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Inquiry into Electricity Price Path

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Submission on the Inquiry into Electricity Price Path Issues Paper

TXU is pleased to submit our views on the points raised in the Electricity Price Path issues paper released by ESCOSA (“the Commission”) in June 2004.

We see the current price review as a critical watershed in the development of the South Australian energy sector. Areas that the review will impact on include:

- Ongoing development of the SA competitive retail market
- Achievability of improvements in customer service
- Attractiveness of SA as an investment environment for the energy industry
- Sustainability of investment, and viability of further investment in the SA generation sector
- Sustainability of investment in the SA gas sector.

While previous price reviews have impacted on these fundamental aspects of the energy sector, the fact that this review will look to install a multi-year price path raises the stakes, by reducing the chance to correct any miscalculations in the following year.

Despite this increased risk, we support moving toward a medium term price path. Set at an appropriate level, such a price path should facilitate the development of competition and investment by providing certainty to industry over future pricing, as well as provide pricing stability and certainty to customers.

As outlined in more detail below, we strongly advocate facilitation of retail competition over the course of this price-path period, as the best long-term protection mechanism possible for SA customers. In facilitating moves toward long-term customer protection, the Commission would clearly be meeting its primary pricing objective, as defined in the ESC Act.

We note the positive recent developments in the market. Two primary examples include entry of new retailers with new products into the retail market, and the construction of infrastructure such as SEAGas. These developments have very real and clearly identifiable benefits for SA energy consumers. In particular, the commissioning of SEAGas averted significant electricity supply reliability difficulties for SA consumers in summer earlier this year and highlighted the value of infrastructure diversity and investment in maintaining reliability.

However, the importance of a positive investment and competitive environment can be easily overlooked, particularly in the face of significant external pressures for lower retail prices. The certainty offered by a multi-year price path, set at an appropriate level, will have a positive impact in both the short and long-term for SA consumers. Conversely, failing to adequately take into account these issues could place the development of competition, viability of existing investment and investment required to maintain and improve electricity supply reliability in South Australia at risk. We therefore urge the Commission to set its regulatory parameters with a clear aim of promoting competition and maintaining a reliable electricity supply to SA consumers, and resist external pressures which may compromise this goal.

Our detailed comments on the issues raised for discussion follow.

Objectives for Retail Electricity Price Path

The objectives proposed by the Commission are:

In considering consumers' long-term interests, the Commission proposes to establish a price path which establishes the lowest possible price consistent with:

- ▲ *the costs that an efficient retailer would be expected to incur in meeting the responsibilities of standing contract supply to small customers in SA over the period;*
- ▲ *encouraging the development of competition among retailers for the benefit of consumers;*
- ▲ *encouraging ongoing, efficient investment to meet consumers' long-term requirements; and*
- ▲ *providing an appropriate return for an efficient declared retailer.*

Overall this set of objectives covers most of the areas that we believe should be addressed by the review. Appropriately, the objectives appear to recognize the fact there will be a range of retail price outcomes that can be regarded as “efficient”. This comes about because of the relatively imprecise nature of many of the variables that are used in

deriving retail prices by regulators. Normally this process produces a range of prices that can be regarded as “efficient”.

By seeking to provide the lowest possible price subject to ensuring the price will be sufficient to allow for appropriate investment, return to the declared retailer, and competition, the objectives attempt to strike an appropriate balance between the needs of the energy sector, and consumers. Importantly, the objectives do not place undue focus on achieving a low end user price at the expense of long-term industry sustainability.

If any of the objectives was to be increased in priority, in our view it should be encouraging the development of competition. This would be consistent with the Commissions prime objective of ensuring the long-term interests of customers are protected. We make more detailed comments on the importance of competition below.

What form of regulation should be used?

Perhaps the most fundamental parameter to be decided on with regard to the form of regulation to be used, is the length of the price path to be adopted. The terms of reference of this inquiry require a price path of at least 3 years. In our view the path should be long enough to span the full transition period between monopoly retail service provision (ie. Prior to full retail contestability), and the development of an effectively competitive retail market. If this transition can be achieved, it should then be possible to remove the requirement for price-caps following the price path, leaving competition and market forces as the primary determinants of retail pricing thereafter.

While it is difficult to forecast precisely when effective competition will have developed, we note the retail churn statistics achieved in SA to date appear promising. These statistics, which provide a measure of how many consumers are changing retailer, are sometimes used as a high level indicator of the uptake of competition in recently created markets. In the short period to date, our understanding is that annualized churn rates of around 5% have been observed in South Australia. This compares favorably with the 4% observed in the first year of Victorian FRC. History in Victoria has shown that churn rates have increased dramatically the longer FRC has been in force, with annualized rates of approximately 9.5% and 19% being observed in 2003 and the 2004 year to date.

The increased 3rd year Victorian rate of around 19% appears to have been spurred on by the introduction of a multi-year price path in Victoria. This price-path has provided certainty which has encouraged new retailer licensees to enter the market and begin offering competitive products to Victorian consumers. We would expect an appropriately set price path to have a similar impact in accelerating new entrant retailer penetration rates in South Australia when adopted.

Closely related to the importance of a price-path as a tool for transition to competition, is our belief that it is essential that the tariff trajectory selected is sufficient to ensure that at the end of the price path, there will not be a need for major step changes in tariffs to match market conditions at that time. This can be achieved by setting a price path that brings all customer tariff categories to cost reflective levels by the end of the path, and is based on a sustainable long term average wholesale energy cost. Importantly, it should be noted that if the price path was used as a crude tool to artificially hold down retail prices, upstream infrastructure investment needed either toward the end of the path, or soon after the end of the path, would not proceed. Such an outcome would not only suppress the development of retail competition, but lead to large price shocks to support essential investment following the end of the multi-year pricing arrangement.

Assuming however that an appropriate path is put in place, and considering the favorable environment for the development of competition that such a path would create, we believe SA is well placed to commit to a medium term price path, which will provide stability in customer pricing, an attractive retailer investment environment, and leave the market well placed for the removal of price-caps at the end of the price-path period. A price path of 3 to 4 years, subject to a mid-term review which could re-open the price if it breached pre-agreed margin limits, would be appropriate in our view.

More specifically, we recommend that the Commission adopt the following form of regulation:

- Price path term should be 3 to 4 years
- Mid-term review to assess if price is outside pre-agreed retail margin levels – with optional re-opening of the price if trigger margin levels are breached
- Calculate the total allowable revenue required for the declared retailer in the first year of the price path
- Escalate this total revenue over the course of the review period on a CPI based price path
- Allow re-balancing between tariff classes to be performed by the retailer provided that all rebalancing brings tariff classes closer to cost-reflectivity
 - Optionally, the regulator may wish to limit the overall annual change to any particular tariff class to (Overall revenue adjustment factor) +/- 5%

What correction factors and rebalancing parameters, if required, should the Commission consider or allow?

In our view, the main objective of any rebalancing should be to move tariff categories toward cost reflectivity. To the extent this is necessary, conceptually the move should be achieved in the fastest time possible, in order for all consumers to become equally

attractive in the contestable energy marketplace, and increase economic efficiency through the removal of cross-subsidies.

While the principle of moving to cost reflectivity is generally accepted by regulators and other industry groups in Australia, step change moves to cost reflectivity can result in price shocks to some customer groups that have historically enjoyed significant levels of cross-subsidy. In order to manage this potential impact, a transition path is often seen as desirable to ease any required tariff category impacts. If the potential for rebalancing price shocks is perceived to be an issue, we recommend a customer class level constraint of (overall revenue adjustment factor) +/-5% be adopted.

We strongly discourage consideration of any Bill level, or other price constraints more finely targeted than the tariff category level. Heavy-handed constraints of this kind are typically very difficult to implement, and these practical difficulties may discourage the incumbent retailer from making appropriate re-balancing adjustments, which may be required to move toward cost reflectivity. Ultimately failure to bring customer groups toward cost reflectivity only results in delaying inevitable pricing changes, and potentially increasing the ultimate level of price shock to which customers may be exposed. Contestability, which is to become the ultimate form of regulation, will ultimately force cross-subsidies to be removed.

What methodology should the Commission use to obtain estimates of wholesale electricity costs for a future three-year period?

As noted in the issues paper, one of the most critical elements of establishing a multi-year price path, will be developing a wholesale price estimation methodology which is sustainable for the declared retailer, and fair to consumers across the entire price path period.

A core principle in setting a regulated retail energy price is to recognize that the price must be set with regard to the cost to a prudent retailer of hedging its load. Importantly, it could not be considered prudent for a retailer to rely on purchasing un-hedged energy from the pool. This principle has been recognized by the Commission in previous reviews, however we re-iterate the importance of this approach again for completeness.

Historically, the Commission has used a contract portfolio based methodology, developed by IES, to estimate wholesale energy costs. While we generally support this methodology for estimating wholesale costs one year out, we note that implementation of the methodology has been problematic for the Commission due to the problems of obtaining reliable input data. In particular the lack of suitability of the AFMA public forward price information in assessing the cost of large-scale energy contract prices in SA has been widely noted.

While the shortcomings of the AFMA based approach have been overcome in the one year determination process by the addition of liquidity margins and other risk loadings, we do not believe this approach to establishing hedge contract input prices is at all workable over a multi-year time horizon. The key reason for this is the lack of suitable AFMA forward market data over the price-path period.

While this is a significant hurdle to overcome, we believe this core methodology can be modified to produce an appropriate multi-year price path energy input cost (see the next section).

What modifications to the approach adopted by IES in estimating wholesale energy costs in the 2002 and 2003 reviews should the Commission adopt?

Methodology

As recognized in the previous section, the core problem with the otherwise generally robust IES contract portfolio methodology is sourcing accurate forward contract pricing information to be used as input data. The key input data elements required are the costs of large volume “flat” wholesale contracts, large volume “peak” contracts, and large volume “cap” contracts. These large volume contract prices also need to be applicable over the medium term in South Australia.

In its policy directive to the commission with regard to this enquiry, the SA government has opted to establish a multi-year price path for Electricity retail prices in the state. This policy decision values price stability to consumers, as opposed to allowing retail prices to dramatically cycle up and down over time in sympathy with wholesale energy price movements. Over time, both approaches will result in the same overall cost to consumers. However, under a multi-year arrangement, the long-term annual average industry cost should be recovered each year, while under the alternate approach of following the wholesale market pricing cycle, retail prices would fall to levels that recover less than the long term average in some years, and rise significantly to recover more than average infrastructure cost in other years. Our experience in dealing with consumers indicates that in general they prefer to be exposed to a stable long term average price over time, rather than have to manage large variations in pricing from year to year. For this reason, we support the introduction of a multi-year pricing arrangement.

As discussed above, if a multi-year price path is to be implemented, it will need to ensure that it recovers the average energy infrastructure costs required by the industry over time. Once this point is accepted, the question of what a suitable long-term average level of pricing to use in the price path energy costing needs to be considered. Such a price level will need to be able to fund existing and future infrastructure. This will need to include

investments in generation, and the fuel supply infrastructure required to reliably support such generation.

Over the life of an infrastructure asset, the investment needs to recover its costs on average. Sometimes the contract market may deliver higher returns than this average, and sometimes lower, however over the medium term, the average cost must be recovered if the project is to be viable. On this basis, we recommend that the annualized cost recovery required by new entrant plant be used as the basis for establishing what the medium term price of wholesale energy should be.

This approach is not without precedent. It very much mirrors the Long Run Marginal Cost (“LRMC”) based approach, which was adopted by IPART in NSW. Even in the last SA price review, this approach was used to estimate the cost of Cap contracts in SA.

In order to use the new entry cost estimates to develop a set of high volume “flat”, “peak” and “Cap” contract values for use in the IES contract portfolio model, we suggest the following new entrant plant estimates be used:

Contract Type	Contract pricing source
Flat	CCGT @ 80% load factor
Peak	CCGT @ 45% load factor
Cap	OCGT @ 5-10% load factor

Contract market rates in each of these categories would then be used in the IES model, along with the load shape, hedge mismatch, other risks, ancillary service and energy loss parameters recommended by IES to derive an appropriate load weighted energy contract portfolio cost for SA regulated customers.

Care would need to be taken in selecting appropriate demand curves for use over the price path (see demand comments below), and a margin for reserve plant would also have to be factored into the analysis.

Wholesale Price Considerations

We note that the recent addition of the SEAGAS pipeline to South Australia has significantly improved the reliability of gas supply to the state (as well demonstrated in the Moomba incident earlier this year). However this increased reliability comes at the cost of increasing the recovery required to fund this additional gas transmission infrastructure in the state. It is public knowledge that much of this transmission infrastructure is required to support power generation capacity, and therefore the new entrant generation cost estimates used will need to incorporate this additional cost.

In addition to these increasing gas transmission costs, significant upward pressures in gas commodity costs also exists in SA. Our information indicates that Santos is planning a significant increase in gas pricing from the Moomba basin during the proposed price path period. We recommend that the Commission examine gas price impacts closely in establishing a long run price path and in particular reference to price path re-opening mechanism.

Any methodology needs to take account of the specific physical characteristics of SA supply, of course. For example, SA is highly reliant on gas for electricity generation, not having the same degree of access to coal sources for base-load as other NEM states.

Comparison with IPART LRMC based methodology

As mentioned above, the approach taken by IPART in determining a multi-year energy price component was the Long Run Marginal Cost (“LRMC”) based approach. Once again the LRMC approach used by IPART was developed by IES. It fundamentally mirrors the approach to pricing we have proposed above, and we supported the use of the methodology in NSW (although we did dispute how it was implemented by IPART).

Fundamentally, the NSW LRMC approach is the same as the new entrant contract portfolio based approach we have outlined above. The key difference is the inclusion of a hedge mismatch risk factor in the approach we propose, compared to no such factor being adopted in NSW (despite arguments from participants in the IPART review that such a factor should be included).

IPART justified the exclusion of this factor on the basis that NSW regulated customers are hedged by the ETEF scheme – which they believe to be perfectly load following - leaving NSW retailers with no hedge mismatch exposure. Due to diversified ownership of the Generation and Retail sectors in SA, cross-subsidisation of hedge mismatch risk, via an ETEF style mechanism is not available to the incumbent retailer. This leaves the retailer with no option, but to purchase a portfolio of contracts from a range of generators – with the result that hedge mismatch is unavoidable – and to price this mismatch into their energy purchase costs.

On this basis, we believe the methodology adopted needs to account for the hedge mismatch factor. The new entrant based IES contract portfolio methodology, as we have described, is the preferred method for a multi-year SA price path.

How should the Commission, in setting a price path, treat actual and prudent costs?

In previous reviews the Commission has recognized the problems and risks of attempting to use actual cost data to establish pricing levels. The current issues paper also recognizes these problems, which include:

- Difficulties in allocating costs between regulated and unregulated load
- Difficulties in allocating purchase costs between jurisdictions
- Perverse incentives which have the potential to encourage inefficiency
- Scope for interpretation with regard to depreciation and other policies

Overall, attempting to assess actual costs is bound to be difficult, open to interpretation, and is a step back from the principle of light-handed regulation. For these reasons we have historically resisted moves in this direction. Nonetheless, we appreciate that in this instance the Commission has been directed to attempt to assess the “actual” costs of the incumbent retailer for comparison with the “prudent” costs traditionally used by the Commission as part of this review. However, in light of the difficulties mentioned with regard to the use of actual data, we encourage the Commission to use such information with caution.

What factors should be taken into account by the Commission in establishing a price path re-opening mechanism?

In considering the issue of re-opening triggers, there are two major categories of change that could impact on the validity of the price path:

- A major change in input cost assumptions (eg. Major change in Network tariffs, gas price resets etc.)
- An unforeseen and unmanageable event outside the control of a prudent retailer (eg. a Force Majeure event)

Major change in input assumptions

In our view, the price path should be set at a level which covers the prudent costs of the retailer over the medium term, as well as providing them a market based return (ie. Retail margin), we believe an appropriate trigger to re-open the price path would be to assess a band of acceptable retail margins.

We believe that it would be appropriate to conduct a mid-term review, to check if major changes in input cost assumptions had caused the retail margin to fall outside this trigger range. If the review found that retailer margins had strayed outside the trigger bands, the Commission and the incumbent retailer could then consider if reopening the price path

was warranted. We would suggest that if the margin assessed was below the low margin trigger level, the incumbent retailer would have the right to decide if the price path should be reopened. On the other hand, we propose that if the margin exceeded the upper trigger margin, the Commission would have the right to consider if a price reset was warranted.

In conducting the mid-term review, pre-agreed cost component estimate methodologies would need to be used.

The advantages of this methodology are that it offers protection both to the retailer if costs turn out to be significantly higher than forecast, as well as protecting the customer by ensuring the retail margin does not exceed an appropriate upper band. By ensuring the band is sufficiently wide enough to absorb a reasonable level of cost change without triggering a re-opener, the objective of providing price stability and predictability over the price path will be maintained.

Force Majeure

As history has shown, South Australia has a relatively delicate electricity system compared to other Australian states. This is largely due to the sparse population spread in SA, and the fact that it lies at one end of the National interconnected power system (and therefore becomes disconnected from the NEM from time to time).

In order to ensure that a major unforeseen and unmanageable risk sufficient to threaten the retailer's viability can be managed, a Force Majeure ("FM") re-opening provision should be adopted. This approach would allow a price re-opening assessment to be conducted at any time during the price path, provided that an FM event had occurred. This would allow for the recovery of additional revenue sufficient to cover additional costs resulting from a major FM event – previously not factored into the price path cost assessment.

The FM provisions should also cover major regulatory disruption events.

Should the Commission regard the standing contract price for small customers:

- ***as a "fail-safe" standard: with regard being had to the fact that market offers should be better than the standing contract price and customers seeking a better price should move to a market contract, or***
- ***as the "standard" supply arrangement: with no regard to the price having an impact on market development.***

We have long held the belief that in the long-term, retail prices should be regulated by the forces of competition. This approach would deliver the best outcome for consumers over time, by ensuring they get prompt access to new innovative products as they are developed, and by providing discipline on retailers to deliver the levels of customer

service demanded by consumers. Under this approach, retailers face the ultimate incentive of either providing competitively priced, quality services – or losing their customers to more effective retailers, and going out of business. No regulatory regime will ever be able to provide such compelling drivers.

While we strongly espouse moving toward competitive forces as the main regulator of prices in retail energy markets, we also recognize the concerns expressed by regulators, that the complete deregulation of retail markets which are dominated by previous monopoly providers may leave customers exposed to inappropriate pricing in the transition period prior to the entry of new entrant retailers of sufficient scale to impose competitive discipline on the incumbent. With this concern in mind, we acknowledge the need for price caps for an interim period as a “safety-net” until new entrant retailers have established sufficient presence to impose pricing discipline on incumbents.

Consistent with this view, we definitely see the role of price caps as a “fail-safe” or “safety-net” to protect consumers from uncompetitive pricing over the transition period until competition has established itself. Under this approach, it is therefore preferable to select a retail price at the top end of the efficient pricing range (see discussion above), in order to allow scope for efficient new entrant retailers to enter the SA market. Pricing at the top end of the efficient range also provides comfort to consumers remaining on the regulated tariff, that they are being protected from pricing in excess of what can be regarded as efficient by a prudent retailer.

We believe that adopting an approach of regarding the price caps as the “standard” supply arrangement (ie. Adopting a price at the low end of the efficient range), would be a very dangerous development, likely to severely curtail the promising signs of new entry retailer activity currently being observed in South Australia. Reduced new entrant retailer activity is likely to further delay the transition to competition, with potentially damaging long term impacts on the pricing of energy to consumers – and consequent impacts on the South Australian economy more generally.

We note the Terms of Reference for the inquiry do not allow “head-room” and believe this is unfortunate as it will likely have the effect of stifling the development of competition.

Apart from the negative economic and consumer impacts that the delay of competition is likely to produce in SA, adopting this approach is contrary to the stated objectives of this review (see our comments on these above), and ultimately of the primal legislative requirement of the Commission of protecting the long term interests of consumers (specified in the ESC Act, as quoted in the issues paper).

***How could the Commission improve its ability to estimate demand parameters?
What other approaches, such as sensitivity analysis, could the Commission use to manage this demand forecast uncertainty?***

Overall Regulated Customer demand (for wholesale pricing)

In assessing a medium-term price path, it will be essential that the overall regulated customer demand likely to occur in each year be factored in. South Australia tends to be a capacity limited system, due to the low – and continually worsening - load factor of its demand. In addition, volatile weather patterns mean that high demands cannot be relied to occur every year, and that in some years peak demand will be significantly lower than the maximum demand that would occur in years when weather patterns produce a series of hot days. The tables below show the number of days that the SA system demand reached levels in the demand ranges shown and the number of days that the maximum temperature exceeds 35C.

Maximum Demand (MW)	Number of Days			
	2000	2001	2002	2003
< 1500	63	47	42	56
1500 - 1750	148	174	161	154
1750 - 2000	105	95	129	97
2000 - 2250	26	22	26	45
2250 - 2500	16	13	4	9
>2500	8	11	3	4

Number of days where Max Temp >= 35.0 deg C

1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	Average
4	6	1	4	3	5	4	7	4	8	6	17	3	11	5.9
3	7	2	7	1	7	3	11	4	5	10	9	3	2	5.1
5	1	3	1	-	-	3	-	4	-	3	2	1	1	2.1
-	-	1	-	-	-	-	-	-	-	-	-	-	-	0.1
-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
1	-	-	-	-	-	-	-	1	-	-	-	-	1	0.2
5	2	-	3	-	-	-	4	-	-	4	-	3	3	1.8
2	2	-	1	6	2	2	-	4	1	3	-	7	3	3.0
20	18	7	16	10	14	12	22	17	14	26	28	17	21	18.1

Key points to note from these tables are that hot weather patterns, and consequently demand, can be very volatile from year to year. Despite this, plant must still be built in

order to be able to meet the infrequent high demand occurrences if supply reliability is to be maintained – and the wholesale energy price built into the retail price needs to be sufficient to fund such plant.

In order to ensure that retail prices will be sufficient to support investment in capacity to cope with this worsening load factor, and increasing peak demand, we advocate the use of 10% Probability of Exceedence (“POE”) regulated customer demands being factored into the forecasts. Further a prudent retailer mindful of sound commercial governance would use such a POE.

We also point out that the ongoing reduction in load factor, associated with the continuing penetration of air conditioning into the community, needs to be factored into any multi-year price review. From a hedging perspective, this effect is likely to be exacerbated in future as the significant development of windfarms in SA take effect. In order to factor in this reducing load factor, we recommend that the demand used in calculating pricing should factor in a decreasing load factor in each progressive year of the review period.

We note the analysis commissioned by ESIPC and conducted by CRA into air-conditioning load in South Australia, and recommend that this report be factored in by the Commission.

Customer tariff category demand breakdown

The best source of tariff category demand breakdowns is the incumbent retailer. Breakdowns based on the last full year of actual data available are probably the most appropriate set of data to be used for this purpose.

Factoring weather dependencies into this data is likely to be problematic, and discussions with the incumbent will provide the best guides for how the load, and the various categories of load, is likely to be affected under differing weather and economic conditions. We note in particular that recent years have seen summer weather patterns well below what could be expected in a 10% POE peak demand year. It will be important for the Commission to factor in potential impacts of such peak weather conditions – perhaps through scenario analysis based on scenarios developed in discussion with AGL.

Over the course of the price path period, we suggest that the customer category volume data should be assumed to remain static. This can be stress tested by assessing the impact of churn as discussed below.

Churn impacts

In the section above on the form of regulation we discussed our optimistic views on the likelihood of churn developing in the SA market. We also note that the level of churn

assumed could have the potential to impact on the overall revenue stream available to the incumbent retailer – particularly if churn activity focuses on high value customers, who have historically paid above cost reflective prices in order to subsidise other customers. If, as would be expected, high value customers show a higher propensity to leave the incumbent retailer than lower value customers, over time the ability of the incumbent to recover an appropriate return could become threatened.

We encourage the Commission to conduct a scenario test in which it assumes that 80% of the assumed churn occurs in “high value” customer segments, with the remaining 20% occurring in lower value segments. Results on this test could be used to inform the Commissions decisions on the appropriate margin trigger bands.

What additional information should be requested from AGL SA to assist the Commission in its evaluation of the price path proposal?

Our comments above on the real practical problems, and questionable value of any “actual” information sourced from regulated entities, lead us to conclude there is minimal value in requesting more than the minimum required information.

In our view the key parameters to be sourced, will relate to demand forecasts and actual customer tariff category breakdowns of historic and forecast demand. Actual cost to serve estimates produced by AGL may also provide useful insights for regulators.

The problems we mentioned above with respect to allocating wholesale contracts both between regulated and market based customers, and between SA and the rest of the complex AGL national energy portfolio makes it very unlikely that useful insights will be gained from reviewing actual wholesale purchase contracts. These issues will generally also be compounded by confidentiality clauses in wholesale contracts, which are likely to require sign off from contract counterparties prior to their disclosure. Taking these factors into account, in the interests of efficiency, we therefore do not support reviews on any wholesale cost information.

What approaches, other than the building block approach, could the Commission consider in reviewing and setting a price path for the next three years?

We support the use of the building block approach for establishing prudent retail price levels. This is widely used in other Australian Jurisdictions, and is well understood by regulators, industry participants and consumer advocacy groups.

Conclusion

We support the introduction of a price path approach to retail pricing in SA, provided it is based upon realistic long term average infrastructure cost requirements. Such an approach will provide a stable retail price for consumers, while underwriting current and future investment in SA energy infrastructure, and assisting the development of competition.

Similarly we look forward to participating in the rest of the price path establishment process. In particular we believe we would have some useful contribution to make on the detailed input parameters adopted once the Commission has selected the overall methodology.

In the mean time, we would be happy to further discuss or clarify our views on an SA retail electricity price path. I can be contacted on (03) 8628 1244, to facilitate such discussions.

Yours sincerely

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