



ActewAGL
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6 March 2009

Mr Paul Baxter
Senior Commissioner
Independent Competition and Regulatory Commission
GPO Box 296
Canberra City ACT 2601

Dear Mr Baxter

Submission in response to Issues Paper 11 February 2009 - Retail Prices for Non-contestable Electricity Customers 2009-2010

ActewAGL Retail (ActewAGL) has prepared the attached response to the Independent Competition and Regulatory Commission's (the Commission) Issues Paper regarding Retail Prices for Non-contestable Electricity Customers 2009-2010.

The current price direction expires on 30 June 2009. The new terms of reference requires the Commission to set a further one year price direction, being the fourth consecutive one year direction to be set by the Commission. The Commission had recommended that the Transitional Franchise Tariff (TFT) be removed from 1 July 2007.

ActewAGL believes that the move to full retail contestability in the ACT has delivered many benefits for consumers that are associated with a competitive retail electricity market. This has been successfully assisted through a transition period with a regulated retail tariff. However, continuing to regulate retail prices in a competitive market place threatens to deny consumers the benefits that flow from a truly competitive market, free of regulatory distortion.

The Australian Energy Market Commission (AEMC) has found evidence of effective retail competition in both Victorian and South Australia and recommended that the regulation of standing offer retail prices for gas and electricity cease at the expiration of their respective current price determinations. ActewAGL endorses the Commission's statement in its Issues Paper which proposes that the Victorian model could provide a starting point to facilitating a similar lighter-handed approach in the ACT.

ActewAGL's response to the Issue Paper is made in an uncertain market environment with continuing expectations of volatility in the future wholesale cost of electricity, the introduction of the ACT's feed-in-tariff scheme, the prospect of further ACT Government environmental initiatives impacting the energy sector and an impending Carbon Pollution Reduction Scheme (CPRS).

ActewAGL has closely reviewed the Issues Paper and appreciates the opportunity to comment on the matters identified by the Commission in its difficult task to set a regulated tariff within a competitive market context.

As a result of its review, ActewAGL recommends important changes to the components that make up the decision variables for the TFT. In particular, the operation of the Commission's purchase cost/hedging model warrants review and enhancement. The model was first applied in 2007, and was used again in 2008. ActewAGL accepted the necessary simplicity of the model as it did provide certainty and consistency as part of the transition towards the removal of price regulation. However, given the ACT Government's intention to continue with a period of regulated prices in a fully competitive electricity market, it is now necessary to refine and adjust the model. This is necessary to more accurately reflect the commercial complexity and risks associated with forward purchasing energy requirements in an uncertain environment where there is the continuing spectre of ongoing price regulation. ActewAGL has proposed two important enhancements to the model to more accurately reflect market benchmarks.

The main components of ActewAGL's submission in direct relation to the Issues Paper are as follows:

Purchase costs

The purchase cost model has been updated with current market data using ICAP data, being ActewAGL's preferred source of relevant market data, to derive a proposed price of energy for 2009/10, in direct comparison to \$68.90/MWh in the current 2008/09 decision.

Energy Hedging, Contract and Management Costs

As part of ActewAGL's proposed enhancements to the purchase cost model, an updated component that properly reflects the additional management of purchase risk needs to be included. To date this extra cost has been incurred and absorbed by ActewAGL Retail and not compensated in TFT regulatory decisions. ActewAGL proposes energy hedging costs be lifted above the current allowance of 105% provided by the Commission as this hedge assumption is too low and is not consistent with commercial practice. A prudent retailer must hedge significantly more than 105% of forecast load. A prudent retailer takes commercial cover by using a mix of swaps and caps to manage an electricity portfolio.

Retail operating costs

ActewAGL proposes that the retail operating cost calculation for 2009/10 be increased in line with CPI and also incorporate an allowance for customer acquisition and retention costs. ActewAGL first proposed this for the 2007 review. The ACT is currently the only jurisdiction where the regulated retail tariff does not include an allowance for customer acquisition costs.

ActewAGL proposes that a retail margin of at least 5% apply to total retail costs for the 2009/10 period.

Pass through costs

ActewAGL proposes that pass through arrangements for the feed-in tariff and other environmental initiatives apply in 2009/10 together with a pass through of network costs and that smart metering also be included as a pass through provision.

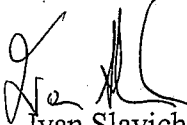
ActewAGL has provided its response to the Issues Paper and identified changes to several key parameters which drive the regulated tariff, to ensure that prices are based on efficient, market-based costs of supply and the competitive market can continue to develop to its full potential.

ActewAGL notes that the Commission has highlighted the Australian Energy Regulator's (AER) draft decision on distribution charges that has provided for a real increase of 13.82% in 2009/10. The Commission's retail decision regarding the TFT is separate from the Australian Energy Regulator (AER) consideration of ActewAGL Distribution's electricity network costs, and ActewAGL Retail proposes that the final TFT decision facilitate a full pass through of these network costs, once confirmed.

A confidential response to the more detailed and commercially sensitive matters identified for consideration within the Issues Paper is attached. Please contact David Graham, Director Regulatory Affairs on 6248 3605 if you would like to discuss ActewAGL's response to the Issues Paper.

Once again, we appreciate the opportunity to provide our input to this process.

Yours sincerely



Ivan Slavich
Head of Retail