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12 May 2011

Mr Rod Sims
Chairman
Independent Pricing and Regulatory Tribunal of NSW (IPART)
Level 8, 1 Market Street
Sydney NSW 2000

Dear Mr Sims

RE: Changes in regulated electricity retail prices from 1 July 2011 – Draft Report and Draft Determination (the Draft Decision)

TRUenergy welcomes this opportunity to respond to the Draft Decision. Our key points can be summarised as follows:

- The retail cost increases foreshadowed in the Draft Decision are an unfortunate consequence of rising network costs and renewable schemes.
- TRUenergy understands that these price rises will make energy affordability even more of a challenge for many NSW families and we will work proactively with the NSW Government and consumer groups on a targeted approach to reduce hardship.
- TRUenergy is pleased that, in most areas, IPART's policy of maintaining the methodologies used in the 2010 Determination ensures regulatory stability and certainty.
- IPART's Terms of Reference (ToR) require it to promote competition but in some areas its decision will not do this.
- IPART adopts a heavily theoretical model but does not apply it consistently, producing some outcomes that lead to regulatory allowances below efficient costs.
- The Draft Decision should be updated to reflect actual inflation data.
- The Greenhouse Gas Reduction Scheme (GGAS) is a real cost on an ongoing basis. Therefore it is not appropriate for IPART to set the GGAS allowance to zero.
- IPART's suggested change to the approach to determining the energy cost allowance in any future review will, if adopted, add to regulatory risk and would not be in the best interests of consumers.
- The outcomes of the pass through calculations for the Large-scale Renewable Energy Target (LRET) are contrary to the government's stated reasons for the changes to the scheme and actual market outcomes.
- IPART's reasons for rejecting the Carbon Pollution Reduction Scheme (CPRS) pass through applications effectively lead to a significant narrowing of the applicability of the pass through provisions which does not appear consistent with the stated objectives for creating these provisions and may create issues for future reviews.

TRUenergy notes that IPART in the past has considered that *"effective competition in the retail electricity market is crucial to deliver long-term benefits to customers"*.[1] TRUenergy agrees with this and believes that over the long term customers will be better off if retail energy prices are disciplined by effective competition, rather than if prices are based on regulatory estimates.

IPART's ToR require it to *"ensure its determination is consistent with the Government's policy aim of reducing customers' reliance on regulated prices."*[2] Consistent with this aim, the new NSW

[1] IPART, "Review of Regulated Retail Tariffs and Charges for Electricity 2010-2013, Electricity - Final Report", March 2010, page 17
[2] IPART, "Changes in regulated electricity retail prices from 1 July 2011 - Draft Report", April 2011, page 100

Government's Tamberlin Inquiry has been asked to, inter alia, "*promote competitive electricity prices.*"[3]

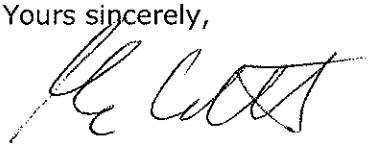
It is therefore disappointing that the Draft Decision does not mention promoting competition at all. While it is true that the Draft Decision is primarily a review of external cost allowances, the lack of focus on reducing customers' reliance on regulated prices is demonstrated by outcomes such as the zero allowance provided for Greenhouse Gas Abatement Scheme (GGAS) costs. A zero GGAS allowance means that a component of regulated prices is below efficient cost and hence a constraint on competition.

TRUenergy believes that while the Draft Decision is generally in accordance with IPART's ToR and the processes established in the 2010 Determination, there are some notable exceptions to this. While some use of theoretical modelling is required, its adoption in areas such as LRET and GGAS has led to outcomes that are not realistic. In effect, IPART has adopted a lower of LRMC and market approach to setting these allowances which is contrary to the methodology mandated for the energy purchase costs. Such an approach is also inconsistent with the ToR, both in terms of promoting competition and also ensuring that regulated prices reflect "the efficient costs faced by a Standard Retailer Supplier."

The attached submission considers various elements of the Draft Decision in more detail.

Should you wish to discuss any of the issues raised in this submission please feel free to call Andrew Dillon, Regulatory Pricing Manager, on (03) 8628 1120.

Yours sincerely,



Mark Collette
Director Energy Markets

[3] NSW Premier, "Brian Tamberlin QC to head Electricity Sale Inquiry", May 2011, page 3

TRUenergy Response to IPART Draft Decision

12 May 2011

Contents

1 Executive Summary

TRUenergy welcomes this opportunity to respond to the Draft Decision. Our key points can be summarised as follows:

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- IPART's Terms of Reference (ToR) require it to promote competition but in some areas its decision will do the opposite.
- IPART adopts a heavily theoretical model but does not apply it consistently, producing some outcomes that lead to regulatory allowances below efficient costs.
- The Draft Decision should be updated to reflect actual inflation data.
- The Greenhouse Gas Reduction Scheme (GGAS) is a real cost on an ongoing basis. Therefore it is not appropriate for IPART to set the GGAS allowance to zero.
- IPART's suggested change to the approach to determining the energy cost allowance in any future review will, if adopted, add to regulatory risk and would not be in the best interests of consumers.
- The outcomes of the pass-through calculations for the Large-scale Renewable Energy Target (LRET) are contrary to the government's stated reasons for the changes to the scheme and actual market outcomes.
- IPART's reasons for rejecting the Carbon Pollution Reduction Scheme (CPRS) pass-through applications effectively lead to a significant narrowing of the applicability of the pass-through provisions which does not appear consistent with the stated objectives for creating these provisions and may create issues for future reviews.

TRUenergy notes that IPART in the past has considered that *"effective competition in the retail electricity market is crucial to deliver long-term benefits to customers"*.[1] TRUenergy agrees with this and believes that over the long term customers will be better off if retail energy prices are disciplined by effective competition, rather than if prices are based on regulatory estimates.

IPART's ToR require it to *"ensure its determination is consistent with the Government's policy aim of reducing customers' reliance on regulated prices."*[2] Consistent with this aim, the new NSW Government's Tamberlin Inquiry has been asked to, inter alia, *"promote competitive electricity prices."*[3]

It is therefore disappointing that the Draft Decision does not mention promoting competition at all. While it is true that the Draft Decision is primarily a review of external cost allowances, the lack of focus on reducing customers' reliance on regulated prices is demonstrated by outcomes such as the zero allowance provided for Greenhouse Gas Abatement Scheme (GGAS) costs. A zero GGAS allowance means that a component of regulated prices is below efficient cost and hence a constraint on competition.

IPART's ToR require it to consider both the least cost mix of generating plant and market based electricity purchasing costs, which necessitates a complex theoretical model to determine the long run marginal cost (LRMC). However for green costs (LRET and GGAS) IPART has chosen to consider only the theoretical LRMC, setting allowances below market based outcomes. Such an approach is inconsistent with the ToR, both in terms of promoting competition and also ensuring that regulated prices reflect "the efficient costs faced by a Standard Retailer Supplier."

[1] IPART, "Review of Regulated Retail Tariffs and Charges for Electricity 2010-2013, Electricity - Final Report", March 2010, page 17
[2] IPART, "Changes in regulated electricity retail prices from 1 July 2011 - Draft Report", April 2011, page 100
[3] NSW Premier, "Brian Tamberlin QC to head Electricity Sale Inquiry", May 2011, page 3

2 IPART's approach and process for this review

IPART sets out its approach to the Annual Review in the 2010 Determination and TRUenergy generally supports the way it has followed this approach and the resultant outcomes. However we are concerned that some decisions IPART has made, most notably in regards to GGAS, are contrary to its ToR which require IPART to ensure its determination reduces customers' reliance on regulated prices and to have regard to the efficient costs of complying with green schemes.

The timing of the 2010 Determination and the Draft Decision meant that estimates of inflation were utilised in both. These should be updated with actual CPI data. It is preferable to use actual data where possible and to use a consistent approach to inflation across all components of the Annual Review.

The 2010 Determination was based on calculations undertaken in $2009/10 and then converted to $2010/11 using an assumed March 2010 All Groups CPI. As the Determination was released in March 2010, an estimate of the 2010 March quarter CPI had to be used as the actual was not available. There is an internal inconsistency between the estimated CPI used to derive the $2010/11 allowances in the 2010 Determination and the actual CPI definition in the 2010 Determination. The 2010 Determination deemed the March 2010 CPI Index to be 170.2 (the actual came out at 171.0).

TRUenergy is not seeking clawback for the differences between the allowances in the 2010 Determination and what the allowances would have been if the actual inflation index had been used. A pass-through event application has not been made. However, it is appropriate for all allowances originally calculated in $2009/10, including the fixed R value, to be converted from $2010/11 to $2011/12 using the 2010 Determination's deemed March 2010 All Groups CPI of 170.2. This will ensure that all future allowances reflect actual inflation and avoid "locking in" the erroneous estimates used in the 2010 Determination.

Further, Frontier was advised to use 2.7% to inflate items from $2009/10 to $2010/11 in preparing its draft advice[4] and, to ensure consistency, this should be amended so that they are advised to use 2.9%, the actual CPI increase, in preparing their final advice (with the exception of assessing the pass-through applications – see below).

The Draft Decision also needed to use an estimate of the 2011 March quarter CPI as the actual had not been released. Since the release of the Draft Decision the final March CPI figure of 176.7 has been released and this should be adopted in the Final Decision and in Frontier's final advice.

TRUenergy notes that the methodology and base calculations behind the fixed R value and other retail allowances are not being assessed as part of the Annual Review. However, an adjustment for inflation is required in order to inflate $2010/11 allowances into $2011/12. In order to remain consistent with the 2010 Determination and to avoid locking in an error TRUenergy recommends IPART adopt:

- CPI March 2010 of 170.2; and
- CPI March 2011 of 176.7

This is an annual increase of 3.8%. To use any inflator lower than this will mean that the 2011/12 retail allowances will be demonstrably below the efficient cost that was set in the 2010 Determination and hence contrary to the ToR requirement to ensure that regulated tariffs *"should reflect the efficient costs faced by a Standard Retailer Supplier"*.[5]

It is also appropriate for calculations undertaken to determine the pass-through amounts to remain consistent with CPI figures used in the 2010 Determination. For these items, the original 2010 Determination allowances were calculated in $2009/10 and then inflated

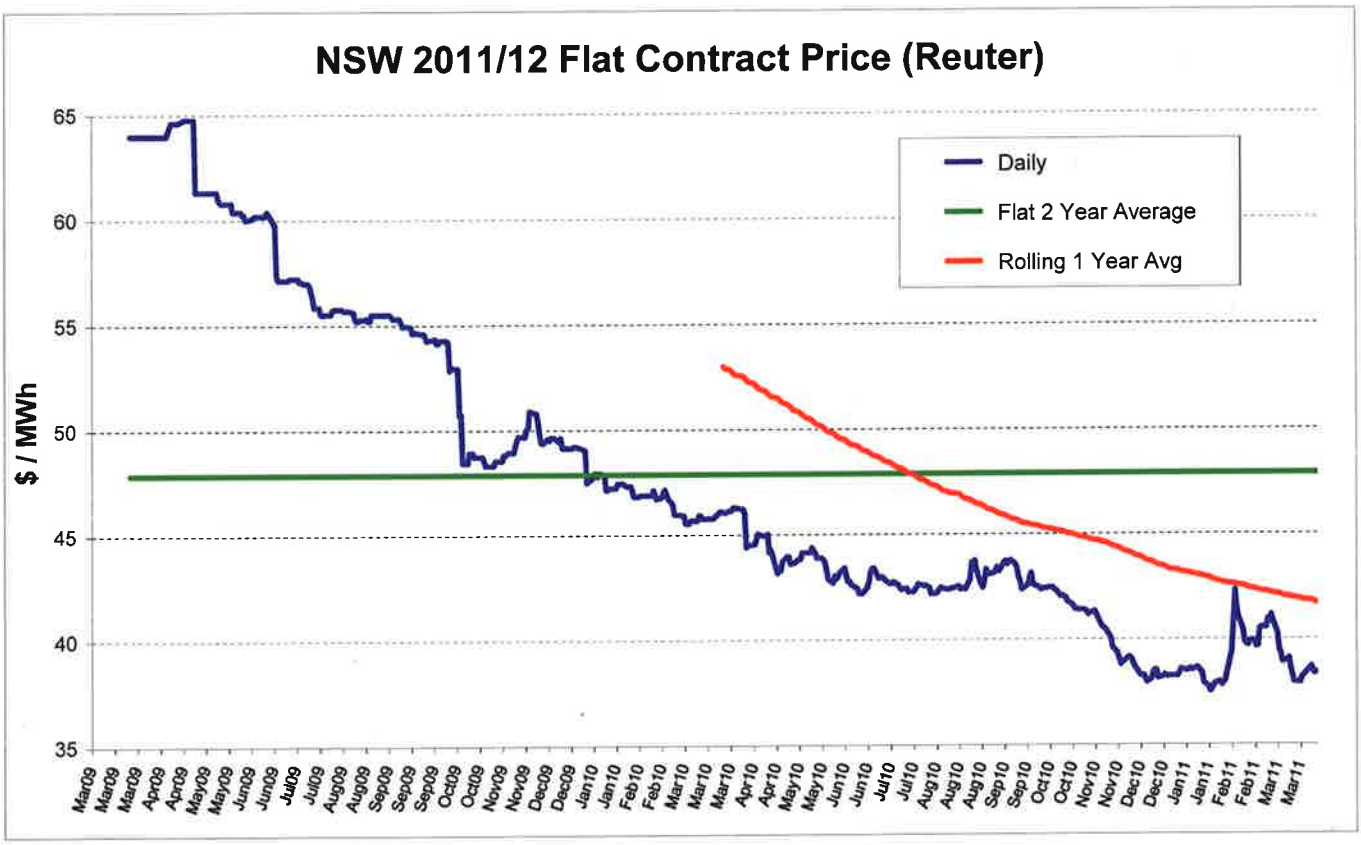
[4] Frontier Economics, "Energy costs – Annual Review for 2011/12 and 2012/13 - Draft Report", April 2011, page 13
[5] IPART, "Changes in regulated electricity retail prices from 1 July 2011 - Draft Report", April 2011, page 100

using the CPI assumption of 170.2 (an annual increase of 2.4%) to form the final $2010/11 allowances. To ensure consistency with the actual allowances Standard Retailers have been able to recover through regulated prices, Frontier must be advised that these allowances, for the purposes of pass-through calculations, should again be inflated from $2009/10 to $2010/11 using 2.4%. Frontier has used 2.7% for this in its draft advice[6].

3 Energy purchase cost allowance – market based cost

TRUenergy notes that no retailer would actually hedge its entire regulated load at today's market prices as assumed in Frontier's assessment. Prudent hedging would occur over a period of time (with different contract prices). It would be impossible to hedge the entire regulated load in a single on market trade.

In a period of wholesale electricity price volatility, there is can be a significant difference between a point in time estimate and likely actual hedging behaviour. Actual hedging would occur progressively over a period of 24 months or more. The chart below demonstrates how Frontier's point in time approach currently leads to their market based cost being significantly lower than a prudent hedging strategy based on progressive purchases over a year or two.



It is also pertinent to note that Frontier's point in time approach significantly overstates, relative to actual prudent market behaviour, the current difference between the market based energy purchase cost and the LRMC of generation.

Having analysed Frontier's methodology, TRUenergy has little confidence in the appropriateness of the theoretical volatility premium in any given year. This is particularly the case for 2012/13 where the premium is materially lower than the 2011/12 premium despite the fact that Frontier's modelled spot prices for 2012/13 exhibit a very similar incidence of very high spot prices to those for 2011/12.

[6] Frontier Economics, "Energy costs – Cost pass-through application for LRET and SRES - Draft Report", April 2011, page 13

4 Energy purchase cost allowance – LRMC capital costs

The LRMC calculations undertaken by Frontier have been based on ACIL Tasman's draft advice to the Queensland Competition Authority (QCA), which in turn largely used values from ACIL's 2009 report.

IPART has justified the use of the ACIL draft report for the QCA rather than the forecasts prepared as part of the 2010 National Transmission Network Development Plan (NTNDP) on the basis that the NTNDP is scenario based and does not have a set base case. However, the report prepared by ACIL includes base estimates of capital costs by technology sourced from the Electric Power Research Institute (EPRI). The EPRI new entrant cost data was developed incorporating amendments agreed by a broad Stakeholder Reference Group in December 2009 and April 2010; the scenarios produced by ACIL for the NTNDP involved a percentage adjustment to this central estimate based on the assumptions for each case. EPRI prepared its report for the federal Department of Resources, Energy and Tourism in February 2010. These estimates are the most current set of capital costs to have been critically evaluated by the industry, meaning they are a more robust source than the ACIL draft report for the QCA.

TRUenergy supports the use of publicly available input assumptions and also the consistent use of inputs from a comprehensive analysis such those undertaken by ACIL. In recent times the Australian dollar (AUD) has appreciated significantly compared to the US Dollar (USD). However it would be inappropriate to simply change the AUD/USD rates adopted, as it is too early to be confident that a fundamental break from long term historical averages has occurred. Further, to only change one element of a comprehensive analysis, the AUD/USD exchange rate, would ignore the fact that most capital equipment is made outside the USA and the USD has depreciated against a wide range of currencies of late, meaning that base USD costs for many items will also have increased.

5 Energy purchase cost allowance – LRMC weighted average cost of capital (WACC)

TRUenergy notes that only market WACC parameters are being updated as part of the Annual Review. Frontier Economics' WHIRLYGIG model runs on a 10 year timeframe. Consequently, for electricity generation the logical term to maturity to use for these market parameters is 10 years.

This is consistent with the targeted debt maturity profiles of the three largest non-network private energy operators in the NEM. For electricity retail and generation, recent market evidence suggests a term to maturity of less than 10 years is not appropriate.

The Draft Decision notes that changes to the Australian bond market have necessitated a change in the approach to estimating the debt margin. TRUenergy is concerned that the Bloomberg 7 year BBB fair value curve used as part of IPART's sample is at the upper end of that sample, when it would be more logical for it to be near the midpoint.

6 Carbon price

TRUenergy believes that it is appropriate that IPART includes a carbon price of zero for both 2011/12 and 2012/13. An assumption for 2013/14 and beyond is only required for modelling green scheme costs. TRUenergy supports putting a price on carbon as the least cost way of reducing emissions. However, under the current circumstances with:

1. the recent failure of the CPRS;
2. no detailed carbon pricing model yet defined; and
3. the minority position of the Federal Government in both Houses of Parliament,

it is very difficult to make a reasonable estimate of when a carbon price will start and what the price will be.

The ToR do not require IPART to include a carbon assumption for setting green scheme cost allowances– the CPRS reference is only in relation to electricity purchase costs.[7] Given the current carbon uncertainty and the nature of IPART's pass-through mechanism, the only sensible assumption for IPART to make is to assume a carbon price of zero for all years. This is due to the following asymmetry:

- If a carbon price of zero is assumed by IPART but a carbon price is subsequently legislated, then the pass-through provisions can be triggered and the 2011/12 total energy cost allowances can be adjusted if required. Allowances beyond 2011/12 will be reconsidered in the 2012 annual review.
- If a carbon price is assumed to commence but this subsequently does not happen, then there will be no recourse under IPART's narrow interpretation of the pass-through provisions (see CPRS deferral section below).

In short, if a zero carbon price assumption proves to be incorrect it can be adjusted for, but if a positive carbon price assumption proves to be incorrect then it cannot. In this situation, unless IPART changes its Draft Decision regarding the current CPRS deferral cost pass-through applications, the only appropriate way to ensure fair regulated electricity prices is to assume no carbon price going forward.

7 GGAS costs

TRUenergy is concerned that IPART's zero allowance for GGAS is inconsistent with its ToR that state that *"IPART should have regard to the efficient costs of meeting any obligations that Standard Retail Suppliers must comply with, including the costs of complying with greenhouse and energy efficiency schemes"*.[8] In the 2010 Determination IPART justified the use of zero value for NSW Greenhouse Gas Abatement Certificates (NGACs) based on a consideration of *"the resource cost of meeting the scheme, rather than the financial or commercial value of NGACs"*.[9] However IPART did not consider the impact on individual retailers. Whilst the short-term resource cost for some retailers may be zero as they have surplus certificates, the resource cost for other retailers will not be zero if they do not have sufficient certificates to meet their obligation to surrender certificates and are required to purchase NGACs or pay the penalty price.

Even for a retailer who has surplus NGACs, these certificates will be considered assets under Australian Accounting Standards.[10] These standards require the carrying value of the asset to be set at the higher of value in use or fair value less costs to sell. If the value of these NGACs is subsequently reduced to zero, the assets would be impaired and the

[7] IPART, "Changes in regulated electricity retail prices from 1 July 2011 - Draft Report", April 2011, page 101
[8] IPART, "Review of Regulated Retail Tariffs and Charges for Electricity 2010-2013, Electricity - Final Report", March 2010, page 201
[9] IPART, "Review of Regulated Retail Tariffs and Charges for Electricity 2010-2013, Electricity - Final Report", March 2010, page 210
[10] Australian Accounting Standards Board, AASB 136, Impairment of Assets, December 2009

losses would also be accounted for as an expense incurred by the retailer that would need to be considered in determining the efficient cost of complying with GGAS.

TRUenergy is not aware, in the 2010/11 period, that any retailer has been able to purchase a material quantity of NGACs for zero consideration. This demonstrates that the approach adopted in the 2010 Determination set an allowance below the efficient cost, in breach of the ToR. Further, by setting an allowance below cost IPART has also contravened its ToR in another area, where it is required to "*ensure its determination is consistent with the Government's policy aim of reducing customers' reliance on regulated prices.*"[11] If allowances are set with a zero value when retailers will incur a cost for NGACs then for that component any potential competitor is at a disadvantage compared to the regulated price, which will therefore inhibit competition and not reduce reliance on regulated prices.

Given current market NGAC spot and forward prices of around $5, the significant uncertainty around carbon pricing, and the potential for consideration to be paid for NGACs if a carbon price is introduced, it is highly likely that if the 2011/12 allowance for GGAS is set to zero it will again be below efficient cost and contrary to the two areas of the ToR outlined above.

For the Draft Decision, IPART asked Frontier to update the green allowances using the same methodology as was used in making the 2010 Determination, with the carbon assumptions updated. This is in accordance with the process set down in the 2010 Determination for conducting the Annual Reviews. However, the process also requires IPART to "*compare the modelled price outcomes against publicly available electricity forward price market data*" and to make a decision based on "*the most appropriate source of forward price data to be used*".[12]

Essentially, while IPART's process encourages it to stick with the methodology it used in the 2010 Determination, it also requires IPART to check these outcomes against what is going on in the NGAC market. It is clear that the 2010 Determination's approach has led to outcomes demonstrably below efficient cost and hence in breach of two areas of the ToR. As a continuation of that approach for 2011/12 is highly likely to do the same again, TRUenergy recommends IPART amends its methodology. Changing methodology is not a desirable regulatory approach, but producing an outcome that is contrary to the ToR is worse.

The approach IPART has adopted for the energy purchase cost allowance, the higher of cost and LRMC, provides a sound basis for setting regulated prices in accordance with the ToR. Setting the allowance for GGAS (and LRET, see below) using this approach would mean IPART is no longer contravening its ToR. Setting these allowances with a carbon price assumption of zero (see carbon assumptions section above) will mean that if the carbon price assumption proves to be incorrect it can be adjusted for. This will not be the case if a positive carbon price assumption proves incorrect. Significantly, adopting a zero carbon price assumption is also likely to lead to Frontier's theoretical allowance for GGAS (and LRET) being far more consistent with market outcomes.

In the 2010 Determination IPART partly justified the adoption of a zero GGAS allowance by noting that the energy purchase cost allowance was above market based estimates, meaning an efficient retailer could remain financially viable. However this ignores the requirement in the ToR that "*IPART should have regard to the efficient costs of meeting any obligations that Standard Retail Suppliers must comply with, including the costs of complying with greenhouse and energy efficiency schemes*".[13] A zero allowance for GGAS is below the efficient cost.

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11 IPART, "Changes in regulated electricity retail prices from 1 July 2011 - Draft Report", April 2011, page 100
12 IPART, "Review of Regulated Retail Tariffs and Charges for Electricity 2010-2013, Electricity - Final Report", March 2010, page 146
13 IPART, "Review of Regulated Retail Tariffs and Charges for Electricity 2010-2013, Electricity - Final Report", March 2010, page 201

8 LRET costs

For the Draft Decision, IPART adopted Frontier's advice that an LRMC approach is the appropriate method to determine the LRET allowance, applying the same methodology as was used in valuing the old Renewable Energy Target (RET) in the 2010 Determination. However, this ignores the fundamental differences between the LRET and the RET and indeed the core reasons for changing the RET.

Approaches for setting the price for Large-scale Generation Certificates (LGCs) include:
1. An incremental full market LRMC model such as the Frontier WHIRLYGIG model;
2. Estimating the LRMC of wind generation and subtracting wholesale energy costs; and
3. Market based LGC prices.

Given that wind energy is expected to provide the vast majority of new large scale renewable investment in the medium term, it would be expected that all three approaches should return similar LGC prices.

Current published LGC prices are around $40 spot and increasing to over $47 for 2013.

In South Australia, AGL proposed a LRMC of $117/MWh for wind based generation. The regulator engaged SAHA International Limited. SAHA reviewed the following:
- a confidential report provided by an independent consultant;
- the off take agreement entered into between AGL and the buyer of the Hallet 4 Wind Farm;
- ACIL Tasman's estimated LRMC of wind generation; and
- a KPMG's estimate

Based on these factors, SAHA concluded that AGL's proposal was reasonable.[14]

Internal TRUenergy forecasts are based on approaches from various wind farm developers to enter into Power Purchase Agreements. These estimate the total 'bundled' expected LRMC of new entrant wind in line with AGL's estimate of $117/MWh. Therefore, allowing for expected wholesale prices, this implies an LRMC of LGCs in the order of $50-$70 to ensure that proposed wind farm investments will become viable. Adjusting these estimates for carbon is difficult, but outcomes would be above current market based prices.

Exactly how Frontier's WHIRLYGIG model derives its LGC estimates is unclear. What is clear is that the output of around $37 per LGC is materially lower than the other two estimates. We do not fully understand how and why Frontier and IPART have used the stand alone LRMC for the black energy price, but for calculating the LRMC of the LRET, the LRET is applied as a constraint to the incremental LRMC model not the stand alone version. Had Frontier modelled the LRET by imposing it on the hypothetical system optimised to serve the regulated load, the same model could have been used to produce LRMC values for both the wholesale energy purchase cost and LGCs. The LGC estimates produced by the stand alone approach may have been more consistent with the other LGC cost estimates outlined above.

Setting the LRET allowance using the Frontier LRMC calculation when it is materially lower than the other LGC cost estimates increases the chances that the allowance is below the efficient cost, in breach of the ToR. Please refer to the section above on GGAS for an outline of TRUenergy's concerns with this approach.

Given the LRET is a materially different scheme from the old RET, IPART is not compelled to use the same approach that it used in the 2010 Determination. The approach IPART has adopted for the energy purchase cost allowance, the higher of cost and LRMC, provides a sound basis for setting regulated prices in accordance with the ToR. Setting the allowance for LRET using this approach would mean IPART is not at risk of contravening its ToR.

[14] SAHA, "Review of Wholesale Energy Cost Estimation Methodology - Final Report", September 2010, page 52

9 Small scale Renewable Energy Scheme (SRES) costs

The SRES scheme subsidises small scale renewable energy projects and is funded by small-scale technology certificates (STCs). STCs can be sold through a government clearing house for a fixed price of $40. The obligation on retailers to buy STCs makes a material contribution to the forecast 2011/12 price rises.

TRUenergy supports the approach taken by IPART of using official Small-scale Technology Percentages (STPs) from the scheme regulator, the actual surrender timing profile and the fixed STC price of $40.

TRUenergy notes that the market price of STCs has been below $40, influenced primarily by supply surplus or shortfall expectations. Trading edged up to $39 when it was thought there would be a shortfall for the Quarter 1 STC surrender in late April. However towards the end of March market estimates changed to oversupply for Q1 and through Q2, and STC prices dropped off quickly. It is reasonable to expect STC market prices will rise during Q3 and Q4 as the changes to the solar credit multiplier announced last week impact on supply. In light of such price uncertainty, with the only certainty being that any seller can get $40 for their STCs through the government clearing house, IPART's use of the fixed STC price of $40 is appropriate.

The changes to the solar credit multiplier announced last week also highlight the challenges in accurately predicting the STP for future years. The likely reduction to the 2012 STP due to these changes is difficult to forecast given the complex demand dynamics. The subsidy for solar PV will further decrease on 1 July, but it was already going to decrease on that date. The upcoming reduction may lead to a rush before 30 June this year but this was already an issue, it has just been magnified post the announced change. A further dynamic is whether the reduced subsidy for solar PV will result in an increase in the uptake of Solar Hot Water, which is not effected by the multiplier.

IPART asks for comment on the best way to manage the risk that when the STP is finalised each year it may vary significantly from previous estimate. TRUenergy believes it is appropriate for regulated tariffs to reflect actual STP outcomes and hence for any future variations from current official forecast STPs to be treated as pass-through items. TRUenergy assumes that new regulations setting the STP for the 2012 year and beyond will clearly qualify as a Regulatory Change Event under the pass-through provisions, but would appreciate IPART confirming this in its Final Decision.

10 Cost pass-through applications – SRES & LRET

TRUenergy believe the approach of treating the SRES as a new obligation and using the official STP, the actual surrender timing profile and the fixed STC price of $40 is appropriate.

However the approach taken for LRET leads to a theoretical outcome that does not correlate to actual market outcomes and is inconsistent with the public rationale for removing small-scale technologies from the RET scheme.

Frontier's modelling approach attempts to isolate the certificate price change as a result of moving from RET to LRET, which is appropriate. However, the modelling result, that LGCs are worth $3.65 less than RECs, is flawed and indicates a problem with Frontier's approach. There is no doubt that the efficient cost of purchasing LGCs is higher than the efficient cost of purchasing RECs, not lower.

As IPART has noted in the past,[15] a stated policy objective of the Commonwealth in removing small-scale technologies from the RET scheme was to *"achieve a level of large-scale renewable electricity generation above what was expected under the existing Renewable Energy Target"*[16]. In order to proceed, large renewable generation projects now expected to fulfil the LRET required higher certificate prices than were occurring under the old RET. If this was not the case, these large renewable generators would already have been displacing small-scale technologies and no RET changes would have been needed.

The Commonwealth's stated policy objective was consistent with the independent modelling that was released in May 2010 as part of the consultation on the RET changes. This modelling forecast, under both of two alternate carbon scenarios, that long run LGC prices would be higher than REC prices by around $3.[17] This was due to more large scale renewable energy generation being required because the high proportion of small scale RECs created under the old RET disappears. The report also noted that this impact *"will more than offset the reduction of the annual targets by 4,000 GWh in the early years".* [18]

Observed market data is also contrary to Frontier's theoretical outcome. Weekly AFMA reported REC price data revealed the following:

- 18 February 2010 – REC price $35.38
- 25 Feb - REC price $35.38
- 26 Feb - REC changes announced
- 4 March – REC price $42.15, an increase of $6.77 in one week
- 11 March – REC price $42.18.

We are not provided with Frontier's modelling however it appears likely that a key reason for its outcome being illogical is the assumption Frontier made regarding the creation of RECs by small-scale generators. Frontier relied on a 2005 report from the Australian Business Council for Sustainable Energy (BCSE). [19] That report is confidential, but a public submission from February 2006 testified that the BCSE 2005 report forecast solar water heaters would *"contribute 16% of RECs".*[20] Another BCSE paper from 2006[21] confirmed that 16% estimate and added another 2% for small solar PV and wind, a combined creation by small-scale generators of 18%. In 2010 small-scale generators accounted for around 75% of all REC creation, more than four times the apparent BCSE forecast. It cannot be considered reasonable to adopt this modelling approach again.

IPART's outlined approach to assessing cost pass-through applications does not mandate that it use the same methodology to calculate REC costs that it used in the 2010 Determination to assess the cost pass-through. It would normally be appropriate to do so, but IPART is required to look at costs that *"are incurred as a direct result of the event and are incremental".*[22]. When the following items are considered:

- the stated reasons for the RET changes;
- the modelling performed to support the changes;
- observed market data after the changes were announced; and
- the gross inaccuracy of the small scale REC creation assumption used in 2010,

it does not make sense to use the approach Frontier has adopted to calculate the LRET pass-through amount and it is unreasonable to assume that Frontier's approach properly estimates incremental costs as a direct result of this event.

In order to be consistent with IPART's outlined approach to assessing cost pass-through applications, TRUenergy recommends that it is far more appropriate to use reported AFMA REC prices before and after the changes were announced to determine the

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15 IPART, "Review of Regulated Retail Tariffs and Charges for Electricity 2010-2013, Electricity - Final Report", March 2010, page 201
16 Commonwealth Government, Department of Climate Change, "Fact Sheet: Enhanced Renewable Energy Target", February 2010, page 2
17 MMA, "Impacts of Changes to the Design of the Expanded Renewable Energy Target", May 2010, pages 23&35
18 MMA, "Impacts of Changes to the Design of the Expanded Renewable Energy Target", May 2010, pages 23&35
19 Frontier Economics, "Energy costs – Cost pass-through application for LRET and SRES - Draft Report", April 2011, page 12
20 CEEM "Submission to the Issues Paper: Driving Investment in Renewable Energy in Victoria: Options for a Victorian market-based measure", February 2006, page 16
21 BCSE, "Australia's Renewable Energy Use, Technologies and Services", September 2006, page 54
22 IPART, "Review of Regulated Retail Tariffs and Charges for Electricity 2010-2013, Electricity - Final Report", March 2010, page 146

certificate price impact. This result should then be applied to the LRET target and adjusted to account for the LRET target being different to the RET one.

11 Cost pass-through applications – CPRS deferral

The Draft Decision finds that the deferral of the CPRS does not meet the definition of a decision made by an authority for two reasons:

1. The decision was made by Parliament, which does not meet the definition of an authority; and/or
2. A decision only includes those that affect legal rights and obligations, which the CPRS deferral was judged to have not met.

TRUenergy considers that these findings are:

- not legally correct;
- inconsistent with the purpose of the cost pass-through mechanism; and
- not fair and reasonable interpretations of the 2010 Determination.

An extended response can be found at Appendix A, the key issues being:

1. There was clearly a decision to delay the implementation of the CPRS and this decision was made by an Authority, being either the former Prime Minister (Kevin Rudd), in his capacity as a minister of the government,[23] or by the Cabinet (being the executive branch of government).
   - The terms "minister" and "government" are both included in the definition of "Authority" in IPART's Final Determination of March 2010. [24]
   - It is evident that the decision to delay the implementation of the CPRS was made by the former Prime Minister and/or the Cabinet. Both fit within the definition of an "Authority".
   - IPART should be applying a common sense interpretation of what constitutes a decision in the circumstances. IPART appears to have placed undue weight on the need for some formal instrument evidencing the decision. There is no need for such a requirement and confuses outcome with process.
   - Therefore, the decision to delay the introduction of the CPRS is a decision by an authority. Parliament's role is to scrutinise, debate and vote on legislation brought before it. It does not have the power to defer legislation or decide what Bills are considered as part of the Government Business Program, hence it did not make the decision not to proceed.
2. The term "decision" in the definition of "Regulatory Change Event" is not expressly limited to decisions that affect legal rights and obligations.
3. The implication of an additional term, which was not clearly defined, contradicts IPART's own requirement of having a clear definition of the term "Regulatory Change Event". [25] In addition, there is no need to imply this new requirement as it is substantially dealt with by the requirement that the decision have the effect of substantially varying the nature, scope, standard or risk of the relevant electricity services.

More broadly, TRUenergy is concerned that by taking an overly narrow approach to what constitutes "a decision made by any Authority", IPART is limiting the scope for future pass-through applications which could lead to future regulated electricity prices being higher than they should be. When the purpose and context are considered, IPART's unduly narrow interpretation to the term "decision made by any Authority" is not appropriate.

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[23] Prime Minister of Australia, "Transcript of Doorstop - Nepean Hospital, Penrith", 27 April 2010

[24] IPART, "Review of Regulated Retail Tariffs and Charges for Electricity 2010-2013, Electricity - Final Determination", March 2010, page 40

[25] IPART, "Review of Regulated Retail Tariffs and Charges for Electricity 2010-2013, Electricity - Final Report", March 2010, page 160

12 Impact of the Draft Decision on customers

The retail cost increases foreshadowed in the Draft Decision are an unfortunate consequence of rising network costs and renewable schemes. TRUenergy understands that these price rises will make energy affordability even more of a challenge for many NSW families. In particular, TRUenergy is aware of the particular impact on low income earners as highlighted by IPART's analysis.

TRUenergy will work proactively with the NSW Government and consumer groups to manage customers experiencing energy hardship. We note the suggestion from the Energy and Water Ombudsman of NSW's Office that a national approach be taken to identify the effectiveness or efficiency of various assistance measures to ensure those adopted reduce hardship as much as possible.[26] We would support this approach and would be keen to participate in such an exercise. In terms of any future changes to rebates and other concessions, we do request that sufficient notice is provided in order to ensure retailers and distributors are able to make the necessary systems and processes changes to make sure the new rebates or other concessions are effectively distributed to those in need.

13 Recommended actions to improve electricity affordability

TRUenergy broadly supports most of IPART's recommendations in this chapter. Large rises in network costs have accounted for the majority of retail price increases over the last three years. So it is appropriate to examine the role of the Australian Energy Regulator (AER) and the framework within which it regulates the network business. The customer cost/reliability trade off, the efficiency of capital expenditure and the regulatory process should all be reviewed.

As IPART notes in the Draft Decision, green schemes add 6% to the 1 July 2011 price increase so it is certainly appropriate to consider adjustments to these to alleviate future price increases. Recent state and federal government announcement show that work is underway on this issue.

Recommendation 7.2 calls for retailers to contribute to the costs of the solar bonus scheme in regards to the wholesale value of the energy produced. TRUenergy does not have concerns with this concept. However, we note that many retailers already pay customers a premium above the base feed-in tariff to account for the wholesale value of the energy produced. So any adjustment would need to be developed in such a way to ensure retailers are not paying twice for the energy generated.

Recommendation 8 is of great concern to TRUenergy. In particular, IPART's recommendation appears to assume that there will be an ongoing need for full retail price regulation due to the presence of monopolistic power. This sits in contrast to IPART's ToR which require it to reduce reliance on regulated tariffs, which can only be done by promoting competition. IPART claim to *"support removing price regulation where there is effective competition"*[27] but ignore the key role that the regulator has in terms of promoting competition, as required in current ToR.[28]

IPART's suggested change to allow it to set the energy purchase cost below either the market based cost or below the LRMC will add to regulatory risk and cost. It is difficult to

[26] IPART, "Public Forum on changes in regulated retail electricity prices from 1 July 2011 - Transcript" (May 2011), pages 22-23
[27] IPART, "Changes in regulated electricity retail prices from 1 July 2011 - Draft Report", April 2011, page 90
[28] IPART, "Changes in regulated electricity retail prices from 1 July 2011 - Draft Report", April 2011, page 100

see how this could be anything other than a detriment to competition and hence not in the long term interests of consumers.

Setting the energy purchase cost allowance below the LRMC is likely to lead to a reduction in forward contracting and generation investment decisions being delayed. Given uncertainty already in the market regarding carbon costs, such an approach will make long-term forward contracting even harder and create further challenges for private capital investing in the new generation capacity that NSW will require.

Setting the energy purchase cost allowance below the market based cost is even more problematic. Retailers will be forced to sell energy at below cost, increasing the risk of a retailer failure.

Adoption of a "higher of" approach where the resultant energy purchase cost allowance is above the market based cost, as is the case in the Draft Decision, is likely to increase competition and hence reduce reliance on regulated prices. This is exactly what IPART's ToR require.

If IPART adopts any variant of a "lower of" approach in any future review then the impacts on the NSW energy market could be disastrous. If a cost-based form of retail price regulation is deemed necessary beyond 2012-13, TRUenergy supports the cost of energy allowance continuing to be the higher of the LRMC and the market-based cost. This will facilitate efficient market development both in the short and long term, in the best interests of consumers.

14 Conclusion

TRUenergy believes the while the Draft Decision is generally in accordance with IPART's ToR and the processes established in the 2010 Determination, there are some notable exceptions to this. While some use of theoretical modelling is required, its adoption in areas such as LRET and GGAS has led to unrealistic outcomes. In effect, IPART has adopted a lower of LRMC and market approach to setting these allowances which is contrary to the methodology mandated for the energy purchase costs. Such an approach is also inconsistent with the ToR, both in terms of promoting competition and also ensuring that regulated prices reflect "the efficient costs faced by a Standard Retailer Supplier."

Appendix A – CPRS Cost pass-through application

The Draft Decision finds that the deferral of the CPRS does not meet the definition of a "decision made by any authority" for two reasons:
1. The decision was made by Parliament, which does not meet the definition of an authority; and/or
2. A "decision made by any authority" is only directed at decisions that affect legal rights and obligations, which the CPRS deferral was judged to have not met.

TRUenergy believes these findings are misguided and evidence an unreasonable interpretation of the 2010 Determination.

Decision by an Authority

In terms of Parliament not being an authority, the outline of the deferral in the Draft Decision does not accord with the actual events and in particular with the true decision maker.

The decision to defer the introduction of the CPRS was announced by the then Prime Minister Kevin Rudd on 27 April 2010 and reflected the deliberations of Cabinet. Both the Prime Minister and the Cabinet meet the definition of an Authority as the terms "minister" and "government" are both included in the definition of "Authority" in the 2010 Determination.[29] Therefore the decision to delay the introduction of the CPRS is a decision by an Authority.

Mr Rudd's statement outlines the decision to delay the implementation of the CPRS:
Our current actions delivered through until the end of the current Kyoto commitment period which finishes at the end of 2012 - the critical question is then what actions postdate 2010, and the decision that we've taken as a Government is that that provides the best opportunity to judge the actions by the rest of the international community before taking our decision about the implementation of a Carbon Pollution Reduction Scheme from that time on... The implementation of a Carbon Pollution Reduction Scheme in Australia will therefore be extended until after the conclusion of the current Kyoto commitment period, which finishes at the end of 2012.[30]

In addition, while not determinative of itself, it is instructive that numerous government media releases indicate that the delay in the implementation of the CPRS was a decision of the Government. For example:

On 27 April 2010 the Prime Minister announced that the Government has decided to delay the implementation of the Carbon Pollution Reduction Scheme.[31]

TRUenergy notes that Parliament's role is to scrutinise, debate and vote on legislation brought before it. It does not have the power to defer legislation or decide what Bills are considered as part of the Government Business Program, hence it did not make the decision not to proceed. It is the executive government that decides the Government Business Program that Parliament considers. Formal withdrawal of a Bill is not required in order to enact a decision not to proceed. There is no effective difference between allowing a Bill to lapse and formally withdrawing it. Either action evidences a decision on the part of the executive government or the relevant minister not to proceed with the Bill.

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[29] IPART, "Review of Regulated Retail Tariffs and Charges for Electricity 2010-2013, Electricity - Final Determination", March 2010, page 40
[30] Prime Minister of Australia, "Transcript of Doorstop - Nepean Hospital, Penrith", 27 April 2010
[31] Department of Climate Change and Energy Efficiency, "Carbon Pollution Reduction Scheme" News Release, 5 May 2010, http://www.climatechange.gov.au/media/whats-new/cprs-delayed.aspx

Parliament is an Authority

Even if it is considered that it was Parliament that made the decision to not proceed with the CPRS, the Draft Decision does not provide any justification for its determination that Parliament does not fall within the definition of "Authority".

- The terms "government" and "instrumentality or other authority of government" which are included in the definition of "Authority" are not defined in the 2010 Determination.
- "Parliament" is defined in the Encyclopaedic Australian Legal Dictionary as: "an arm of government in which legislative powers are vested". This appears to indicate that the term "government" is not limited to the executive branch.
- Accordingly, Parliament is a "instrumentality of government" which falls within the definition of "Authority". In this context, the "instrumentalities of government" would comprise Parliament (the legislature), the executive and the judiciary. This is logical - for example, judicial interpretation may alter the existing application of a current law. In and of itself, a judicial decision (without further legislative intervention) is unlikely to fall within paragraphs (b) or (c) of the definition of "Regulatory Change Event", yet may clearly and substantially alter the nature, scope, standard or risk of a Standard Retailer's electricity services. When purpose and context are considered, the term "government" should not be construed narrowly.

Legal rights and obligations – a new requirement

IPART has implied an additional requirement that the decision must affect legal rights and obligations. There are a number of grounds as to why this is not justified.

First, there is no such requirement in the relevant definition of "Regulatory Change Event" and IPART gives no justification for implying this requirement.

- The term "Regulatory Change Event" is defined in the 2010 Determination as including "a decision made by any Authority".[32]

- The term "decision" is not defined in the 2010 Determination. The term "decision" in the definition of "Regulatory Change Event" is not expressly limited to decisions that affect legal rights and obligations.

Second, the implication of an additional term, which was not clearly defined, contradicts IPART's own requirement of having a clear definition:

"our final decision allows the Standard Retailers to pass-through material, unforseen changes in costs associated with a clearly defined set of regulatory or taxation change events. We consider that a clear definition is important, to provide greater certainty for retailers and customers about how and why regulated retail prices might change during the determination period. It is also important to reduce the potential for disputes over whether a particular event can trigger a cost pass-through review, which could result in significant administrative costs for both retailers and IPART."[33]

Third, there is no need to imply this new requirement as it is substantially dealt with by the requirement that the decision have the effect of substantially varying the nature, scope, standard or risk of the relevant electricity services.

Fourth, this new requirement is a further demonstration that IPART is taking an overly narrow approach to what constitutes a decision made by an Authority.

- IPART has indicated that the *CPRS deferral is an unusual circumstance in that it was a policy proposal that had not received Parliamentary support. However, future schemes affecting Standard Retailers' obligations are likely to be implemented*

[32] IPART, "Review of Regulated Retail Tariffs and Charges for Electricity 2010 to 2013 - Final Determination" (March 2010), page 46.
[33] IPART, "Review of Regulated Retail Tariffs and Charges for Electricity 2010 to 2013 - Final Report" (March 2010), page 160.

through legislation, such as the RET change. The legislative change in those situations would more likely qualify as a Regulatory Change Event. [34]

- This statement implies that IPART believes that it will be easier to establish that a Regulatory Change Event has occurred where the event or circumstance arises from the implementation of new or amended legislation.

- However, these changes would be caught by the paragraphs (b) or (c) of "Regulatory Change Event" definition being the coming into operation of an Applicable Law or the coming into operation of an amendment to or revocation of an Applicable Law. [35]

While IPART's observation may be correct that it would be easier because the other provisions would apply, it gives retailers little comfort about the scope of paragraph (a) of the definition of Regulatory Change Event, namely "a decision made by an Authority", as providing a mechanism for decisions which impose unanticipated costs which do not involve changes in legislation and which this provision was clearly designed to capture.

Substantial variation to services

Earlier correspondence indicated that IPART also appears to be of the view that the delay in the CPRS does not substantially vary the nature, scope, standard or risk of the retailer's services. IPART clearly indicated that the prices were determined on the basis that the CPRS would be introduced:
We have assumed that the CPRS will commence as currently proposed in the Federal Government's Carbon Pollution Reduction Scheme Bill 2010. We have modelled the impact of the CPRS on electricity prices using the Commonwealth Treasury's forecast estimate of the market-based carbon price in 2012/14, and have also indicated the price impacts if the CPRS does not proceed. We have provided for periodic reviews of this modelling throughout the determination period, so we can adjust regulated tariffs if these assumptions prove to be incorrect.[36]

Accordingly, the Final Determination effectively defined pass-through Services for a standard retailer as being based on the CPRS commencing in July 2011 and GGAS subsequently terminating. Indeed the ToR specifically required IPART to incorporate the CPRS into its determination.[37] It is TRUenergy's view that this forms the baseline against which the issue of substantial variation to services should be measured.

Affecting legal rights and obligations

Even if IPART is correct and it is necessary by implication that the decision must affect legal rights and obligations (not just substantially varying services), then the decision to delay the CPRS Bill should meet this criterion. It is difficult to interpret IPART's new condition because it does not appear in the 2010 Determination but generally "affect" in both ordinary and legal parlance has a broad meaning.

The 2010 Determination constrains the standard retailers' right to charge for its services for a large number of its customers. As outlined above, the 2010 Determination was based on an assumption that the CPRS would commence and GGAS costs would be zero as a result, then a decision to defer the CPRS which in turn means GGAS costs are incurred and cannot effectively be recovered does affect the retailers' legal rights.

As the 2010 Determination clearly sets out the standard retailers' legal rights and obligations in a number of material ways, then it follows that a decision which is

[34] IPART, "Changes in regulated electricity retail prices from 1 July 2011 - Draft Report", April 2011, page 54.
[35] IPART, "Review of Regulated Retail Tariffs and Charges for Electricity 2010 to 2013 - Final Determination" (March 2010), page 46.
[36] IPART, "Review of Regulated Retail Tariffs and Charges for Electricity 2010-2013, Electricity - Final Report", March 2010, page 5
[37] IPART, "Review of Regulated Retail Tariffs and Charges for Electricity 2010-2013, Electricity - Final Report", March 2010, page 201

completely at odds with the 2010 Determination necessarily affects the standard retailers' legal rights and obligations.

Ensuring costs are incremental

The 2010 Determination states that when considering a cost pass-through application, IPART must check that *"the costs the retailer proposes to pass-through are incurred as a direct result of the event and are incremental (i.e., ensuring they are not already included in the cost allowances for the 2010 determination)."*[38]

The increased costs incurred as a result of continuing compliance with the GGAS directly result from the decision to delay the implementation of the CPRS and are not already included in the cost allowances for the 2010 determination. Hence the decision to delay the CPRS significantly varies the financial risk of the Standard Retailer Supplier in comply with GGAS in order to provide the pass-through Services.

Summary

TRUenergy considers that a Regulatory Change Event has occurred within the meaning in the 2010 Determination. However, if IPART considers there is some ambiguity, then TRUenergy recommends that IPART should refer to the purpose of the cost pass-through mechanism and the context of IPART's determination.

IPART stated that the purpose of the cost pass-through mechanism is *"to manage the financial risk associated with material and unforseen changes in costs due to defined regulatory or taxation change events.*[39]

IPART has specifically acknowledged that the possibility that the CPRS *"will be introduced at a time or in a form that differs from the assumptions we used, or will not be used at all"*, is a *"non-systematic risk"* faced by all retailers.[40] The delay in implementation of the CPRS now materially increases the financial risk faced by the standard retailers given the assumptions made by IPART on this issue in its determination. This is precisely the type of Regulatory Change Event intended to be addressed by the cost pass-through mechanism.

[38] IPART, "Review of Regulated Retail Tariffs and Charges for Electricity 2010-2013, Electricity - Final Report", March 2010, page 159
[39] IPART, "Review of Regulated Retail Tariffs and Charges for Electricity 2010-2013, Electricity - Final Report", March 2010, page 161
[40] IPART, "Review of Regulated Retail Tariffs and Charges for Electricity 2010-2013, Electricity - Final Report", March 2010, page 142