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Hon. Patrick Conlon BA LLB (Hons) MP

Minister for Infrastructure

Minister for Energy

Minister for Emergency Services

Mr Lew Owens
Chairperson
Essential Services Commission of South Australia
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Dear Mr Owens

Thank you for the opportunity to comment on the "Inquiry into Retail Electricity Price Path Discussion Paper" as provided under cover letter dated 15 September 2004.

As you are aware, the Government is extremely conscious of the need to ensure the standing contract price charged to small customers is as low as possible and is fully justified with the interests of small customers in mind. It was for this reason that the Government commissioned the Independent Pricing and Regulatory Tribunal of New South Wales (IPART) to review the methodology adopted by the Essential Services Commission of South Australia (ESCOSA). All of the recommendations of the IPART Report to further improve the existing price justification regime were implemented through legislative amendments to the *Electricity Act 1996*.

While the Government is confident the new regime provides additional clarity and improves the consultative process, it is ultimately the resulting price path that will provide the best indicator of its effectiveness.

The price path submitted by AGL is based on variations in the retailer's average revenue, rather than average tariffs. I further note that the increases proposed, namely an initial increase of CPI in January and 1.3% for the first full year period, with increases of CPI to follow in the next two years, are exclusive of the various pass-through items highlighted in AGL's proposal.

When taking these two features of the price path into account, it is possible for individual tariffs to experience significant variations, particularly if the AGL proposal for tariff rebalancing of CPI+5% is adopted. The Government does not support the potential for such significant increases for small customers and considers that any rebalancing, if allowed by ESCOSA, should be limited to an increase of no more than a maximum of CPI. Further, the Government considers that any CPI increases to average revenue should only be applied to AGL's controllable costs.

As you are aware, it is the residential customers who have been most adversely affected by the impact of increased electricity prices in recent years, while business customers, particularly large business customers, have benefited from the reform process. It is for this reason that the Government has undertaken numerous initiatives, such as the Energy Transfer Rebate and the significant increase in the level of the State Energy Concession, so as to mitigate this impact.

Retail Price Components

The breakdown of an average annual residential customer bill on page 27 further highlights the disproportionately high network charge component (44%) followed by the wholesale energy cost component (35%) of the retail price. The impact of high network charges, locked in by the previous Government, cannot be overstated, particularly given, as illustrated in section 4.5, these are significantly higher than those applicable in Victoria and New South Wales.

It is interesting to note, however, that in terms of tariffs paid by South Australian businesses (with reference to an annual consumption of 10,000kWh, as illustrated in the graph on page 68), South Australia's network tariffs are below those charged in Victoria, on a weighted average cost basis. This would suggest that some rebalancing towards higher network charges for business customers, both small and large, could be justified as part of the ETSA Distribution Price Review.

With regard to estimating the wholesale electricity costs paid by AGL, I remain conscious of the documented reductions in the wholesale pool prices and contract prices over recent years. As such, I would expect the contract option selected for input into the retailer's prudent controllable costs, which will be benchmarked against the actual costs consistent with the terms of reference, to take these reductions into account.

With respect to the level of retail margin, I do not see any justification for any further increase in the current retail margin. Indeed, there appears to be a divergence in the retail margins approved in New South Wales and the actual retail margins received by retailers in Victoria and there appears to be no compelling reason to increase retail margins in this state.

Importantly, I strongly oppose the inclusion of the price paid by AGL for the state's electricity retail business in January 2000 as an intangible asset. Whilst it is accepted that AGL's purchase price may include some legitimate intangible assets, I consider the purchase price would primarily be the expected profits that could be earned from customer tariffs. Accordingly, depreciating the purchase price as part of the intangible assets, whilst also including an allowance for the retail margin in the formulation of the tariffs, would in effect be "double-dipping".

Issuing of Price Determination

One of the key improvements of the new price path process is the longer consultative period prescribed by the legislation. Specifically, section 36AA(4a)(d)(ii) requires the retailer to submit its proposed price path and justification not less than six months and not more than nine months before the making of the determination. In the absence of the new legislative provisions, the terms of reference were drafted to emulate them, to the extent possible.

Consistent with this improved regime, I would anticipate a price determination being issued late in the year for the full period so that consumers can benefit from the price reductions. The price path would also include some adjustment mechanism, to

incorporate any necessary adjustments which have been identified as part of the continuing consultation, as well as the outcome of the Distribution Price Review, including any further rebalancing. This adjustment would then take effect from 1 July 2005.

Conclusion

In summary, I support the adoption of a price path that is transparent and simple, so that it achieves the intent of the newly amended regime. This in turn will facilitate competition as small customers will be able to make better informed decisions as to the benefits of transferring to a market contract.

While I am encouraged by the levels of customer transfers, particularly in the last six months, I am conscious that there will continue to be groups of small customers who remain on the standing contract, particularly the less well off in the community. As such, care must be taken to ensure these customers are not financially disadvantaged.

I look forward to reviewing the submissions you receive as part of this consultation process and thank you again for the opportunity to comment.

Yours sincerely



HON PATRICK CONLON MP
MINISTER FOR ENERGY

30 October 2004