AGL Energy Limited
ABN: 74 115 061 375

Level 22, 101 Miller St
North Sydney NSW 2060

Locked Bag 1837
St Leonards NSW 2065

T: 02 9921 2999
F: 02 9921 2552
www.agl.com.au

A few words.

The Independent Competition and Regulatory Commission

GPO Box 296

CANBERRA CITY ACT 2601

9 May 2012

Dear Sir/Madam

Re: Draft Report – Retail prices for non-contestable electricity customers 2012-14, December 2011

AGL welcomes the opportunity to comment on the Independent Competition and Regulatory Commission's (***ICRC***) *Draft Report: retail prices for non-contestable electricity customers – 2012-14 (**Draft Report**).*

AGL operates across the supply chain and has investments in coal-fired, gas-fired, renewable and embedded electricity generation. AGL is Australia's largest private owner, operator and developer of renewable generation in Australia with 1,205 MW of renewable capacity (at 30 June 2011). AGL is also a significant retailer of energy with over 3 million electricity and gas customers.

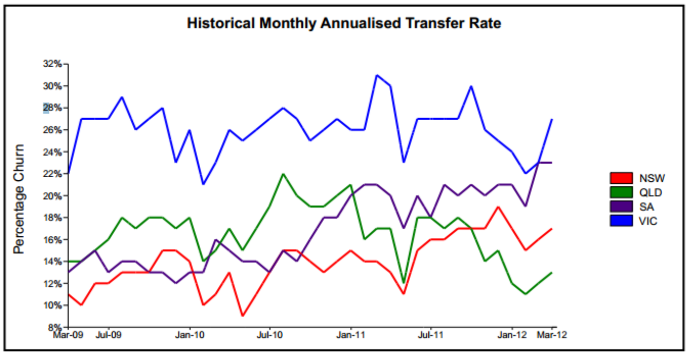
In commenting on the Draft Report, AGL highlights the state of competition in the ACT retail electricity market and, given the cost index approach, points out specific areas relating to electricity purchase costs and green costs where AGL has concerns.

Retail Competition

The ICRC's approach for 2012-14 is basically a continuation of the approach adopted for 2010-12 with adjustments to account for carbon costs from 1 July 2012. Despite the introduction of full retail contestability since 2002, the level of regulated prices resulting from the ICRC's reviews has resulted in the absence of effective competition in the ACT electricity market. Setting prices based on the incumbent retailer's efficient costs provides an effective barrier to second-tier retailers entering the market, and limits incentives for existing retailers to develop new products and actively market to ACT customers.

Figure 1 shows the latest historical one month annualised churn rate for the retail electricity market over three years published by AEMO (March 2012) in NSW, QLD, SA and VIC. Nationally, the churn rate is about 20% but in the ACT, the churn rate is less than 1%.

Figure 1 - Monthly churn rates in NSW, QLD, SA and VIC



Data from National Electricity Market, Month Retail Transfer Statistics, March 2012, AEMO

AGL anticipates that the Draft Report will not improve the level of competition in the ACT retail electricity market.

Energy Purchase Costs

The ICRC has stated in the Draft Report that “AGL conceded that the Commission may continue to apply its market-based methodologies”[1]. AGL wish to clarify that while our submission included possible amendments to the current market-based approaches for the energy purchase cost and LRET cost, to better reflect retailers actual costs. This should not be interpreted as unqualified support for using the current market-based approach for setting prices.

Regarding the ICRC’s updated EPC methodology, AGL considers that it is not appropriate to use a truncated sample of SFE contracts in an attempt to ameliorate the legislative uncertainty related to the introduction of the carbon price. While using this approach might better reflect the impact of the carbon price on the wholesale electricity price, it does not accord with the strategies used by retailers to manage their hedging requirements i.e. purchase contracts to hedge price risk over 2 – 3 years.

As noted in our previous submission, AGL is of the view that it is difficult to accurately isolate the impact of one particular policy or event in the market on futures prices. Therefore, using ‘carbon inclusive’ futures price data from this period would result in an under estimation of retailers costs associated with the carbon pricing mechanism.

Green costs

The change in the ICRC’s proposed approach to estimating a retailers green costs is a significant departure from the previous approach. In the Draft Report, this has resulted in a 17.33% reduction in green costs from $13.16/MWh to $10.88/MWh. AGL does not consider this reduction to be justifiable.

The ICRC’s proposed approach of sourcing all retailers’ LGC and STC requirements from a single broker over a one week period completely ignores the way retailers manage their costs, and therefore is fundamentally flawed. AGL’s concerns with this approach include:

- No information has been provided on whether these prices represent a reasonable estimate of retailers costs. The prices from the Clean Energy Council website are sourced from a single broker, TFS Green. Setting a retailer cost based on a single broker’s price is likely to result in costs which are not representative; and
- ICRC has proposed calculating the LGC and STC price using “the average closing spot price for each of the last five business days in the month of May preceding the price direction”. This approach implies that a retailer will source all of its liability over five days, in one month from one particular broker. AGL considers that the level of price and volume risk that a retailer would be exposed to using this approach would not be allowed within typical board-mandated risk policies.

Specifically, AGL considers that the scheme targets (i.e. RPP, STP) and the certificate prices (i.e. LGC and STC prices) used in the Draft Report to determine the relevant cost allowances should be revised as detailed below.

[1] ICRC, Draft Report: retail prices for franchise electricity customers 2012-14. Report 2 of 2012 (April 2012). Page 44.

2013 LRET RPP estimate

ICRC have used a 2013 RPP estimate of 9.80% for the Draft Decision. The Clean Energy Regulator (CER) has published estimates of the future default RPP on their website.[2] The CER estimate for the 2013 RPP is 10.42%. The ICRC have not presented any evidence on why their own 2013 RPP estimate is more appropriate than the forecast provided by the CER. In the absence of any specific modelling of the RPP, AGL considers that the CER 2013 forecast RPP of 10.42% should be used.

2013 SRES STP estimate

ICRC have used a 2013 STP estimate of 7.87% for the Draft Decision. The CER has also published an estimate of the STP for the next two years on their website.[3] The latest estimate of the 2013 STP is 7.94%. AGL notes that over recent years the STP has been high variable, and whilst AGL is of the view that this forecast could likely underestimate the final 2013 STP, in the absence of any other published estimates the ICRC should use the latest CER 2013 STP estimate of 7.94%.

SRES 2012 and 2013 STC price

In applying the approach described in the Draft Decision to determine SRES costs, the ICRC has proposed a methodology to calculate the STC cost that has been rejected by regulators in QLD and NSW. In IPART's Draft Report for regulated electricity prices from 1 July 2012 the reasons for setting the STC cost in line with the fixed price of $40 (nominal) for 2012/13 include:

- *"It is problematic to forecast the market price of certificates over 2012/13 given that it is an emerging market and there are a range of factors that affect the supply that are difficult to forecast including government policy and market participants carrying costs.*
- *Over the longer term we would expect market prices to be consistent with the fixed clearing house price of $40 given that one of the stated objectives of the SRES is to provide households that have placed their certificates in the clearing house a fixed price of $40 per certificate. CER aims to achieve the $40 fixed price over the longer term by including a 'catch up' element in future binding STPs that equates demand with supply."*[4]

Similarly, as part of the QCA's recent Draft Determination of regulated electricity retail prices for 2012/13, ACIL Tasman has recommended that the QCA not adopt an approach of attempting to estimate a suitable price for STCs. ACIL has noted that attempting to forecast a market price for 2012-13 would require a forecast of the proportion of the STCs that would likely be traded in the year[5]. On this basis, the ICRC should use an STC cost set in line with the fixed $40 price offered through the clearing house.

---

[2] Australian Government, Clean Energy Regulator, Future renewable Energy Targets (2012 – 2030). Accessed 4 May 2012: http://ret.cleanenergyregulator.gov.au/For-Industry/Liable-Entities/rpp

[3] Australian Government, Clean Energy Regulator, Small-scale technology percentage, Publication of non-binding estimates of STP. Accessed 4 May 2012: http://ret.cleanenergyregulator.gov.au/For-Industry/Liable-Entities/stp

[4] IPART, *Changes in regulated electricity retail prices from 1 July 2012, Electricity – Draft Report, April 2012*. Page 38.

[5] ACIL Tasman, *Estimated energy purchase costs for 2012/13 retail tariffs, March 2012.* Page 54.

LRET 2012 and 2013 LGC Prices

As noted earlier, AGL consider that the ICRC's proposed approach for determining the 2013 and 2013 LGC prices does not reflect a retailer's actual costs. On this basis, AGL suggest that the ICRC should consider a calculation of the LGC price that reflects the longer-term costs that a retailer will be exposed to. As suggested in our previous submission, this should reflect the LRMC of compliance under the scheme.

If you have any queries in relation to this matter, please do not hesitate to contact Andrew Dudgeon on (02) 9921 2612 or adudgeon@agl.com.au.

Yours sincerely,

Elizabeth Molyneux

Head of Regulated Pricing

AGL Energy Ltd