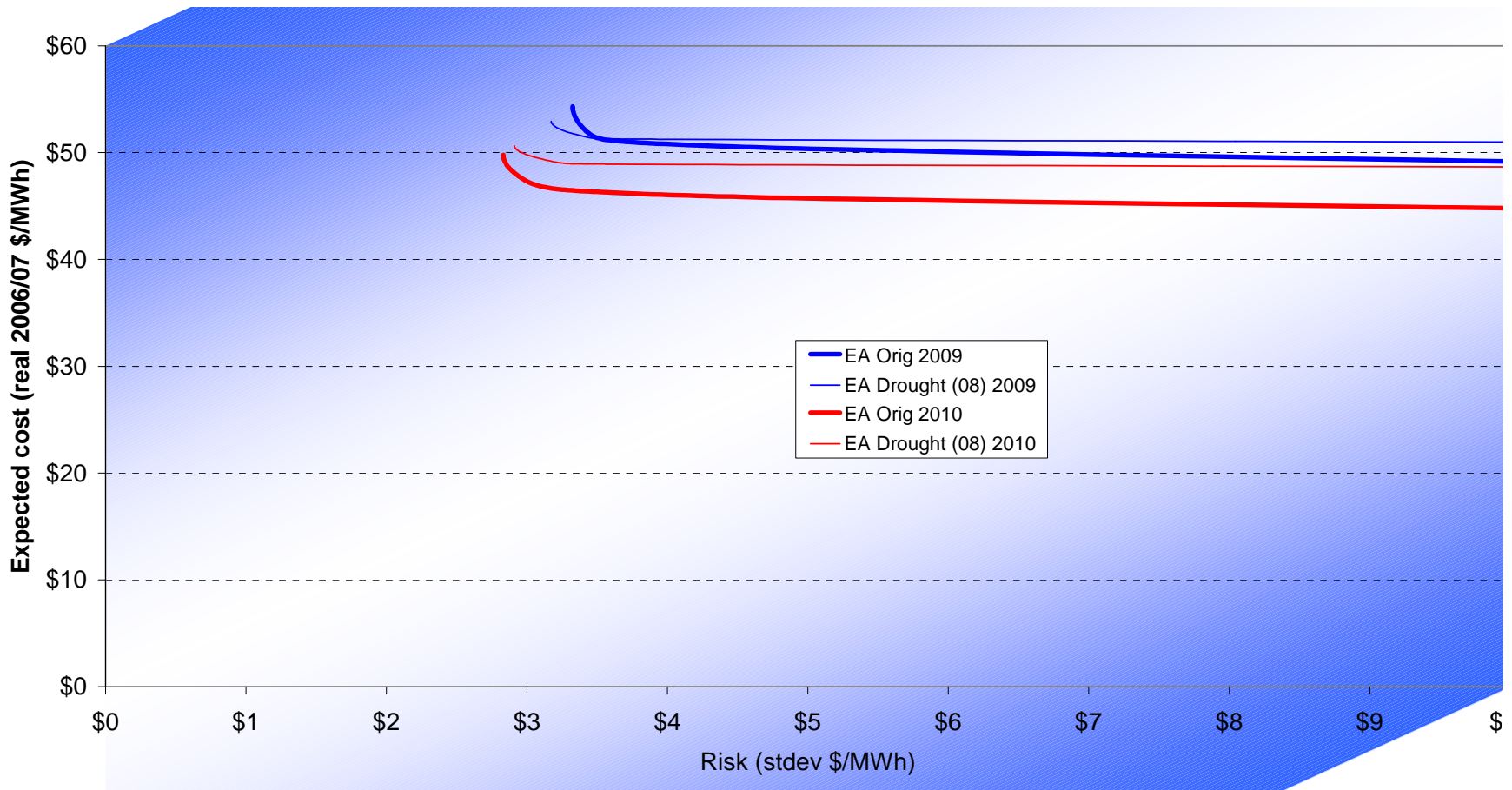
Price estimates and movements (flat)



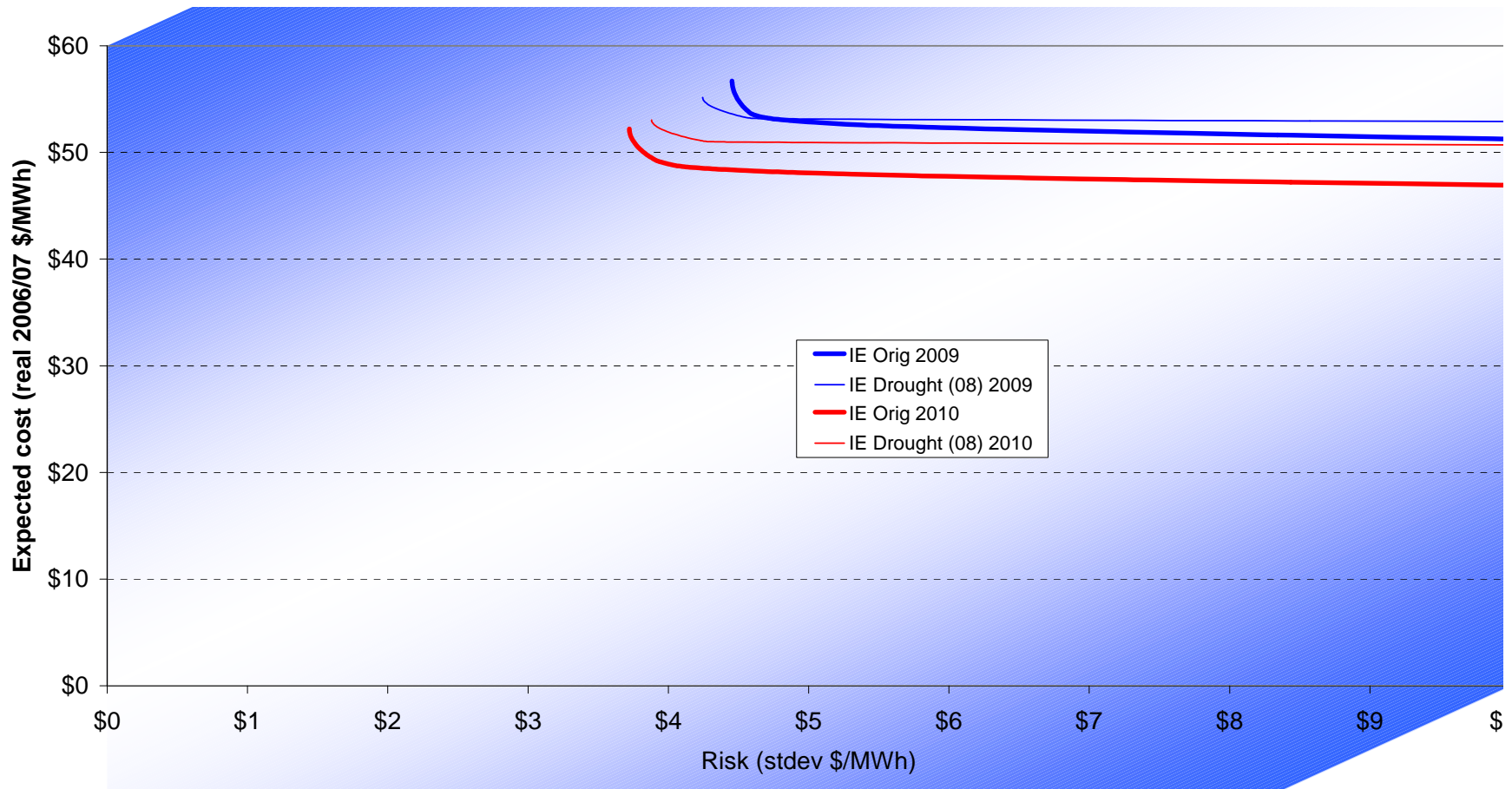
Country Energy energy costs



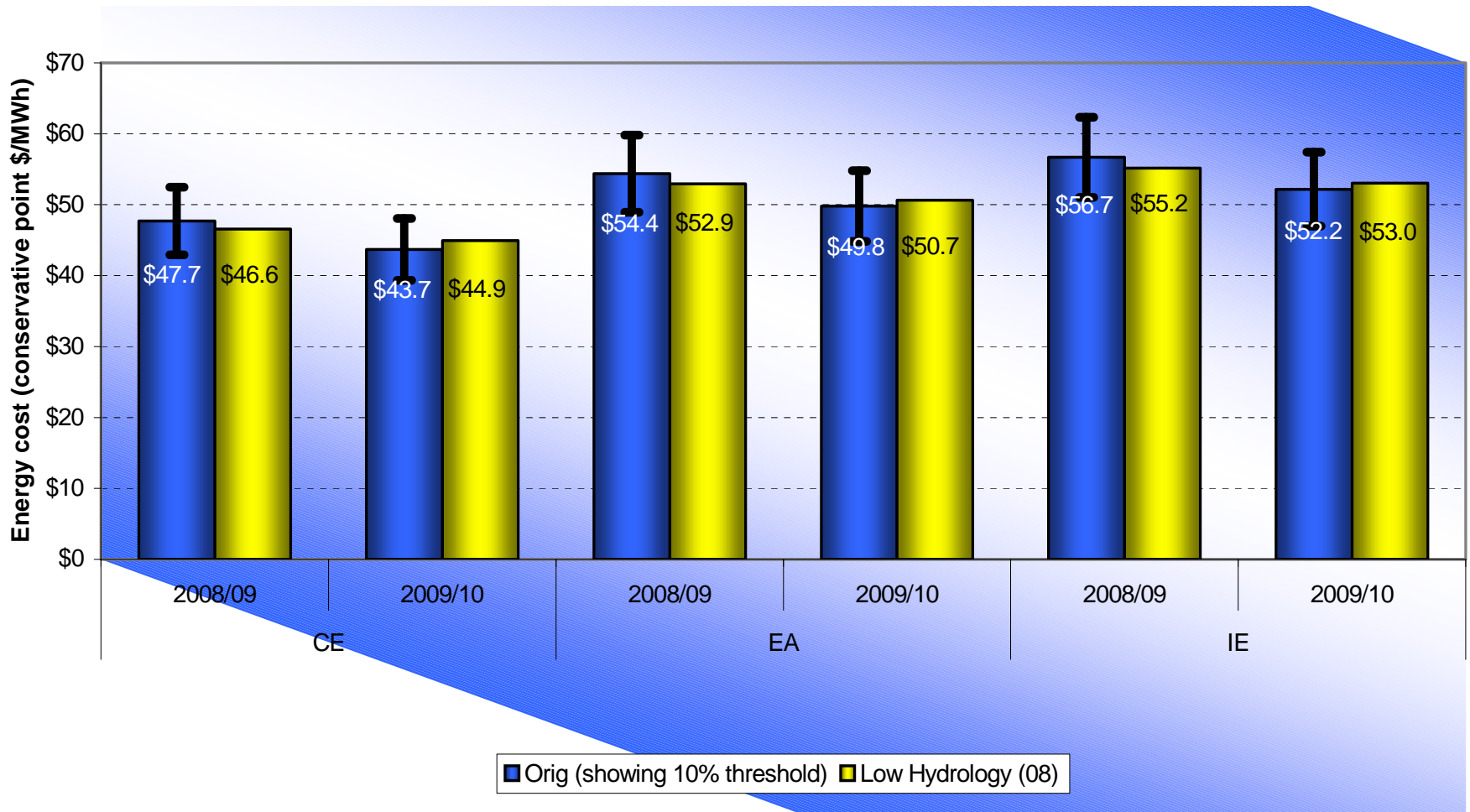
EnergyAustralia energy costs



Integral Energy energy costs



Comparison – conservative point



Summary

- At this stage FE price forecasts are slightly lower in 2008/09 and slightly higher in 2009/10 compared to November 2006 modelling used in Determination
- 2008/09 forward prices, as indicated by d-cypha on 3 March 2008 (following Qld Government announcement on lifting of water use by power stations), suggest a difference to FE's November 2006 price estimates of just 1%
- d-cypha prices for 2009/10 on 3 March 2008 suggest a price that is 14% higher than FE estimates for same period, but this reflects low volumes
- Given the approach required in the annual energy cost allowance review and FE's current view of forward prices, the Frontier recommendations would not trigger the 10% threshold



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