ActewAGL

Retail Prices for Non-contestable Electricity Customers 2009-2010

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ActewAGL Retail Response to Independent Competition and Regulatory Commission Issues Paper -
Retail Prices for Non-contestable Electricity Customers 2009-2010

ActewAGL

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1. Introduction

On 23 December 2008 the ACT Government issued a Terms of Reference for the Independent Competition and Regulatory Commission (the Commission) to provide a price direction for the supply of electricity to franchise customers for the period from 1 July 2009 to 30 June 2010. This paper responds to an Issues Paper released by the Commission in February 2009.

ActewAGL Retail (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 being in place for the last four years. However, continuing regulation of retail prices in a competitive market place threatens to deny consumers the benefits that flow from a truly competitive market, free of any regulatory distortion.

ActewAGL notes that the Australian Energy Market Commission (AEMC) found evidence of effective retail competition in Victoria 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. In place of price regulation, the AEMC recommended a flexible and efficient approach to keeping prices in line with costs, mainly through consumer protection, price monitoring and reporting initiatives.

ActewAGL agrees with the Commission's comments that "the approach adopted in Victoria perhaps provides a starting point for consideration of what should be the next step to facilitating full retail competition in the ACT."[1] ActewAGL further notes the Commission's concerns that "the current arrangements whereby the Commission plays such a significant role in determining the price for both negotiated contracts and non-negotiated contracts in the market is not sustainable or economically efficient and may in fact be reducing the long-term competitiveness of the market."[2]

ActewAGL believes that while the Commission is required under the Terms of Reference to provide a price direction for the supply of electricity to franchise customers with regard to the requirements of section 20 of the Independent Competition and Regulatory Commission Act 1997 (the ICRC Act), the Commission can continue to take steps in its 2009/10 decision to move prices closer toward those that would be available in a fully competitive environment. This would benefit consumers by facilitating increased competition in the retail electricity market.

In doing so, ActewAGL proposes important changes to the operation of the Commission's purchase/hedging cost model. While ActewAGL initially expressed concern with a number of elements of the model when it was first introduced in 2007, it nevertheless accepted that it did provide certainty and consistency to the transitional process and noted the Commission's

[1] ICRC 2009, p. 5
[2] ICRC 2009, p. 5

reasoning for implementing the method: that from the Commission's perspective, it would best meet the competing requirements in section 20 of the ICRC Act. However, with the ACT Government's intention to continue with a period of regulated prices in a competitive market, it is 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 important enhancements to the model in section 2.2 in order to more accurately reflect commercial market operations and benchmarks.

ActewAGL also proposes that the Commission adopt an approach as in NSW where retail operating costs and margins are based on those of a mass market new entrant. That is, regulated tariffs are based on commercial benchmarks that reflect efficient new entrant retail operating costs and margins. While the actual operating costs for the ACT may differ from those set for NSW, due to specific factors in the ACT such as the smaller customer base and lower economies of scale, the inclusion of customer acquisition costs and other costs that may be incurred by a new entrant is necessary to facilitate competition amongst participating and potential new entrants. The ACT is currently the only jurisdiction where the regulated retail tariff does not include an allowance for customer acquisition costs.

ActewAGL notes that the Commission has highlighted the AER's draft decision on distribution charges that has provided for an increase of 13.82% real in 2009/10. The Commission's retail decision regarding the Transitional Franchise Tariff (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.

In summary, the main components of ActewAGL's response are as follows:

- ActewAGL supports the use of the Commission's purchase cost model, subject to enhancements, for determining purchase costs for 2009/10.
- As part of the enhancement to the purchase cost model, an updated component that properly reflects the additional management of purchase risk, also needs to be included. To date this extra cost has been incurred and absorbed by ActewAGL Retail and not compensated in TFT regulatory decisions. This cost component represents the additional costs to the retailer to cover the inefficiency of swap contracts (selling back into the pool when 'long'), cap limited spot exposure when 'short' and premiums paid for cap instruments above that allowed by the Commission.
- ActewAGL proposes retail costs that include retail operating costs, plus customer acquisition costs.
- ActewAGL believes that the allowed retail margin should remain set to at least 5% applied to total retail costs in 2009/10.
- Full pass through of network costs for 2009/10 as approved by the AER.

- 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 for smart metering also be included as pass through provisions.

ActewAGL requires prices to continue to be better aligned with market based costs and to fully pass through an increase in network costs as approved by the AER.

1.1 Competition in the Market

ActewAGL notes that full retail contestability has resulted in a competitive retail electricity market in the ACT and that the continuing regulation of retail prices creates significant costs which deny consumers the benefits that flow from a truly competitive market free of regulatory constraints.

The 2006 Notice of Amendment to the Australian Energy Market Agreement (AEMA) states the MCE's (Ministerial Council on Energy) objective to, "phase out the exercise of retail price regulation if competition is determined to be effective and an appropriate timeframe; or promote the growth of effective competition for those users or areas of a jurisdiction which do not enjoy effective competition."[3] The same agreement, signed 2 June 2006 by the MCE, requested the AEMC to review the effectiveness of retail competition in electricity and gas retail markets in each Australian jurisdiction (except Western Australia) and to publicly report the results.

To date, the AEMC has conducted reviews of retail competition in Victoria and South Australia, issuing Second Final Reports on 29 February 2008[4] and 18 December 2008[5] respectively. Reviews are scheduled for New South Wales in 2009 and the ACT (if required) in 2010. In its Victorian and South Australian reviews, the AEMC found that competition has been effective in constraining retailers' prices to reflect real input costs, and that profit margins were at or below competitive levels. That is, the AEMC found evidence of effective retail competition in both jurisdictions. Accordingly, the AEMC recommended to each jurisdiction that the regulation of standing offer retail prices for gas and electricity cease at the expiration of their respective current price determinations. In place of price regulation, the AEMC recommended a flexible and efficient approach to keeping prices in line with costs, mainly through consumer protection, price monitoring and reporting initiatives. These include:

- Maintaining the obligation for retailers to offer to supply energy to residential customers;
- Requiring retailers to publish the prices at which they will offer to supply and sell energy;
- Introduction of a regime to monitor and report publicly on these published offer prices for at least 3 years after retail price regulation ends;

[3] COAG 2006, p.29
[4] AEMC 2008a.
[5] AEMC 2008b.

- Undertaking an awareness campaign to assist consumers in negotiating the transition to deregulated energy retail prices; and
- Enabling jurisdictions to seek the AEMC's advice on the continued effectiveness of retail competition and, conditional on the AEMC's advice, the powers to re-regulate retail energy prices.

As stated above, 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 from 2010/11.

2. Technical Matters

2.1 Methodology

ActewAGL believes that the broad approach proposed by the Commission and used in past reviews is still appropriate:

> In estimating the individual cost components, the Commission draws on benchmark cost information available in the marketplace or in other regulatory decisions within the retail electricity sector in Australia.[6]

However, ActewAGL believes that it is not necessary to limit the decision to "estimating the economically efficient cost base of an *incumbent* [emphasis added] electricity retailer providing retail electricity supply services to a regulated customer segment."[7] ActewAGL believes that the Commission's recent decisions whereby it has based its decision on the benchmark cost base of an incumbent retailer has been a contributing factor in impacting the level of competition in the ACT.

ActewAGL proposes that the Commission adopt the approach taken in NSW for setting retail operating costs and margins where they are based on those of a mass market new entrant. This reflects efficient new entrant retail operating costs and margins.

In relation to purchase costs, the Commission's energy purchase cost model was developed to assist in understanding the purchase cost of energy[8]. ActewAGL has reviewed the model and identified where the assumptions in the model could be strengthened to better reflect the activities of an efficient electricity retailer in the marketplace. This is discussed in more detail at sections 2.2 and 2.3 below.

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[6] ICRC 2009, p. 7
[7] ICRC 2009, p. 7
[8] "For its final decision on the price direction, the Commission has continued to use current market data and a number of assumptions about an ideal electricity retail hedging strategy to understand the reasonable electricity purchase costs that might be faced by an incumbent retailer in the ACT." ICRC 2007, p. 31

2.2 Energy purchase costs

The Commission noted in its 2008 Final Report that "the issue of the wholesale energy market clearing price is extremely important in the decision about the TFT level."[9] ActewAGL fully concurs with this statement.

Given the price volatility of wholesale electricity prices experienced in recent years, ActewAGL is in a difficult position as a result of continuing price regulation. ActewAGL is required to purchase energy to cover the energy requirements of its customers but has had no certainty regarding the price that it is able to charge its customers beyond the current year.

Without price regulation, ActewAGL would be free to respond to market signals and to hedge its energy purchases without the constraint of its prices being based on a set of hypothetical hedging arrangements. ActewAGL believes that removing such regulatory measures and the associated risks and implications, would benefit consumers in the ACT.

In its Issues Paper, the Commission describes its purchase cost model as follows:

> The Commission cannot readily observe directly the actual cost of electricity to the incumbent retailer as this cost is comprised of a myriad of contracts and supply arrangements which are negotiated at various points in time in advance or over the year for which the TFT is set. However, this cost can be estimated using publicly available market data on historical and future electricity prices combined with a range of assumptions aimed at mimicking the purchasing activities of an electricity retailer.[10]

While ActewAGL had initially expressed concern with elements of the model, it noted the Commission's view that it would best meet the competing requirements in s20 of the ICRC Act. However, there have been ongoing concerns that the model may not present a reasonably accurate or valid measure of purchase costs, particularly in recent times because of the lack of trades to populate the model given continuing uncertainty with electricity market structure and ownership in NSW and the prospect of a carbon pollution trading scheme. To some extent these matters will now be more relevant to the setting of prices from 2010/11, so ActewAGL can support continued use of the purchase cost model process for 2009/10.

ActewAGL believes that the model must be adjusted to more accurately reflect the realities facing a retailer in a commercial environment. ActewAGL can no longer absorb the impacts of a modelled outcome on purchase costs unless it more accurately reflects commercial market operations and benchmarks.

Prudent Hedging arrangements

The Commission provides a simplified version of the application of a portfolio purchasing approach to derive a purchase cost.

[9] ICRC 2008a, p. 9
[10] ICRC 2009, p. 8

However, ActewAGL notes that one of the measures in the model does not accurately reflect prudent purchasing behaviour. The Commission has assumed:

> that the retailer hedges to 105% of forecast load at the beginning of the delivery period.[11]

ActewAGL can advise that this is not enough to fully cover a retailer for its hedging requirements. If a retailer is not fully covered, it faces significant exposure to price variations in the event that its load shape differs from forecast.

Furthermore, the Commission has assessed that the 105%:

> is a conservative estimate and ensures that the retailer is unlikely to be exposed to spot market prices.[12]

However, the 105% hedge assumption is too low and, far from being conservative, it significantly under weights the true position. It is not a realistic measure of this component because it would expose the retailer to spot market prices, which is not an acceptable position for a prudent retailer or ActewAGL.

In order to mitigate this exposure, a prudent retailer undertakes to take commercial cover by using a mix of swaps and caps to manage an electricity portfolio. Retailers will typically hedge their average energy load with swaps and their remaining exposure with caps. ActewAGL estimates that the necessary cost to cover a prudent retailer is significantly greater than 105% of the energy purchase cost and the basis for this is discussed in detail in section 2.3 below.

2.3 Energy, Hedging Contract and Management Costs

The energy contract and management costs include the cost of maintaining an energy trading desk. In addition there are hedging costs which retailers pay to minimise exposure to the spot market.

As discussed in section 2.2, ActewAGL believes that the current assumption in the purchase cost model that a retailer hedges to 105% of forecast load does not represent the behaviour of an efficient and prudent operator.

A prudent retailer will adopt two types of hedging contracts: swaps and caps. A retailer is fully exposed to the spot market if it does not have a swap contract to cover that load.

Swaps are effectively contracts to purchase a defined amount of energy at a certain time at a certain price. Prudent retailers purchase swaps for quantities up to the maximum of the average demand of all half hour periods within defined peak and off-peak times. More often than not, the 30 minute settlement price in the spot market will be lower than the price the swap contract was struck at. Retailers must make a difference payment to the generator for the entire volume traded under the swap contract in addition to the spot price payment made

[11] ICRC 2009, p. 8
[12] ICRC 2009, p. 8

to NEMMCO. The generator makes a difference payment to the retailer when the spot price is above the swap contract.

When actual demand is higher than the contracted amount under the swap contract, the retailer is exposed to the spot market price for the 'short' volume. To minimise the risk of a high spot price, retailers purchase 'insurance' in the form of a cap that limits their exposure, usually to $300/MWh. Caps may be purchased for both peak and off-peak periods and are priced accordingly. Prudent retailers purchase caps for the *difference* between the *maximum* of the maximum daily demands and the *average* of the maximum (swap level) daily demands of all half hour periods within defined peak and off peak times. The 'payout' from a cap instrument is the difference between the spot price and the 'strike' price ($300/MWh) multiplied by the size of the cap. This 'payout' is paid on all half hour periods when the spot price exceeds the 'strike' price of the cap.

A retailer *could* purchase a swap contract for quantities of energy up to the maximum of the maximum daily demand of all half hour periods within defined peak and off-peak times and not use a cap instrument. With this strategy the retailer expects to belong in the market virtually all the time; the retailer is exposed to the spot market *only if* demand exceeded previous record highs (used to set the swap contract). A prudent retailer would not use this strategy because it results in larger difference payments to generators for the difference between the contracted swap price and the spot price (noting again, more often than not, the 30 minute settlement price in the spot market will be lower than the price the swap contract was struck at). The difference payments are larger because they are made on a larger volume of energy under the larger swap contract.

By utilising cap instruments in conjunction with swaps, the prudent retailer *reduces the overall cost* of hedging because the reduction in difference payments under the smaller swap contract exceeds the total cost of the cap instrument (premiums *less* 'payouts'). The overall cost of purchasing and hedging would be approximately 5% greater if the retailer were to use swap contracts alone.

Retailers not only have to pay for their swap contracts for the energy used, but when demand is low and the retailer is 'long', retailers must make difference payments for the energy not used. During periods of low demand, spot prices tend to be lower than the swap contract price so the retailer makes a loss on the surplus electricity sold back into the pool. These are costs for energy that the retailer did not sell to consumers. When demand is high and the retailer is 'short', additional energy is sourced from the pool to meet the high demand. During periods of high demand, spot prices tend to be high and can reach as high as $10,000/MWh. The cap instrument limits the retailer's exposure to high spot prices by capping the price paid per MWh to the 'strike' prices (usually $300/MWh).

ActewAGL knows that the overall cost of these hedging arrangements adds a significant amount to the cost of the energy. Whilst net returns year on year for cap instrument are generally negative, prudent retailers must take out cap products to insure against very high spot outcomes when actual demand is higher and the retailer is 'short'. Caps are like any insurance product, they are essentially a cash-flow smoothing instrument. Several hours of

VOLL ("Value of Lost Load" noting that the price of VOLL is $10,000 per MWh) coincident with a retailer being 'short' can cost tens of millions of dollars in a single day.

Therefore ActewAGL proposes that the purchase cost be increased to better represent the prudent costs for managing risk and meeting the demand or energy for this regulated market segment.

2.4 Green Costs

ActewAGL has estimated its Green Costs are made up of a cost to meet liability under the Mandatory Renewable Energy Target (MRET) and a cost to meet liability under the Greenhouse Gas Abatement Scheme (GGAS).

2.5 Energy Losses

The distribution loss factors and transmission loss factors for 2009/10 are not yet available. There are two transmission loss factors for the ACT: one for energy supplied at 132 kV from Canberra and the other for the 66 kV supply from Queanbeyan. As the bulk of the supply to TFT customers in the ACT is through the 132 kV supply point, it is proposed to use the transmission loss factor for that supply point.

2.6 National Electricity Market Fees

It is proposed that the National Electricity Market (NEM) fees for 2009/10 be the same as those that the Commission adopted for the 2008/09 TFT adjusted for inflation.

2.7 Retail Operating Costs

As identified by the Commission in its Issues Paper, the costs incurred by the incumbent retailer in providing retail services to TFT customers include "billing services, including meter reading; call centre costs; customer information costs; and general operating overhead costs."[13] Another component of retail operating costs is "the cost of acquiring new customers"[14] or customer acquisition costs.

The retail operating cost component of the TFT was first derived in 2003. Since then, increases in the retail operating costs component have moved in line with inflation, with no allowance for customer acquisition costs. ActewAGL believes that the resulting operating cost in 2008/09 does not account for recent movement in these costs for the industry.

However, ActewAGL proposes that the estimate of retail operating costs be increased by CPI in 2009/10, but it is essential that an allowance also be made for customer acquisition as discussed below.

[13] ICRC 2009, p. 11
[14] ICRC 2009, p. 11

Customer acquisition and retention costs

ActewAGL believes that the retail operating cost component of the transitional franchise tariff does not reflect the efficient costs of a mass market new entrant as it does not incorporate an allowance for customer acquisition and retention costs. ActewAGL believes regulated tariffs must be based on commercial benchmarks and incorporate an allowance for customer acquisition and retention costs.

ActewAGL originally proposed that customer acquisition and retention costs be incorporated in its submission to the Commission's review of transitional franchise tariffs in 2007. This followed the inclusion of customer acquisition and retention costs in NSW. The Commission originally accepted, in its 2007 Draft Decision, that customer acquisition and retention costs should be included, but this was not incorporated in the 2007 Final Decision.

ActewAGL also proposed that customer acquisition and retention costs be incorporated into the transitional franchise tariff in its 2008 submission. ActewAGL advised that it did not believe that "these costs should be used as a balancing tool"[15] and that it "does not believe it is appropriate to make a zero allowance for customer acquisition and retention costs in the retail operating cost"[16]. In its 2008 Price Direction, the Commission did not incorporate customer acquisition and retention costs in its estimate of retail operating costs.

Over this period, the Commission has presented reasons why it has not included customer acquisition and retention costs in its estimate of retail operating costs. In 2007, the Commission stated its belief that "the negative social impact of the inclusion of such costs in this instance outweighs the need to reduce barriers to new entry. The Commission recognises that the use of an external benchmark for these costs supports the aims of section 20(2)(a), (e), (i) and (j), but that those objectives deserve lower weight than the negative social impacts of inclusion of these costs."[17] In 2008, the Commission stated that by deciding to exclude customer acquisition and retention costs it believed "it has met the requirements of the terms of reference and the social impacts of its decisions"[18].

ActewAGL recognises the difficult task facing the Commission of balancing the requirements of s. 20(2) of the ICRC Act. However, ActewAGL believes regulatory distortions can also create unintended social costs. The Commission has acknowledged that, "the current arrangements…may in fact be reducing the long-term competitiveness of the market".[19] This is contrary to the current policy of the ACT Government as demonstrated by being a signatory to the COAG Agreement to Implement the National Competition Policy and Related Reforms. The Commission itself has stated:

> the Commission believes that the development of competition would likely be fostered by allowing these costs into the cost recovery for the TFT customer base. This would support the objective of s. 20(2)(c) by reducing the barrier to entry for competing electricity

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[15] ActewAGL 2008, p12
[16] ActewAGL 2008, p11
[17] ICRC 2007 (Final), p39.
[18] ICRC 2008, p46
[19] ICRC2009, p.5

> retailers, which would allow competing price discounts to be offered to the TFT customer base.

ActewAGL proposes that the Commission now include customer acquisition and retention costs. At present, the ACT is the *only* jurisdiction in which these costs are not recognised as legitimate retail market costs based on external benchmarks, and their continued exclusion will only continue to undermine the benefits of competition which the Commission notes can be reaped by:

> vigorous competition at the retail level among electricity retailers sourcing electricity from a competitive and hence efficient wholesale market for electricity will be in the best long-term interests of consumers.[20]

The Commission has also argued that it "does not believe that further cost increases relating to customer acquisition and retention costs for ActewAGL Retail are necessary, as the costs for its current migration strategy appear to be already covered."[21]

Given that the allowance for ActewAGL's operating costs has only been increased by CPI in recent years and do not reflect changes in industry costs over this period, the Commission's assertion that the allowed retail operating cost already covers the cost of acquisition cannot be supported.

ActewAGL has noted a reduced level of competitor activity in the ACT market during 2008/09 compared to previous years. In addition, no new competitors have been observed to enter the market. ActewAGL can speculate that this is at least partly driven by a TFT which is below a sustainable, commercial electricity market price.

ActewAGL believes that the retail operating costs for 2009/10 must now include the customer acquisition costs in order to set a TFT at a level closer to market price to reflect prudent and efficient retail benchmarks and achieve the full benefits of competition in the ACT marketplace.

2.8 Retail margin

ActewAGL has consistently argued for a minimum 5% retail margin since the introduction of the transitional franchise tariff in 2003. A 5% margin was accepted in the Commission's 2008 decision and welcomed by ActewAGL. However, ActewAGL has noted recent submissions by retailers in other states have confirmed that a 5% retail margin is below a competitive market outcome.

In its submission, AGL argued that:

> the minimum bottom-up retail margin should be 12.1% of WEC+ROC because benchmark retail margins exhibit an asymmetric risk. If the benchmark costs and margins are set below realistic levels then competition and investment are likely to be stifled. However, if

[20] ICRC 2008, p12.
[21] ICRC 2008a, p. 29

> margins are set above realistic levels then any benefit is likely to be competed away as other retailers seek to attract standing contract customers.[22]I

In their Final Report for 2008-2010 prices, the Essential Services Commission of South Australia (ESCOSA) adopted a 5% (or 10% of WEC + ROC) Retail Margin. APG, Origin and Energy Australia all proposed that 5% was too low, arguing that it did not reflect the risks or costs faced by retailers. [23]

Queensland Competition Authority (QCA) also elected to keep the retail margin at 5% in its December 2008 Draft Decision for 2009-10 prices. They reasoned that this will provide a reasonable return for a retailer whose risks have not changed since the previous year. This retail margin is calculated on total retail costs (energy costs, network costs and retail costs).

ActewAGL has required that a retail margin of at least 5% be applied to total retail costs and this should be maintained as a minimum for the 2009/10 period, consistent with the margin applied to comparable entities in other states.

2.9 Transmission and Distribution Network Costs

ActewAGL notes that the Commission has highlighted the AER's draft decision on distribution charges that has provided for a real increase of 13.82% in 2009/10 and the Commission's accompanying comment:

> If the TFT was to remain unchanged from its 2008-09 level, other cost elements would need to fall to offset this increase in distribution charges.[24]

ActewAGL notes that the Commission's decision regarding retail costs cannot be influenced by factors such as distribution costs, over which ActewAGL Retail has no control.

The average network costs for the customers remaining on the TFT will depend on the outcome of the AER's Final ACT Distribution Determination.

3. Non-Technical Matters

3.1 Social Impacts

ActewAGL notes that the Commission has reiterated its statement that "the TFT was never intended to be a safety net measure for more vulnerable customers."[25]

ActewAGL believes that the best way for the Commission to take account of the social impact of its decision regarding the TFT is to implement measures that will best accelerate

[22] ESCOSA 2007 p 71.
[23] QCA 2008, p 36.
[24] ICRC 2009, p. 12.
[25] ICRC 2006, p. 53.

competition in the ACT, thereby improving the benefits to consumers that flow from a truly competitive market, free of regulatory constraints and distortions.

ActewAGL has proposed a number of measures to achieve this in the submission, including adjusting the hedging model to better account for the risk facing retailers in purchasing energy in the current market and the inclusion of customer acquisition costs to bring the ACT in line with other jurisdictions.

In accord with the Commission[26], ActewAGL supports the use of targeted concession arrangements as the best means of supporting vulnerable customers to manage their electricity accounts. Where the Government is able to identify particular social equity or affordability issues, these should be addressed through direct, transparent government payments, not through price controls, which have the potential to inhibit competition and have other unintended consequences. Electricity customers are also afforded protection under consumer protection laws and ActewAGL's customer hardship programs. Further ActewAGL offers a range of flexible payment options to assist its customers, such as "Even Pay" and "Budget Pay" which effectively smooth a customers billing cycle for seasonal load, assisting households to effectively budget for energy purchases.

3.2 Pass-through arrangements

ActewAGL believes that, although this TFT decision will only apply for one year, the inclusion of certain pass through provisions is important given the current climate where potential changes can impact the business at any time.

ActewAGL suggests that the following four issues require pass through arrangements in the Commission's determination and each is discussed in turn below.

- Feed-in Tariff
- Environmental Initiatives
- Smart Metering
- Network Tariff Change

Feed-in Tariff

On 1 March 2009, the ACT Government introduced a feed-in tariff (FiT) scheme to apply to renewable energy produced by small generation systems and fed back into the electricity network. Under the FiT Scheme, customers are paid for the gross output of their generation installation for a period of 20 years. The rate to be paid over the 20 years is generally determined by the date of connection of the generation unit. The FiT rate can be set by the ACT Government each year, with a default formula in the FiT scheme legislation if the ACT

[26] ICRC 2009, p 15.

Government does not set a rate. The ACT Government has set the current FiT rate until 30 June 2010.

This scheme has potentially large financial and administrative implications for ActewAGL. ActewAGL must ensure it is no worse off as a consequence of the policy. The costs imposed on it could include not only the cost of the tariff but any costs it was required to incur to help implement, manage, administer, report, publicise or advise on the scheme. This would include any cash flow or holding costs incurred as a result of the timing of payments to customers and the re-imbursement from the networks business.

As well, ActewAGL Retail understands that ActewAGL Distribution has sought the inclusion of the FiT in its electricity network prices that are to be determined by the AER. ActewAGL Retail is assessing how it will be separately impacted by the introduction of the FiT, including increased exposure to the spot market. ActewAGL Retail will endeavour to assess the financial implications of the scheme and advise the Commission during the course of this review.

Given the ACT Government's expectation to announce Stage 2 of the scheme in June 2009, ActewAGL believes that the cost pass through mechanism regarding the FiT that was incorporated into the 2008/09 final decision should be maintained so that any incremental costs can be recovered in full once the details and the financial implications are known.

Environmental Initiatives

The ACT and Commonwealth Governments are continuing to actively consider policies to manage carbon emissions. ActewAGL notes the Commission's statement that "the need for the inclusion of pass-through arrangements in the price direction for 2009-10 may…have been reduced"[27] as "the Commonwealth Government has stated that the Carbon Pollution Reduction Scheme will commence from 1 July 2010."[28] However, ActewAGL is also aware that the ACT Government is considering a range of separate and related initiatives and that there is sufficient uncertainty regarding environmental initiatives and potential implications for electricity costs during the 2009/10 financial year that a broader pass through mechanism be developed to apply in 2009/10 to recover any costs that may arise from any new initiatives during the period.

Smart Metering

The MCE has released an exposure draft of legislation amending the National Electricity Law (NEL) to support the national smart metering framework. The proposed amending legislation creates a power for jurisdictional Ministers to make a determination requiring the relevant distribution business to undertake a smart metering pilot or trial, or full rollout in a particular jurisdiction. The intention of the legislation is to create a mechanism whereby distribution businesses can ensure cost recovery of smart metering pilots, trials and rollouts where

[27] ICRC 2009, p 16
[28] Ibid, p 16

jurisdictional Governments deem that these actions are necessary. The proposed amendments are intended to come into effect on 1 July 2009.

While the proposed legislation focuses on distribution business cost recovery, retail businesses will also incur significant costs where smart metering pilots, trials and rollouts are mandated. In particular, retail businesses face significant billing system and data management costs incurred to support new functionality available through smart metering. These costs can arise through the operation of a pilot or trial where full end-to-end business processes are being tested.

The proposed amendments to the NEL do not address retail cost recovery as retail pricing in jurisdictions where retail regulation is still in place remains the responsibility of jurisdictional Governments.

ActewAGL considers that it is appropriate that the 2009/10 determination reflect the possibility that the ACT Government will issue a smart metering trial, pilot or rollout determination under the amended law during the price determination period. ActewAGL therefore proposes that a smart metering determination made under the NEL be included as a pass through event in the 2009/10 determination.

This event should cover both a change in network tariffs in the period resulting from a network pass through event in respect of smart metering, as well as the pass through of retail costs associated with the trial.

Distribution Network Tariff Change

Mechanisms under the National Electricity Rules, in particular pass through mechanisms, create scope for network tariffs to change during a regulatory year. ActewAGL Retail considers that it should not bear the risk of a potential change in network tariffs and should not be required to carry these costs for any remaining period of that year. Therefore, ActewAGL will require an ability to pass through these costs during the financial year.

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