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To: IPART Mailbox
Subject: Jackgreen submission on Review of regulated retail tariffs

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Review of regulated retail tariffs and changes for electricity 2010-2013

Jackgreen would like to make a further submission in relation to the regulated retail tariff changes that are proposed after attending the workshop earlier this month. Whilst we agree with much of the process and formats for determining the cost that a retailer faces we do have a few reservations.

We are not encouraged by the Terms of Reference that have moved the focus back to an established retailer and not a new market entrant. It had previously been determined that the price decision should be reflective of cost by 2010. This latest review has now moved this target to 2013 at the earliest and as such steps need to be taken to have a gradual increase rather than a step change at 2013. Further to this if the market is to move away from the reliance on regulated tariffs and if the current government owned retailers are to be sold off then there needs to be a move towards the reflective costs of electricity in the tariffs. It is our view that the prices should be set reflective of cost now so that a step change may be avoided in the future.

In the development of the retail margin there is triangulation of the three methods so that a better picture can be made using three methods. We believe this methodology is a good idea but we now have some reservations of the method based on the weighting it will receive from the tribunal. We have learned at the workshop that instead of just using an average the tribunal plans to weight it and is not setting the rules for the weighting prior to the results. This means that the answer delivered will not have any transparency and will be weighted in a way that is currently not known. It would be better to see the weighting method prior to the results being published to create transparency.

We believe the retail margin has another issue that needs addressing. We understand that as in previous years the margin will be set as an absolute number. This will mean that if the networks get an additional increase it will be at the cost of the retail margin as occurred last year. The retail margin should be set as a percentage just like the other costs that make up the cost of electricity.

In relation to the carbon cost there are a number of issues that need more transparency. Frontier Economics will not be trying to work out the cost of carbon. Instead, they will be given a few price points by the tribunal. We feel that it would be better for work to be done on the price of carbon based on market information than a predetermined number that may not reflect the actual costing. If preset numbers are to be used we would also like to understand the determination of the set carbon prices and the reasons for where they will be set as this issue requires transparency.

Another issue with the carbon cost is the volatility being set to zero for the model as it was too hard to calculate. Whilst we appreciate the difficulty of the task, the easiest way to work out volatility is to look to markets that already have carbon trading. For example the European ETS, carbon has traded at 25 Euros and 5 cents in the first period of the scheme until December 2008. We would recommend using information from other markets around the world to at least have some volatility in the model as this would be more representative than having zero volatility.

One of the underpinning variables used in the modelling of the returns to businesses is the Weighted Average Capital Cost. For transparency and accuracy Frontier economics should be using the most up to date value as taken from the market. However, we have learned the tribunal will be determining the values of these costs. The Tribunal should not be making this decision as it wants to and should stay impartial to the results and it goes against the idea of using an independent consultant to do the modelling.

Another short coming of the energy cost model that was bought up at the workshop was the way in which the model is built. The model was not able to use the 17520 half hours of the year and was relying on the use of 50 high half hour points. It was pointed out by an attendee that 20% of the entire years pool cost comes from less than 50 half hours in the year. It would be statistically improbable that the 50 points chosen will coincide with the market highs for any given year. As the model has not hit the actual market highs it will under value the cost of energy and reduce the costing for the model flowing on to under pricing the costs for retailers. We also learned that the hedge prices would also be viewed differently from the reality of the market. It would seem that the hedges that were taken some time ago could be valued at today's rates for the model. The hedges need to costed at the time they were taken as they represent a market with different pricing compared to today's price.

With the privatisation of the NSW government retailers looking to occur in the review period we are interested to see if prudential costs are to be included in the cost build up, as the new owners will not have the benefit of government backed guarantees that currently exist. This tied up capital carries a reasonable price and after the GFC, money is more costly due to the supply restrictions which will be seen for the coming years.

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