

INDEPENDENT PRICING AND REGULATORY TRIBUNAL

**REVIEW OF REGULATED ELECTRICITY RETAIL TARIFFS AND
CHARGES FOR SMALL CUSTOMERS FROM 2010 UNTIL 2013**

PUBLIC FORUM TRIBUNAL MEMBERS

DR MICHAEL KEATING AC - CHAIRMAN

MR JAMES COX

MS SIBYLLE KRIEGER

Held at IPART Offices, Level 8, 1 Market Street
Sydney, NSW

On Tuesday, 1 September 2009, at 10.00am

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1 OPENING REMARKS

2
3 THE CHAIRMAN: I would like to begin by saying good
4 morning to everyone here. My name is Michael Keating and I
5 am the chairman of IPART for another week. On my left is
6 Mr Jim Cox, the tribunal CEO, and Jim is a full-time member
7 of the tribunal. On my right is Ms Sibylle Krieger, who is
8 the tribunal's part-time member.

9
10 I should begin by thanking you all for coming today,
11 As you are no doubt aware, IPART has been asked to set
12 regulated electricity retail tariffs and charges from 2010
13 until 2013. We put out on issues paper and draft
14 methodology papers which set out our preliminary thinking
15 on an integrated regulatory package, where all the relevant
16 costs and risks should be accounted for, that they should
17 only be accounted for once.

18
19 This proposed package essentially builds upon our
20 previous determination in 2007. The key ingredients, I
21 guess, are that it includes, first, an efficient cost
22 allowance for a standard retailer, including energy
23 purchase costs, retail operating costs and retail margin.
24 Detailed discussion of the technical reports on the draft
25 methodologies for the wholesale energy cost and retail
26 margins will take place in the afternoon session.

27
28 However, I can say now that IPART will examine both the
29 long run marginal cost and market based electricity
30 purchase cost allowances making allowance for environmental
31 obligations. To enhance transparency, IPART will rely upon
32 publicly available data as inputs to the modelling to the
33 greatest extent that we can.

34
35 The second ingredient of our approach is that we
36 anticipate that there will be a periodic review of energy
37 purchase cost allowances so as to allow for any step change
38 in the electricity market. The third key element is that
39 there will be a pass through mechanism to allow retailers
40 to pass through to customers material changes in costs
41 associated with regulatory or taxation change events that
42 were unanticipated at the time of the determination.

43
44 Fourth and finally, we anticipate that the
45 determination will be based on a weighted average price
46 cap. That allows standard retailers to recover the costs
47 of retailing together with applicable network charges.

1 This average price cap also allows standard retailers the
2 flexibility to set their own cost reflective tariffs within
3 the overall cap.

4
5 We believe it is important to carefully consider the
6 entire package given the current challenges involved in
7 setting retail tariffs. Specifically, those challenges are
8 the nature of the electricity market coupled with
9 uncertainties within that market. In particular, the New
10 South Wales government is privatising the standard
11 retailers and selling the trading rights to the state-owned
12 generators.

13
14 At this stage, the market structure is therefore
15 unknown, but the market structure will in fact impact on
16 this review in three ways: first, the determination will
17 apply to the new owners of the standard retailers, and at
18 present, it is unclear what the structure and therefore the
19 competitiveness of the retail market will look like after
20 the sale.

21
22 For example, if large existing retailers in the
23 national energy market buy the businesses, the market will
24 initially increase in concentration.

25
26
27 Secondly, the owners of the trading rights to the New
28 South Wales generators which represent the vast majority of
29 the generation capacity in New South Wales may bid
30 differently into the national energy market compared to the
31 current generators. This could have an impact on the
32 wholesale price and experience in the national energy
33 market. The electricity purchase cost allowance will be
34 discussed in more detail this afternoon. These
35 considerations will, of course, be relevant there.

36
37 While the New South Wales government has committed to
38 release a strategy document resolving outstanding industry
39 framework issues, uncertainty remains for the moment at
40 least about the schedule of phasing out ETEF. The
41 existence of the ETEF has in the past influenced the
42 bidding strategy of New South Wales state-owned generators
43 and therefore the balance between spot and contract prices.
44 As I am sure you will all agree, a further significant
45 uncertainty surrounds the passage of legislation and the
46 details of the Commonwealth government's emissions trading
47 scheme. It is clear that an emissions trading scheme will

1 increase the price of electricity. The uncertainty
2 surrounds the passage of the legislation and the details of
3 the emissions trading scheme, and that has impacted on
4 market participants and has reduced liquidity in the
5 forward market for electricity.
6
7 Further, it is unclear how the cost of carbon will
8 filter through to final electricity prices in the early
9 years of the emissions trading scheme. The Commonwealth
10 government has recently passed legislation expanding the
11 renewable energy target, and that also will increase prices
12 in the national energy market.
13
14 So in sum, these uncertainties add to an already
15 difficult task of setting a retail price that is fixed for
16 a period of time while wholesale spot and contract prices
17 in the national energy market tend to be volatile and, we
18 have found, difficult to forecast. Wholesale prices can
19 change in response to a range of factors including
20 variations in total demand, gas prices, network constraints
21 and weather conditions.
22
23 It is difficult for a regulator to ensure the retail
24 price is set at an appropriate level and the consequences
25 of setting the price too high or too low are indeed
26 significant. If, for example, the cost estimates are too
27 high, customers who remain on regulated tariff will pay
28 more than necessary to recover the efficient costs of
29 supplying, them and that is contrary to the underlying
30 rationale for regulation in the first place.
31
32 On the other hand, if the cost estimates are set too
33 low an efficient standard retailers will not generate
34 sufficient revenue to cover their costs which may damage
35 their financial viability and the reliability of future
36 electricity supplies as well as hindering the development
37 of effective competition in the market.
38
39 Indeed, against that background, IPART considers that
40 it would be better not to regulate retail prices but to
41 rely on an effective and competitive market to protect
42 consumers. However, the critical point is that it is
43 unclear whether the market is effectively sufficiently
44 competitive now or will be after the sale process, and
45 ultimately that is a question for the government to finally
46 decide.
47

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1 Furthermore, IPART has been given a task which we must
2 carry out, and that is to regulate electricity retail
3 tariffs and charges, but we have to do that in a time of
4 high level risk and uncertainty. So IPART will need to
5 ensure that it makes its decisions on estimates of
6 efficient retailers' costs. But those estimates may turn
7 out to be wrong, so we will also need build sufficient
8 regulatory flexibility into the determination so that
9 regulator tariffs can be adjusted during the determination
10 period if these costs prove to be significantly different
11 from our estimates.
12
13 IPART anticipates that over the 2010 to 2013 period
14 retail prices will increase, that is because, firstly,
15 there are increased network prices which are determined by
16 another regulator, the Australian Energy Regulator; and,
17 secondly, there will be increased electricity costs
18 reflecting the introduction of the emissions trading scheme
19 and expanded renewable energy target, and there may be
20 other reasons why electricity costs are rising.
21
22 IPART will report to government on the impact of the
23 increased charges on customers, in accordance with the
24 terms of reference.
25
26 I am going to hand over now Anna Brakey and Jean Marc
27 Kutschukian from the secretariat. They will make a short
28 presentation on issues the tribunal will consider in this
29 review before I invite stakeholders to make comments.
30
31 There is a technical session that I have alluded to
32 already this afternoon. That will address the more
33 technical issues associated with the energy purchase cost
34 estimates and the retail margin.
35
36 Finally just before handing over, as you have no doubt
37 noticed, the workshop today is being transcribed. It is
38 therefore important that you introduce yourself and state
39 which organisation you represent for the benefit of the
40 transcribed record and that you speak loudly. Thanks,
41 Anna.
42
43
44
45
46
47

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1 PRESENTATION FROM SECRETARIAT
2
3 MS BRAKEY: Thanks, Michael. IPART has developed some
4 preliminary thoughts on its approach to the 2010 to 2013
5 determination. It has focused on identifying the risks
6 that the standard retailers will face and ensuring that
7 the appropriate risks are allocated and
8 considered within the regulatory package but not
9 double-counted. Therefore, when you look at our regulatory
10 package, it is important that we, and you, look at it as a
11 package and not as any one element in isolation.
12
13 As the Chairman indicated, IPART considers that the
14 energy purchase cost and retail margin methodology that
15 were developed as part of the 2007 determination can be
16 augmented to deal with the additional uncertainties and
17 complexities of this determination, so we will be talking
18 about that this afternoon.
19
20 But this morning's session is about
21 stakeholders having the opportunity to comment on broader
22 issues that have been raised in our issues paper and our
23 draft methodologies paper. Specifically that includes the
24 retail operating costs, the periodic review and cost pass
25 through mechanism, recognising that they are likely to come
26 up in this afternoon's session as well and also the form of
27 regulatory control, and by that I mean weighted average
28 price cap and any other additional constraints.
29
30 An important piece of work that the tribunal did in
31 the 2007 determination was an assessment of the
32 competitiveness of the market. The tribunal will also
33 conduct that competitiveness assessment as part of this
34 determination process, and it will do that for two reasons.
35 The first one to inform itself on the form of regulation
36 and what mechanisms are required; secondly, it will look at
37 it to assess the performance of the 2007 determination
38 against its objectives.
39
40 As the Chairman said, it will be difficult for the
41 tribunal to consider the effectiveness of the market while
42 the sale process is going on. In particular the tribunal
43 will not know what the market concentration is likely to be
44 before its draft report in December.
45
46 What we can do is have a look at the information that
47 we have available now, and then also the information that

1 we will have available before December, and see what's
2 happened to the competitiveness in the market. Since 2007,
3 the standard retailers have lost market share to new
4 entrants. This suggests that the current conditions for
5 entry into and expansion of the retail market are a
6 positive influence on retail competition.
7
8 Customers move to and from the regulated tariffs.
9 This diagram shows that since 2006/2007, the percentage of
10 customers on the regulated tariff in EnergyAustralia's
11 supply area has increased and it has increased
12 marginally for Integral Energy over the last year.
13
14 We have also observed that the level of retail
15 marketing activity appears to have decreased and the
16 discounts on offer have decreased from around 10 per cent
17 to 5 per cent off the regulated retail tariff.
18
19 This graph shows the switching activity between
20 retailers in New South Wales. It shows that switching
21 activity peaked in 2007, but that there is still switching
22 occurring. But the rates in New South Wales are
23 below the rates that are experienced in other jurisdictions
24 like Victoria.
25
26 However IPART notes that switching activity in itself
27 is not a robust indicator of the competitiveness in the
28 market. IPART will further consider its full analysis in
29 the competitiveness of the market and look at the
30 requirements in the terms of reference of what it considers the
31 form of regulation that is required.
32
33 The terms of reference will require the tribunal
34 to reduce reliance on regulated tariffs, facilitate the
35 development of effective competition and resulting prices
36 that reflect the efficient cost of supplying small retail
37 customers.
38
39 IPART has formed some preliminary views on the form of
40 regulation. They include that it should not regulate the
41 voluntary green premium component of regulated tariffs, and the
42 stakeholders, in their responses, have agreed with the tribunal.
43
44 The tribunal also feels that the weighted average cap
45 price with the N plus R approach is appropriate, and
46 stakeholders have agreed with that as well. However it is
47 unlikely that a weighted average price cap in and of itself

1 is sufficient and it would require either additional
2 mechanisms and/or a competitive market in order to protect
3 customers.

4
5 IPART does not think that it should apply an
6 additional side constraints limitations on EnergyAustralia and
7 Integral Energy and it should provide for obsolete tariffs
8 to be removed, and retailers have agreed with that.

9
10 IPART also considers that it should not allow the
11 standard retailers to establish new regulated retail
12 tariffs unless there are exceptional circumstances and they
13 have IPART's approval. The retailers have argued for
14 greater flexibility to allow the introduction of time of
15 use tariffs in particular.

16
17 In the 2007 determination, IPART applied an additional
18 constraint on Country Energy requiring it to seek the
19 tribunal's approval if it were to increase prices by more
20 than 5 per cent greater than the average price increase.
21 It also had to seek the tribunal's approval to remove
22 obsolete tariffs if the tariff that their customers were
23 moving to was not at the same level as the obsolete tariff. The
24 retailers have argued in general that these constraints be
25 removed, and IPART notes that Country Energy has
26 undertaken significant tariff rationalisation during the current
27 determination period but has not finalised its
28 rationalisation process.

29
30 In the 2007 determination, IPART included a cost pass
31 through mechanism to account for changes in taxation
32 regulatory events, and most stakeholders have supported
33 including a cost pass through mechanism, although some
34 have argued that the materiality threshold that IPART has
35 applied should not be continued.

36
37 Finally some stakeholders have called for prices to change on a
38 date other than 1 July so that price change date did not
39 coincide with a period of high usage during winter.
40 However, because network prices change on 1 July each
41 year, moving away from that date is problematic
42 and stakeholders offered only limited support for doing so.
43 Jean Marc will talk about calculating retail costs.

44
45 MR KUTSCHUKIAN: The purpose of this presentation is to
46 briefly outline IPART's methodology for calculating retail
47 costs, and the material that I will be going through

1 corresponds to chapter 4 of IPART's draft methodology
2 paper. In keeping with the terms of reference, IPART
3 proposed to estimate the two broad categories of retail
4 costs. The first is a retail operating cost allowance, and
5 this is the efficient cost in performing the retail
6 functions required to serve a small customer base.

7
8 The second allowance is a customer acquisition and
9 retention cost. These are primarily marketing costs
10 involved with both acquiring new customers and retaining
11 existing customers. The CARC allowance also includes the
12 cost of transferring customers, so transfer process costs.
13 IPART proposes to estimate both ROC and CARC on a per
14 annum per customer basis.

15
16 IPART proposes to estimate both ROC and CARC using two
17 approaches. The first is the bottom-up cost approach under
18 which both ROC and CARC estimates are built up from the
19 separate component of these costs. In the bottom-up
20 approach, the data will include both historical and
21 forecast data on costs and customer numbers provided by all
22 retailers, and this is from the information requests made
23 by IPART, also various market research reports and
24 financial year results from all retailers.

25
26 The second approach is the benchmarking approaching
27 under which both ROC and CARC estimates will be based on
28 allowances for electricity retail costs from regulatory
29 decisions in other jurisdictions and other relevant
30 information.

31
32 IPART notes that the proposed methodology here has not
33 changed since the 2007 determination and is broadly accepted
34 by all stakeholders.

35
36 So turning attention now to the retail operating cost
37 allowance, and specifically to how IPART intends to define
38 it, IPART proposes to include the following categories in
39 the ROC allowance: call centre costs, customer information
40 costs, corporate overhead costs, regulatory compliance
41 costs, billing and revenue collection costs, and provision
42 for bad and doubtful debt.

43
44 How we depart from the 2007 determination is that
45 IPART proposes to exclude all marketing costs from ROC and
46 include them in CARC - the customer acquisition and
47 retention cost allowance - and this is to minimise double

1 counting and improve the transparency of these cost
2 allowances. The basic reason for that is that the CARC
3 allowance now includes a provision for defending existing
4 customer base.
5
6 IPART will seek further understanding of the
7 composition of marketing costs to undertake this transfer
8 and, in particular, the objectives of the marketing
9 expenditure. That is the proportion of marketing costs
10 aimed at attracting new customers; I understand also the
11 proportion of marketing costs aimed at retaining existing
12 customers; and the proportion of marketing costs that might
13 be multipurpose in nature, and so that's marketing
14 expenditure that targets both the acquisition and retention
15 of existing customers.
16
17 Finally, focusing on customer acquisition and
18 retention costs, initially IPART intends to estimate four
19 different CARC allowances, and this is to reflect the
20 greater diversity of the standard retailer's customer base.
21 There will be two CARC allowances estimated for acquiring
22 new customers from another retailer - so these are
23 customers that are acquired on standard contract and
24 customers that are acquired on the negotiated contract.
25
26 Then there will be two CARC allowances for defending
27 existing customers. The first will be a provision for
28 customers transferring to the standard contract from a
29 negotiated contract within the same retailer; and the
30 second is a provision for customers transferring to the
31 negotiated contract from a standard contract within the
32 same retailer.
33
34 To estimate each of those four CARCs, IPART proposes
35 to split them into two components. The first is direct
36 acquisition and retention costs; and the second is a
37 transfer process cost.
38
39 The direct acquisition and retention costs are those
40 of soliciting or winning over customers, as well as
41 retaining customers, so, for example, door-to-door selling
42 and other direct-marketing activities.
43
44 The transfer process costs are the costs involved in
45 transferring customers once they've been acquired or
46 decided to switch contracts, and these include registration
47 and internal credit checking, as well as the AEMO's

1 customer transfer procedures.
2
3 IPART's preliminary thinking on each of the CARCs for
4 each customer segment is presented in the draft methodology
5 paper, and that is chapter 4, table 4.1, on page 43. IPART
6 notes that the customer acquisition and retention cost for
7 a new customer on a negotiated tariff forms the ceiling for
8 the customer acquisition and retention costs.
9
10 Finally, to then come up with a single CARC allowance,
11 IPART proposes to amortise each of the four customer
12 acquisition costs and then form a composite CARC by
13 weighting each of those four CARCs by the customer
14 numbers in each relevant customer segment. Thank you.
15
16 ROUNDTABLE DISCUSSION
17
18 THE CHAIRMAN: It is now open to people, firstly at the
19 table, for any comments. I assume that the silence means
20 that there is total agreement.
21
22 MS LYDFORD: Carol Lydford from AGL. I would just like
23 to obviously mention that we are pleased that the tribunal is
24 actually having this round-table discussion. Just the
25 ability to provide feedback is extremely helpful.
26
27 With regards to, specifically, the operating costs,
28 one of the things we would like to see with the
29 benchmarking approach is that that's connected to the fact
30 that those benchmarks are from a different time and place,
31 and we also need to look at all risks now imposed on
32 retailers - things such as CPRS and any new requirements
33 that come up - so those benchmarks, on face value, may need
34 to be adjusted and adjusted specifically for New South
35 Wales.
36
37 One thing we would like to see as well, just maybe in
38 going forward, is consultation. Currently, the timetable
39 shows that the draft report is due out in December with the
40 draft methodology report for the wholesale energy costs and
41 margin and obviously the opex at the same time. We would
42 find it useful if there were some further engagement
43 between now and then, maybe with some of the preliminary
44 thinking.
45
46 I understand that, especially with potential
47 privatisation, a lot of people will be looking at the draft

1 report to potentially be a final, so that people can see
2 how the market is going. So if we could actually,
3 I suppose, look to ensure that everyone's comments and
4 thoughts are taken into account before then it would be
5 helpful. So maybe if there is anything that could be fed
6 back to the retailers for comment prior to the draft
7 report, that would be helpful. Thank you.

8
9 MS BRAKEY: It is a compressed timetable that we are working
10 to. We have developed a process to try and maximise
11 the amount of consultation, and one thing that we've done
12 is, in particular, come out with these draft methodologies
13 and holding today's sessions. So we are really trying to
14 maximise the amount of consultation throughout this
15 process.

16
17 We need to conduct our analysis
18 and we need to hear back what people have to
19 say in response to today and in submissions
20 on the draft methodology reports, and it is highly unlikely
21 that there will be an opportunity for another round of
22 consultation between now and the draft report. The timetable
23 just does not allow it. We do want this to be a
24 consultative process, but, even if we could, the letter that
25 came with the terms
26 of reference asked us to do the review faster, if we can.

27
28 MS LYDFORD: Yes. Thank you.

29
30 THE CHAIRMAN: Can I just add, I don't think it should be
31 inferred that the draft report is necessarily a final
32 report, otherwise we wouldn't bother having a draft report.
33 While I think there is some onus on those who disagree with
34 the draft report to establish the basis for their
35 disagreement, I think in the past the tribunal has been
36 prepared to amend draft reports, not just in electricity,
37 but I can think of other industries where there have been
38 significant differences between the draft report and the
39 final report, where the tribunal was properly persuaded by
40 the evidence that it should change its mind.

41
42 MS LYDFORD: Thank you.

43
44 MR HAMILTON: Graham Hamilton from TRUenergy. Again,
45 thank you for the opportunity of today. There were three
46 comments in the introductory remarks which I would just
47 like to comment upon, and these have been detailed in our

1 submission. The first is that you see the risks of retail
2 pricing as symmetrical. Certainly we don't. We see them
3 as asymmetrical, from the point of view that if costs have
4 been overestimated, the customers still have the
5 opportunity to transfer to a market offer, which will be
6 below the regulated rate, and the competition will erode
7 any excess margins in the market.

8
9 The second point relates to the setting of regulated
10 rates. You mentioned that there should be set an efficient
11 rate to protect consumers, related to the first point.

12
13 Our view, and I think the view of certainly the policy
14 makers when retail regulation was first introduced, was
15 that the regulated rates were seen as a safety net price; a
16 fair and reasonable price within the constraints of an
17 emerging competitive market, but if regulated rates are set
18 at an efficient rate, that does minimise the scope for
19 competition to emerge.

20
21 Our third point, which is again related, is as to the
22 comments that transfer rates are not a robust measure of
23 effective competition. I think we would see that they are
24 a good objective measure of competition. Once you make
25 that acknowledgment, you can look at what has occurred in
26 other jurisdictions, in particular, other jurisdictions
27 with higher transfer rates, which are indicative of
28 retailers actively pursuing customers and acquiring
29 customers, and it is a market that is predominantly
30 retailer driven; where customers will respond to retailer
31 activity; whereby high transfer rates reflect competitive
32 activity and, effectively, a competitive market.

33
34 If you look at what has actually happened particularly
35 in Victoria, where competition has been in the most
36 successful competitive market in the world to date, that
37 regulated price was not tied to efficient pricing, but was
38 actually allowed to vary within a reasonable range in
39 response to the market conditions, and to the extent that
40 competition wasn't emerging during those early years, the
41 regulated price was allowed to respond to those market
42 developments and set it within a reasonable range, which
43 allowed retailers to enter the market and establish what
44 has been a very competitive market.

45
46 I think the objective evidence supports the fact of
47 the success of the Victorian market, and being able to

1 compare it directly to New South Wales on that basis, it
2 then leads to, well, where has New South Wales been
3 ineffective in allowing the market to transition to
4 cost-reflective pricing within a reasonable band and
5 encourage retail entry and aggressive market acquisition
6 programs? Establishing the differences and the rationale
7 between those two jurisdictions, we can look at how New
8 South Wales could achieve that level of competition.

9
10 THE CHAIRMAN: I might just make an observation on that.
11 There is a substantial amount of agreement between you and
12 the tribunal. Indeed, when we made our last determination,
13 in 2007, at the time we convinced ourselves we were setting
14 prices high enough to achieve further progress towards a
15 competitive market. That was a factor in our thinking and
16 influencing our judgment.

17
18 As it turned out, we got the prices too low and they
19 were revised earlier this year. We acknowledge that we got
20 them too low. They were revised.

21
22 I think it is probably fair to say that it is too
23 early yet to see what the impact of the revised price
24 increase - which was announced in May; is that right?

25
26 MS BRAKEY: Yes.

27
28 THE CHAIRMAN: Right. So a couple of months ago.

29
30 It is too early to determine whether that very
31 substantial increase - an increase, I might add, that we
32 were widely criticised for announcing - whether we will
33 have righted the economic shift, if I can put it that way.
34 So I think we are not poles apart on this.

35
36 Indeed, while personally I have some doubts about the
37 viability of regulating prices when the wholesale price is
38 so volatile - and I have alluded to that in my earlier
39 remarks - at the end of the day, we are obliged to follow
40 our terms of reference and, indeed, the legislation, and,
41 clearly, the government does see a role for protecting
42 consumers as well. We are trying to get the right balance
43 in that context.

44
45 We haven't heard from any of the standard regulators.

46
47 MR MARTINSON: Mike Martinson from Integral Energy. First

1 of all, like the other retailers, thank you for the
2 opportunity to attend the round-table session today.

3
4 I guess first of all, from Integral's perspective,
5 with regard to the framework that the tribunal has put
6 forward in the draft methodologies paper, we are generally
7 comfortable with that. We think it is a pragmatic approach
8 to actually continue on with the positive elements from the
9 2007 review that we think were quite effective. As a
10 starting point, starting with the 2007 determination and
11 only changing, therefore, where new developments warrant,
12 seems to be quite pragmatic. We think it meets the terms
13 of reference, so we are largely comfortable with the
14 overall framework. I think it is also something that, just
15 reflecting, some of the regulators in other jurisdictions
16 are picking up on IPART's framework generally, so I think
17 overall it probably gets a tick from that perspective.

18
19 Certainly there will be more discussion, obviously,
20 possibly later this morning, but certainly this afternoon,
21 on analysis relating to the energy purchase costs, so
22 I won't really touch on that now.

23
24 Picking up on one of the previous comments about
25 whether the risk is symmetrical between setting regulated
26 prices that are too high or too low, I certainly share the
27 view that we don't believe it is a symmetrical risk
28 profile, and that actually if prices are set too high - and
29 too high in the context of being prices set above the
30 marginal costs - will enable competition to come in. So if
31 we're saying that prices are higher than the underlying
32 costs, it isn't sustainable, competition won't come in, we
33 don't see that as a symmetric risk profile. Obviously,
34 prices set too low really will result in potential
35 hardships, lack of viability, I guess, on the retailers,
36 which certainly isn't conducive to a competitive market.

37
38 I guess the third area, and it is probably a
39 comment/question, is that, certainly from the risk profile
40 that you have set out in the draft methodology paper,
41 we think it generally seems to be reasonably appropriate.

42
43 I would make a couple of comments, I guess. We have
44 some concerns, or interest, more likely, in how you define
45 step changes versus normal activities. Clearly, depending
46 on where you draw that line, there could be significant
47 differences.

1
2 One comment in particular: there is certainly a lot
3 of discussion in the methodologies paper on pass-throughs
4 and, in particular, a potential pass-through in the event
5 that there is a retail transaction, a sale in the future.
6 I have to say, reading the terms of reference, I didn't
7 necessarily get the sense from reading that that there was
8 a requirement to build a pass-through arrangement following
9 any potential sale, and it would be good to get some sort
10 of comment from the tribunal as to where the thinking is on
11 that and, in terms of certainly moving forward, what type
12 of arrangement you would be looking at.
13
14 MS BRAKEY: On the pass-through, I what we were
15 saying is there are two mechanisms: there is the annual
16 review and a cost pass-through mechanism. So the
17 cost pass-through mechanism would deal with any regulatory
18 or taxation change event. To the extent that there was
19 a regulatory change that arose from the sale process, it
20 could potentially be picked up through that mechanism.
21
22 What we are saying in terms of the
23 annual review and in relation to the generators is that the
24 generator bidding strategies will change with ownership
25 changes, and you saw that in the 2009 annual review
26 ownership structures led to bidding changes within the
27 modelling, and that did deliver a different price outcome.
28
29 So what we are saying is we can't anticipate, at this stage,
30 the ownership structure of the generating trading rights,
31 and that might ultimately affect the bidding structure.
32 As a pragmatic way through this issue, we will have
33 regard to the current structure when making the
34 determination. And then, as we did in the annual review this
35 year, when the ownership structure changes, the tribunal
36 will have regard to that changed ownership structure in
37 developing up the energy purchase cost allowance.
38
39 MR MARTINSON: It is only in terms of the energy purchase
40 cost allowance? In reading through the methodologies
41 paper, it wasn't clear to me if it was looking at it from,
42 I guess, a costs and margin perspective as well or if it
43 was just limited to changes in the energy purchase cost
44 allowance that could be, I guess, consistent with any other
45 types of changes in purchase costs that would be triggered
46 in your annual review.
47

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1 MS BRAKEY: As I said, to the extent that if there was some
2 regulatory change basis to it, then that would feed into a cost
3 pass through. But, in fact, we are talking about a retailer of
4 scale anyway, and so it wouldn't impact on the retail operating
5 costs or margins.
6
7 Is that right, Stephen?
8
9 PROF GRAY: We will probably say more about this this
10 afternoon. What we did last time, what we're likely to do
11 this time, is, in our advice to the tribunal, recommend a
12 range. Do you have in mind that a value should be chosen
13 other than the mid point of the range to compensate for the
14 asymmetric risk? Is that what you guys are getting at?
15
16 MR MARTINSON: First of all, on the discussion on margin,
17 I guess it was probably just more a response to saying,
18 from previous comment from the chairman that the risk was
19 symmetric, I don't necessarily believe that the risk is
20 symmetric in the level and the approach to where IPART sets
21 its allowances more generally, and, again maybe we can
22 discuss that in more detail in the margin discussion this
23 afternoon.
24
25 It's back to Anna, I guess, on the question relating
26 to whether or not a pass-through arrangement as part of a
27 retail sale is part of the question you were asking Stephen
28 for?
29
30 MS BRAKEY: Yes, sorry, it was in relation to the scale.
31 We haven't defined the scope of the annual review as
32 yet, and it's an open question, but I don't think
33 we would include margin - because the margin advice is
34 about systematic risk, and I don't think that this impacts
35 on systematic risk. So I don't see that the margin, in
36 itself, would change.
37
38 Retail operating costs - we're assuming scale in terms
39 of the retailers, regardless of who owns it, and so I can't
40 see that changing. So that leaves the wholesale energy
41 purchase cost as the area that the sale process would affect.
42
43 MR MARTINSON: So, just to paraphrase that, if you were
44 looking at something in some sort of annual review or some
45 pass-through/annual review arrangement, in the event of a
46 transaction of the retail businesses, what I'm hearing is
47 that you think what you would be setting in the

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1 determination for the operating costs and the margins would
2 hold, and you would then be looking at any potential change
3 in energy costs based on some bigger potential changes in
4 bidder behaviour; is that a fair assessment?

5
6 MS BRAKEY: They are preliminary views, but yes.

7
8 MR MARTINSON: Okay. Thank you.

9
10 THE CHAIRMAN: Just to be clear, also, what gets into
11 pass-through, and obviously what gets into the annual
12 review - what gets into a pass-through is basically
13 something over which you have no control and where you
14 can't adjust to the answer, even. For example, a tax
15 change or the decision by another regulator to change
16 distribution costs that you pay, they get into a
17 pass-through. But something which you can respond to by
18 altering, if you like, your configuration of purchasing or
19 whatever, where costs might be absorbed by the seller or
20 whatever, that would be in the annual review.

21
22 MR COX: Perhaps it is just worth saying, I don't think a
23 transaction by itself would affect the determination, it is
24 just that the transaction leads to consequential changes in
25 the market that would be need to be reflected in the energy
26 purchase costs.

27
28 MR MARTINSON: That wasn't clear to me from the
29 methodology paper.

30
31 MS BRAKEY: There is another point of clarification, if I
32 could just make it. I don't think that Mike said that the
33 risks were symmetrical. He said there are risks on both
34 sides of setting the price too high and too low, but he
35 didn't say that those risks were symmetrical.

36
37 MS LINDSAY: Natalie Lindsay from Country Energy. Thanks
38 for the opportunity to speak today. I would just like to
39 make a few comments on the general form of regulation.

40
41 The current determination period for the weighted
42 average price capping phase, I think, from our perspective,
43 has been quite effective in actually allowing us to
44 rationalise tariffs for the first time in many, many years.
45 So in terms of our strategy, we have progressed quite well.
46 We probably have one step of the process to go. For that
47 reason, we think it is important that the current weighted

1 average price cap is maintained.

2
3 In terms of the threshold test for Country Energy, we
4 don't really see a need for that going forward. During the
5 current period it wasn't really an issue for us at all,
6 and, going forward, it is more of a regulatory burden than
7 anything else.

8
9 For the last determination period, we actually believe
10 the periodic review needs some enhancements. I think we
11 all realise that competition has been somewhat subdued
12 during the past period. We think the periodic review
13 should be in line with the AEMC's recent report, the Second
14 Interim Report for its Review of Energy Market Frameworks
15 in light of Climate Change Policies. What we have
16 recommended in our proposal, and we hope the tribunal will
17 consider, is more frequent reviews, as often as six months,
18 and also a review that can be initiated by a retailer.

19
20 We think that if that sort of mechanism had been
21 available during the current period, some of the
22 cost-reflectivity issues may have been avoided. For
23 example, the 2008 review concluded that energy purchase
24 costs had not changed enough to trigger the energy purchase
25 cost allowance threshold, and if we look at our historical
26 costs, it is clear that this threshold has been breached.

27
28 In terms of operating costs, I actually support the
29 comments of AGL. I think benchmarking the cost is fine,
30 but we do need to consider that things have changed and,
31 going forward, things will change. There is a lot of
32 change in the industry; the CPRS is coming in; the National
33 Energy Consumer Framework will also impact. So those are
34 things that aren't captured in the current operating costs,
35 and benchmarking from that perspective may result in some
36 error. So it is important that those issues are
37 considered. Thank you.

38
39 THE CHAIRMAN: I might just make some observations on
40 reviews and their frequency. We have not reached a
41 position, but I think it is fair to say that the background
42 to the 2007 determination was that we were trying to
43 provide a definite answer in that determination, and that
44 was against the background of wanting to provide certainty,
45 and that meant we weren't keen on having reviews. So when
46 we did have a review, we tried to reduce the amount of
47 discretion as much as we could. We had a very mechanistic

1 approach to how we would conduct the review and how we
2 would incorporate a change in the wholesale price analysis.

3
4 It is fair to say our thinking now is that the range
5 of uncertainty - the various sources of uncertainty - is so
6 large at present and for one thing, we don't see it as
7 being nearly as mechanistic as last time. The review will
8 therefore be more demanding upon us all than it was last
9 time where we deliberately tried to make it non-demanding.

10 We will not have the advantages of certainty. That is
11 because the world is uncertain at the moment. We can't
12 make it certain, but it is probably a similar situation
13 where it is much more likely, but there certainly will not
14 be an attempt as last time to reduce the chances of a
15 review, if I can put it that way.

16
17 On the question of the frequency of the review, our
18 jury is out on that at the moment. What I think I can say
19 is that there is not a great disposition towards an
20 enterprise-initiated review. As to the practicalities of
21 that, essentially the proposition is if you charge too much
22 you give rebates back to people following the review. We
23 have some doubts about the practicality of that.

24
25 Having submitted myself to lots of radio media
26 interviews just a couple of months ago, I wouldn't relish
27 having to explain that system to shock-jocks. So my hunch
28 is that it would not be widely relevant.

29
30 MS LINDSAY: I understand that from what you have said in
31 the methodology paper.

32
33 THE CHAIRMAN: If the government and the public at large
34 so trusted you people, we wouldn't be regulating in the
35 first place.

36
37 MS LINDSAY: We have actually discussed this internally at
38 length. I think our preference is obvious that it should
39 be a retail initiated review, but there also might be some
40 ground for compromise in terms of what does end up in the
41 final determination, whether that be a retail initiated
42 review subject to IPART's approval, or something along
43 those lines.

44
45 THE CHAIRMAN: You need to work out the mechanism,
46 though. We can take a supplementary submission from you
47 on that, if you like, just going into consultation. But our

1 disposition is not very supportive. Anna, did you want to
2 add anything to those questions raised?

3
4 MS BRAKEY: Just to add further clarification to the
5 Chairman's point, I think he is speaking specifically about
6 the AEMC's preferred model in its second interim report on
7 the climate change review, and that was whether the
8 retailers institute their own change and then it can be
9 rebated if not justified.

10
11 THE CHAIRMAN: Thanks, Anna. There were a couple of
12 other issues that were raised.

13
14 MR COX: Can I just say, before Anna continues, that I was
15 interested in your comment that you were basically
16 favouring more frequent reviews despite the fact you would
17 have to resource them. I thought that was an interesting
18 comment.

19
20 MS LINDSAY: To resource them?

21
22 MR COX: Meaning you would have to work yourselves to
23 participate in those reviews.

24
25 MS BRAKEY: In response to your other question, in our
26 draft methodology paper we did acknowledge that there were
27 changes that would need to be accounted for when looking at
28 benchmarks. So we are aware of that.

29
30 THE CHAIRMAN: EnergyAustralia.

31
32 MS MARSHALL: Catherine Marshall from EnergyAustralia.
33 Thank you for the opportunity to say something today.
34 There are some really good points in the methodology paper.
35 We agree with the continuing on with the approach, which
36 has allowed the flexibility to get rid of obsolete tariffs.
37 Obviously we did not have quite as many as Country Energy,
38 but still it enables us to supply our systems.

39
40 There are probably some concerns we have around the
41 proposal on customer acquisition and retention cost. We
42 don't necessarily agree with the assumptions that have been
43 made. We will obviously go into more detail with that in
44 our response.

45
46 We think the comment about having more transparency
47 around the criteria report is a good step forward and it

1 helps us better understand how the wholesale energy costs
2 are being determined. There is the continual issue - the
3 devil is in the detail - as to how the methodology plays
4 out. There is a broad scope there, so decisions could be
5 made that do meet the outcome of the methodology, but how
6 that plays out into actual numbers will be where it does
7 become interesting.

8
9 THE CHAIRMAN: Thank you for that.

10
11 MS HUGHSON: I am Bev Hughson from Origin Energy.
12 Again, thank you for the opportunity. A lot of things that I
13 was going to say have already been covered by various
14 commentators. I would like to say that I appreciate some
15 of your responses to those remarks. They show a real
16 desire to identify and address the issues and a real
17 recognition perhaps of the need to consider some of the
18 things that didn't work so well in the previous
19 determination, and that is really good to see

20
21 The proposal to do this competition review and to look
22 critically at what happened in the context of that is
23 excellent. Rather than repeat what others have said, I
24 would just endorse them. More generally, one of the big
25 questions in our mind is why did the 2008/2009 review
26 process, the interim review processes, not pick up those
27 trends? Again you have heard us talk about that and I
28 appreciate the recognition.

29
30 It is really a matter of emphasising that the thinking
31 that will go into how this next review process will occur
32 will be so important. Even if we don't have another round
33 of discussions before the draft decisions, perhaps there
34 could be some interim papers put out on that particular
35 issue: one, because clearly something didn't work very
36 well; but also if ETEF wasn't there, the impact on the
37 businesses of that 2008/2009 decision would have been very,
38 very significant. Whilst statutory retailers were to some
39 extent protected by ETEF, had they not had that protection,
40 which will not be available presumably in the future, that
41 really would have been a quite a major thing. Anyhow I put
42 up for your consideration that maybe that could be covered
43 by issuing as a separate set of papers.

44
45 THE CHAIRMAN: Let me say I don't see us putting out
46 papers in advance of the draft determination for two
47 reasons. One reason that has already been given is the

1 shortage of time with the whole process. Secondly, I am
2 not sure what purpose they serve.

3
4 I suppose where I am coming from is I think we are
5 going to have a methodology that is as robust as it can be
6 given what we currently know. The real problem with this
7 determination is the set of uncertainties about what we
8 don't know --

9
10 MS HUGHSON: Absolutely.

11
12 THE CHAIRMAN: -- and what we still won't know in two or
13 three months, I suspect. Maybe some of them will be
14 resolved, maybe the CPRS will be passed by the parliament
15 next week - possibly not. So that will be just as
16 uncertain in the future.

17
18 The sale process and how new owners conduct their
19 pricing strategies in the wholesale market will still be
20 unknown. There are a series of unknowns now that won't be
21 resolved, so that is fundamentally the reason for a review,
22 to build in a mechanism for that and, frankly, more
23 frequent reviews.

24
25 As I have said, we haven't made up our minds as to what is the
26 appropriate frequency, but we are anticipating more
27 frequent reviews, because of these unknowns. However,
28 I don't think myself that putting out an interim paper
29 before the draft report will help enormously. We will be
30 putting out the best methodology we can given what we
31 currently know, and that is likely to stay roughly what we
32 currently know till Christmas, I expect, or close to
33 Christmas.

34
35 MR COX: There will also be the opportunity, of course, to
36 comment on the draft report and that is an important
37 opportunity.

38
39 MS HUGHSON: I suppose I am seeing that as a leading
40 indicator of how this tribunal will think about the risk that
41 all these unknowns bring into it. It is not that I am talking
42 about specifying the unknowns, because many of them
43 will still be unknown there. I think probably what is
44 important for the world at large to understand is how you
45 think about dealing with this. Will you be looking at 12
46 monthly reviews? Will you be looking at retrospective
47 reviews? Will you be looking at six months? You have

1 already made some indications of that. I think that
2 understanding will be the input into retailers and other
3 stakeholders' concern or assessment, if you like, of how
4 errors can be addressed and --

5
6 MS BRAKEY: Just on that point, I said in my comment that
7 I think it is really important that we all look at the
8 regulatory package in its entirety and not look at any
9 specific element. It is very difficult for us to come out
10 with one small piece of something that you can't see how it
11 all fits together.

12
13 MS HUGHSON: I do appreciate that.

14
15 MS BRAKEY: Given we are coming out with a draft
16 determination in December, it is very difficult for us to
17 come out with a substantive additional round of
18 consultation between now and then. It is impossible.

19
20 THE CHAIRMAN: Could I ask you a question in terms of
21 what you just said. One of the things that will be in the draft
22 determination are expectations about future reviews, the
23 criteria for them, further frequency or whatever. My
24 colleague Jim Cox just asked how Country Energy felt about
25 six monthly reviews. Traditionally, price reviews are
26 never more frequent than a year because the decision has
27 been made that that is the right balance between a lot of
28 work and getting the answer right. So how do you feel
29 about six monthly reviews versus annual?

30
31 MS HUGHSON: I think in the first two years it depends;
32 obviously that is qualified by what is being reviewed and
33 what is the approach to that, so I am talking a very
34 abstract principle. The annual reviews are probably a
35 reasonable compromise. I think because there is so much
36 uncertainty about 2012/2013, there is so much uncertainty
37 about how the monthly auction process may or may not evolve
38 and how that might change prices in a much shorter time
39 frame in a way that is not quite so understood, that will
40 be intertwined in the methodology as well, as to how that
41 is picked up. I am not particularly enamoured of six
42 monthly reviews in the first two years. I am not sure
43 there is a need for that, subject to what the general
44 framework looks like, but we should be open to those
45 considerations as we go forward into the last year.

46
47 That is really what the AEMC were looking at when

1 they were talking about six monthly reviews in the period
2 in the lead-up and the commencement of the CPRS, the full
3 CPRS.

4
5 THE CHAIRMAN: Is there anybody in the audience that
6 would like to weigh in at this point?

7
8 MR MORRIS: Daniel Morris, from Jack Green Energy. Just
9 like everybody else I think we agree that we are happy that
10 we are at least moving forward. To some degree we
11 emphasise with the issues that you guys have with greater
12 uncertainty. Basically we agree with most of the points
13 that have already been raised.

14
15 I think the six-month review, particularly later, on
16 is a good idea. The main reason for that is looking at the
17 historical point of view, like markets in Europe which have
18 already done this. I have previously bought green
19 certificates at 25 euros and I have bought them at 5 cents
20 in the same year. So setting an annual number just does
21 not seem like a particularly smart idea, because it is
22 prone to error. It is significantly prone to error. Maybe
23 a more regular review of that can help align it a little
24 bit better. We don't envy your position at all. You're
25 going to be left or right. You will never get it smack in
26 the middle; so maybe a more regular process could address
27 that.

28
29 In addition to that, it may be an education process.
30 We get a lot of flak from the public about step changes and
31 all those things. We perhaps need to have an organised
32 program between all the retailers that just goes out to the
33 public saying, "The price will be increased because of
34 green. If you want to save the planet. This is what it
35 will cost."

36
37 Maybe there needs to be a more sort of cooperative
38 view of trying to work together to put forward that there
39 is going to be a step change so that people don't get hit
40 in the back of the head and see this big news story and, as
41 you know, the news will tend to run with something that is
42 particularly lopsided.

43
44 One other point that has not been raised yet that we
45 would like to add is also the cash requirements with
46 Prudential. Sales in the future will obviously shift that
47 and costs will increase based on stumping up a hell of a

1 lot of money to hedge. We are interested in finding out if
2 those costs will come in early or whether they will wait
3 for the sale of the businesses to sort of take that into
4 consideration.

5
6 THE CHAIRMAN: Thank you. I might deal with your last
7 point. I did I say in my opening remarks that I would
8 expect price rises, which is not something we normally do
9 when hearing a price determination. That is consistent
10 with what you were saying about the public needing to be
11 prepared for that.

12
13 Secondly, one of the arguments for more frequent
14 reviews which we have not touched on is the size of the
15 price shock if you leave it for quite a while. Again,
16 reflecting on the experience of a few months ago, I am not
17 sure it would help that much if it is early, because it
18 will be a big price increase whenever we had it is the way
19 the market works. Potentially in a rising market, if you
20 do it more often with smaller increases, and that can
21 possibly help, at the margin, public perception, but you
22 would not want to overstretch that.

23
24 The third point I want to make is that one
25 possibility - which we have not - in terms of the frequency
26 of reviews is that they are set by threshold, which is what
27 we did last time, actually. There would be a question then
28 of how high you set the threshold. Presumably the most
29 obvious thing would be to set it in terms of the wholesale
30 purchasing cost of electricity. Just how high you set it
31 and how you assess whether it is being overtaken or not,
32 that is something you may want to reflect on.

33
34 MS LYDFORD: May I make a few more comments again.
35 Firstly we support Truenergy's comments that the regulated
36 tariff should be set using the safety net approach for
37 customers. That will help increase the competition in the
38 market. As you noted in your report, effective competition
39 between retailers provides the most powerful protection for
40 consumers from inefficient prices.

41
42 Secondly, we definitely support Country Energy on
43 their views that there be retailer initiated reviews for
44 material increases where there are pass through costs,
45 whether it be CPRS. We suggest in our report that we
46 support the second recommendation of the AEMC on the
47 retailer reviews, with the retailer increasing and then

1 obviously coming through for review post increase.

2
3 Lastly, you mentioned increasing threshold, we are
4 finding that the current rate of 10 per cent is too high.
5 If it comes in at 9.5 per cent, it is actually not an
6 increase, so we would be actually looking to see some kind
7 of cumulative consideration where it is getting higher and
8 potentially just actually looking to remove the threshold
9 altogether or bringing it down. But we have yet to give
10 more consideration to that, thank you.

11
12 THE CHAIRMAN: If you want to pursue the retail initiated
13 review, but we don't get into retailers actually setting
14 the price and then us attempting to claw it back later on -
15 that distinction which Anna drew attention to - and if you
16 wanted us to pursue that as a serious proposition, you
17 might want to think about what criteria the retailer would
18 use to justify it. Just to say a retailer can do it
19 whenever a retailer feels like it, some people might see
20 that as akin to no regulation at all. You might want to
21 think about that because if you do come up with a set of
22 criteria, it might be just as easy for you to say that the
23 tribunal initiated the review on those criteria.

24
25 Just one other point: the discussion so far has
26 tended to take the existence of competition as axiomatic,
27 as being a good thing and that it will lead to lowest
28 possible prices. I don't personally want to debate that
29 proposition, but the submissions we get from public
30 interest groups don't accept that proposition in its
31 entirety. They tend to argue that competition is not an
32 end in itself; it has to be seen to deliver benefits.
33 They explicitly have said that - that is one submission -
34 and that they can't see that setting the regulated price
35 high in order to allow retailers then to offer discounts to
36 contracted customers is a good thing.

37
38 The thing at the back of their mind is that not
39 everybody's contract can offer discounts. It might apply
40 particularly in the country areas, and so they need to be
41 persuaded that competition will achieve the results that
42 are being mentioned. They don't accept that competition
43 should be the index. What they would emphasise is that
44 lower prices that are available to everybody is the
45 objective, not competition. Unfortunately they are not
46 here to say it for themselves, but I think I have
47 paraphrased their opinions.

1
2 MS KRIEGER: When you are thinking about any form of
3 retailer initiated change, it is worth saying that we have
4 very little enthusiasm for any retrospective form of
5 regulation, that the whole system has been a
6 forward-looking thing. I think Origin mentioned the
7 concept of reviewing it retrospectively. I think we can
8 basically forget that.
9
10 MR HAMILTON: Just in regard to the retailer initiated
11 process, which is something we would also support, it is
12 important to recognise that retailers do have an incentive
13 not to reopen too frequently from the point of view that
14 there are competitive pressures to be seen if you increase
15 prices too frequently. There are cost pressures in terms
16 of our internal costs of going through the process. So
17 there are inbuilt disincentives for to us to do it which
18 impose their own threshold on the need for a re-opener
19 itself.
20
21 Again looking at the Victorian model, it is
22 essentially a retailer initiated process. If you look at
23 the legislation and subsequently the way it was imposed by
24 the Victorian government it was very much retailers
25 proposing prices, government assessing them on the basis of
26 them being fair and reasonable again, rather than
27 efficient, fair and efficient reasonable prices. That does
28 provide a model which you could look at. If you talk to
29 the Victorian jurisdiction about how it was implemented, it
30 was very much about retailers going forward, justifying
31 their costs and being assessed about whether they were
32 reasonable in terms of going forward.
33
34 THE CHAIRMAN: What I was getting at earlier is that if
35 you go down the route with the retailer in justifying
36 reopening, you don't get a very different set of criteria
37 when the tribunal is bound to reopen.
38
39 MR COX: Perhaps also we are saying that we have to answer
40 to the terms of reference and emphasise, if you like
41 efficient costs, efficient prices rather than fair and
42 reasonable prices, and there is a difference.
43
44 MR PRICE: Danny Price, Frontier Economics. I was about
45 to say what Jim just said then. Before I do that, New
46 South Wales does not have a proposed respond model. It is
47 not the way that this framework is established. It is a

1 very different framework. It is very consistent with what
2 has happened for many years and that will not change
3 between now and the end of the determination.
4
5 The terms of reference are really clear in terms of
6 the basis on which IPART is to do this determination -
7 wholesale costs, retail costs very clearly on the basis of
8 efficient costs. It is not a safety net tariff.
9
10 That is not to suggest that the government has not
11 been mindful of the need to encourage a competitive market.
12 In fact the entire first page of the terms of reference
13 talks about the context in which this review is to be done;
14 that is, to encourage the operation of a competitive market
15 but it is also very interested in balancing the interests
16 of protecting customers. Some customers will probably
17 never want to switch.
18
19 So the government has a clear policy position to offer
20 those tariffs on an efficient cost basis at least until
21 2013. The government has made it really clear that it will
22 be conducting a competition review in 2011 with a view to
23 getting rid of that retail price regulation at the end of
24 2013.
25
26 You might want a proposed respond model. That won't
27 happen. That is not this framework, you might want it to
28 be a safety net tariff, but the tribunal is bound by the
29 terms of reference, which is an efficient cost basis. That
30 is clear.
31
32 MR O'REILLY: Cameron O'Reilly from the Energy Retailers
33 Association of Australia. First of all can I say that we
34 sympathise with the tribunal in the task that it has been
35 given to try to predict the price direction into the next
36 period of 2010/2013. The sorts of complications you are
37 facing, not just with CPRS but also the market structure in
38 this state, certainly make for a challenging three-year
39 determination. We note the comments by the chair in
40 recognising that, and we appreciate those sentiments.
41
42 We still need to remind the government that it has
43 signed an agreement which says that retail price
44 regulations and transitional mechanisms will give effective
45 competition and then should be phased out. That is why I
46 guess at the end we would still say that is the ultimate
47 objective of every price determination.

1
2 The terms of reference, for the last determination and
3 for this one, are very much focused on the needs and costs
4 of a mass market image of retailers to encourage
5 competition in New South Wales. For that reason, in terms
6 of what Anna put up on the screen on market share by the
7 standard retailers, I think going forward, particularly if
8 we assume that post privatisation there will be no ETEF
9 mechanism, the focus should be on monitoring competition on
10 the level of market share held by new entrant retailers. I
11 assume there will be some form of standard retailer under
12 the privatisation model.

13
14 A good barometer in Victoria, if you have an
15 effectively competitive market, particularly in an industry
16 like retailing, which is about barriers to entry, is the
17 market share achieved by new entrant retailers. That has
18 been going backwards; you could say the last three years
19 have achieved the objective of bringing large new mass
20 market new entrant retailers into New South Wales. Some
21 might say it is not just the cost but also the existence of
22 ETEF. But going forward, assuming all those issues are
23 resolved, I think a better and more informative way of
24 testing the effectiveness of realising the terms of
25 reference given to you will be the market share held by new
26 entrant retailers in New South Wales.

27
28 MS BRAKEY: When I put those slides up, they were just two
29 slides that provided updated information since the 2007
30 determination. We will be conducting a full analysis of
31 the competitiveness of the market. That was only a very
32 small subset, just to give a bit of a flavour of what has
33 been happening.

34
35 THE CHAIRMAN: Perhaps I should just remind you of a
36 difference in the terms of reference this time from last
37 time. Last time the terms of reference referred, as you
38 said, to the mass-market new entrant; this time they don't.

39
40 MR O'REILLY: I note that, Mr Chair, but I note that the
41 Government, who give you the terms of reference, still have
42 an agreement which says that price regulation is a
43 transitional mechanism to create effective competition.
44 They have agreed to having this market reviewed in 2011 for
45 effective competition, and, therefore, we would assume that
46 if they give you the terms of reference, that is still
47 their objective.

1
2 THE CHAIRMAN: I'm not sure what agreement you are
3 referring to. If it is the COAG agreement --

4
5 MR O'REILLY: It is the Australian Energy Market
6 Agreement.

7
8 THE CHAIRMAN: This is a matter for the government as to
9 when it makes that decision, and they have said that there
10 is sufficient competition.

11
12 I just note that the South Australian government has
13 decided to continue retail price regulation,
14 notwithstanding the fact that the AEMC came to the
15 conclusion there was sufficient competition in South
16 Australia, and I also note that the amount of competition
17 in South Australia is measured by the number of people with
18 standard contracts, subject to price regulation. It is
19 quite a lot higher than it is in New South Wales. That is
20 a matter for the government to determine. We are bound by
21 the terms of reference.

22
23 Are there any more comments?

24
25 MS HUGHSON: I just wanted to go back to a point that was
26 highlighted before when I mentioned retrospective recovery.
27 I perfectly well understand where you were coming from in
28 your response to that. It was more in the light of it
29 being one option. But I would like to comment that it does
30 also highlight the fact that if there is, if I can call it,
31 a regulatory error, there is really no compensation
32 mechanism in the process. It might forward-adjust for
33 forward expectations, but it never says, even under the
34 review process, "Oh, gee, we got it wrong; retailers have
35 lost a heap", or, alternatively, "Customers have paid way
36 over the top."

37
38 THE CHAIRMAN: Yes, there are swings and roundabouts.

39
40 MS HUGHSON: Yes, but in particular, because I think it is
41 not an asymmetric risk - "Retailers lost a bit, okay, we
42 will close the book on that and move forward" - I think we
43 need to understand that that is a real issue.

44
45 It is inevitable, and I don't know what the answer is,
46 but it is part of the asymmetric nature of risk that it has
47 a time dimension as well. There is no correction

1 retrospectively, and that needs to be considered when
2 retailers are looking at these businesses, that there is no
3 going back, if you like, and a loss is a loss and it is
4 locked in.
5
6 In a different sort of market there are ways that you
7 can adjust for that loss going forward, but you can't
8 necessarily do that with a regulated price, which is what
9 I think is the more pertinent point: rather than expecting
10 the tribunal to agree to some sort of retrospective
11 adjustment; just acknowledge that there is that time
12 dimension in the risk as well.
13
14 THE CHAIRMAN: I think we do. That is why we are talking
15 about having more frequent reviews.
16
17 MS HUGHSON: Absolutely.
18
19 THE CHAIRMAN: And/or having a threshold that is set so
20 that there is not too big a loss to either retailers on the
21 one hand or to customers on the other hand, where the
22 customers have been paying too much. That is exactly why
23 we are having this conversation.
24
25 Well, I don't wish to prolong people here
26 unnecessarily. We will resume at 1 o'clock. Is that the
27 idea?
28
29 Can I just say, it might be useful if I make a couple
30 of observations about the discussion so far, just so that
31 you can contradict me when we resume if I have got it
32 wrong.
33
34 I think there is a general acceptance that there is
35 considerable uncertainty this time - more uncertainty than
36 last time - and even if the new sources of uncertainty
37 didn't exist, I think we have a better understanding,
38 because of the events of the last year or two, about how
39 uncertain weather can be and the extent to which it can
40 impact on electricity prices. So there are things like
41 that, and possibly also the cost - and we will get into
42 that, no doubt, in due course - by which capital equipment
43 has gone up and coal prices have gone up, things like that.
44 There is more uncertainty than we had allowed for, even
45 irrespective of changes in market structure and CPRS,
46 et cetera.
47

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1 I think, flowing from that uncertainty, there is a
2 general recognition that for major elements - by no means
3 all elements of the determination, but some major
4 elements - we anticipate building in a review process.
5 Some people are attracted to a retailer-initiated approach.
6 Can I just suggest that you need to make the case for the
7 criteria that would allow that to happen, how that would,
8 work if you want to pursue that.
9
10 In any event, whether you pursue that line of argument
11 or not, submissions on just what criteria the tribunal
12 ought to adopt, whether it be thresholds or whatever, would
13 be helpful. Is there anything else we should add?
14
15 MS BRAKEY: Could I just add one administrative thing?
16 For those who are not coming back this afternoon,
17 submissions are due on 18 September.
18
19 THE CHAIRMAN: Thank you for that. We will see some of
20 you, at least, at 1 o'clock.
21
22 LUNCHEON ADJOURNMENT
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1 UPON RESUMPTION

2
3 OPENING REMARKS

4
5 THE CHAIRMAN: Okay, we might make a start. In case you
6 were not here this morning, I will just reintroduce
7 ourselves. I am Michael Keating. I am chairman of the
8 tribunal. Jim Cox, on my left, is the tribunal's CEO and
9 full-time tribunal member. Sibylle Krieger, on my right,
10 is the tribunal's part-time member. Then we have three
11 people from Frontier: Danny Price, on the end; Andrew
12 Harpham, here; and James Allan in the middle. Then we
13 have two people from SFG: Stephen Gray and Jason Hall.
14 Finally, Anna Brakey is from our secretariat.

15
16 As I indicated this morning, this afternoon's session
17 is going to get into more detail on the draft methodologies
18 for estimating the energy purchase cost allowance and the
19 retail margin for this review of regulated retail
20 electricity tariffs for 2010 to 2013.

21
22 As we set out in IPART's issues paper and the draft
23 methodology papers - we have one from IPART, one on the
24 energy purchase cost allowance from Frontier and one on the
25 retail margins from SFG; we have sent them all out - we are
26 basically proposing to draw upon the methodologies that we
27 used to set the energy purchase cost allowance and the
28 retail margin back in 2007, but to adapt them, where
29 necessary, to take account of the particular risks and
30 uncertainties over the forthcoming determination period.
31 We went through those uncertainties this morning at some
32 length.

33
34 There is a slight change in program, because Stephen
35 has to get away. We will discuss the retail margin first
36 and the energy purchase cost allowance second.

37
38 Just to introduce the retail margin, which is a key
39 cost allowance, you should be aware that IPART has engaged
40 SFG to provide advice on the appropriate margin for an
41 efficient standard retailer. As I noted this morning, that
42 is not the same as a mass-market new entrant.

43
44 SFG was our consultant last time, in 2007, and we
45 propose to build on the methodology that it developed for
46 that 2007 review, which means that we will be using three
47 alternative approaches.

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1

2 The first approach is the expected returns approach,
3 which estimates the expected cash flows that a retailer
4 will earn and the risks associated with those cash flows,
5 and, in terms of the retail margin, that will compensate
6 investors for the systematic risk associated with those
7 cash flows.

8
9 The second approach is the bottom-up approach, which
10 starts from an assumed investment base and cost estimates
11 and then determines the earnings and revenue which will
12 allow the retailer to earn an expected return equal to its
13 estimated cost of capital.

14
15 The third approach is the benchmark approach, which
16 examines the reported margins of listed energy utilities in
17 Australia and other countries.

18
19 I will hand over to SFG. At the conclusion of the
20 presentation there will be an opportunity for the rest of
21 the people here to ask questions.

22
23 STRATEGIC FINANCE GROUP PRESENTATION

24
25 PROF GRAY: Thank you, Michael. I have a number of slides
26 here that I will run through that give an overview of the
27 three approaches that we will use.

28
29 The starting point, I guess, is the definition of
30 "retail margin". We are going to report a retail margin as
31 an EBIT:sales ratio. Number one because that is consistent
32 with the way that was quoted in the last review. It is
33 also broadly consistent with most of the regulatory
34 precedent out there, so just to allow for benchmarking and
35 comparison. So when we talk about retail margin, they are
36 the units, if you like, that we are referring to.

37
38 As part of the analysis, of course, a whole bunch of
39 other profitability and return-type metrics fall out of the
40 analysis. So we will also be reporting margins and ratios
41 in relation to EBITDA, net profit after tax, gross profit,
42 and a number of other things. But so far as people focus
43 on a particular number for the retail margin, that is going
44 to be the EBIT:sales ratio for those sort of consistency
45 reasons. I just wanted to make that point first.

46
47 Before I go on, we are very happy to take questions

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1 along the way. So if something arises, if I am going to
2 deal with it later in the presentation I will let you know,
3 but I am very happy to take questions as we go. We have as
4 long as it takes for questions when we are finished.

5
6 The second point that I want to make is in terms of
7 what risks are included in the retail margin. I draw your
8 attention in that regard also to table 2.1 in the
9 tribunal's draft methodology. That sets out, I think,
10 quite usefully, a range of different risks that arise, some
11 of which are crystallising with this particular review that
12 might not have been around in the last review.

13
14 Table 2.1 in the draft methodology really sets out
15 what those major risks are and where they might be picked
16 up in the review process.

17
18 There are three places where risks can be accommodated
19 within the overall framework. For those of you who were
20 here at this morning's session, the point that Anna made is
21 that we are willing to look at this from an aggregated
22 point of view, that all of the risks need to be
23 incorporated in one place, not two and not zero. So we
24 want to make sure that there is no double-counting and that
25 none of the risks are missed.

26
27 So the places that risks can be accommodated are:
28 number 1, in the energy purchase costs; number 2, in the
29 form of regulation, and so there we are talking about more
30 frequent reviews, pass-through mechanisms and that sort of
31 thing; and then number 3 is the retail margin.

32
33 The last main bullet point on this slide says that,
34 consistent with the standard regulatory framework, and in
35 particular the framework that would apply to distribution
36 and transmission and really all other areas of regulation
37 in Australia, the margin or the return component is a
38 compensation for systematic risk as opposed to
39 diversifiable or firm-specific-type risks. So I just
40 wanted to take a moment to explain again what systematic
41 risk is and what types of risks are going to, therefore, be
42 included in the retail margin, and then other firm-specific
43 or diversifiable type risks will be incorporated in one or
44 other of the two components that I have mentioned.

45
46 So a systematic risk is one that is related to
47 movements in asset classes generally or to states of the

1 economy. So in some states of the world the economy will
2 be growing, unemployment will be low, interest rates tend
3 to be high, the market tends to be up, asset prices tend to
4 be increasing, and so on. We would call that a good or an
5 up state in the economy. That will have some implications
6 for the demand for power and, potentially, also the price
7 of power.

8
9 Then there will be another state of the world that you
10 might imagine which is a down market, where we are in a
11 recession, economic growth is low, the market tends to be
12 down, interest rates tend to be lower, et cetera. It is a
13 useful exercise to begin thinking about there being those
14 two states of the world - the up market, or a good market,
15 and the down market. Demand and volumes for power might
16 differ between those two states of the world, and prices
17 may also differ between those two states of the world.

18
19 It is that kind of risk, that is driven by whether the
20 market is up or the market is down, whether we're in a good
21 state or a bad state; it is those kinds of risks that are
22 compensated for in the retail margin.

23
24 Diversifiable risks are those that are firm- or
25 industry-specific and could be diversified away at the
26 investor level - not the firm level, for a pure-play
27 retailer, but at the investor level.

28
29 So diversifiable risks, in particular, are
30 one-off-type events that are neither more nor less likely
31 to crystallise when the market is up or the market is down.
32 They are not related to aggregate economic conditions. We
33 are certainly not saying that those kinds of risks are
34 irrelevant; we are just saying that they are not
35 compensated for in the retail margin. It is just that
36 systematic or market component that goes into the retail
37 margin.

38
39 If I take as one particular example the uncertainty
40 surrounding a future carbon price, our view is that that
41 particular risk, if you like, which is obviously a very
42 important one, is best handled outside of the retail margin
43 and more appropriately handled elsewhere in the framework,
44 via a review or in the energy cost or some combination of
45 those two.

46
47 The reason for that is if you think about what are the

1 risks or what are the uncertainties surrounding what the
2 future price of carbon might be - and particularly in the
3 third year of the current regulatory period - there is
4 still uncertainty about whether a scheme gets implemented
5 in Australia and exactly what that scheme would look like;
6 how other countries would respond; how that would affect
7 the price of carbon in Australia; whether Australia is part
8 of an integrated market or a separate market; how might the
9 Australian government respond by way of regulation or
10 concession for certain industries; might all of this change
11 over time, and so on. So all of those things are not more
12 or less likely to be risk factors or to crystallise in an
13 economic expansion versus a recession. It's just that last
14 bullet point here that is really, we think, very small
15 relative to the others, that has any sort of systematic
16 component.

17

18 It may well be that the price of carbon would be higher
19 during economic expansions when demand for power and
20 economic growth is high, and low if you are in recession.
21 It is just a demand/supply issue. All we are talking about
22 here is if there is some sort of expected or average price,
23 and how much higher than average would the price be during
24 an economic expansion versus a recession. That, we think,
25 is small potatoes, if you like, relative to the vast
26 uncertainty about where the point estimate, or where your
27 expected price, might be in year 3. There are huge amounts
28 of uncertainty about that. Is it going to be \$10, \$15,
29 \$30, \$45 a tonne?

30

31 The last point, which is the only bit that has any
32 sort of systematic component, is: having determined what
33 the average price of carbon is, will it be a little bit
34 higher than that during expansion and a little bit lower
35 than that during a recession? That sort of uncertainty,
36 that piece of uncertainty, is really small relative to the
37 massive uncertainty about where the average or point
38 estimate price will be.

39

40 So for that reason, we would propose to not try to
41 incorporate in a single number, three years in advance,
42 into the retail margin, some sort of compensation for
43 carbon price risk. That is much better and much more
44 logically taken into account elsewhere in the framework.
45 So that is just one example of systematic versus
46 non-systematic risks and where it might be compensated,
47 where it might be taken into account in the framework.

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1 There are a number of others that are listed in table 2.1
2 that I have referred to.
3
4 So, having said that, there are three approaches that
5 we look at. There is a bottom-up approach, which builds a
6 retail margin from individual components. That is quite
7 analogous, if you like, with the approach that regulators
8 would take for distribution and transmission.
9
10 There is a benchmarking approach, where we look at
11 retail margins and other regulatory decisions, margins from
12 retail businesses in other industries and also the retail
13 segments of listed energy utilities that might have more
14 business units than just retail.
15
16 Our approach will be to consider results from each of
17 these three approaches, and the design of this is that
18 those three approaches will tend to corroborate one
19 another; we will try to triangulate around a reasonable
20 range for the best estimate for the retail margin.
21
22 So if I go through each of the three approaches in
23 turn, first of all. There is the bottom-up approach. As
24 I said, it is really analogous to what is done in the
25 distribution and transmission regulatory spheres. So the
26 starting point is to begin with an estimate of the value
27 for business. So if this were a distribution or network
28 business, we would have a DORC value - so a depreciated
29 optimised replacement cost. So the engineers would go and
30 look at the assets, kick some tyres, and tell us what those
31 assets are worth as the starting point.
32
33 For a retail business, there is going to be the need
34 to get some other estimate of what the starting value is.
35 So that will come from maybe a multiple of customers or a
36 multiple megawatt hours, something of that nature, just the
37 standard valuation metrics that are used for retail
38 businesses. The reason for doing that is that a large part
39 of the value of the business is in intangibles, the
40 customer base and so on, that can't be measured in that
41 sort of DORC type framework as would be done for
42 distribution and transmission.
43
44 We have a starting point estimate of the value of the
45 business. So think about this as a dollar value per
46 customer as a starting point. That gives you a value
47 starting point for the business. Then we need to multiply

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1 that by a weighted average cost of capital or, if you like,
2 an estimate of the "fair return" on that business. That
3 produces then an estimate of what is a fair return on
4 capital.
5
6 The idea in this framework is the business has
7 X million dollars tied up in the value of the business and
8 the WACC, the weighted average cost of capital, gives us an
9 estimate of what a fair percentage return would be on that
10 capital that is being invested, and in a standard
11 regulatory process, prices need to be set so that investors
12 are able to receive that fair return on the capital that is
13 required to be invested.
14
15 Added into the mix are estimates of operating costs,
16 depreciation tax, et cetera, that will be inputs for us
17 from the tribunal and from Frontier. That provides an
18 estimate of the total required revenue, with it being
19 sufficient to cover all of those costs and also to provide
20 a fair return on the capital that investors have sunk into
21 the business.
22
23 An output of that whole process is the retail margin
24 which we will again, as I said before, report as the ratio
25 of EBIT to sales or EBIT to required revenue. That
26 approach, of course, has to be consistent with the energy
27 cost and retail cost estimates to make sure there is no
28 double-counting and that no costs are missed.
29
30 That framework is really what would be done in a
31 regulatory framework for distribution transmission and we
32 will follow that process in as close a way as possible in
33 the retail sector. That will provide one estimate or in
34 fact one range out of that approach.
35
36 The second approach that we will look at is
37 benchmarking. There are two aspects to the benchmarking
38 exercise that we propose to engage in. The first one is to
39 look at other regulatory determinations. There is a
40 growing sort of developing regulatory precedent in
41 Australia and so we would have regard to that. That would
42 be one piece of relevant evidence.
43
44 The second of the small bullet points there is
45 something we will have particular regard to. That is
46 something that was raised this morning. We will be mindful
47 of the historical context and the extent to which retail

1 margins historically have been assigned or developed in an
2 environment that may be different in some respects from the
3 one that we are facing now.
4
5 There are a number of additional sort of risk factors
6 that we have been discussing this morning, carbon being the
7 most obvious example. To the extent that that might have
8 any impact on the retail margin now and that historical
9 decisions reduced retail margins without any need to
10 consider carbon pricing, we will have regard to that.
11
12 Obviously we would provide greater weight to those
13 regulatory decisions that deal with retailers that are most
14 comparable and a regulatory framework that is most
15 comparable to the terms of reference in this case.
16
17 So that is the first element of benchmarking against
18 other regulatory determinations. Again, that is one of the
19 key reasons for defining this in terms of an EBIT to sales
20 margin.
21
22 The other aspect of benchmarking is to look at retail
23 businesses. Here there is a trade-off between, on the one
24 hand, you want a really relevant comparable sample. On the
25 other hand, you want a decent size sample, so there is some
26 sort of statistical reliability in the results, and there
27 is a trade-off between those two things.
28
29 Ideally we would like to do this benchmarking analysis
30 with 57 pure play Australian retail businesses, but there
31 are not a huge number of pure play Australian retail
32 businesses, so we have to look more broadly. We propose to
33 look at three different sets. One is Australian energy
34 retailers, which is obviously the most directly relevant
35 set, but it is quite a small set. That is certainly an
36 important source of information, so we will have regard to
37 that. The second one is retail segments of Australian, UK
38 and UK listed energy utilities. A number of the listed
39 businesses are utilities that have retail activities but
40 also other activities, maybe generation, maybe some
41 distribution and so on. So to the extent that segment data
42 is available, we would have regard to the retail segment of
43 those businesses.
44
45 Then the third set is Australian, US and UK listed
46 retailers. This is our broadest set with the largest
47 number but they are also the less directly relevant. We

1 would need to bear all of that in mind in trading off
2 against the three samples. In that last set we would
3 include retailers that are not energy firms - so just
4 retailers more broadly. We would have regard to all three
5 of those subsets. We would also have regard, in a
6 benchmarking analysis, to past regulatory determinations,
7 and that would provide a second range to go with the
8 bottom-up approach in the first stage.
9
10 The third approach is the expected returns approach,
11 which was another one of the approaches that was applied in
12 the last review. One issue with the bottom-up approach is
13 that there is an assumption in there that the value of a
14 firm can be estimated before you know what the retail
15 margin is.
16
17 There is somewhat of a circularity in that the value
18 of the firm will depend ultimately on what the retail
19 margin is firm. We want to use a process that seeks to
20 estimate both of those things simultaneously or at least in
21 a way that is internally consistent. We want to get sort
22 of internal consistency so that the retail margin and the
23 returns that are available for the business, for the
24 investors in the business, are consistent with the risks
25 that they are bearing.
26
27 At the same time, we will compare the outputs of this
28 process with a bunch of external benchmarks that I will
29 talk about further in a moment. The idea is that, at the
30 same time, we want to have this internal consistency, so
31 the retail margin is perfectly consistent with the risk
32 that investors are bearing - that is internal consistency -
33 and then also that the outputs that come from this process
34 match up with observed commercial benchmarks - so that is
35 the external consistency. Then we compare those outputs
36 from the three methods to triangulate around an appropriate
37 range for the final retail margin.
38
39 How does the approach work? Going through those
40 bullet points starting with, "For an assumed retail
41 margin", if you tell me the following things - if you tell
42 me what the retail margin is, what the retail costs are,
43 what the energy acquisition costs are and what the
44 appropriate hedging strategy is - I can basically reproduce
45 the net cash flows for the business. If you tell me all of
46 those things, then the output of that would be the net cash
47 flows for the business. Once I have that series of net

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1 cash flows for the business, I can then discount them back
2 to present value to estimate the value of the business, and
3 I will discount that back using a weighted average cost of
4 capital and an appropriate discount rate that embeds in it
5 some assumptions about the risk that faces various
6 investors in the business.
7
8 That is the first point. I can then perform that sort
9 of valuation in different scenarios, and here is where the
10 sort of estimation of risk or the systematic component of
11 risk comes in. In an up market where there is economic
12 growth, volumes are high, so net cash flows might be higher
13 in that scenario; and then in a down market where volumes
14 are lower and net cash flows are lower. In the up market,
15 because cash flows are higher, the value of the business
16 will be higher and then vice versa in a down market. That
17 is where there is some systematic risk, so the fortunes of
18 your investors and the value of the business will be
19 impacted by economic conditions, and that is where there is
20 a systematic component of risk. It is that systematic
21 component that needs to be compensated for in the retail
22 margin.
23
24 Out of that relationship, if you like, between
25 economic growth or broad economic conditions, on the one
26 hand, and the value of the business or the cash flows that
27 the business might generate on the other, flows an estimate
28 of systematic risk or we call that beta implied in that
29 usual regulatory framework.
30
31 Internal consistency requires that the beta or the estimate
32 of systematic risk that comes out of that analysis has to be
33 the same number as was assumed when we were doing
34 the discounting and cash flows to estimate value in the
35 first place. Otherwise you have sort of the same parameter
36 or the same value in two places in the valuation exercise.
37 It has to be the same value in both places. That internal
38 consistency is achieved by ensuring that the level of
39 return that investors are getting is commensurate with the
40 risk that they are bearing. That sort of looks at internal
41 consistency.
42
43 We also want to test external consistency. We don't want
44 this to be a purely academic theoretical exercise. It needs
45 to be tied as much as possible to external benchmarks as well
46 to corroborate with commercial reality along the way.
47 The estimated market value can be benchmarked against

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1 comparable entities in terms of multiples of a number of
2 things: so multiples of enterprise value per customer or a
3 multiple of megawatt hours, enterprise value to earnings
4 ratios, earnings per customer values - all of these sorts
5 of metrics that would be commonly looked at or commonly
6 understood in the market, and all of those things would be
7 compiled as part of the bottom-up approach. So this is
8 where the two tie in, and then the estimated margins can be
9 compared against those compiled from the benchmarking
10 approach; so it ties into that approach as well.

11
12 At the end of the day from this approach, we want to
13 have two things: number one is everything has to be done
14 internally consistently; and, number two is that all of the
15 outputs from that approach have to reconcile quite
16 reasonably with observable commercial benchmarks. Those
17 two requirements sort of put a level of rigour around that
18 approach.

19
20 As to more detail and precisely how this works,
21 perhaps I will go to the next slide, which has a figure
22 that is probably more instructive. On the left-hand side,
23 we have a bunch of inputs, if you like. If we start with
24 an assumed retail margin and then we receive inputs from
25 the tribunal and from Frontier in terms of retail costs,
26 energy costs, any other costs and volumes, then that
27 produces an estimate or a forecasted series of cash flows.

28
29 I can then take those cash flows. This is the bottom
30 line here. I can take those forecasted cash flows that are
31 conditional on all of those inputs and those forecasted
32 cash flows can then be discounted back to present value and
33 that gives me an estimate of the value of the business. So
34 that is sort of going in one direction.

35
36 With the other direction up the top here, I can look
37 at the relationship between cash flows and the state of the
38 economy. This is where the systematic risk bit gets built
39 in. In an up market when the economy is strong, retailers
40 will have higher volumes and price may be higher. The
41 value of the business cash flows will be stronger in that
42 scenario than on the flip side where the market is weak,
43 volumes will be lower and prices might substantially be
44 lower.

45
46 You want to look at what is the degree of variation in
47 terms of cash flows and business values across different

1 market scenarios and the strength of the relationship
2 between the value of the business and whether the economy
3 is up or down. It is that sort of risk, that sort of
4 systematic risk, that investors in these businesses are
5 wearing and for which they would require compensation.
6 That basically comes down the right-hand side there.

7
8 By looking at different states of the economy and how
9 the business value and cash flows will vary, we have an
10 estimate of systematic or market-related risk. That then
11 implies a discount rate which then implies a value for the
12 business.

13
14 I want to make sure that, for internal consistency
15 reasons, the discount rate and the compensation for
16 systematic risk that is assumed when we discount cash flows
17 to get an estimate of business value is the same as the
18 discount rate and the estimate of systematic risk that is
19 obtained by looking at how cash flows and business values
20 vary across different economic scenarios. So that is
21 internal consistency.

22
23 Along the way a whole bunch of obvious benchmarks are
24 thrown out of the analysis - these things here: ratios of
25 earnings per customer, multiples of customer value and so
26 on and so forth. I suppose there are two aspects:
27 everything needs to be internally consistent plus
28 benchmarked against sort of commercial reality, if you
29 like, these external benchmarks.

30
31 In the final approach where we put everything
32 together, each of the three approaches will produce a
33 range. It is not the case that any one of those approaches
34 will produce a point estimate to four decimal places.
35 There will be a range for each of those. In the last
36 review, you would be aware that the three approaches tended
37 to corroborate one another in the sense that we didn't have
38 exactly the same range coming out of each of the three
39 approaches, but there was a fair degree of commonality
40 among the three approaches. That produced then a
41 corroborated or triangulated range of what we considered to
42 be reasonable retail margins. Then from that point on, it
43 is up to the tribunal to select or to take that on board
44 and ensure that the finally selected retail margin is
45 consistent with what has been done for energy purchase
46 costs and other costs and so on.

1 THE CHAIRMAN: Open to comment.
2
3 MS HUGHSON: Just a general question, when you are
4 looking at this, do you consider the broader objectives, for
5 instance, of the decision-making process around reducing
6 customers' reliance on regulated tariffs or in-house
7 competition or are they something that are dealt with
8 elsewhere in the regulated bundle?
9
10 PROF GRAY: Our riding instructions quite clearly are in
11 terms of a standard efficient retailer, so we will produce
12 ranges based on that consideration. I guess the short
13 answer to your question is that that is not something - we
14 wouldn't shade our range up or down to take account of
15 those sorts of incentives, if you like. That would be more
16 an issue, in my view, for the tribunal.
17
18 THE CHAIRMAN: And we will be guided by our terms of
19 reference as we went through this morning.
20
21 MR MOODY: Phil Moody from EnergyAustralia. I quite like
22 this model. I think it is excellent in principle. There
23 is one issue I had with it last time that was not in
24 relation to the systematic risk but the non-systematic
25 risks which are not managed in this framework. I guess
26 that is probably the area --
27
28 THE CHAIRMAN: Could I ask you to speak up, please.
29
30 MR MOODY: I was talking about the way that non-
31 systematic risks are being viewed. I think in one of the
32 opening slides you identified three areas. There was the
33 margin, the reopener and I forget the third one, but --
34
35 PROF GRAY: Energy costs.
36
37 MR MOODY: Energy costs, yes. I think implicit in some of
38 the documentation is a fourth one, which is the investor
39 who is going to manage some of those risks. That is one
40 area that I probably feel a bit uncomfortable with. Is
41 that essentially what you're implying with the management
42 of non-systematic risks?
43
44 PROF GRAY: No. This is probably really more a question
45 for the tribunal or for Frontier, I think, as to where
46 non-systematic risks are being taken into account. Our
47 approach is to come up with a retail margin that we believe

1 provides appropriate compensation to the investors for the
2 systematic risk that they bear. So if we can estimate the
3 amount of systematic risk that investors are bearing, what
4 sort of compensation in terms of retail margin would be
5 appropriate for that?
6
7 Certainly it is the case that there are a number of
8 other risks that are real tangible risks, and they are not
9 taken into account. It would be, in our view,
10 inappropriate to take them into account in the retail
11 margin. They will be taken into account elsewhere.
12
13 To the extent that perhaps you have some examples in
14 mind of particular non-systematic risks that are not in
15 your view factored in, I think that is more a case of if
16 they are non-systematic, they will not be things that will
17 ever be factored into the retail margin. They will either
18 have to be taken into account in terms of a reopener, reset
19 pass through or in energy purchase costs. I am not sure if
20 I answered your question.
21
22 MR MOODY: No, I would be certainly very comfortable with
23 that if that is the case. I guess I read that some of them
24 are actually managed by the investor, I guess, buying a
25 portfolio in other asset classes, for example. So it is
26 actually not managed through either the energy purchase
27 cost or the reopener.
28
29 PROF GRAY: So as not to tread on any toes, I will take an
30 example from the distribution and the regulation of
31 distribution and transmission businesses. It is not the
32 case that non-systematic or diversifiable risks are
33 completely ignored and get zero compensation. All that we
34 are saying is that those diversifiable non-systematic risks
35 are not something that show up in a margin or rate of
36 return by way of compensation.
37
38 An example from the distribution field is insurance on
39 the network, on the physical network assets. The risk of
40 network assets being damaged by storms and bushfires is a
41 non-systematic diversifiable risk. Storms and bushfires
42 are not more likely to occur during a recession than a
43 boom. So they are non-systematic and don't show up in the
44 regulated rate of return from the WACC in that setting, but
45 that doesn't mean that, well, it is just all pushed onto
46 the investor to manage by themselves. An allowance will be
47 made in the cash flows in that case for insurance against

1 that particular risk.
2
3 In that setting if it is viewed by the regulator as an
4 efficient business expense to manage that diversifiable
5 risk, then that gets compensated for by the cash flows and
6 shows up in the regulated price. It is not the case that
7 any risk that is deemed to be non-systematic or
8 diversifiable is therefore just thrust on to the investor
9 to manage as they can. That is one example where there is
10 compensation in the regulatory framework for that
11 non-systematic risk, but it is not in a marginal rate of
12 return.

13
14 MR HARPHAM: Perhaps this is an issue about swapping the
15 order around, but when we get to our presentation we will
16 talk at some length about how the framework which we have
17 developed - which is similar to, or the same, really, as
18 the framework we developed for the previous determination -
19 does capture a lot of the risks that retailers do face,
20 even though they may not be systematic risks. So I guess
21 we will get into that a bit later on.

22
23 MR COX: Perhaps it is just worth drawing your attention
24 to the table in chapter 2 of our methodology paper. That
25 sets out our preliminary view as to where various risks
26 will be catered for in the framework. So it is worth
27 having a look at that to see whether you agree with it or
28 not.

29
30 MR MOODY: Yes, thank you, Jim, I have had a look, but
31 I will leave my question for the moment.

32
33 MR AARSEN: Glen Aarsen from Integral Energy. You talk
34 about scenarios that you run in valuing business, taking
35 into account the market risk for the benchmark comparables
36 for a booming market and a declining market. Can you give
37 us a brief overview of some of those scenarios that you are
38 talking about, some of the parameters that you set within
39 them?

40
41 PROF GRAY: Yes. We have more detail on that in the draft
42 methodology. If I can just give you an overview: think
43 about GDP as measuring the state of the economy. So you
44 might have an up-market boom sort of state where GDP
45 growth is high, and then one where GDP growth is low or
46 negative. So we want to model the state of the economy in
47 terms of GDP states.

1
2 So if you start out thinking about there being just
3 two states - an up or a down state - what we want to do is
4 to calibrate the two scenarios so that it matches various
5 statistics related to GDP from historical data. So we want
6 to be able to match the mean GDP growth; we want to match
7 the volatility or the variance around that mean.

8
9 We don't want to have an up market where GDP growth is
10 50 per cent and a down market where it is negative 40,
11 because that is ridiculous compared to what we have seen
12 historically. We want to calibrate to historical
13 movements.

14
15 That is what we do. Basically, GDP is our statistic,
16 if you like, for determining whether we are in an up or a
17 down market. The size of the up-market GDP and the size of
18 the down-market GDP is calibrated to what we have observed
19 historically in terms of mean and variance.

20
21 So conditional, then, on a particular value for the
22 GDP, we then take those inputs. So retail costs, energy
23 costs, et cetera, are provided conditional on a particular
24 state of the world, if you like.

25
26 One of the things that comes out of the Frontier
27 modelling is that conditional on a particular state of the
28 world, say the up market, there will be higher volumes
29 required and potentially higher prices, as well, coming out
30 of that. So we just match those inputs in the grey box
31 with the assumed state of the world in terms of economic
32 growth.

33
34 MR AARSEN: Over what period of time? Is it just the
35 three years that you are talking about, to the next
36 determination period?

37
38 PROF GRAY: No. We will go out ten years and then have an
39 assumed constant growth from then on, because ultimately in
40 the bottom row we want to take a forecast series of future
41 cash flows and discount them back to present value to get
42 an estimate of business value.

43
44 MR AARSEN: The crucial period, the ten-year period, was
45 the important bit for me, thank you.

46
47 MR SMYTH: My name is Chris Smyth. I am from AGL. My

1 question is regarding the triangulation: I remember from
2 my days at high school that if you are solving a maths
3 problem, if you do it two or three ways and get the same
4 answer you can be more confident that you've got it right,
5 so it seems like a worthwhile approach.

6
7 My question is: how much iteration is required to
8 settle in on an approach, given that you have to do a lot
9 of this benchmarking. It seems the temptation must be
10 quite strong to introduce some subjectivity in order to
11 reach that convergence.

12
13 Then, secondly, is the benchmark data going to be made
14 available to stakeholders so that we can see who we are
15 compared against?

16
17 PROF GRAY: Do you want to deal with the second part
18 first?

19
20 THE CHAIRMAN: You will be putting a firm set of
21 benchmarks in the report.

22
23 PROF GRAY: Yes. And that will be released?

24
25 THE CHAIRMAN: Yes.

26
27 PROF GRAY: So that is the second part. In terms of the
28 subjectivity, there is no subjectivity - do you mean in
29 terms of the expected returns approach or in terms of --

30
31 MR SMYTH: I suppose selection of the benchmarks and the
32 requirement to converge on a solution.

33
34 PROF GRAY: Okay. So in terms of the benchmarking
35 approach, what gets into the set, we will look at those
36 three sets that I mentioned. There is no subjectivity at
37 all in terms of what is in each of the three sets.

38
39 We would like to place most weight on that set which
40 is most relevant, which is the Australian energy retailers,
41 but, given that there is such a small number of them, we
42 think it is only prudent to look at expanded sets and see
43 what we can infer from that. But in terms of there being
44 any subjectivity out of this approach, it would be
45 exercised in terms of weighting more heavily what we
46 consider to be the most relevant subset, if you like.

47

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1 THE CHAIRMAN: I think we might be a bit at cross-purposes
2 here. Within a particular approach - such as the expected
3 returns approach- because the model, in a sense, is
4 overdetermined, or there is the circularity that Stephen
5 referred to, where you have to start by assuming the rate
6 of return or the value of business first up, in summary,
7 that's why you get iteration within a single approach.
8 That approach, after it has been iterated so that there is
9 a common rate of return within that single approach, may or
10 may not turn out to be the same as the benchmark approach.

11
12 When it was done last time, it turned out to be pretty
13 similar to the benchmark approach, but, a priori, you can't
14 say that it will be the same as the benchmark approach, and
15 in that case, the tribunal has to decide. To the extent
16 that the three approaches give different answers, two of
17 them are formula driven, I suppose, as a way to describe
18 it; they are iterations given by a formula, in effect, so
19 they are not subjective in themselves.

20
21 I accept that with a benchmark it depends on who you
22 include in the benchmark as to what the answer is. But it
23 would be the tribunal who would have to decide between
24 three approaches, to the extent that the three approaches
25 give different answers.

26
27 MR MORRIS: So basically, when you have the triangulation,
28 you aren't actually going to weight them evenly - that's
29 essentially the conclusion you have come to?

30
31 THE CHAIRMAN: Say that again?

32
33 MR MORRIS: The triangulation that we are having from the
34 three different approaches won't have an even weight. So
35 if one comes up with six, one comes up with four and one
36 comes up with two, you get four, because it is just an
37 average. You guys will take a view of what is going to be
38 weighted more; is that correct?

39
40 THE CHAIRMAN: We are not going to commit ourselves in
41 advance to saying, "They have all got equal weight; we will
42 take the arithmetic mean of them." At the end of the day
43 we will have three answers which may actually, if the
44 experience of last time is repeated, turn out to be pretty
45 much the same, in which case it is pretty easy.

46
47 If they were different, we would want to try to

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1 understand the reasons why they are different; we would
2 come to a judgment as to what is the best, for want of a
3 better phrase, compromise between the three answers, and we
4 would give our reasons for why we chose the number we
5 chose within those three answers.

6
7 MR COX: Having regard to the terms of reference.

8
9 THE CHAIRMAN: Having regard to the terms of reference.

10
11 MS BRAKEY: Just to further emphasise that point, last
12 time, those three approaches developed a range.
13 Last time we didn't use some sort of weighted approach.

14
15
16 MR MORRIS: I understand that, but there might be three
17 ranges, two might be concurring and one is out, and whether
18 that is going to scale the other two up or not is the
19 question.

20
21 THE CHAIRMAN: Can I just perhaps add that earlier today
22 I referred to the last determination. Within, if you like,
23 the margin of judgment that one has, we gave quite a lot of
24 weight to wanting to increase competition. I know many of
25 you feel that we didn't give enough weight to it and we got
26 the answer wrong, but the truth is we did give quite a lot
27 of weight to that. In exercising our discretion within the
28 range of the retail margin, we did give weight to that.

29
30 MR PENNINGS: Michael Pennings from EnergyAustralia.
31 I'm not sure if you realise, but the last time around, when the
32 IPART decision was made and you granted a 5 per cent retail
33 margin, it didn't actually deliver a 5 per cent retail
34 margin, and there are a couple of reasons for that. In
35 part, it related to network prices going up very steadily
36 in the final year of the determination, but there was also
37 the re-open as well.

38
39 This is probably more a regulatory framework issue
40 rather than something that SFG would address, but what in
41 fact happened is that it under-delivered on 5 per cent
42 simply because you saw the base, the sales number in that
43 formula, increase beyond what the tribunal had originally
44 expected and modelled. So I'm just wondering if IPART had
45 contemplated that issue and if they were going to make any
46 efforts to address it?

47

1 MS BRAKEY: Can I answer that? I'm happy to answer that.
2 You are right. The way that we modelled it, we set the
3 margin on a 5 per cent EBITDA margin, but it was put in as
4 an absolute value into the calculations of the R values.
5 So, in particular, in the last year when network prices
6 went up by more than what we had anticipated, the margin,
7 all else being equal, would have fallen below the
8 5 per cent on an EBITDA basis.

9
10 That was contemplated and written into the
11 determination like that, and that's why we calculated it in
12 that way. Obviously, it is a matter for consideration this
13 time around.

14
15 THE CHAIRMAN: Are there any more comments or questions?

16
17 MS HUGHSON: Bev Hughson, from Origin, again. Again a
18 more general question. Do you see any particular difference
19 in your analysis between the previous analysis, where it was
20 about a new-entrant retailer, and the analysis now where
21 you are doing it for a standard retailer? Has that made
22 any difference to the way you are conceptualising the model
23 working?

24
25 PROF GRAY: That doesn't flow through substantially at all
26 into retail margin considerations. There are certainly
27 some differences in terms of energy purchase costs, and so
28 on, that I'm sure the Frontier guys will talk about in a
29 moment, but in terms of the retail margin and the framework
30 that is used for estimating systematic risk, getting
31 everything internally consistent, and so on, that is, very
32 broadly, the same last time as this.

33
34 THE CHAIRMAN: I will, however, indulge you by saying
35 that it also could affect the customer acquisition costs. I say
36 "could affect". The extent to which it could affect is
37 something we will have to think about.

38
39 PROF GRAY: I want to be clear, I'm not saying that's
40 completely irrelevant and necessarily it will be the case
41 that the same answer is achieved. In this expected returns
42 approach here, all of those things in the grey box will
43 affect the ultimate outcome. So we want to make sure that
44 any retail margin that comes out at the end of the day is
45 consistent with inputs that we receive in terms of energy
46 costs and the other costs. So to the extent that those
47 numbers may be different for a standard retailer than a

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1 mass-market new entrant, that will be permeating through
2 our expected returns approach.

3
4 MS HUGHSON: I suppose there are a number of ways you
5 can look at the question I asked, but one of the things I had
6 in mind is that a new entrant retailer can also manage risk
7 by moving in and out of the market by managing their
8 volumes in terms of their activity in and out, where a
9 standard retailer with an obligation to offer has no
10 ability to manage that exposure and, in fact, if the
11 margins get thin, then more and more customers fall back
12 into that box, so they have less ability to do it.

13
14 So there are some complexities about the way you might
15 think about volumes and whatever, by virtue of that
16 difference, that obligation to offer. There is a general
17 obligation to offer a standard offer. All customers have
18 the right to convert to a standard offer, or to take it up
19 if they are a new connection; whereas with a new-entrant
20 retailer, if you are in that position, if you are not
21 comfortable, one of your risk management tools is to
22 withdraw partially or wholly from the market.

23
24 MS BRAKEY: Bev, that that will come in through the energy
25 purchase costs and volumes used in estimating that.
26 The model takes account of the standard retailer's load.

27
28 MS HUGHSON: I put it on the table for consideration, not
29 for argument here, as to how it might impact a systematic
30 risk as well.

31
32 THE CHAIRMAN: I think you have raised an interesting
33 point about what I will call retailers' last resort
34 obligations, but, as I think Anna said, that's something we
35 will need to think about, whether that should be
36 incorporated into the energy purchase cost or where we
37 position ourselves on the curves that Frontier will no
38 doubt explain to us later on.

39
40 MS HUGHSON: Thank you.

41
42 THE CHAIRMAN: I think we might now move on to
43 Frontier. Thank you, Stephen. I appreciate that you have to
44 get away.

45
46
47

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1 FRONTIER ECONOMICS

2

3 THE CHAIRMAN: I would just like to say a few words before
4 I hand over to Frontier. The terms of reference require
5 IPART to determine the target energy purchase cost
6 allowance for each year of the determination using a
7 transparent and predictable methodology that recovers the
8 efficient costs of managing the risks associated with
9 purchasing electricity from the national energy market,
10 including any obligations on the retailers, such as we have
11 just been discussing.

12

13 The terms of reference further specify that the energy
14 purchase cost allowance for each year must not be lower
15 than the least cost mix of generating plant, based on those
16 plants earning an economic rent of their market value.

17

18 That effectively means that the long run marginal
19 cost, which we are obliged to estimate, then becomes a
20 floor for the energy purchase cost allowance. The long
21 run marginal cost is a floor for it.

22

23 Since the 2007 determination, capital and fuel costs
24 have increased, notwithstanding the impact of the global
25 financial crisis - which you might have thought would have
26 led to lower costs; but, in this case, fuel costs have come
27 down a bit from their peak, but they are still higher than
28 they were a couple of years ago, and capital costs,
29 particularly for generating equipment, apparently have
30 risen.

31

32 So for those reasons we do anticipate that our
33 estimate of the long run marginal cost in the forthcoming
34 determination will be higher than the 2007 estimate. That
35 is not something we normally say in advance, but the
36 evidence seems to be pretty strong on this.

37

38 As we set out in our draft methodology paper, IPART is
39 relying on publicly available information, including the
40 ACIL Tasman 2009 estimates of fuel and capital costs, which
41 are used by the AEMO. Frontier Economics will provide
42 advice to the tribunal, which it will consider in its
43 deliberations for its draft report, but they will be
44 relying on those ACIL Tasman estimates of fuel and capital
45 costs.

46

47 I think it is also worth observing in advance that

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1 whilst I have just said the long run marginal cost
2 estimates are likely to be higher than they were in 2007,
3 the market-based price estimates have fallen since the
4 tribunal conducted its review in May 2009 of the
5 market-based electricity purchase cost allowance. So they
6 have come off from where we were when we increased prices
7 by, what was it, 20 per cent or thereabouts?

8
9 MR COX: Yes.

10
11 THE CHAIRMAN: We believe this reduction primarily arises
12 from lower demand, consistent with the recession, and for
13 the purposes of estimating prices, IPART will use the most
14 recent system-wide demand information available from the
15 AEMO and the various jurisdictional planners. These demand
16 projections have been reduced recently as a consequence of
17 the impact of the global financial crisis on the Australian
18 economy, and that reduced demand has eased the
19 supply/demand balance within the electricity market and
20 that is, of course, why both the spot and contract prices
21 have softened.

22
23 So, in principle, it is possible in the short term, at
24 least, that the long run marginal cost estimate will be
25 higher than the market-based estimate of electricity costs.
26 I do say in the short run, because how long such a
27 situation could continue, I think, is a moot point.

28
29 The 2007 determination provided for an annual review
30 of the market-based energy purchase cost allowance in 2008
31 and 2009. We thought we didn't need one in 2008; we didn't
32 need one in 2009. That annual review was intended to
33 explicitly address the risk of significant but
34 unforeseeable change in the wholesale price of electricity,
35 and, as I said this morning, our aim at the time was to
36 increase regulatory certainty and minimise perverse
37 incentives, and so the scope of any price revision was
38 largely predetermined and, accordingly, the methodology
39 used was pretty mechanistic.

40
41 But again, as I think we have tended to flag already,
42 in the forthcoming determination it is likely that the
43 scope of the periodic review of the market-based
44 electricity purchase cost will need to be broader and to
45 take account of the much greater sources of uncertainty,
46 and, for that reason, we are not disposed to the same
47 pre-determined mechanistic approach as in the 2007

1 determination. We will, for example, consider the
2 emissions trading scheme as part of the periodic review
3 process.

4
5 We are also disposed to examine the circumstances that
6 are driving any increase changes in energy purchase costs,
7 and, in that context, we will examine the long run marginal
8 cost of electricity generation in accordance with our terms
9 of reference, as well as the estimated purchase cost.

10
11 I think it is probably useful if I now hand over to
12 Frontier.

13
14 FRONTIER ECONOMICS PRESENTATION

15
16 MR HARPAM: Thank you, Michael. I thought I would
17 briefly run through our methodology again today and, to
18 some extent, discuss the assumptions we are proposing to be
19 using for our advice to the tribunal.

20
21 As I am sure you are aware, there is a lot more detail
22 in the documents that IPART have put up on their website -
23 our report on modelling methodology and assumptions - so
24 obviously I am not going to go into that much detail, but
25 if there are any questions at the end or as I go through
26 the presentation, just let me know.

27
28 I was going to start by running through more or less
29 what Michael mentioned. Effectively, the terms of
30 reference this year ask us to look at the energy cost in
31 two different ways: we need to look at the long run
32 marginal cost to set a floor, effectively, for the energy
33 costs; and we also need to look at the energy purchase cost
34 allowance.

35
36 So the way we think about the difference between these
37 is that effectively the long run marginal cost is the
38 resource cost associated with meeting the regulated load,
39 so it is effectively going to be driven by things like the
40 capital costs of new plant, fuel costs, operator costs and
41 things like that, whereas the energy purchase cost
42 allowance is effectively the cost that you face going out
43 to the market and buying energy or buying contracts to meet
44 the regulated load shape.

45
46 We did very similar work, obviously, for the previous
47 determination, and looked at both the long run marginal

1 cost and energy purchase cost allowance for our work for
2 the previous determination, and we propose to use the same
3 framework that we used for that last determination for this
4 determination.

5
6 Just to review what that framework is, we have three
7 energy market models - Whirlygig, Spark and Strike - which
8 we will be using in our advice to the tribunal. These are,
9 to an extent, interrelated. Whirlygig is our cost
10 optimisation model. That's the model we use to estimate
11 long run marginal cost, as well as to do other things.
12 Essentially, it assumes that the markets are perfectly
13 competitive and looks at what the least-cost options are
14 for meeting the regulated load. So it provides the
15 long run marginal cost; it also provides investment paths,
16 so models efficient new investment and efficient dispatch.

17
18 Spark is our energy market model. It is formulated
19 very similarly to Whirlygig and has very similar
20 assumptions to Whirlygig. The key difference is that it
21 relaxes the assumption about perfect competition and allows
22 for strategic bidding by participants. So effectively it
23 takes into account the sorts of strategic bidding behaviour
24 that you might see in the NEM. So that the key output from
25 Spark is a forecast of market prices as well as plant
26 output.

27
28 Strike is our portfolio optimisation model. So using
29 Strike we can look, for a particular business, at efficient
30 ways to hedge a particular load, given a particular
31 half-hourly spot price. So it effectively constructs
32 hedging strategies that are efficient, in the sense that
33 you can't improve on those hedging strategies without
34 either increasing risk or the cost of that strategy.
35 I will go into a bit more detail about how we use each of
36 these models as we go through.

37
38 Starting with long run marginal costs, which acts as a
39 floor effectively, we are going to use Whirlygig to
40 estimate the long run marginal cost. The terms of
41 reference are clear that we should be thinking about the
42 long run marginal cost for the regulated load shape of each
43 individual retailer. We have calculated three long run
44 marginal costs, one for each retailer.

45
46 Our proposed approach to estimating long run marginal
47 cost is what we call a stand-alone approach. Effectively

1 what we do there is take a forecast of each retailer's
2 regulated load shape and build a hypothetical generating
3 system to supply that load.

4
5 When we are doing this, we ignore all of the existing
6 plant that is in the market. We really are just looking
7 at new investment decisions and dispatch of those
8 plant to meet the regulated load. The reason we do
9 that is that obviously if you are trying to think about
10 serving the regulated load, then this embedded mix of plant
11 that is there to serve the system load will not have any
12 relationship to that load shape, so we effectively wipe the
13 slate clean and start again.

14
15 When we are doing this, we calculate a marginal cost
16 so that we put a regulated load shape into the model and
17 the model works out how to serve that regulated load shape
18 and it is calculated at the marginal cost. We add
19 increments to that load, and the increment we add is
20 shaped. It has the same shape as the regulated load shape,
21 so that when we calculate the marginal cost on it, we
22 calculate the marginal cost of the profile, we calculate
23 the marginal cost of a load that has a shape on the
24 regulated shape for each retailer.

25
26 Very briefly there is a lot more detail in the paper
27 we have released, but the input assumptions that are
28 important for us to estimate the long run marginal cost for
29 each of the regulated loads are obviously the regulated
30 load shape for each retailer, and that is information that
31 the tribunal has asked the retailers for as part of the
32 process in this determination.

33
34 Then the other key set of assumptions that we need are
35 assumptions about the options for plant to meet that load.
36 Firstly, we need a list of plant technologies - oil, gas,
37 and things like that. Then we need to understand what
38 their capital costs are, what their fuel costs are, what
39 their operating costs are and also what their operating
40 characteristics are. Also, what are their
41 emission rates, and things like that. Effectively we need
42 to understand what is the sort of relative cost of building
43 and operating these different plants and we need all that
44 information to enable those choices to be made.

45
46 Further on the load that we use when we are looking
47 for a lower margin of LPMC and a regulated load shape, we

1 typically don't put the full half hourly load shape into
2 the model. We will receive a forecast, a half hourly
3 forecast, from each of the regulators, but it just becomes
4 a computation to find the margins to put the full half hour
5 load shape into the model.
6
7 What we do both for Whirlygig and for Spark is we tend
8 to put in representative demand points. Actually this
9 diagram has not turned out that clearly, but typically what
10 we do is choose 30 or 50 representative demand points and
11 match those to the regulated load shape. The thing you
12 can't see very clearly in this diagram, unfortunately, is
13 that it is important that these representative demand
14 points are weighted towards the peaky end of the load
15 duration because that is what really drives the cost.
16 Whether you are talking about the long run marginal cost or
17 the cost of serving a particular load, it is really what
18 happens up the peaky end that matters, so we tend to weight
19 these representative demand points up that end.
20
21 Moving on to the energy purchase cost allowance, which
22 is a bit more detailed, we will actually be using the sort
23 of full modelling framework to come up with an energy
24 purchase cost allowance - so Whirlygig, Spark and Strike.
25 Importantly, we run Whirlygig differently for the energy
26 purchase cost allowance than for the long run marginal
27 costs of serving the regulated load shape.
28
29 The reason we are running Whirlygig is to look at
30 requirements for new investment, for instance, as well as,
31 in some cases, we might actually look at the long run
32 marginal costs of meeting the renewable energy target.
33 When we are doing that, it is obviously important to look
34 at the full system rather than just look at this mini shape
35 that we are looking at for the long run marginal cost for
36 regulated load. So when we are running Whirlygig as a
37 first step in our energy purchase cost allowance estimate,
38 we have a full representation of the systems. We will have
39 all of the existing plant in there, the interconnectors,
40 regional demand for each region and so on.
41
42 What we get from that is requirements for new
43 investment which, over the period, we are looking at is not
44 a big issue because we already have all of the committed
45 investment to serve load over the next few years. We also
46 get estimates of the marginal costs of meeting the
47 renewable energy target, for instance.

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1
2 These inputs are then fed into Spark. As I said,
3 Spark is our market model which has a very similar
4 representation of the energy market, as is in Whirlygig,
5 and it allows us to forecast pool prices. From pool
6 prices, we can derive contract prices and feed both of
7 those along with the half hourly regulated load shape for
8 each retailer into Strike and Strike determines efficient
9 hedging strategies for each retailer.
10
11 We will be running through the full energy modelling
12 framework that we have. What we will also be doing - I
13 guess, similar to what Steve Gray mentioned about
14 triangulating the retail margin, effectively triangulating
15 the energy purchase cost allowance - is we will be using
16 other estimates of forward spot contract prices as inputs
17 into Strike. Strike works with any set of forecasts for
18 prices, not just the forecast prices that come out of
19 Spark. As well as our own forecast prices, as we did in
20 the last determination, we put in forecast prices from
21 stakeholders and from d-cypha as a check.
22
23 MR ENGLUND: Anthony Englund, from Integral. So will
24 you be using d-cypha or not? I sort of got slightly mixed
25 signals out of some of this paperwork.
26
27 MR HARPAM: We will be. All through the process of the
28 last determination, we ran d-cypha prices through Strike.
29 In fact when we get to the slide, I have at the end, it
30 shows you what these frontiers that come out of Strike look
31 like. You will see that for different sets of forecast
32 prices, you will have different frontiers of energy
33 purchase cost. We are proposing to do the same thing for
34 this determination - effectively come up with a bunch of
35 different efficient frontiers which are contingent on
36 different forward price forecasts.
37
38 To go through each of the models in turn, for the
39 Whirlygig modelling we do for determining purchase cost
40 allowance, rather than using the stand-alone approach, we
41 are using the incremental approach in the NEM. So we have
42 all of the existing plants in the NEM, all committed
43 plants, where that is consistent with what is in the ESOO.
44
45 I guess now is a good time to say that the document we released
46 a month or so ago obviously was largely based on the
47 previous ESOO. The new ESOO has now come out now, so

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1 there will be a revision of that document which will be fed
2 into the modelling of the draft report and will be released
3 with the draft report, but I think it does not yet show you
4 how we use that information.
5
6 So we will have all existing and committed plants. We
7 will have forecasts of demand in each region and also
8 certainly from the most recent ESOO. Effectively what
9 Whirlygig does is, based on the existing plant and the
10 options for new plant and the costs of those, it maps a
11 least cost path for investment, of investment providing new
12 plant and operation of the new investment plant to meet
13 those regional demand forecasts.
14
15 So the input assumptions are existing plant - so
16 things like capacity, short run marginal costs and
17 operating characteristics. We don't have any fixed costs
18 for existing plant in the model on the basis that these
19 have already been sunk and therefore are not relevant to
20 economic decisions. For new plant, we have all of the same
21 sorts of information but we also have fixed costs on the
22 basis that those investment decisions have not been made
23 and those costs are not sunk. We have interconnectors in
24 there and capacity and losses on those interconnectors. We
25 have system load and constraints. So we have reserve
26 constraints that the model has to meet, the same as from
27 AEMO and greenhouse constraints - so MRET and GGAS.
28 There is a lot more detail on all of that in our report.
29
30 As I mentioned the key difference between Spark and
31 Whirlygig is that Whirlygig is least-cost dispatch. It
32 effectively assumes that all generators make all their
33 capacity available at short run marginal cost; whereas
34 Spark has essentially the same input assumptions but allows
35 strategic generators the opportunity to bid strategically
36 into the market, so it better reflects the sorts of
37 decisions that large generators can make in bidding into
38 the market.
39
40 As with Whirlygig, we don't run Spark for a full half
41 hourly load trace. We use a number of representative
42 demand points simply because it becomes computationally
43 very difficult to look at the full half hour. For each of
44 these representative demand points, we run it as a separate
45 game. We look at the bid incentives that each strategic
46 generator will have in that half hour and search for and
47 find equilibria given that set of possible bidding strategies.

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1
2 Effectively each equilibrium provides an outcome, so
3 an outcome in terms of bids into the market and hedge
4 prices from the market that generators won't unilaterally
5 deviate from. It can come up with a number of equilibria
6 for each representative demand point which are consistent
7 with different possible combinations of bids which are
8 stable and this gives us a price distribution for each
9 representative demand point.
10
11 Modelling inputs for Spark: as I said a number of
12 times, it is essentially the same as Whirlygig. The key
13 difference is that whereas in Whirlygig ownership of plant
14 does not really matter, in Spark ownership does matter.
15 The reason for this is depending on what plant you own, you
16 will have different strategic opportunities and different
17 pay-offs from those opportunities as well. So we have
18 information on who owns what in the market. Essentially
19 the rest of the input assumptions that represent the market
20 are the same as in Whirlygig.
21
22 The two additional input assumptions which are
23 important in Spark but not in Whirlygig are the bidding
24 strategies. So for strategic generators, what sorts of
25 strategies can they employ in the market? We define these
26 essentially as proportions of available capacity which will
27 be offered to the market by a particular generator. We
28 base these on market information essentially, what we have
29 seen in the market over the last few years.
30
31 Importantly the model doesn't force a particular
32 bidding strategy on any generator. It offers them a number
33 of bidding strategies and then looks for equilibria which
34 are combinations among different generators and strategies
35 which are stable.
36
37 The other thing we need to put into Spark are contract
38 levels for the generators. Obviously the pay-offs to
39 generators from having different strategies will depend on
40 what their contract levels are. Again, those contract
41 levels will go into the modelling on evidence that we have
42 seen in the market and we have talked about that in the
43 last annual review.
44
45 MR ENGLART: Paul Englart, Country Energy. In regards to
46 the bidding strategy that is based on, as I read here, a
47 historic bidding behaviour, what will the happen with the

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1 introduction of CPRS and when we have all the changes for
2 generation fuel types? How do you cater for or are you
3 catering for that in the model?
4
5 MR HARPHAM: One reason that we have the bidding
6 strategies that we have in the model at the moment is that
7 experience has shown that generators like to have a fair
8 bit of their capacity contracted firmly into the market
9 because they like to cover their fixed costs from the
10 contractor rather than being exposed to the market. I
11 don't know that that will necessarily change a lot as a
12 result of the introduction of CPRS; one would presume that
13 generators would still want to cover those fixed costs.
14 I'm not sure if James may have something else to add.
15
16 MR ALLAN: Actually the bidding options that we put into
17 the model are more based on the typical risk limits that a
18 generator would face rather than their actual observed
19 historic bidding pattern. What we are doing is basically
20 giving them the option to withdraw capacity within a
21 range - the actual min and max risk limits that the
22 businesses face.
23
24 We are not assuming any actual kind of bidding set of
25 strategies for a given half hour. What the model will
26 actually do is then find out if the equilibrium bidding
27 strategies across all the participants, when they all have
28 those options, do change as a result of time or CPRS. So
29 it will be an output of the modelling. It is exactly what
30 we are looking for.
31
32 MR PRICE: I would like to add to that. In fact one of
33 the virtues of using an approach like this is that we have
34 no history on which we can base any sort of bidding
35 behaviour. It would be ridiculous to go back and use
36 historical patterns, because the whole point of the CPRS is
37 to alter patterns of production. So by just allowing the
38 model to find the equilibria itself having regard to the
39 profitability of different bidding strategies allows the
40 market to find its own level.
41
42 MR ENGLUND: I assume that will only come about when
43 you have the cost of carbon --
44
45 MR PRICE: That's right.
46
47 MR HARPHAM: Moving on to Strike, what we get from Spark,

1 and what we also can get from other sources - d-cypha, the
2 stakeholders - are a set of prices for spot prices and
3 contract prices. Strike uses portfolio theory to search
4 for or find efficient contracting strategies based on these
5 inputs.
6
7 To put this into some context, if we add a contract to
8 a retailer's hedging portfolio, then it is going to do two
9 things: it will change the expected cost of that
10 portfolio, generally cost will increase to the extent that
11 the contract is at a premium to spot. But the other thing
12 the contract does, which obviously is very important to the
13 retailers, is it will have an effect on risk. As long as
14 the a retailer is not over-contracted, then a contract like
15 a swap or a cap will potentially reduce the retailer's
16 risks.
17
18 Effectively what Strike does is, recognising this
19 trade-off between costs and risks, it looks for hedging
20 strategies that are efficient. When we talk about
21 efficient hedging strategies in the context of Strike, we
22 are talking about hedging strategies from which you can't
23 improve risk without increasing cost, for instance; or
24 putting it the other way, you can't lower cost
25 without increasing risk.
26
27 I have an example which --
28
29 MR SMYTH: I have a question regarding the contracting
30 strategies of both the retailers and the generators. I
31 am wondering what influence on the model the presence or
32 absence of ETEF was having? How do you account for that?
33
34 MR HARPHAM: I guess ETEF is one of the uncertainties
35 that we have to deal with as part of this determination.
36 In fact we also had to deal with it as part of the last
37 determination. ETEF can be accounted for in Spark, in our
38 modelling of forecast spot prices, because we think it does
39 have an impact on generators' bidding behaviour.
40
41 Given that there is sort of some uncertainty about the
42 roll-off of ETEF, I guess we will need to look at what
43 announcements are made on that roll-off schedule; but at
44 the moment it seems that it will be there until at least
45 July 2010. So presumably in modelling Spark we will need
46 to look at scenarios in which it remains and potentially
47 scenarios in which it rolls off as well.

1
2 The way we take that into account is effectively by
3 altering the contracting levels of the generators in Spark
4 to reflect the fact that they are exposed to ETEF. This is
5 something that we did, I guess most recently, for the last
6 annual review. We looked at two scenarios. I can't
7 remember what the two scenarios were at that stage, but at
8 that stage there were two scenarios for the roll off of
9 ETEF.
10
11 We looked at a scenario where we had that roll-off, or
12 we kept it at 100 per cent, and there was a difference in
13 the pool price forecast you get out of Spark because of the
14 different assumptions about the contracting levels of the
15 generators. So it looks like we will need to do that
16 again.
17
18 MR MOODY: Earlier on you showed the cumulative
19 distribution and that you don't use all 17,500 points, you
20 choose a selection, which is, I don't know, presumably a
21 number representing 100 or something like that. Does that
22 mean that when running each of the games, as you described
23 them, you end up with that many results instead of 17,500
24 and you spread them across the year somehow?
25
26 MR ALLAN: So as part of constructing those points, we
27 weight them by the number of hours that we are trying to
28 represent. So that is exactly right; we have a weighted
29 set of outcomes.
30
31 MR MOODY: I guess historically around about 20 per cent
32 of the value of the spot prices comes from about 0.2 per
33 cent of the price bids, which is clearly where all the risk
34 is in retailing. How do you capture that since you won't
35 have that level of resolution?
36
37 MR ALLAN: We bias the resolution of those points heavily
38 towards the peak and along the load duration curve, which is
39 the point Andrew made earlier. So we are modelling
40 individual half hours at the top end of the curve.
41
42 The other point is that when it comes down to the
43 final hold on energy costs that we get out of Strike, that
44 has as much as anything to do with the contract positions
45 we have held during those times as well. So it will be
46 smoothed out a little bit, just so that the model will be
47 able to contract away some of our risk.

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1
2 MR MOODY: I guess the thing that would concern me is
3 that out of that 7.2 per cent is less than 100 hours or
4 100 hours of price outcomes over a full year. If you are
5 only doing 100 points to start with, you don't have
6 sufficient - it is even less than 1 point that would need
7 to include that price volatility; yet that price going
8 from, say, \$30, \$40 a megawatt hour to \$10,000 has enormous
9 risk in it. I just can't see how you can extract that and
10 therefore flow into the efficient frontiers without having
11 perhaps more resolution around that volatile component.
12
13 MR PRICE: You have to think about the nature of the
14 competitive conditions with those top 100 hours - so where
15 you think there is demonstrably more market power in the
16 last 50 hours versus the last 100 hours. For the most
17 part, Spark does not distinguish it, but if it finds an
18 opportunity to hit a VOLL price, it will take it. It does
19 not care about any sort of regulatory risk; if anything it
20 tends to bias it on the upside because of it, whereas in
21 reality the market is a lot more subdued than Spark will
22 have you imagine.
23
24 If anything it tends to the push prices up not down
25 because the last 100 hours, the market comes under
26 severe pressure, virtually any generator under those
27 circumstances has an almost unilateral market power under
28 such circumstances. It won't care whether it is the top 50
29 or top 100; it will behave in exactly the same way.
30
31 MR MOODY: I didn't see that flow through into the
32 results last time. Maybe I just didn't interpret them.
33
34 MR COLEBOURN: I think the related point to what Mr
35 Moody was making is that if the retailer knew in advance
36 which half hours were going to be really high, they are the
37 ones you would contract, clearly. But, of course, retailers
38 don't know in advance what is going to happen; they have to
39 contract years in advance, and they contract against
40 potential outcomes.
41
42 MR HARPHAM: Yes, that's right. I think there are a
43 couple of points that that raises. One of them is that
44 there is going to be a forecasting risk associated with the
45 work that we are doing and the advice that we are giving to
46 the tribunal, and this is part of the reason why there were
47 annual reviews last year, so that as information on the

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1 market became available through the course of the
2 determination, the tribunal was in a position to go back
3 and look at how that new information might flow through
4 into the energy purchase cost allowance.

5
6 I guess the other point to think about is that
7 ultimately we have this three-stage modelling process which
8 results in an efficient frontier, like the ones we have up
9 here. I think these have come out of the last report that
10 Frontier did for the previous determination - I think it is
11 Country Energy's - but essentially it results in these
12 frontiers, and for any point on the frontier that the
13 tribunal considers appropriate - last time they chose the
14 conservative, so the top-left point - there is a
15 contracting strategy associated with that point on the
16 frontier, and so there is a particular mix of swaps and
17 caps and exposure to the market as well.

18
19 One of the things we have been thinking about is the
20 fact that, particularly with CPRS coming in, forecasting
21 prices becomes more difficult. But one of the things we
22 need to investigate is to what extent the hedging strategy
23 at these points on the frontier changes as a result of the
24 new assumptions about what the carbon price is. So, for
25 instance, if the carbon price is \$40 instead of \$25,
26 obviously that has a different cost, but it may not
27 actually result in a markedly different hedging strategy at
28 the conservative point or the elbow point.

29
30 If that is the case, it brings us back to the issue
31 that the tribunal faces, and that is that it needs to set a
32 price ultimately on some view of what the world will look
33 like in the future and what prices will look like in the
34 future, but it may be that that is not driven to a large
35 extent by differences in the hedging strategy at that
36 conservative point.

37
38 MR PRICE: Can I just add to that? Just going back to
39 your point a bit more closely about the demand, in fact
40 what goes into this is a distribution of demand and a
41 distribution of prices, and there is correlation between
42 them. So around each of those points there is a
43 distribution. The problem, of course, with a retailer
44 hedging - or a generator hedging, for that matter - is that
45 there is uncertainty about how much load they have to hedge
46 for and at what price, and we explicitly take that into
47 account when we formulate that optimal hedging strategy,

1 which is why we spend so much time getting quality retail
2 load data so that we do that correctly.

3
4 MR COLEBOURN: Yes. I'm just pointing out that a retailer
5 is trying to hedge in a position of uncertainty, because he
6 doesn't know what his demand is going to be, but what your
7 model is doing is efficiently hedging a demand that you
8 actually know.

9
10 MR PRICE: Yes. Explicitly, they don't know it, but there
11 is a distribution around it, there is an expected value,
12 and they have to take a view as to how wide that
13 distribution is. We need to reflect that in the way that
14 we model it, and that's exactly what we do.

15
16 MR COLEBOURN: I might go on to the issue of reserve. The
17 way AEMO manages the system, of course, is that it applies
18 reserve not on top of an actual observed demand but on top
19 of a 10 per cent POE demand, a forecast demand, so they are
20 different things. The actual demand is different to having
21 to commit plant, in advance, against a forecast.

22
23 MR PRICE: That's right.

24
25 MR ALLAN: So the way we cover that off is in the first
26 stage of our modelling with Whirlygig we implement the
27 exact same kind of constraints that AEMO does when they do
28 the supply/demand balance modelling. So we input that
29 abstract 10 per cent POE demand - which is actually even
30 more abstract, because it is 100 per cent coincident 10% POE;
31 so every region peaks at the exact same half hour - we put
32 that point into our first-stage modelling and we apply the
33 reserve margins published by AEMO, and that's one of the
34 constraints when Whirlygig works out the optimal build path
35 for the period that we're looking at.

36
37 MR PRICE: That then influences prices subsequently, of
38 course.

39
40 MR LIU: Dongsheng Liu from AGL. One of the points on
41 this frontier, apparently, it seems that there is a
42 distribution associated with that point in terms of risk
43 and price and what-have-you, but what is the hedging
44 strategy associated with the point? Is it associated with
45 a fixed hedging strategy or a bunch of strategies?

46
47 MR HARPHAM: I am sorry, I missed the end. What was it?

1 Hedging strategy associated with the conservative point?
2
3 MR LIU: Is it associated with a fixed hedging strategy or
4 bunch of strategies?
5
6 MR HARPHAM: So each of the points along --
7
8 MR LIU: What I was trying to say is: at a point on the
9 efficient frontier you will have this distribution of the
10 costs associated, but behind that, is that a single site of
11 optimal hedging strategy associated with that point, or
12 involving a bunch of different optimal hedging strategies
13 over the same point? That is my question.
14
15 MR ALLAN: I think there are two bits to that. Firstly,
16 to construct one of these frontiers, we input, as Danny
17 said, distributions around load and price and various other
18 inputs and their correlations, such that the model can
19 determine optimal hedging positions.
20
21 As to the curve itself, every point on that curve
22 represents a single quantity of, say, swaps and caps, which
23 corresponds to an optimal position. So every point on the
24 curve is an optimal position, and underneath each point
25 there is a unique quantity of swaps and caps and various
26 other products that make up that optimal position.
27
28 The choice to be made is then which optimal position
29 is the best one, and in the last determination the tribunal
30 decided on the most conservative point, the lowest risk,
31 which is that one at the upper left. But every point on
32 the frontier is an optimal point.
33
34 MR LIU: Thank you.
35
36 MR HARPHAM: That might be enough about the efficient
37 frontiers, I guess other than to say - and this is
38 something I mentioned at the start - for the previous
39 determination we calculated these efficient frontiers for
40 different sets of forward prices, so that's the reason
41 there are four of these efficient frontiers, and we will be
42 doing the same for this determination.
43
44 I guess the last thing we thought we might talk about
45 is CPRS. Obviously CPRS will be a factor over this
46 determination. We will have a capped carbon price for
47 2011/12 and then an uncapped carbon price in 2012/13. So

1 CPRS obviously is going to add to generators' costs and
2 we're going to see that flow through into the spot market.
3
4 The tribunal's issues paper discussed in some length
5 the alternatives between modelling a carbon-exclusive spot
6 price and then having a separate carbon cost or a
7 carbon-inclusive spot price which incorporates a carbon
8 cost.
9
10 From our point of view - and this is something that we
11 talk about in our modelling methodology paper - we are
12 proposing to do our modelling on a carbon-inclusive basis,
13 I guess for a couple of reasons. Firstly, we think this is
14 where the market will ultimately head, and to the extent
15 that the modelling we are doing for our advice to IPART is
16 consistent with what is out in the market, then that makes
17 it easier for us to compare our modelled results to what is
18 observable in the market.
19
20 The second reason is that whether you model a
21 carbon-exclusive or a carbon-inclusive spot price, in order
22 to understand and think about how the carbon price is going
23 to flow through to the spot price and then ultimately to
24 retailers, you need to understand what is called the
25 pass-through rate, so the extent to which the carbon price
26 flows through to spot prices.
27
28 You clearly need to do that under a carbon-exclusive
29 spot price, but because of the complex way that the carbon
30 price will affect the spot price, effectively, to work out
31 what that pass-through rate is you end up having to model a
32 carbon-inclusive spot price in any case. So it is not
33 clear that doing a carbon-exclusive spot price is simpler
34 or more transparent from a modelling point of view. .
35
36 MR ENGLUND: Will you be making some assumptions
37 transparent about the extent to which you think the
38 pass-through is happening?
39
40 MR HARPHAM: In fact this is something we're talking about
41 in this slide. To a large extent, our assumptions are
42 already in that methodology and assumptions book. So just
43 to be clear about how carbon is dealt with in our models,
44 in Whirlygig we have a carbon cost as an input and we have
45 emissions rates for each of the generating plants, so the
46 extent to which any single generator's cost increases is
47 just the multiple of those two.

1
2 It is similar for Spark, so short run marginal costs
3 increase due to the carbon price and the emissions
4 intensities, so we have put all the emissions intensities
5 in that modelling report. We have also put in the carbon
6 price forecasts that we are proposing to use. So that is
7 based on Commonwealth Treasury's forecast as, I guess, the
8 most robust or transparent source of carbon cost inputs.
9 So those are the only things that go into our modelling -
10 the carbon price and the emissions intensity, really, and
11 I think that's all transparent in our report.
12
13 MS BRAKEY: And in our methodology paper IPART has
14 said that it will instruct Frontier on what assumptions to use
15 for the carbon pricing.
16
17 MS HUGHSON: Do you mean in terms of dollars per tonne,
18 Anna?
19
20 MS BRAKEY: We will ask for certain scenarios and, yes, it
21 will be about that.
22
23 MR HARPHAM: There are risks associated with CPRS,
24 obviously. In the way that we have been thinking about it,
25 there are two key risks to retailers through this
26 determination as a result of the CPRS.
27
28 The first one is the forecast risk, so, as I mentioned
29 earlier, we have to take a view at the moment on what the
30 carbon price is going to be for 2011/12, which is less of
31 an issue because of the cap on the carbon price, but
32 ultimately for 2012/13 as well. So we are proposing to use
33 Commonwealth Treasury's forecast of the carbon price for
34 2012/13, but for the purposes of informing the tribunal
35 about the sort of magnitude of the risks we're talking
36 about, we will also be modelling scenarios in which there
37 is no CPRS, so no carbon price in 2012/13; and it is only
38 in doing that, I guess - part of an answer to your
39 question - that you can actually work out the pass-through
40 rate by looking at what the spot price is on a no-carbon
41 basis and comparing it to the spot price on a CPRS5 basis,
42 for instance.
43
44 We will also be modelling it on the basis of the
45 CPRS15 prices, so those are the higher carbon price
46 forecasts from Treasury, largely based on the assumption
47 that there are going to be tighter restrictions on carbon

1 globally and, as a result, a higher global carbon price.
2
3 We intend to do that to understand, I guess, the
4 extent of the forecast risks associated with CPRS, but
5 ultimately the design of the regulatory process, I think,
6 is the best way to deal with those forecast risks. So
7 through the annual review process, as we get closer to
8 2012/13, no doubt there will be more certainty about the
9 scheme design, implementation and the likely carbon price,
10 and that's something that can be taken into account in
11 those annual reviews.
12
13 I guess the other way that the CPRS can affect risk
14 for the retailers is if the carbon price itself is volatile
15 over the course of a year. So when we talk about modelling
16 CPRS5, effectively what we mean is we will take the CPRS5
17 price for 2012/13 from Commonwealth Treasury modelling
18 and put that in as a fixed price for the year, but no doubt
19 that won't happen; the carbon price itself will be volatile
20 across the year.
21
22 The difficulty with trying to model this risk at the
23 moment is there is really no basis on which we can come to
24 a view on what the volatility of the carbon price is going
25 to be, and also how that volatility will be related to the
26 spot market conditions, because, in principle, the carbon
27 price - any carbon price itself, or some carbon prices
28 themselves - may in fact reduce volatility in the spot
29 market, to the extent that the imposition of a carbon price
30 flattens out the merit order. The impact on the cheapest
31 generation is greater than the impact on the more expensive
32 generation, so it flattens out the merit order.
33
34 So, in principle, for some carbon prices, the
35 introduction of the CPRS may actually reduce the volatility
36 in the spot price, although, obviously, to the extent that
37 the carbon price then is volatile, and as you get to a
38 higher carbon price that effect may be washed out.
39
40 I guess the upshot of all of that is that without
41 having any basis for predicting what the volatility of the
42 carbon price in 2012/13 will be at the moment, or how the
43 volatility will relate to conditions in the NEM, it sort of
44 becomes a meaningless exercise for us to try and take a
45 volatile carbon as an input into our pool price modelling
46 at the moment.
47

1 So at the moment we are proposing just to use a fixed
2 carbon price for each year to model the effect of varying
3 that carbon price, the level of that carbon price, but at
4 the moment I don't think there is a lot more we can do in
5 terms of taking into account a carbon price that is
6 volatile across the year in any systematic way.
7
8 That's, I guess, all I really wanted to run through by
9 way of presentation. If there are further questions, we
10 are happy to hear them.
11
12 MR LIU: My first question is about the stand-alone
13 approach to the LPMC, it is about the minimum reserve
14 margin for the system; my second question is about the MRET
15 targets; my third question is about the interconnector.
16
17 On the stand-alone method, I just found the report unclear
18 on how you handle these assumptions which belong to
19 the system, but now you model part of the load - is it
20 pro rata or whatever? Especially in New South Wales, the
21 marginal reserve is negative, and that's probably because
22 of the in-flow from other regions to New South Wales. So
23 what is the adjustment to that? That is my first question.
24
25 My second question is related to the efficient
26 frontier. When you put up the chart, when you look at the
27 end, at the minimum risk point, there is still a \$2 or \$3
28 risk. What I am trying to understand is what is the
29 potential driver of the risk that will actually eventually
30 cause that cost to shoot up more, the energy cost.
31
32 MR ALLAN: I might answer your second question first. So
33 the reason why there is still some residual risk, even on
34 the most conservative part of the efficient frontier, is
35 due to the blockiness of the contract options that we give
36 the model.
37
38 So if we included products whereby you could construct
39 an optimal position that perfectly followed your load
40 across the whole year, you could completely minimise the
41 risk in your portfolio. But that's not what we do. What
42 we have included is quarterly peak and off-peak swaps and
43 caps, so there is always going to be some element of overs
44 and unders across the course of the year, against any
45 position constructed out of those instruments. So there
46 will always be some sort of residual risk on the portfolio.
47

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1 MR PRICE: Just to add to that, the more contract types we
2 add to the portfolio, the lower the cost and the lower the
3 risk.
4
5 MR ALLAN: Well, not necessarily the lower the cost.
6
7 MR PRICE: Well, if we price those off the opportunity
8 cost of the spot market, it will most certainly be the
9 case, if you can fill in all the coarseness of that
10 contract. So long as it is internally consistent with the
11 spot market, the price and risk will fall. So we use a
12 limited range of contracts and still there is some
13 coarseness there, but, in reality, that won't be a
14 retailer's book; that would be much more exotic contracts.
15
16 MR LIU: I understand that. Can we regard that residual
17 risk as a volume risk rather than a price risk?
18
19 MR ALLAN: It is a combination of the two.
20
21 MR LIU: Still a combination? Thank you.
22
23 MR HARPHAM: One of the things we haven't talked about
24 today is the volatility allowance, which was incorporated
25 as part of the previous determination and is something that
26 we will be looking at in our advice to the tribunal. So
27 the volatility allowance was effectively based on that
28 residual risk and the working capital that retailers
29 required to ensure that, effectively, they could cover that
30 risk in case, you know, at the beginning of the
31 determination, things moved against them, so that they were
32 in fact below the expected cost. The volatility allowance
33 was the cost of the working capital to effectively tide
34 them over until things turned around. Did you have a
35 question?
36
37 MR MOODY: No, that essentially answers my question.
38
39 MR LIU: What about my first question?
40
41 MR ALLAN: The first question seemed to be mostly about
42 how do we treat reserve and interconnector flows in the
43 stand-alone approach. Just on the interconnectors, we
44 assume that there are no interconnectors. So all we are
45 modelling is the shape, and we are trying to find an
46 optimal mix of new plant options to fit that shape, and we
47 don't consider any kind of multi-regional system in doing

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1 that at all.
2
3 The second point is that we do include a reserve
4 margin in doing that. It is not one that is based on
5 anything published by AEMO, because of course they don't
6 publish what should be a reserve margin for the regulated
7 load shape of an individual retailer. So I don't think we
8 have come to an actual mandate on exactly how that would be
9 done, but I know in the last determination it was a
10 percentage basis, I think it was about 15 per cent reserve
11 margin.

12
13 MR HARPHAM: I think it was 15 per cent in the last
14 determination.

15
16 MR LIU: Above the maximum demand?

17
18 MR HARPHAM: Yes. And I think you asked about MRET?

19
20 MR LIU: Yes, MRET.

21
22 MR HARPHAM: What we are proposing to do is, because
23 we run Whirlygig both on a stand-alone basis and then on an
24 incremental basis with the full system in it, we're
25 proposing to come up with the MRET cost in the full system
26 version of Whirlygig, rather than the sort of stand-alone
27 version.

28
29 MR LIU: So in stand-alone, there is no MRET content?

30
31 MR HARPHAM: No, because effectively, to do that, we
32 would need to make a bunch of assumptions about how to
33 allocate. So we are doing MRET on a system basis.

34
35 MR COLEBOURN: A point of clarification, the 15 per cent
36 reserve margin or whatever per cent you use, is above the
37 10 per cent POE forecast number.

38
39 MR ALLAN: On the stand-alone basis we are using
40 information provided by the retailers and we have asked for
41 those on a number of POE bases. For each of those shapes
42 we would expect to get a different LRMC number, so it will
43 come down to which one we choose to use basically.

44
45 MR PRICE: Which is why getting that data on a consistent
46 basis is important for us.

47

1 MR SMYTH: I have three questions which relate more to
2 the recent documentation rather than your presentation.
3 The first one is regarding transparency. We really do
4 welcome the comment that the spot prices will be released
5 in spreadsheet format at a half hourly level for
6 stakeholders' perusal. Will the associated system demand
7 profiles also be released on these spreadsheets? So you
8 model the spot price and you provide that model spot price
9 in the report that will be published. Associated with that
10 there will be load shape at a half hourly resolution
11 presumably. Will we see that as well?

12
13 MR HAMILTON: That will be the regulated load shape
14 mentioned --

15
16 MR SMYTH: It is the system load that drives the spot
17 price so you can regulate that properly.

18
19 MR ALLAN: The way we do is it take a load profile of the
20 system and then we construct the representative demand
21 points and Andrew showed a slide on that. Our modelling
22 then works with those representative demand points to come
23 out with pricing outcomes at the representative demand
24 point level and we use that methodology to blow that back
25 out to a half hourly price series.

26
27 MR SMYTH: So we will see a timed series of both spot price
28 and associated load?

29
30 MR ALLAN: We had not planned to actually correlate it to
31 system demand but there is no reason why we couldn't.

32
33 MR PRICE: Yes.

34
35 MR SMYTH: It gives us confidence that the model reflects
36 reality.

37
38 The second question is related to assumptions
39 regarding capital costs. It is not clear in the
40 documentation that the interest costs that are approved
41 during construction of assets are included in the fixed
42 costs of new builds in the LRMC calculations. Could you
43 comment on that?

44
45 MR ALLAN: We based the majority of our costs on ACIL's
46 most recent report. There is a section in that talking
47 about how they split out the construction costs across the

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1 different years of construction. I have the report here.
2 I can tell you the page reference and talk you through it
3 later.
4
5 MR SMYTH: Thank you. My final comment: in the
6 documentation there is a discussion about the concept of
7 layering in hedges. That is in the context of the
8 discussion about whether market-based prices should be used
9 versus models to contract prices. It seems to me that you
10 have refuted the assertion that market-based prices or
11 observed prices should be used because retailers should be
12 marketing their hedge book to the market and making their
13 economic decisions on that basis.
14
15 My comment is that a retailer doing this will also
16 have a load which they will mark to market as well which
17 moves in an exactly opposite fashion and therefore
18 marketing your hedge book on its own in this context does
19 not seem to be relevant. Hence we should be able to be
20 using the observed market prices more readily than you
21 would seem to be saying.
22
23 MR HARPHAM: Sorry, are you saying you want to be using
24 observed market price, so the timed series from the sites,
25 say, over the past two years?
26
27 MR SMYTH: Over a period of time. There seems to be an
28 approach used in other jurisdictions that the sort of
29 prudent retailer layers in their hedges over time and,
30 wherever the data is available, uses that as the basis for
31 calculating what the contract prices are.
32
33 MR HARPHAM: We don't have any sort of issue with the
34 idea that retailers will layer in contracts. When retailers
35 want to buy contracts is up to you guys really.
36
37 Our concern comes with then pricing those contracts
38 according to whatever price you pay for them historically.
39 It seems to us that in making the decision to sell energy
40 today, you should base it on the cost of energy today, not
41 the cost you paid for it last year or the year before last.
42 I guess that is our issue with the approach of taking a
43 weighted average price from d-cypha for two years,
44 and using that as a benchmark to price a retail offering
45 today.
46
47 MR PENNINGS: So you are saying that practically then the

1 retailer should hedge a day ahead or very near term?
2
3 MR PRICE: No. It is just the opportunity cost of that
4 contract at that point in time. It says nothing about how
5 you go about hedging. Of course, you will be hedging for
6 the load now sometime in the near past. That is a distinct
7 difference from the value of the contract that you choose
8 to sell to the customer at a single point in time. That is
9 the opportunity cost of that contract and it is how much
10 other people would be paying for that contract at the same
11 point in time.
12
13 MR PENNINGS: But you talk about choice in selling to a
14 customer. We are reflecting the modelling for a standard
15 retailer who is obligated with the right to supply. I am
16 just trying to understand --
17
18 MR PRICE: I don't think it is a complex concept because
19 it is exactly how every other market works including things
20 that you are familiar with. For example, you wouldn't sell
21 your house that you bought two years ago for the price you
22 paid for it two years ago. It would be on the price that
23 the house is valued on the day of the auction, and the same
24 principle --
25
26 MR MOODY: I wouldn't sell a house I don't own.
27
28 MR PRICE: The same principle is true with any other
29 hedging contract as well. You sell it for what you can get
30 for it on the day including either back to the market or
31 through to another customer.
32
33 MR MOODY: The fundamental difference with this product
34 being a regulated tariff from anything else that certainly
35 we do, or any other retailers I know of in any business, is
36 that over the next few months we will sit here and
37 determine the price of a product we don't currently own for
38 the next three years, and that is fundamental.
39
40 With your house example, I don't mind selling a house
41 that I have for a price negotiated on any base that I am
42 comfortable with, but selling a house that I don't own but
43 I need to buy at some point in the future, that is the bit
44 I am having trouble with
45
46 MR PRICE: All you have done is reflected some of the
47 complexities of regulating in a volatile market.

1
2 MR MOODY: Yes, absolutely.
3
4 MS HUGHSON: Could I confirm that in your stand-alone
5 model used in Whirlygig in the long run margin cost
6 calculation, will you be using those same CPRS scenarios to
7 develop alternative --
8
9 MR HARPHAM: We can do it either way. So we can include
10 CPRS in the stand-alone approach. Effectively it comes
11 down to the choice between carbon inclusive or carbon
12 exclusive, I think. So in that stand-alone approach, we
13 can include the carbon price for each generation type and
14 we can include, obviously where we have the emissions
15 factors, these generation options in that as well. So for
16 each generation option, there can be a cost of meeting the
17 carbon obligation.
18
19 Ultimately, we can do the stand-alone LMRC modelling
20 excluding carbon and then work out the carbon cost
21 effectively as a separate cost item either on a cost basis
22 or, well, probably most likely on a market basis through
23 Spark. So we can do it the same way we propose to do it
24 through Spark by modelling.
25
26 MS HUGHSON: So you haven't yet come to a decision --
27
28 MR HARPHAM: I think it relates in large part, and we will
29 be informed by the tribunal's considerations on which
30 approach between carbon inclusive and carbon exclusive
31 makes more sense. But certainly when we have had further
32 discussions with the tribunal, we will make clear what
33 basis that is in our --
34
35 MS HUGHSON: So it would be consistent across the
36 stand-alone and the regulated bundle or whatever you call
37 it?
38
39 MR HARPHAM: The assumptions about the carbon?
40
41 MS HUGHSON: Yes.
42
43 MR HARPHAM: They would be the exact same assumptions.
44 You would get a different answer potentially because, in
45 the stand-alone, obviously you are building a new mix of
46 generators which turn out a different emissions profile, if
47 you can call it that, compared to the market. So you get

1 different answers from the two. It does, I think, depend
2 upon which approach between carbon inclusive and carbon
3 exclusive is adopted.
4
5 MS HUGHSON: It is difficult to understand what the
6 difference is. The stand-alone acts as you described for
7 all as I understand it.
8
9 MR HARPHAM: Yes, that's right.
10
11 MS HUGHSON: So we need to understand where there is a
12 consistency.
13
14 MR HARPHAM: Yes, sure.
15
16 MS SHEPHERD: Michelle Shepherd from AGL. Once again
17 thank you for providing the assumptions behind this model
18 and your tending be very willing to do that through the
19 process, which is very helpful.
20
21 There were a couple of things that we would be
22 interested in finding out a little bit more about. You
23 talked this morning about the potential change in structure
24 of the market and the sale of various New South Wales
25 assets. We would be interested to understand how, if at
26 all, that is captured in the model. AGL's view is that the
27 ACCC is there to make sure that any acquirer of the
28 business will not be in a position to alter the market
29 outcomes from what they are today. I would be interested
30 to know how that is factored into the model
31
32 MR PRICE: I think that is one way of thinking about.
33 Obviously the tribunal has some views about it, but it is
34 unlikely that the ACCC would accept any sort of merger that
35 would substantially lessen competition; in fact they
36 have a statutory duty to do so, and that would generally be
37 reflected in prices. You can think about it from the
38 modelling sense or just in principle how they think about
39 it, so it is unlikely to be substantially different.
40
41 MS SHEPHERD: In terms of the WACC that was used for the
42 long run marginal cost analysis, my understanding is that
43 you have used various ACIL Tasman data, which we support
44 other than the fact that it does not include interest
45 during construction, as far as we can understand. Which we
46 believe to be an omission. Why is it the decision was made
47 not to use that ACIL Tasman WACC?

1
2 MS BRAKEY: That's an IPART decision. We have instructed
3 Frontier and SFG on the appropriate WACC they should use.
4
5 MS SHEPHERD: But is there any reason for that,
6 particularly for the long run marginal cost analysis, given
7 that ACIL Tasman had a WACC in there?
8
9 MS BRAKEY: Because IPART has its own views on WACC.
10
11 MR PENNINGS: The last time round, I had the privilege of
12 seeing the composition of the hedge portfolio at the
13 conservative and efficient points, and I noted that from
14 quarter to quarter the hedging profile changed
15 dramatically. You might have had a portfolio that in one
16 quarter was 50 per cent swaps and 50 per cent caps, and
17 then the next quarter had 80 per cent pool exposure and
18 30 per cent caps. I am just wondering what Frontier's view
19 was of the practicality of the retailer achieving such a
20 substantial change in the composition of their hedging
21 structure from quarter to quarter.
22
23 MR ALLAN: Firstly, I would say in the modelling that I
24 have done with Strike I have not seen wild swings at the
25 conservative end of the frontiers like you have just
26 described. It certainly does happen as you start to go out to
27 the riskier end absolutely, but at the conservative point
28 it is typically much more kind of stable across the whole
29 year.
30
31 On the second issue, there is no sort of in-principle
32 reason why you guys could not pursue quite a different
33 strategy quarter to quarter if you were so inclined. That
34 will be more sort of an execution issue for the retailers.
35
36 MR PENNINGS: But it is a practical issue. If it was five
37 megawatts or ten megawatts that is easily achievable, but I
38 think the reference point here in the modelling is that of
39 a standard retailer who is looking after a mass market base
40 of a significant size. We are talking hundreds of
41 thousands of megawatts. So, yes, there is an execution
42 issue and that is why I raised it because I think it is
43 largely ignored in the modelling.
44
45 I would suggest as a possibility that there be some
46 parameters in the strike model, I guess an additional level
47 of aggregation as a parameter such that you would not see

1 those wild swings from quarter to quarter
2
3 MR PRICE: One of the parameters that we have for this
4 reason include a cost of ditching
5 contracts including the cost of realising the
6 value of a contract that you don't need in exchange for one
7 that you do. That is a possibility, but at the moment, it
8 is seen as fairly flexible range of options..
9
10 MR PENNINGS: Just on that point, I note in page 73 of
11 your draft methodology paper, that under the old approach
12 or for the current determination your contract prices were
13 set at 5 per cent premium to the spot forecast. Is there
14 any reason you chose 5 per cent?
15
16 MR PRICE: We actually consulted fairly widely at the time
17 on that, and that was certainly the view including from you
18 guys
19
20 MR SMYTH: I am wondering if you take into account some
21 of the public statements that have been made by generators
22 such as regarding maintenance at Yallourn, do you see
23 changing levels of reliability in some generation affecting
24 outcomes of the modelling?
25
26 MR PRICE: I have seen those statements. You have to keep
27 in mind, first of all, that this is modelling that we are
28 doing for the next three years, because those statements
29 are made in the context of an emissions trading scheme. So
30 it is extremely doubtful that within the context of three
31 years anything will change. My own view is that I think a
32 lot of those statements are overblown. It is pretty hard
33 to imagine that, given the low and avoidable cost of
34 maintenance generally and particularly in the context of
35 brown coal generation, they will stop maintaining those
36 power stations. Particularly if that lack of maintenance
37 causes prices to go high, it is hard to imagine a generator
38 just wouldn't spend money to be on the bars.
39
40 THE CHAIRMAN: If there are no more questions, I will
41 wind the proceedings up. In concluding I would like to remind
42 you that the submissions on the draft reports are due on
43 18 September. All submissions and questions should be made
44 directly to IPART and not to Frontier or SFG. Anyone who
45 has questions regarding how to make a submission can
46 contact Anna Brakey, who is sitting to my far right.
47

1 The next stage of this review, which we discussed a
2 bit this morning, is that we will be releasing a draft
3 determination in early December.

4

5 The transcription of today's proceedings will be
6 available on IPART's website in a few days and I think in
7 various slide presentations that have been put up today
8 will also be available on the website. Is that right,
9 Anna; they will be available with the transcript?

10

11 MS BRAKEY: Yes.

12

13 THE CHAIRMAN: Thank you all once again for attending
14 the meeting and the proceedings are closed.

15

16 AT 3.10PM THE TRIBUNAL ADJOURNED ACCORDINGLY

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