



Integral Energy

**2004 Review of Gas and Electricity
Regulated Retail Tariffs**

4 December 2003



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Outline

- Context for the 2004 Retail Review
- Integral's experience under the 2001 Determination
- Appropriate form of regulation
- Appropriate levels of costs to be recovered
- Indicative retail price outcomes
- Customer assistance package
- Summary



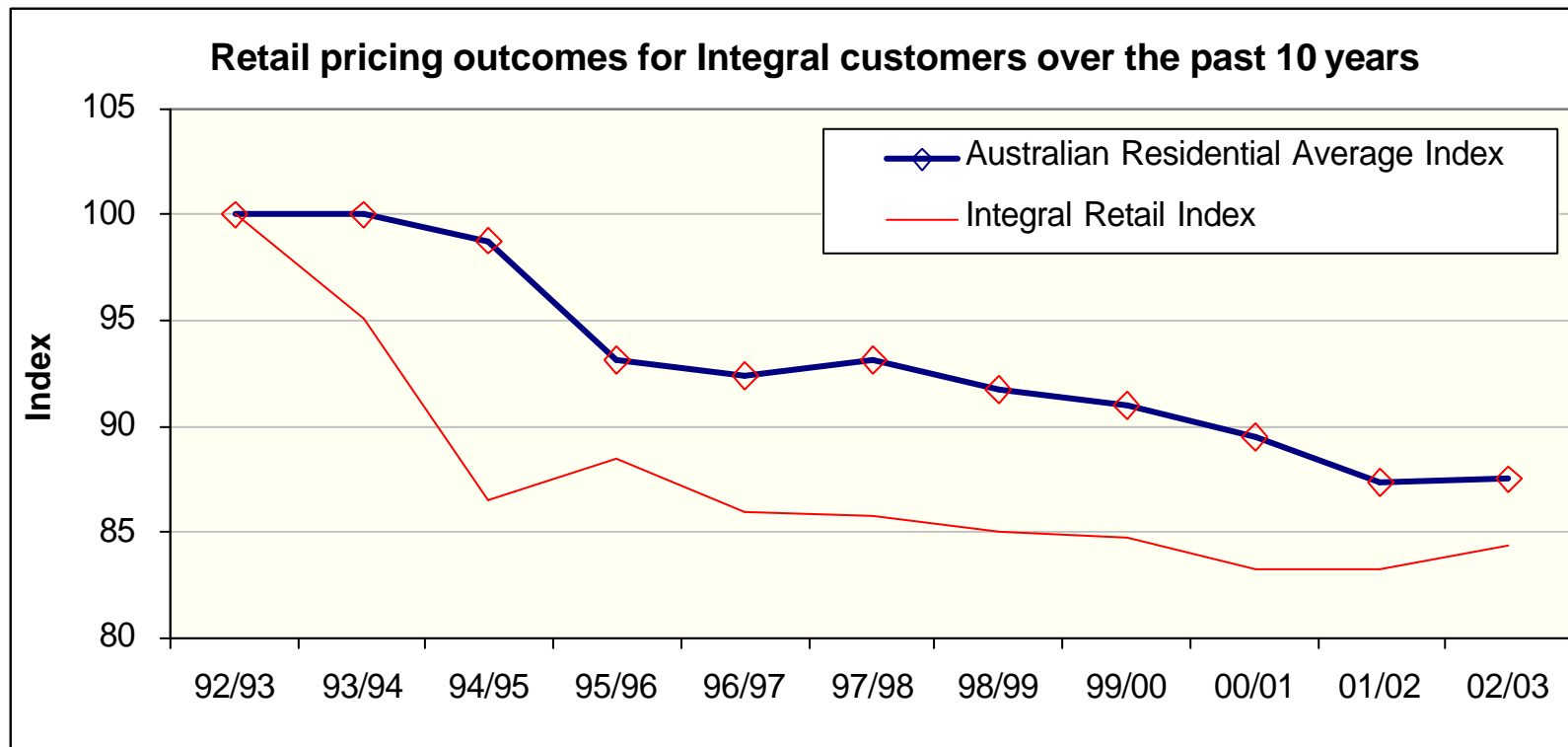
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Context for the 2004 Retail Review



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Industry reform has achieved significant price reductions



Over the past 10 years Average Australian residential electricity prices have fallen by approximately 12.5% in real terms

Source: ABS CPI data, ESAA, NSW Treasury, Integral Energy

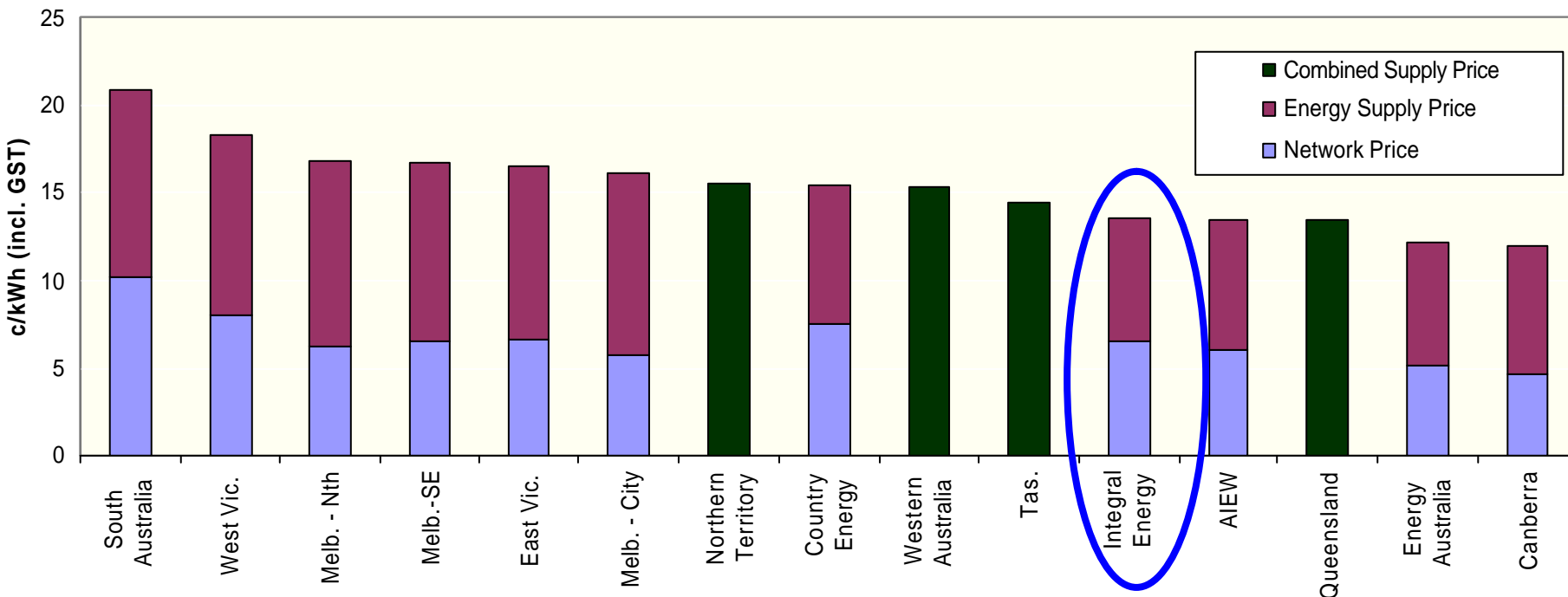


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Integral's regulated retail tariffs are at the lower end in the Australian market

Domestic Electricity Prices

Regulated and Default Standard Domestic Tariff
(with annual consumption of 7,000 kWh)



Source: ESAA, Electricity Pricing in Australia, 2003/2004



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Context for the 2004 Retail Review

- 2001 Retail Determination undertaken at a time when:
 - Retail electricity supply was still effectively a monopoly
 - Full Retail Contestability (FRC) had not started
 - Tribunal and retailers had no experience of competition
 - Form of regulation was to set targets as a proxy for cost reflective prices
- For the 2004 Retail Review, FRC has been in place almost three years and a competitive retail market has developed
- The Government has indicated the Tribunal must consider:
 - The Government's policy aim of reducing customers' reliance on regulated retail prices
 - The Determination's effect on competition



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Integral's approach to the 2004 Retail Review

- Support the desire to move to an effective competitive retail market
- Overall aim should be to establish a framework that removes the need for retail price regulation by 2007
- A workably competitive market is in place in NSW, supporting a move to a light-handed form of regulation
- Support the Tribunal's aims to move to cost reflective levels
- Recognise the need to manage pricing outcomes to customers in the transition to cost reflective pricing



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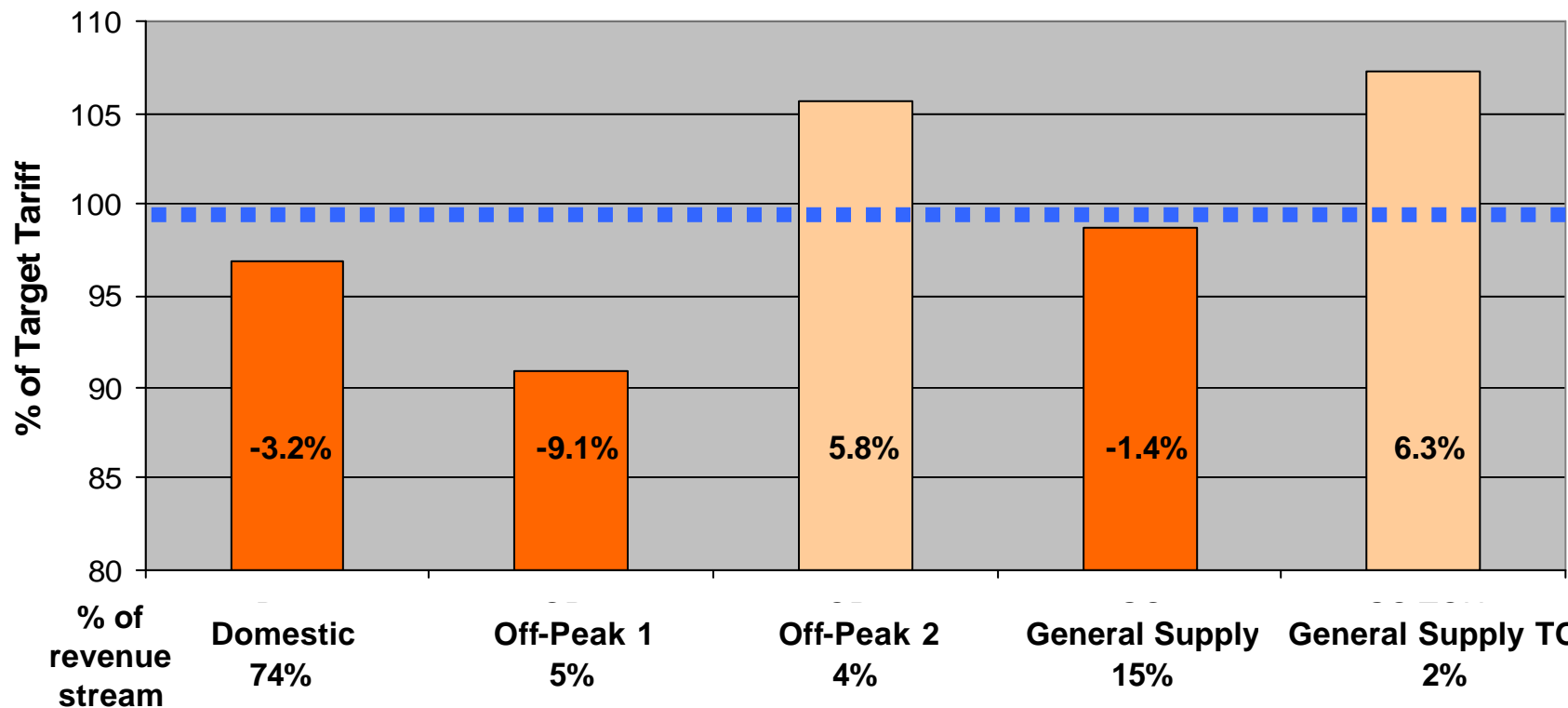
Integral's experience under the 2001 Determination



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Integral has achieved poor commercial outcomes from the 2001 Retail Determination

Current Under/Over Recovery vs Target Tariff



- Currently under-recovering by \$20m pa
- Unable to reach target tariff levels, nor cost reflective tariffs under this form of regulation



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Lessons from Full Retail Competition

- A competitive retail market has developed
- Customers have choice and are better aware of their choices
- Integral's experience is that customer "churn" has occurred where there is a price incentive:
 - Churn occurs where regulated prices provide opportunities for competitive offers
 - In tariffs which are under-recovered, there is less churn
- The regulatory framework needs to be updated to address issues with the existing regulatory approach and achieve the objective of a smooth transition to a competitive retail market



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Appropriate form of regulation



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Updating the form of regulation

- The Tribunal has stated that its primary objective in setting the form of Regulation is to:
 - “move all regulated tariffs towards cost reflective levels without exposing customers on under-recovering tariffs to unacceptable price shocks”*
- Overall aims should therefore be to:
 - Recognise this Determination is a step to removing retail price regulation
 - Support move towards cost reflectivity without exposing customers to unacceptable price shocks
 - Recognise the role of regulated rates as a “safety net” price
 - Ensure desired outcomes of network tariff reform are signalled

Integral's proposed form of regulation

- IPART sets limits on tariff components needed to recover costs
- Limits are set on the fixed system access charge and first block of energy
- Limits as follows (may differ in 2004/05 compared to other years):
 - $\text{CPI} + X$ pa on the fixed system access charge
 - $\text{CPI} + Y$ pa on the first block of energy
 - There is no price constraint on the second block of energy
- X and Y to be determined for each retailer as required to achieve cost reflective levels
- Side constraints would no longer be “one size fits all” - they would be formulated with greater transparency and relevance to each retailer



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Appropriate levels of costs to be recovered



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Integral's proposal for recovery of costs

- It is essential for the Tribunal to make appropriate allowances for all costs associated with providing the regulated retail service
- This includes:
 - taking account of all cost components relevant to meeting statutory requirements
 - considering an appropriate allowance for each cost component
 - giving careful consideration to the nature of costs and how costs are affected by customer churn



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Integral's position on recovery of costs

- The following costs should be treated as a full pass through
 - LRMC/energy purchase costs
 - Energy losses
 - NEMMCO fees
 - “Green” costs
 - Network charges
- Network tariff structure (eg. IBT) should be reflected at the regulated retail tariff
- Cost to serve (increase to reflect forecast costs)

Integral's position on appropriate net margin

- Net margin (range of 3 - 5 %)
- Net margin increase required to encourage competition
- Currently lower than other jurisdictions
- Victoria 2.5 - 5%
- ETEF - residual hedging costs covering profile changes

Indicative retail price outcomes

- Based on holding energy purchase costs*, network charges and NEMMCO fees constant and adding in controllable retail cost elements Integral's indicative regulated price outcomes are:

Tariff	Average over three years
Average Domestic increase	CPI + 2.3 %
Average General Supply increase	CPI + 1 %

* Based on current FTEF rates

Customer Assistance Package



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Customer assistance

- Integral has a “package” of customer assistance initiatives in place
- Trial hardship referral arrangement
- Other initiatives include:
 - Tailored payment plans
 - Centrepay
 - Payment concessions ie. EAPA, pension rebate



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Summary



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Summary

- The 2004 Retail Review is being undertaken at a critical time in the ongoing development of retail competition in NSW
- Important opportunity to learn from the 2001 Retail Determination and establish a more contemporary approach
- The market has changed considerably since 2001 and can be categorised as “workably competitive”
- Regulated retail prices should reflect their role as safety net price
- Significant scope for the Tribunal to adopt a regulatory approach that moves prices to cost reflective levels



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