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6 February 2007

Dr Michael Keating
Chairman
Independent Pricing and Regulatory Tribunal of NSW
PO Box Q290
QVB Post Office NSW 1230

Dear Dr Keating,

REVIEW OF REGULATED RETAIL TARIFFS AND CHARGES FOR ELECTRICITY 2007–2010

Delta Electricity ("**Delta**") is pleased to make the following further submission in relation to this Review, commenting on the Frontier Economics' ("**Frontier**") report "Energy Costs" dated December 2006.

Long Run Marginal Cost ("LRMC")

Delta suggests that the LRMC concept still provides the Tribunal with a useful benchmark for reasonable energy purchase costs, however Delta considers that the LRMC figures in Frontier's report are too low.

It is understood that ACIL Tasman estimates of LRMC of new generation costs (ACIL Tasman: "Report on NEM Generator Costs") are used to inform Frontier's model. Delta considers ACIL's estimates to be too low by a significant amount, especially for baseload generation in NSW.

As to the general level of new entrant costs, Delta agrees more with the alternative views of SKM (Rohan Zauner of SKM: presentation to the EUAA, June 2006) and MMA (McLennan Magesanik Associates: Report to National Emissions Trading Taskforce) which are consistent with NSW black coal new entrant costs of $38.87/MWh and $38.36/MWh respectively. Further, there is reason to believe that movement in costs of imported generation equipment since these estimates were prepared will have increased costs further.

Delta also considers that the LRMC estimates in Frontiers' report show insufficient relative difference between the profile areas. In the case of the most volatile profile area, simply applying a common reserve percentage margin above the 50% POE profile is not sufficient. To address the difference of load volatility across profile areas Delta found it necessary to modify the allocation of reserve margin across those areas. Failure to do this yields, for the most volatile profile area, an understated LRMC and a non-viable plant build that fails to meet the 90% POE demand even with no plant failures.

Delta's median estimates of the LRMC for the franchise load by area follow ($2006/07, real):

Franchise area	LRMC, $/MWh (VWA)
EnergyAustralia	55.68
Integral Energy	58.18
Country Energy	48.08
Load-Weighted Average	53.93

It is noted that the current regulated energy cost (REC) applied to the aggregate franchise load yields a load-weighted average cost of approximately $49.20/MWh compared with approximately $53.93/MWh from the table above.

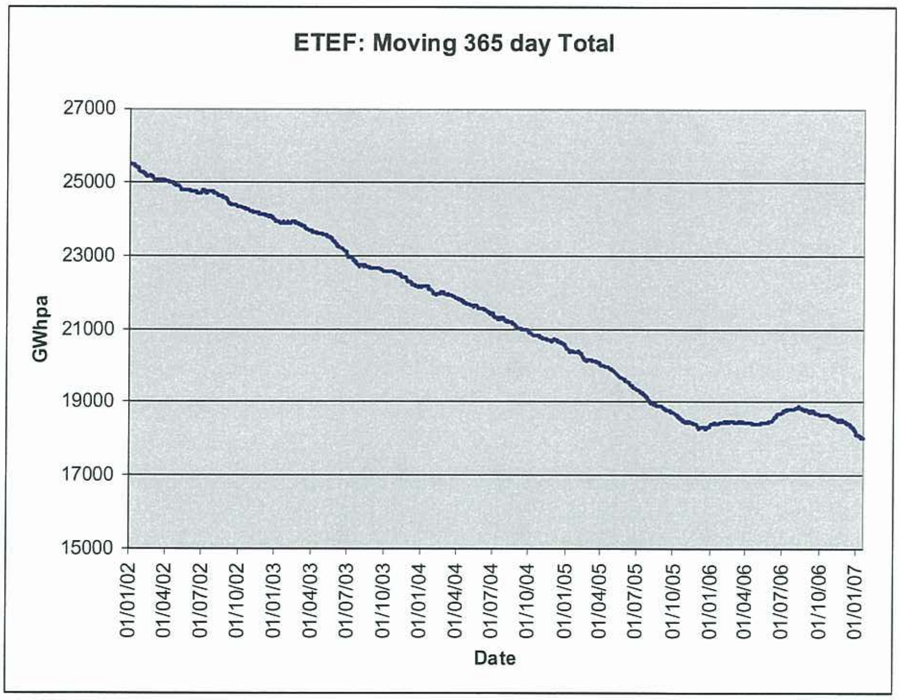
Hedging Costs

Delta has also validated the above estimates by examining the costs of wholesale hedges in relation to the three franchise areas. The estimated hedging costs are within 2% of the above LRMC estimates, with similar relativities.

Retail Competition

The chart below illustrates that retail competition has slowed and the rate of franchise load coming off ETEF plateaued around December 2005. The implication is that the historical rise in hedge market prices overtook the REC rates making it more difficult for retailers to competitively supply franchise customer load with market-based hedges.

Under these circumstances retail efforts are likely to be concentrated on identifying those niche segments where a retailer can construct a cost-effective hedge – this is competition on the margin but not competition for the majority.



Conclusions

From both the LRMC and hedging cost perspectives, it is Delta's conclusion that in order to achieve cost-reflectivity for the franchise load, the allowance for retailers' energy purchase costs should be increased in line with the table above.

Further, the allowance for retailers' energy purchase costs should reflect the substantial differences in the LRMC of each franchise area (a $10/MWh VWA difference between highest and lowest as shown in the table above).

An adjustment to the retailers' franchise energy purchase costs is required to restore retail competition back to the levels prevailing through to 2005.

Delta would be pleased to provide any clarification of the above or any further assistance. If you would like to discuss these matters in more detail, please contact Phillip Colebourn, Manager Sales and Marketing on 02 9285 2751.

Yours faithfully,

Tim Baker

GENERAL MANAGER MARKETING