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Essential Services Commission of SA
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30 July 2004

Dear Sir/Madam

ESCOSA - INQUIRY INTO RETAIL ELECTRICITY PRICE PATH, ISSUES PAPER, JUNE 2004

Thank you for inviting International Power Australia (IPRA) to submit comments with regards to issues raised in the above mentioned paper. IPRA values the Commission's market consultation approach in such matters, and remains available to expand or discuss any of the following comments at your convenience. We apologise for the delayed response and trust that the Commission will find these inputs beneficial.

IPRA's responses are tabulated below. Please note that as a business primarily focussed on generation, IPRA's views on wholesale energy costs are the most important in this submission. We make particular reference to comments on 5.2:

ISSUES PAPER REFERENCE	IPRA'S CORRESPONDING COMMENTS FOR CONSIDERATION
3	<p><i>The Commission seeks views from stakeholders on the objectives it has stated for establishing a retail price path. based on relevant legislation, are there other factors to which it should have regard?</i></p> <p><i>IPRA endorses the objectives stated by ESCOSA.</i></p>
5.1	<p><i>What form of regulation/price path formula should the Commission adopt? What correction parameters should be adopted?</i></p> <p>Subject to the comments regarding wholesale price assessment in 5.2 below, IPRA would support approaches that (a) encouraged increased efficiency by the incumbent retailer, and (b) supported consistency of regulation across NEM states. A CPI-X methodology</p>

	<p>may be consistent with these objectives.</p>
<p>5.2</p>	<p><i>What methodology should the Commission use to obtain estimates of wholesale electricity costs for a future three-year period?</i></p> <p>The approach used previously by the Commission – evaluating a wholesale price from aggregated quarterly wholesale prices over a period representative of the time over which a retailer might reasonably hedge its position, seemed to IPRA to be a fair attempt to replicate the actual costs incurred by retailers. Addition of risk management premiums, regulated charges and a retail margin gave a workable ‘bottom-up’ assessment.</p> <p>However, IPRA is also cognisant of the tension that exists between SA wholesale prices that do not reflect a sustainable return for investors, and the concerns emerging about sources of ongoing supply for SA. In the view of IPRA, it is also important that the regulated prices in SA signal to SA consumers the real cost of energy supply in the state. Consequently, the Commission should set the wholesale prices underlying the regulated retail prices at a level which supports and encourages new generation investment, taking into consideration capacity reserve. A methodology of this nature would be consistent with the Commissions stated objective of <i>‘encouraging ongoing, efficient investment to meet consumers’ long-term requirements’</i>.</p> <p>This is particularly the case when the price determination is for a period of three years. Wholesale market forward prices may significantly move over the three-year period, and SA may well require capacity for reserve within that timescale. This may make the notion of a three-year determination that is of value problematic, and provide the potential for price shocks for consumers. However, predicting a stable 3-year price path designed to signal (or move toward) the real costs of supply is a relatively simple endeavour.</p> <p>IPRA notes that with respect to AGL in particular, the involvement in that business in the wholesale energy market means that it carries some responsibility for the state of SA wholesale prices, and arguably should also face the consequences in regulated prices. While there is sound economic reasoning for this approach (which would lead back to a representative wholesale price history assessment) IPRA considers that the consequences for reliability and investment in SA are too significant to ignore; hence IPRA’s recommendation regarding a more forward-looking, new entrant-based regulated price.</p> <p>At present, this approach may also assist in providing reasonable ‘headroom’ to encourage retail competition, as well as sending SA consumers the correct message regarding the cost of providing reliable electricity supply in South Australia.</p>
<p>5.3</p>	<p><i>How should the Commission, in setting a price path, treat actual and prudent costs?</i></p> <p>The Commission should not only seek actual cost information from AGL SA but should also seek substantiated information from other active participants in the South Australian market. New entrants will, in all likelihood, operate with a leaner more cost effective structure on the basis that they are seeking any competitive advantage they can relative to the incumbent retailer, AGL SA in this instance. This should provide an alternative benchmark for assessment of assumptions and other information provided to the Commission by AGL SA.</p>

<p>5.4</p>	<p>What factors should be taken into account by the Commission in establishing a price path re-opening mechanism?</p> <p>Factors to consider in re-opening the price path should include:</p> <ul style="list-style-type: none"> ❑ Substantial deviations in market outcomes compared to the key underlying assumptions made by the Commission in the price determination. This would include assumptions on key inputs such as rates of customer churn and remaining customer load shape and demand; ❑ Substantial changes in ETSA NUoS charges; ❑ Substantial legislative or regulatory changes either state or nationally; and ❑ Substantial changes in underlying wholesale price levels that support new investment.
<p>5.5</p>	<p>Should the Commission regard the standing contract price for small customers:</p> <ul style="list-style-type: none"> • as a “fail-safe” standard:....., or • as the “standard” supply arrangement: <p>IPRA agrees with the view that “fail safe” pricing could see prices set slightly higher than the “normal” price to encourage retailers to set attractive contract prices and hence encourage customer switching, and hence on this supports this approach.</p>
<p>5.6</p>	<p>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 uncertainty?</p> <p>The Commission now has the benefit, albeit brief, of an active retail market across most market segments. In particular activity in the domestic sector has increased greatly in recent times. This history of activity coupled with trends in Victoria and other competitive markets overseas, such as New Zealand, can be used as the basis for improving demand estimate parameters such as expected customer churn and in turn remaining customer load profile.</p>
<p>5.7</p>	<p>What additional information should be requested from AGL SA to assist the Commission in its evaluation of the price path proposal?</p> <p>The Commission should seek the last three years of financial accounts and forward three-year business plan for the South Australian regulated business. Furthermore, in addition to studies sourced by the Commission, AGL SA could also be asked to provide benchmark studies by which they can be compared.</p>
<p>5.8</p>	<p>What approaches, other than the building block approach, could the Commission consider in reviewing and setting a price path for the next three years?</p> <p>With the exception that it recommends a wholesale price path representative of the cost of reliable supply in SA (see 5.2 above) IPRA supports the Commissions use of the building block approach for the purposes of reviewing and setting a price path for the next three years.</p>

Once again, thank you for the opportunity to provide comments on the above mentioned Issues Paper. Contact in the first instance should be with the undersigned or Mr Domenic Capomolla on (03) 9617 8300.

Yours sincerely

A handwritten signature in black ink, appearing to read "Stephen Orr". The signature is written in a cursive style with a large, stylized initial 'S'.

Stephen Orr
COMMERCIAL DIRECTOR