

28 February 2002

Dr Tom Parry
Chairman
Independent Pricing and Regulatory Tribunal
PO Box Q290, QVB Post Office
Sydney NSW 1230

Dear Dr Parry

Form of Economic Regulation for NSW electricity charges

Integral Energy would like to thank the Tribunal for the opportunity to participate in the public forum on the Form of Economic Regulation held on 21 February 2002.

Integral Energy would like to restate its support for a single tariff basket weighted average price cap, discussed as Option 3 in the paper released by IPART prior to the public forum. Integral Energy considers that this option meets its key criteria for assessing the potential forms of economic regulation. As discussed in our 21 September 2001 submission, Integral Energy considers that the form of economic regulation should deliver:

- Stable and costs reflective end-user prices; and
- Sustainable and commercial revenues for the network business.

The approaches that rely on error correction mechanisms, on-going forecasts, and resets in revenue throughout the course of the determination will not achieve these objectives. The revenue yield cap (Option 2 in the IPART discussion paper) and the existing revenue cap (Option 1) are particularly poor in this regard, as both result in an uncommercial revenue stream that does not reflect the cost to service customers.

The variable revenue cap (Option 4) has many of the characteristics of the current revenue cap. It involves a self-correcting mechanism that would clear any under or over recovery in revenues in the following year. This would result in prices fluctuating from year to year to balance seasonal changes in volume sales. Our modelling shows that this result holds regardless of the choice of lag in the control formula. Integral Energy believes this would be an unsatisfactory result for customers.

Depending on the choice of parameters in the “rolling growth variable revenue cap” (Option 5) it too could have a similarly poor result in terms of volatile prices. However, if the parameters are chosen correctly, the resulting price and earnings

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path for the network is similar to the tariff basket approach. Integral Energy therefore has some sympathy for this option. The advantage of the tariff basket approach over Option 5 is that it offers more stability in prices from year to year. The degree of earning certainty for network owners under a tariff basket approach depends on the degree to which tariffs reflect underlying costs.

Regardless of which price control formula is chosen, it is critical for the Tribunal to consider the likely impact of side constraints. In the current revenue cap arrangement the side constraints and the price actions under Rule 2001/3 (Unders and Overs Account) represent the form of price control and govern the ability of network owners to follow the revenue path dictated in the 1999 Determination.

It is easy to model a situation where a seasonal spike in demand would force DNSPs to change prices (up and/or down) under Options 4 and 5. Depending on the structure of the side constraints in the next determination, such price changes may not be feasible, resulting in a significant earning loss to DNSPs.

The single tariff basket approach offers stability of prices to end user customers because it uses consistent lagged quantities in its price control formula. It does however put an additional amount of earnings risk on DNSPs if they cannot re-balance tariffs to be cost reflective. Integral Energy's support for this approach hinges on the degree to which side constraints can be relaxed.

Integral Energy looks forward to the opportunity to participate further in developing the form of regulation. We are more than happy to assist IPART in developing scenarios that show the impact each form of regulation has on end-user prices and network earnings.

Should you have any questions in relation to this submission, please contact Integral Energy's Regulatory and Pricing Group via David Neville on 02 9853 6144 or Jason Ockerby on 02 9831 9047.

Sincerely

Richard Powis
Chief Executive Officer