

Our Ref: 3451820
Enquiries: David Tovey
Telephone: (08) 6310 1820

18 Brodie Hall Drive
Technology Park
Bentley WA 6102
PO Box 1066 Bentley DC WA 6983
Telephone (08) 6310 1000
Facsimile (08) 6310 1010
www.horizonpower.com.au

16 September 2011



Mr Bruce Layman
Director, References and Research
Level 6,
197 St Georges Terrace
PERTH WA 6000

publicsubmissions@erawa.com.au

Dear Bruce

Submission in response to the Issues Paper: Inquiry into the Efficiency of Synergy's Costs and Tariffs

Horizon Power welcomes the opportunity to comment on the issues paper for the Inquiry into the Efficiency of Synergy's Costs and Electricity Tariffs.

Horizon Power is a commercially focussed, State Government-owned power company that provides quality, reliable power supplies to Western Australia's booming regional economy. We are responsible for generating, procuring, distributing and retailing electricity to residential, industrial and commercial customers and resource developments in our service area.

Our service area, which is outside of the south west corner of the State, is 2.3 million square kilometres and covers the Kimberley, Pilbara, Gascoyne, Mid West and southern Goldfields (Esperance) regions.

Horizon Power provides some general comments on the inquiry and then responds to the individual issues raised in the issues paper. We have also provided some additional information on the contestability threshold in a confidential appendix that is not intended for publication on the ERA web site.

General comments

Horizon Power has a particular interest in the current Synergy inquiry as any potential change to tariff classes or tariff structure resulting from the inquiry has significant implications for Horizon Power. Current tariff policy ensures electricity customers across the State pay the same tariffs regardless of where they live. Therefore, the tariff classes for Synergy are mirrored at Horizon Power. Given the combined use of common tariff classes, it is important that Horizon Power be fully consulted prior to any proposed changes to tariffs to ensure the implications of the changes upon Horizon Power's revenue and costs are fully understood.

Horizon Power generally supports the determination of cost-reflective tariffs for electricity customers as this begins to inform customers of the real cost of supplying electricity across the State. However, any proposed move to cost-reflective retail tariffs should be accompanied by:

- more detailed and time-related demand information for customers to enable them to change their consumption behaviour;
- the gradual phasing of any price increases via a 'glide path' to limit further price shocks for customers;
- continued provision of the 'Tariff Adjustment Payment' (TAP) to Horizon Power and Synergy until cost-reflective tariff levels are reached;
- continued provision of adequate subsidy to Horizon Power (Tariff Equalisation Contribution (TEC) or Community Service Obligation (CSO) payments) to reflect the additional cost of supplying electricity to regional Western Australia; and
- the provision of direct subsidies to eligible customers in financial hardship rather than embedding electricity subsidies in tariffs as this distorts the true cost of electricity usage.

Comments on individual issues

Horizon Power individually addresses each of the points raised in the issues paper for the Synergy inquiry below. However, this submission concentrates more on the potential removal of (currently subsidised) uniform tariffs for large contestable business customers and the modelling of the carbon price. This is because any proposed changes in these two areas will have the greatest impact for Horizon Power's revenue and operating costs.

1. From the current list of uniform tariffs, which tariffs could be amalgamated and why? What are the benefits (if any) of having fewer uniform tariffs?

As Horizon Power utilises the same uniform tariffs as Synergy, we should be consulted in advance of any proposed changes to tariff classes or tariff structure resulting from this inquiry. With full consultation Horizon Power will be able to assess and advise on the potential implications for our revenues and costs.

Overall, Horizon Power supports simplicity and transparency with respect to tariff structure as this ensures tariffs are better understood by customers and are more cost effective for retailers to administer.

Horizon Power only has small numbers of customers on the C, D (charitable organisations), N and P (federal and government institutions) tariff classes. Consequently, it would be advantageous if these customers could be transferred to the more general L and M tariff classes, depending upon the individual customer's consumption level. Fewer tariff classes would be simpler to administer and may help to reduce Horizon Power's operating costs around billing and account administration. However, Horizon Power realises that, particularly for tariffs relating to charitable organisations (tariff classes C and D), changing to general non-domestic tariffs would need to be accompanied by an additional subsidy either paid directly to, or claimed by the charitable organisation. As noted above, providing subsidies outside the tariff structure avoids distorting the actual cost of consumption.

- 2. Should uniform tariffs, which are currently subsidised from cost-reflective levels, continue to be available for large, contestable business customers or should these be phased out? Please provide the reasoning behind your response.**

Overall, Horizon Power supports cost-reflective tariffs on principle for large, commercial customers. However, Horizon Power does note that many small business customers in regional Western Australia on existing uniform non-domestic tariffs (L2 and L4) are already experiencing increased financial pressure given the recent history of uniform tariff rises. Many of these customers, e.g. local service stations with attached retail premises, or local hotels are vital to the communities they serve. Therefore, if the Economic Regulation Authority finds that non-domestic tariffs have to rise significantly to reach cost-reflective levels this will place further pressure on customers that are already financially stressed. If, in such a situation, the business owner decides to close their business or relocate to another area this could have a detrimental effect on a community, particularly smaller communities.

With tariff classes for contestable, franchise business customers set at cost-reflective levels, Horizon Power may need to develop a commercial pricing plan to offer an alternative to franchise tariffs. This will require significant planning to develop and administer such a plan, to communicate tariff and pricing changes to customers and to understand the revenue and cash flow implications that result from customers switching between commercial pricing and cost-reflective franchise tariffs.

In Appendix A, Horizon Power has provided an outline of previous discussions we have had with the Minister for Energy and the Office of Energy regarding the contestable threshold. This appendix is provided on a confidential basis and is not intended for publication.

- 3. How should the efficiency of Synergy's wholesale energy procurement be assessed? What are the indicators of an efficient wholesale procurement process?**

Horizon Power understands that the detail of wholesale procurement contracts is commercial in confidence. However, Synergy should be able to demonstrate the efficiency of its wholesale electricity procurement processes. The indicators of an efficient process would include for example, an open tender process, publication of the selection criteria used to compare and select from alternative tenders and the timely announcement of the successful bid.

- 4. How should the efficiency of Synergy's procurement of renewable energy certificates be assessed? What are the indicators of efficient procurement of renewable energy certificates?**

Similar to the procurement of wholesale electricity, Synergy should be able to demonstrate the efficiency of its processes to procure renewable electricity and renewable electricity certificates. The indicators of an efficient process are outlined above.

Synergy, if procuring efficiently, should also be able to demonstrate that, over a given period, the cost of procuring renewable energy and/or renewable energy certificates is less than the equivalent penalty payment.

5. What issues and risks should be taken into account when determining an efficient retail margin for Synergy?

Synergy's retail margin needs to reflect the systematic risks to which Synergy's shareholder, the Western Australian Government, is exposed by investing in the Western Australian energy sector. Therefore, Synergy's retail margin will need to reflect the inherent volatility in:

- the global economy as this determines demand for and supply of resources and commodities;
- the resources and commodity sectors generally, as these affect how and when projects are scheduled which in turn impacts upon the requirement to provide supporting infrastructure;
- the availability and price of primary fuel (such as Natural Gas) for electricity generation; and
- the Wholesale Electricity Market (WEM), particularly whilst the Market Rules are continuing to evolve.

To ameliorate these risks the electricity industry generally requires more stability with respect to the future of the energy sector, e.g. planning, policy, fuel costs and availability. However, Horizon Power notes that some of this information may crystallise as the detail of the Strategic Energy Initiative emerges from the Office of Energy.

6. Do the current service standards against which Synergy has to report provide a comprehensive picture of its retail performance? If not, what additional service standards would be useful and why?

The retail service standards in the South West Interconnected System (SWIS) are replicated in regional Western Australia, which places an onerous operational requirement on Horizon Power given the low density of its customer base and long travel distances. This is especially relevant with regards meter reading (and so bill accuracy and frequency), disconnections and reconnections. Consequently, Horizon Power would support:

- a review of service standards by region, to include regional Western Australia and the more rural areas serviced by Synergy. With a view to relaxing service standards in more remote regions to recognise the operational issues involved; or
- additional funding to be included in Synergy's operating and capital expenditure to enable retail service providers and their suppliers to introduce Advanced Meter Infrastructure (AMI) to enable remote reading and disconnection/connection to support current service standards.

7. How often should cost-reflective tariffs be determined for Synergy (please explain the reasoning for any timeframe suggested)?

Horizon Power would support a quinquennial review (every 5 years) of cost-reflective tariffs for Synergy, combined with the same review period for the setting of network tariffs for Western Power. The benefits of this longer review period are the increased security over future revenue streams; and the deployment of a longer 'glide path' over which to introduce tariff changes and so avoid price shocks for electricity customers. However, price-setting mechanisms or 'triggers' would need to be introduced to call for an interim tariff review if agreed economic or

market elements differed markedly to the assumptions made at the last quinquennial review.

Furthermore, the suggestion for a quinquennial review is highly dependent upon how the carbon price is translated into retail tariffs. Once the carbon price 'floats' at the market price, this may necessitate more frequent cost-reflective tariff reviews to capture the anticipated variability of a market price for carbon.

8. How should the new carbon price be included in the modelling of cost-reflective tariffs in this inquiry?

There exists considerable uncertainty around how the carbon price will impact upon retail electricity customers. Horizon Power welcomes any clarification of this issue that may result from the inquiry.

The Clean Energy Plan states that the carbon price is 'set' for 3 years from 2012/13 to 2014/15) then reverts to an emissions trading scheme. The inquiry covers the period 2012/13 to 2015/16. Consequently, the inquiry will need to consider Synergy's obligation in both the fixed and floating phases of carbon pricing.

Regardless of the extent to which the carbon price impacts upon retail electricity tariffs, there is a considerable administrative requirement for retailers to administer the carbon price, translate this into information on customer's bills and educate and inform customers generally on carbon pricing.

Horizon Power is currently unclear as to how the carbon price will be integrated within uniform tariff classes. For example Horizon Power could either:

- adopt the same carbon 'element' in retail Uniform Tariffs as Synergy; or
- Horizon Power (and other retailers) can develop an individual retail tariff carbon 'element'. Horizon Power, for example, would have to assess its retail carbon element based on Horizon Power's eligible carbon emissions for self-generation and Power Purchase Agreements (PPAs), probably on a monthly basis. This monthly carbon 'element' would then have to be apportioned across tariff classes and billed.

Furthermore, once carbon reverts to a market price post 2015, how is the potential variability of this price captured on customers' bills? The approach floated in the Clean Energy legislative package suggests dealing with certain fuels and fuel users through the fuel excise and tax credit regime. When the price floats, companies will need to apply a carbon price to their eligible fuel use in order to determine their (reduced) tax credit. The carbon price suggested in federal legislation is the average of the previous six months carbon price. In the absence of any alternative suggestions, Horizon Power supports adopting the federal approach, of an average six month carbon price when the carbon price floats, and using this to provide meaningful information for customers' bills.

There will also be a considerable customer information and education programme required to explain the impact of the carbon price upon retail electricity bills. The costs and complexity of this information programme will be influenced by several factors:

- The extent of diversity in the service provider's customer base will dictate the variability of the information on carbon pricing that is communicated to different customer groups. For Horizon Power, the diversity in our customer base is significant, e.g. remote indigenous communities, small business owners, resort hotels, etc. Consequently, Horizon Power will

need to develop a variety of different information on carbon pricing to communicate to these different groups of customers.

- Similarly, a diverse customer base will also require the development of a variety of differing 'styles' of communication to different groups. This could range from information supplied on or with customers' bills, to direct personal briefings or presentations to representative customer or industry groups.
- Any potential increase in retail electricity bills, such as the inclusion of the impact of a carbon price, should also be accompanied by information on energy saving to enable customers to modify their electricity usage and help to reduce electricity bills. This requirement provides further support for the provision of timely consumption data for customers such as is supplied through Advanced Metering Infrastructure.

In conclusion, Horizon Power advises that the instigation (e.g. development of policy, revisions to billing planning and procedures) and ongoing administration of the impact of the carbon price upon the billing process should not be underestimated. In addition to the direct effect of the carbon price on the cost of electricity generation, there is a considerable increase in operating costs, and possibly capital costs if upgrades or revisions to billing and customer information systems are required, to introduce and administer this additional element of customers' bills.

9. Given the regulatory methodology outlined in this issues paper, are there any other issues for the Authority to consider in conducting this inquiry?

Horizon Power has no additional comments to make in response to this question.

Concluding remarks

Horizon Power is pleased to take the opportunity to respond to the issues paper for the inquiry into the efficiency of Synergy's costs and electricity tariffs and looks forward to the recommendations of the draft and final reports.

Horizon Power does wish to reiterate that if the inquiry recommends any changes to tariff classes or tariff structure then, given the mirroring of uniform tariffs for regional electricity customers, it is imperative that Horizon Power is fully consulted on any proposal so that the impact of the changes upon Horizon Power's revenue, costs and hence subsidies is fully understood.

Yours sincerely



DAVID TOVEY
COMPANY SECRETARY, MANAGER EXTERNAL AFFAIRS

Att.

APPENDIX A: COMMERCIAL IN CONFIDENCE

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]



