29 October 2012

Essential Services Commission of South Australia
GPO Box 2605
ADELAIDE SA 5001

By email: escosa@escosa.sa.gov.au

Re: 2011-14 Electricity Standing Contract Price Determination - Wholesale Electricity Cost Investigation

Pacific Hydro is pleased to provide comment on the Commission's "2011-14 Electricity Standing Contract Price Determination – Wholesale Electricity Cost Investigation".

Pacific Hydro is a leading Australian renewable energy company with over 20 years' experience in project finance, development, construction and operation of hydro, wind, solar and geothermal power projects in Australia, Brazil and Chile. Building on these existing interests, this year we launched a retail electricity business for the Australian commercial and industrial retail market.

We are a wholly owned subsidiary of the Industry Funds Management (IFM) Australian Infrastructure Fund through which Pacific Hydro provides sustainable infrastructure investment opportunities for around 5 million Australian superannuants. We are proud to continue to provide strong returns for the environment, local communities and investors.

Pacific Hydro has applied and been approved for a retail licence with ESCOSA to allow us to retail to commercial and industrial customers.

As a new entrant retailer to the South Australian market, Pacific Hydro is concerned that the ESCOSA draft determination outlined in the above report will add to the perception of regulatory uncertainty and risk that already affects investment in generation and retail.

Part of ESCOSA's objective is creating a more competitive market and in our view removal of retail price regulation would encourage competition in the SA Market. Indeed, as noted in the AEMC's 2008 review "competition in SA's electricity and retail gas markets" was found to be effective.

We recognise that ESCOSA's intention with this determination is to minimise prices for consumers and that is a laudable aim. Unfortunately, using a short-run marginal cost approach could actually have the opposite effect through increasing prices as a result of heightened risk and financing costs.

As such, Pacific Hydro has serious concerns regarding ESCOSA's new methodology which would move from a long-run marginal cost based approach to a short-run marginal cost plus head room approach. It is a fact that short-run spot and forward prices do not capture both fixed and variable costs of generation over the long term.

In our view, the focus on the spot price as the determinant of the regulated price could create an incentive to manipulate the spot price for those players who can do so (SA being a market where that risk exists). Any approach that opens up the possibility of manipulation of the market is by definition anti-competitive.

The new "EPC" method proposed by ESCOSA uses the feature of the market which is the balancing item (ie the spot price) as the feature which sets the regulated price. However, the spot price is not a good indicator of overall market price, which is made up of many contracted positions with much of the balance managed through hedges.

Short run price-based approaches and are also not correlated to financing arrangements required for 15 to 30 year loan arrangements for long-lived assets.

While the ESCOSA report is specifically focussed on standard contract customers and the incumbent retailer, the approach could have negative (and potentially perverse) flow on impacts to other market participants, including:

- The ability of new renewable generators to contract for power-purchase agreements with retail businesses;
- Competition;
- Potential for investment strikes or freezes; and
- Creating an incentive to existing retailers in relation to forward contracting.

In summary, Pacific Hydro urges the Commission to reconsider its approach to this determination and to ensure that its final determination provides a balanced outcome for market participants and consumers.

Yours sincerely

Lane B. Crockett

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Pacific Hydro Australia