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Review of Regulated Retail Prices for the Electricity to 2007 – Draft Report & Draft Determination Submission

Prepared for: Independent Pricing and Regulatory Tribunal
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Prepared by: Australian Inland

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Executive Summary

In relation to the draft report and draft determination on the Review of Regulated Retail Prices for Electricity to 2007, Australian Inland provides the following comment, and/or requests alternative decisions.

- Australian Inland will not be able to pass through fully (to the customer) all network charges.
- Proposed form of regulation as was the case with the previous determination will prevent Australian Inland moving it's tariffs to their target levels fully by 2007.
- Based on IPART's calculation Australian Inland's net under-recovery increases during the determination period, and is only marginally less than the current under-recovery in the final year of the determination, 2007.
- Simplification of tariffs complex in 2004/05 due to price limits and constraints.
- Difficult to implement the price limit formula on customer's bills without significant cost implications.
- Australian Inland is in favour of retaining the target tariff arrangement based on N + R.
- Supports the principle separation of the Network (N) and Retail (R) component.
- Whilst tariffs are not cost reflective there is no competition incentives.
- Australian Inland supports IPART defining the R component for time of use tariffs as per Energy Australia's proposal.

Pass-Through Of Network Charges

The draft report is contradictory in its references to the ability of retailers to pass through network charges to customers.

The draft report states the following:

"allows retailers to pass through their full network charges"¹

"ensures network costs are recovered"²

These statements are misleading as they indicate that the true cost of network charges can be passed through within the retail tariff.

The draft report also makes references to the ability of retailers to pass on the increases in network charges, under the draft network determination 2004/2009³. IPART's assumption is that retailers are currently passing through the full cost of network charges to customers and that only the network increases need to be included in any new retail price increase.

For Australian Inland this is not the case, as previously reported in our original submission to the issues paper⁴. There is a significant under-recovered of approximately 20% of the total network cost for Australian Inland Retail. It should also be noted that Australian Inland Network receive the full scheduled amount of network revenue from Australian Inland Retail, even though this is not recovered from the customer as per the relevant determinations.

Australian Inland is acutely aware of the potential price shock to some customer categories in a sudden move to a fully cost-reflective pass through of charges. For some of our customers, such as domestic, an annual increase of around \$75 per customer would be required just to pass through the true cost of network standing charges. For some other customers, such as irrigation customers, the pass through of network standing charges would be around \$1400 a year. Australian Inland again requests to manage price shocks for each tariff by effectively breaking the end target into stepped increases over the required timeframe which is appropriate for the size of the under-recovery.

The allowed increases and the constraints detailed in Section 7⁵ of the draft determination will not allow the full cost of network charges to be passed through to the customers if the current network costs are not entirely passed through at present. Any constraint that contains an N component, such as the constraint relating to limits on increasing customers' bills will further restrict Australia Inland passing through network chargers.

¹ p.2 Review of Regulated Retail Prices for Electricity to 2007, Draft Report and Draft Determination, IPART, April 2004

² p.6 Review of Regulated Retail Prices for Electricity to 2007, Draft Report and Draft Determination, IPART, April 2004

³ p.2 Review of Regulated Retail Prices for Electricity to 2007, Draft Report and Draft Determination, IPART, April 2004

⁴ p 6 Australian Inland Submission to IPART Review of Regulated Retail Tariffs, December 2003

⁵ Draft Determination in a report of the Tribunal to the Minister for Energy and Utilities

Under-Recovery Of Revenue

Australian Inland is concerned with IPART's modeling results published in Table 5.2⁶ of the draft report. These results clearly show that Australian Inland's net under-recovery (estimated retail revenue recovery versus the target revenue) actually increases, 2003/04 \$3.8 million to 2004/05 \$4.3 million, 2005/06 \$ 3.7 million to 2006/07 \$3.5 million. This would essentially mean that Australian Inland's retail tariffs at the end of the determination period would be around 10% under cost-reflective levels.

This analysis of Australian Inland is contrary to the other three Standard Retailers in which there net under-recovery does not increase and significantly improves during the determination period.

Increases and Constraints

The details of the constraints within Section 7 of the draft determination are confusing and will be costly to implement. The draft determination applies three constraints;

- **The Fixed R component of a regulated tariff must not increase by more than \$5 per customer per year**

Australian Inland does not support the level of this constraint, as many of our tariffs do not contain a fixed R component at present. The draft report states

"The Tribunal proposes that regulated retail tariffs have a fixed and variable structure. However, there is scope for retailers to propose alternative structures (for example, inclining block tariffs) provided the price limits are satisfied. The Tribunal proposes that the fixed R and variable R recover 15% and 85% of total retail costs respectively."⁷

Australian Inland will not be able to structure all tariffs to meet this requirement with the \$5 increase constraint on fixed charges.

- **The total retail revenue from the R component must not exceed (for 2004/05) for Australian Inland;**
(1 + CPI) x (1 + R)
(1 + 2.8) x (1 + 0.03) = 3.914

Australian Inland supports this constraint, although from our initial modeling we have found that it will be difficult to increase the R component by the 3.914 due to the constraint on the increase on a customer bill.

⁶ p.20 Review of Regulated Retail Prices for Electricity to 2007, Draft Report and Draft Determination, IPART, April 2004

⁷ p.11 Review of Regulated Retail Prices for Electricity to 2007, Draft Report and Draft Determination, IPART, April 2004

- **Constraint on the increase on a customer bill per year**
Total previous years bill x (1 + allowed increase)

$$Allowed\ increase = \Delta CPI + \left\{ \left(\frac{N_t - N_{t-1}}{N_{t-1}} - \Delta CPI \right) \times \frac{Network\ Revenue}{Regulated\ retail\ revenue} \right\} + \left\{ \Delta R \times \left(1 - \frac{Network\ Revenue}{Regulated\ retail\ revenue} \right) \right\} \quad 8$$

Australian Inland does not support this constraint, as it will not allow the direct pass through of the network component or the structuring of tariffs to 15% fixed and 85% variable by the end of the determination period.

IPART has attempted to design this formula to pass through the network determination increases. Although, IPART has again assumed that the network charges are at cost reflective levels presently, which is not the case for many tariffs.

Previous determinations have based the customer bill constraints on the annual bill must not increase by more than the greater of \$25 residential, \$50 business or the percentage change in CPI +2% residential, CPI +5% business. The above formula is a significant departure from the previous regulation, which will result in Australian Inland possibly having to implement a new system to monitor the constraint. This will be an additional cost to the retail component that has not been presently included or calculated.

This constraint will further inhibit Australian Inland passing through the full network charges and tariffs meeting their target levels by the end of the determination.

Australian Inland acknowledges that IPART has decreased the total number of constraints, although the resulting combination will be difficult for the average customer to understand. IPART argues that it would be difficult for a customer to understand a constraint on the R component only thus they have imposed a specified price limits on the final bills of customers.⁹ The formula will be difficult for a customer to calculate or comprehend but the resulting percentage increase would be easily understood.

⁸ p.18 Review of Regulated Retail Prices for Electricity to 2007, Draft Report and Draft Determination, IPART, April 2004

⁹ p.17 Review of Regulated Retail Prices for Electricity to 2007, Draft Report and Draft Determination, IPART, April 2004