

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

Dear Mr Cox

## **REVIEW OF REGULATED RETAIL PRICES**

Macquarie Generation appreciates the opportunity to make comment on the Tribunal's draft report on regulated retail prices for electricity to 2007.

We strongly support the Tribunal's decision to separate the pricing constraints on the retail<sup>1</sup> and network components of regulated tariffs. Under previous retail determinations, the bundling of both components, in combination with global price constraints, had severely limited the scope for standard retailers to shift regulated tariffs to target levels. The redesign of the current determination provides for the full and immediate pass through of the Tribunal's recent decision to allow real increases in monopoly network charges. The draft retail determination also allows for some real, albeit small, increase in the retail component for those customers on tariffs that do not recover the costs of supply.

Macquarie Generation's main interest in the review is to ensure that the Tribunal sets an appropriate allowance for retailers to purchase electricity for small retail customers. The electricity allowance effectively caps our potential earnings from the NEM through the obligation to make payments to the Electricity Tariff Equalisation Fund if wholesale prices exceed the regulated energy cost<sup>2</sup>. The Tribunal's draft report provides for an average electricity purchase cost of \$47/MWh. This allowance should ensure that, at a minimum, the existing regulated electricity cost is preserved in real terms throughout the next determination period.

The Tribunal makes the observation in the draft report that "many second tier retailers and potential entrants regard the ETEF scheme as a significant impediment to entry as non-incumbent retailers do not access to the scheme". Macquarie Generation believes there is widespread confusion about the role of the ETEF arrangement. The Fund was designed to manage purchase cost risk on behalf of standard retailers supplying regulated customers in a way that would not create any financial gains or losses for those retailers. If second-tier retailers find it difficult to compete with standard retailers it is simply because they cannot match or better the regulated tariff offer. The Tribunal's conclusion that retail competition is not currently effective in New South Wales is in large part a reflection of the level of regulated tariffs in past determinations.

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<sup>1</sup> The retail component includes the allowance for electricity purchases.

<sup>2</sup> The NSW Treasurer is responsible under the *Electricity Supply Act 1995* for setting the 'regulated energy cost' for NSW generators through the ETEF arrangement based upon the electricity allowance in the Tribunal's determination.

The Tribunal notes that the current determination allows for an average energy allowance of \$49.00/MWh (2003-04) including a \$1.50/MWh margin for green energy purchases<sup>3</sup>. The current regulated energy cost is substantially below this level because of the prevalence of under-recovering tariffs. Macquarie Generation is pleased that the Tribunal has designed its determination in a way that should stop the erosion of the regulated energy cost. However, we believe that the energy allowance is still too low:

- The final report of Intelligent Energy Systems (IES) provides an estimate of long run marginal cost of \$47.84/MWh under a medium cost scenario. The Tribunal's decision to allow the lower amount of \$47.00/MWh reduces potential revenues paid to the standard retailers by almost \$20 million per annum.
- The IES modelling does not account for planned and unplanned outages of base load thermal plant. This is a significant shortcoming of the modelling.<sup>4</sup> The most reliable, high production power stations in the NEM have long run availability factors of around 92%. The failure to account for base load outages under estimates the long run marginal cost of supply by more than \$2/MWh.

Macquarie Generation believes that the draft report provides a significant improvement on the existing regulated tariff model. However, we believe that retail competition will continue to evolve slowly given the lack of an incentive for retailers to compete against the regulated offer. New generation capacity will be required in New South Wales within the next three years. The energy allowance provided in the determination does not adequately cover the cost of building and operating plant to supply the demand profile of residential customers.

Yours faithfully

Signed 14 May 2004

RUSSELL SKELTON  
MANAGER MARKETING & TRADING

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<sup>3</sup> Excluding the green margin and applying a CPI index rate of 2.8%, the equivalent regulated energy cost under the existing determination for 2004-05 would be approximately \$48.80/MWh.

<sup>4</sup> Apart from this assumption, Macquarie Generation supports and endorses the modelling work undertaken by IES.