TRUenergy Pty Ltd
ABN 99 086 014 968

Level 33, 385 Bourke Street
Melbourne Victoria 3000
Telephone +61 3 8628 1000
Facsimile +61 3 8628 1050

enq@truenergy.com.au
www.truenergy.com.au

10 May 2012

Dr. Peter Boxall
Chairman
Independent Pricing and Regulatory Tribunal of NSW (IPART)
PO Box Q290
QVB Post Office NSW 1230

ipart@ipart.nsw.gov.au

Dear Dr. Boxall,

Regarding: Changes in regulated electricity retail prices from 1 July 2012 — Draft Report

TRUenergy welcomes the opportunity to provide comments on *Changes in regulated electricity retail prices from 1 July 2012 — Draft Report* (the Draft Decision).

We note that the retail cost increases foreshadowed in the Draft Decision are a consequence of rising network costs and the introduction of the carbon pricing mechanism. TRUenergy will continue to work with the NSW Government to ensure that the impacts of these price rises on customers are minimised wherever possible.

The Draft Decision applies to the final year in the three year price control period, and the IPART regulatory approach is therefore well understood. In this context, TRUenergy has three primary concerns that I would ask the Tribunal to carefully consider. These concerns, relating to the weighted average cost of capital, price setting beyond 2013, and the energy purchase cost allowance, are outlined below.

1. Weighted Average Cost of Capital (WACC) - Appendix B, Item 1.2

TRUenergy has observed increased credit spreads for stand-alone electricity generators, stemming from ongoing political uncertainty associated with the introduction of carbon pricing. It is TRUenergy's view that this increase in the cost of debt should be reflected in a higher Generation Debt Margin.

Stand alone generators in particular face considerable difficulty in securing debt finance, and face also debt spreads in excess of those referenced by IPART in Table B.2 of the Draft Decision. This is evidenced by the recent experiences of generators including:

- Millmerran Power Station: $468m debt package, with maturity at 15 May 2012. This debt is currently held with a margin of 160 bps, however, there are rumours of bank liquidity shortage and revised margins of 400-450 bps
- Hazelwood: $742m, 2.5 year facility, with maturity at 30 June 2012. This debt is currently held with a margin of 400bps
- Loy Yang A: $455m debt package, with maturity at 12 Nov 2015, and a current margin of 450bps. Further, high debt spreads are implicit in the proposed de-levering of Loy Yang A in AGL's proposed acquisition.

2. *Price Setting beyond 30 June 2013 - Section 7.4*

IPART, in the Draft Decision, re-iterates its continued support for:

> " the removal of price regulation in markets where competition exists. We consider that retail competition offers the best protection to customers that retail prices will not materially exceed the efficient cost of supply." [1]

TRUenergy agrees fully with these sentiments. We believe that, over the long term, NSW consumers will be better off being served by a competitive retail electricity market that provides the optimal conditions for innovation and customer focus. Retail price deregulation should therefore be a core policy objective.

If, contrary to our shared preference for deregulation, it is determined that some form of price regulation is required from IPART for 2013/14, we note that IPART is seeking

> "a suitable degree of discretion in making the determination" in order to provide a balanced, flexible regulatory package." [2]

TRUenergy contends that this request is at odds with IPART's position on competition advancing customer interests. By advocating for increased regulator discretion, IPART would introduce increased regulatory risk, prompting greater uncertainty for retailers, and ultimately working against competition.

Allowing retailers, not regulators, more flexibility in setting their prices in a competitive market will encourage competition. The Terms of Reference require that

> "IPART should also ensure that its determination is consistent with the Governments' policy aim of reducing customers' reliance on regulated prices"[3]

The Draft Decision does not provide incentives for new retailers to enter the market. Aside from acquisition costs, a new entrant retailer would also require price headroom to undercut the regulated tariffs in order to provide a competitive offering. This has been the experience in Victoria and South Australia and these markets now provide customers with significant levels of choice.

If the NSW government decides that some form of regulation is required for 2013/14, TRUenergy urges IPART to adopt a very light-handed approach. This will reduce customers' reliance on regulated prices, as well as reinforcing competitive market dynamics that work against retail prices materially exceeding the cost of supply.

3. *Energy purchase cost allowance (EPCA) - Long Run Marginal Cost (LRMC) inputs - Section 3.2*

The LRMC calculations undertaken by Frontier have been based on ACIL Tasman's draft advice to the Queensland Competition Authority (QCA) from 2010, which in turn largely used values from ACIL's 2009 report. We note that this point of reference is becoming less reliable with the passage of time, particularly with reference to changing fuel costs.

In particular, the black coal and gas prices applied by Frontier to EPCA modelling are lower than currently available under new contract terms of supply. For example, where the ACIL cost of black coal applied by IPART is \$30-\$40 per tonne, net back from export pricing (Newcastle Coal Index) to points of supply within NSW result in prices between \$70-\$90 per tonne. It is our view that no black coal generator is able to source coal at the prices applied to calculate the EPCA, calling into question the EPCA set through this process.

---

[1] IPART, *Strengthening the Foundation for Australia's Energy Future*, March 2012, page 17
[2] IPART, *Changes in regulated electricity retail prices from 1 July 2012 — Draft Report*, April 2012, page 86
[3] IPART, *Changes in regulated electricity retail prices from 1 July 2012 — Draft Report*, April 2012, page 92

No set of inputs is perfect and TRUenergy supports the use of publicly available input assumptions and also the consistent use of inputs from comprehensive analysis. However, the extent of the difference between the assumptions present in the 2010 ACIL report and current market conditions is such that the ACIL report cannot be relied upon to determine, as the Terms of Reference require, an EPCA that

> "must not be lower than the least cost mix of generating plant." [4]

We therefore suggest that the application of the 2010 ACIL data in 2012 leads to an LRMC estimate that falls short of the Terms of Reference.

EPCA – Load growth

With reference to the recent reduction in observed electricity demand, TRUenergy agrees that it appears reasonable to adopt the low growth scenario for 2012/13. From 2013/14, however, this approach is likely to underestimate load growth. It is therefore our recommendation that, from 2013/14, the growth rates in the medium scenario are applied.

EPCA – market based cost

TRUenergy notes that no retailer would hedge its entire regulated load at today's market prices, as assumed in Frontier's calculations. Prudent hedging would occur over a period of time and at different prices. It would be impossible to hedge the entire regulated load in a single on-market trade. As a result of this assumption in hedging TRUenergy has little confidence in the use of Frontier's theoretical volatility premium in any given year.

Large Renewable Energy Target (LRET)

The IPART Terms of Reference require that energy costs are to include the cost of purchases from the National Electricity Market, as well as greenhouse and renewable energy costs. For a Standard Retailer this would require the purchase of LGC's from the market.

The Terms of Reference also require that the energy purchase costs should not be lower than the least cost mix of generating plant, including any plant that would be required to meet regulatory obligations. The energy purchase cost should, therefore, be based on the market purchase cost, with an effective floor price set at the LRMC. This includes the LRMC of the generating plant required to satisfy regulatory obligations such as the LRET.

TRUenergy holds the view that the LRMC cost of wind generation should be used to determine the forecast LGC price. We would like to highlight that due to the non-firm nature of renewable energy, an increase in value is placed on the LGCs. Our analysis of existing wind farms shows that dispatch weighted energy price recovered is on average around 8% lower than the time weighted energy price.

Based on recent experience in the market, an LRMC of $95-110/MWh for wind-based generation is appropriate. This implies an LRMC of Large Generation Certificates (LGCs) in the order of $50 to ensure that wind farm investments become viable. This is higher than the current published market based LGC costs which are in the range of $40-$45/MWh. We would therefore encourage the application of LGC costs reflective of at least the LRMC for wind generation.

Small scale Renewable Energy Scheme (SRES)

---

[4] IPART, *Changes in regulated electricity retail prices from 1 July 2012 — Draft Report*, April 2012, page 93

- Cost of Small-scale Technology Certificates (STC) in 2012/13:
  TRUenergy supports the IPART commitment to employ the $40 nominal price that is available to any STC seller via the clearing house.
- Certificate numbers based on the Small-scale Technology Percentage (STP):
  TRUenergy agrees with the IPARTs reference to the actual and estimated STPs from the scheme regulator.

As we approach the end of the current regulatory period, the issue of cost pass through provisions for early 2013 needs to be considered. The large move in the final 2012 STP from the estimate released in 2011 has highlighted the challenges in accurately predicting the STP for future years.

The SRES regulator has noted that the current non-binding 2013 STP estimate of 7.94% does not include any potential carryover from 2012. Some market observers are already forecasting an overhang of STCs in 2012 that could lead to the final 2013 STP being 10% or even higher. Given this, we ask that IPART request from the SRES regulator the most up to date and realistic 2013 STP estimate for use in the Final Decision.

Removal of price regulation after 30 June 2013 will remove the need for complex and costly pass through provisions as retailers will be able to reflect both increases and decreases in their prices. If this does not occur then we request that IPART consider how the risk of the legal and regulatory changes in 2012/13 should be treated when setting 2013/14 tariffs, in the event that IPART is required to regulate prices.

Conclusion

TRUenergy broadly supports the emphasis placed by the IPART on improving electricity policy and affordability with reference to increasing costs. I encourage you to consider our submission and our requests, with particular note of debt margin adequacy, and the appropriateness of the energy purchase cost allowance.

It is our experience that competition is increasingly robust in the NSW retail energy market, providing a solid basis for retail deregulation. I reiterate that TRUenergy fully endorses the IPART commitment to:

> "support the removal of price regulation in markets where competition exists." [5]

Please don't hesitate to contact me to discuss any part of this submission, on 03- 8628-1632. I look forward to further engagement with you and your office.

Yours sincerely,

L Stockman

Lana Stockman
General Manager Retail Regulation and Compliance

[5] IPART, *Strengthening the Foundation for Australia's Energy Future*, March 2012, page 17