



ICRC

independent competition and regulatory commission

## **FINAL DETERMINATION**

### **Investigation into Retail Prices for Non-Contestable Electricity Customers in the ACT**

**May 2003**



The Independent Competition and Regulatory Commission is established under the *Independent Competition and Regulatory Commission Act 1997* (ICRC Act). The Commission's functions are set out in section 7 of the ICRC Act

The Commission is made up of three Commissioners:

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Robin Creyke, Commissioner  
Peter McGhie, Commissioner

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## FOREWORD

In December 2002, the Treasurer issued a reference to the Independent Competition and Regulatory Commission (the Commission) to investigate and determine retail tariffs for services provided to franchise electricity customers after the introduction of Full Retail Contestability (FRC) on 1 July 2003.

The electricity supply industry in the ACT was opened for retail competition to customers consuming greater than 100 Megawatt/hours (MWh) per annum from 1 July 2001. In its report, Full Retail Contestability of Electricity in the ACT, July 2002 (FRC Report), the Commission recommended that FRC be introduced for all customers in the ACT. The Government has determined that this will occur from 1 July 2003.

Contestable electricity tariffs are made up of regulated transmission and distribution charges, a generation charge based on a competitive market for electricity supply to retailers, the retail service costs (including costs associated with customer contact, billing and customer transfers between retail suppliers (churn), cash collection, and electricity market risk hedging) and a commercial retail margin. In a contestable market, retail costs and margins are subject to market pressure which drive prices to efficient levels through competition between retailers for contestable customers.

However, after FRC is introduced for all customers in the ACT, they will be able to choose whether or not, and when, they become non-franchise customers. For those customers who do not opt for supply from a competitive supplier, the Government has announced that it will allow a three year transition period during which they can remain with their existing supplier, ActewAGL Retail. The Commission will continue to determine the retail price that franchise customers will pay.

Under the terms of the industry reference issued by the ACT Treasurer (see Attachment 2), the Commission is to make a direction on the level, and structure of regulated retail prices for franchise customers consuming less than 100 MWh per annum during the three-year transition period commencing 1 March 2003. The Treasurer subsequently amended the initial industry reference on this matter to the effect that the price direction is to apply from 1 July 2003 for a period of three years.

In this report, unless the context requires otherwise, all references to the industry reference are to the amended industry reference. For the purposes of this investigation, the regulated tariffs for non-contestable customers consuming less than 100 MWh per annum will be termed Transition Franchise Tariffs (TFT). This inquiry addresses setting the TFT from 1 July 2003 to 30 June 2006. A further inquiry will be undertaken at or prior to June 2006 to determine whether the transitional arrangements should continue beyond the three year period to 30 June 2006, including whether the TFT should be extended for a further period. This further inquiry will be initiated by the Government which may, but not necessarily, issue a reference to the Commission for the inquiry.

As the current reference was issued under sections 15 and 16 of the *Independent Competition and Regulatory Commission Act 1997 (ICRC Act)*, the Commission is required to publish a draft report under section 18 and, after consultation, a final report under section 21 containing the price direction. The draft report was released in April 2003. Submissions on the draft report were received until 7 May 2003. This is the final report of the investigation.

The reference required the Commission to consider a range of matters and to provide a price direction that will be effective from 1 July 2003. In the course of its investigation the Commission has sought public submissions and information relating to the issues raised in this report. This report sets out the Commission's price direction and reasons for the particular arrangements embodied in the direction.

**Paul Baxter**  
**Senior Commissioner**  
**23 May 2003**



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## 1. Background to the Investigation

In 1995 the ACT Government, together with other Australian Governments, signed three agreements which constitute the National Competition Policy.

A major commitment in the National Competition Policy was to undertake development of a competitive national electricity market delivering benefits to the economy and consumers. It was agreed that the national electricity market would be more effective by separating the generation, transmission, distribution and retail supply sectors, establishing a central management body for the national grid and creating an independent but consistent approach to the establishment of regulated prices.

The market was to be developed gradually with targets for the structural separation of transmission, distribution and retail services being met by 1996 and the opening of the east coast grid incorporating Queensland, New South Wales, ACT, Victoria and South Australia by the end of 1997. Governments also agreed to a phased opening of the retail market to competition in accord with the assessed benefits to be derived by each jurisdiction.

In the ACT, only large volume consumers, above 160 MWh per annum, were initially made contestable from 1998. The threshold was lowered to 100MWh per annum from July 2001. The ACT market was to be fully opened to retail competition, by making consumers below the 100MWh per annum (essentially households and small businesses) threshold contestable, from 1 January 2002. The timetable was in line with FRC in Victoria and New South Wales.

Victoria and New South Wales made their markets fully contestable from that date. However a decision in the ACT was delayed pending the ACT Legislative Assembly Standing Committee on the Urban Services Portfolio inquiring into the potential benefits of FRC. The Legislative Assembly wished to consider whether there would be a net benefit to the community in exposing consumers using less than 100 MWh per annum of electricity a year to competition. The Committee could not complete its inquiry before the Legislative Assembly rose for the election in October 2001.

The Treasurer subsequently issued a reference to the Commission on 13 December 2001 to conduct an inquiry into full retail contestability in electricity for consumers using less than 100MWh of electricity per year. The Commission's FRC Report found that there were positive (albeit small) net benefits for ACT consumers arising from the introduction of FRC. On 8 October 2002 the Government determined under section 18(1) of the *Utilities Act 2000 (Utilities Act)* that the date of FRC in the ACT would be 1 March 2003. On 14 February 2003 the Treasurer deferred the date of FRC from 1 March 2003 to 1 July 2003. The Government made the deferral because of the damage caused to electricity infrastructure by the bushfires and the consequent disruptions to the electricity distributor's normal operations.



## 2. Terms of Reference for the Investigation

The terms of the reference issued by the Treasurer under section 16 of the *Independent Competition and Regulatory Commission Act 1997 (ICRC Act)* for the conduct of the investigation in relation to the industry reference requires the Commission to have regard to the requirements of section 20 of the *ICRC Act* and other specified matters. The matters specified in the reference are as follows:

- The requirements of Section 20 of the Act;
- The impact of the National Electricity Law and the National Electricity Code;
- The impact of the introduction of Full Retail Competition for Electricity in the Territory, having regard to matters including but not limited to the arrangements for Retailer of Last Resort;
- The retail prices ActewAGL charges in other jurisdictions; and
- The retail prices charged by incumbent retailers in other jurisdictions.

A copy of the reference and the associated terms of reference is provided at Attachment 2. Consistent with the deferred commencement date, the Commission's price direction has been set back from 1 March 2003 to 1 July 2003 for a period of three years.



## 3. Transition Tariffs

### 3.1 Franchise Customers

Currently, consumers using less than 100 MWh per annum are termed franchise customers in section 17 of the *Utilities Act*. Franchise customers do not have a choice about which licensed supplier of electricity will supply them. Franchise customers are connected to the franchise supplier in the ACT, ActewAGL Retail.<sup>1</sup> The conditions under which they are supplied as franchise customers are set out in the terms of a standard customer contract.<sup>2</sup>

All franchise customers are deemed to be parties to a standard customer contract laying out the rights and obligations of the customer and the supplier. The Utilities Act and its attendant codes of practice prescribe the rights and obligations of the parties, standards of service and a range of customer protection measures. Franchise customers are charged regulated prices for the supply of retail electricity and related services, determined by the Commission.

### 3.2 Full Retail Contestability

The ACT Government has declared under section 18(1) of the *Utilities Act* that electricity customers who are currently deemed to be franchise customers will be able to choose their retail electricity supplier from 1 July 2003.

In deciding to make available choice of retail supplier to this final tranche of franchise customers, the ACT Government has given consideration to the benefits to smaller customers of a right to choose a retailer on the basis of a variety of retail tariff and service offerings. There are 13 licensed retail suppliers in the ACT, and as a number of these suppliers may seek to secure customers from the tranche consuming less than 100MWh per annum, it may take some time for these newly contestable customers to decide which retail supplier they would prefer.

### 3.3 Transition Franchise Tariff

To assist these newly contestable customers in exercising their right of choice in a less pressured manner, the ACT Government has decided to provide a period of three years in which current franchise customers will be able to access a regulated Transition Franchise Tariff (TFT) provided by ActewAGL. During the three years, the TFT price will apply until such time as customers opt to exercise their choice and move to contestable retail tariff offerings provided by licensed ACT retailers.

The TFT is a regulated electricity tariff which will only be available to customers who are currently franchise customers and consume less than 100MWh per annum. The TFT will be available only for the period 1 July 2003 to 30 June 2006. Customers who choose to move to an alternative tariff offered by a licensed ACT retailer, will be able to stay with that competitive tariff, or to move to an alternative contestable tariff offered by another licensed ACT retailer. Customers may also choose to remain with ActewAGL Retail but choose to negotiate a contract at a more competitive rate than the TFT. They will also be able to return to the TFT while this

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<sup>1</sup> ActewAGL is divided into several separate business units under the ring fencing arrangements applying in the ACT. In this paper references to ActewAGL mean ActewAGL Retail, as distinct from ActewAGL Distribution.

<sup>2</sup> Standard Customer Contracts are established in Division 6.2 of the *Utilities Act 2000*. The terms of the standard customer contract are approved by the Commission under section 89 of the Utilities Act.

tariff remains in force. For the purposes of this report, customers charged on the basis of the TFT arrangements are termed “TFT customers”.

TFT customers include not only existing customers using less than 100 MWh per annum but also new customers. New customers are included among franchise customers by the definition of franchise customers in the Utilities Act. New customers will have the same opportunity as other franchise customers to choose their retailer or to return to the standard customer contract provided by ActewAGL Retail including the TFT.

## 4. The Commission's Approach to the Investigation

This section sets out the Commission's approach to the conduct of the investigation and to the preparation of this report and associated price direction in relation to the supply of electricity to TFT customers. The Commission's approach has been developed in manner that most efficiently addresses the terms of the reference specified by the Treasurer under section 16 of the *Independent Competition and Regulatory Commission Act 1997 (ICRC Act)*.

### 4.1 Industry Reference

As noted in section 2 above, the terms of reference issued by the Treasurer for the conduct of the investigation in relation to the industry reference requires the Commission to consider certain specified matters. The Commission's approach to the consideration of these matters is discussed the remainder of this section 4, and may be summarised as follows:

#### *Section 20 of the ICRC Act*

The Commission considered the requirements of section 20 of the *ICRC Act* in the primary contexts of the economic efficiency of TFT pricing arrangements, the potential effects of the arrangements of the development of a competitive retail market in the ACT and the implications of the arrangements for economically sustainable development (where these are key contents of section 20 of the Act).

The Commission's major focus in this area was in modelling the efficient costs of supply to TFT customers and in basing the prices in its direction on the efficient costs thus determined. An overview of the Commission's approach to this matter is provided in sections 4.2 to 4.6 below.

#### *National Electricity Law, National Electricity Code and National Competition Policy*

In considering requirements under the National Electricity Law and National Electricity Code the Commission noted that the key points of focus of these instruments are the introduction a national electricity market and the regulation of natural monopoly services (electricity transmission and distribution) respectively. The National Electricity Law and Code set out the rules and standards that govern the operation of the electricity market, so that it works efficiently and allows for effective competition between the market participants.

The National Competition Policy focussed on electricity reform in the context of those microeconomic reforms that had been pursued by all jurisdictions jointly through the Council of Australian Governments (CoAG) and included in the National Competition Policy among the 'Related Reforms'. The key requirements of the policy were to establish wherever possible open competitive markets for utility services. That policy obligation is met through the introduction of FRC in the ACT, which has been determined by the ACT Government to occur on 1 July 2003. The Commission is seeking in this direction not to determine a policy position but to facilitate the development of a competitive market in the ACT in accordance with the Government's policy.

Because the Code is focussed on the regulation of the natural monopoly services of electricity transmission and distribution, rather than the retail supply of electricity, the Commission has considered the requirements of the NEC in terms of the network



costs to be included in the Commission's efficient cost of supply model. The Commission's approach to this matter is contained in section 4.8 below.

#### *Retailer of Last Resort*

Retailer of Last Resort (RoLR) schemes provide contingencies for prudential failures by electricity retailers. A RoLR scheme is the mechanism for designating a supplier for electricity customers when an unplanned exit or failure in the market occurs. The RoLR arrangements in place in the ACT under the Commission's Retailer of Last Resort Guidelines, are not affected by the TFT price direction.

#### *Retail Prices in Other Jurisdictions*

The Commission has adopted a benchmark approach to considering the relativity of ActewAGL's TFT prices and the electricity retail prices applying to franchise customers in other States. The Commission's approach involved assessing transitional retail prices (covering deemed and standing offer tariffs) applied by selected retailers in other States, including prices applied by AGL electricity retail companies in South Australia and Victoria

The different retail prices were assessed on the basis of two simplified consumption profiles. The consumption profiles have been applied solely to provide a common basis for comparing different tariffs (where the tariffs compared have different price structures) and are not meant to represent actual average consumption profiles in any jurisdiction. Refer to section 4.10 below for further information on this matter.

## **4.2 Overview to Approach**

The overarching statutory requirements that the Commission is to have regard to in undertaking the investigation are the requirements specified in section 20 of the *ICRC Act*.

In undertaking the investigation, the Commission modelled efficient benchmark costs of electricity supply to TFT customers. As part of the process of developing the model, on 20 December 2002 the Commission sought specific information of a financial and operating nature from ActewAGL. The information requested by the Commission was provided by ActewAGL on 17 January 2003. Pursuant to the amendment to the reference to provide for the later FRC date of 1 July 2003, ActewAGL provided a supplementary submission on 26 March 2003. References in this report to information submitted by ActewAGL cover its submissions provided on 17 January 2003 and 26 March 2003. Confidential material provided by ActewAGL to the Commission has been omitted in the published version of this report.

By modelling the efficient benchmark costs of supply to TFT customers and by basing the prices in its direction on the efficient costs thus determined, the Commission is seeking to ensure that the direction complies with the requirements of section 20 of the *ICRC Act*. The importance of efficient cost outcomes in terms of the statutory requirements governing the investigation is discussed in section 4.4 below. The efficient cost benchmarks used by the Commission include an appropriate retail profit margin and are considered to be consistent with the development of a competitive retail market in the ACT.

### **4.3 Economic Regulation of the Electricity Retail Market**

Economic theory suggests that market failure can justify the regulation of firms. In the absence of natural competition, governments may need to intervene to enhance economic efficiency. Generally, market failure is associated with a particular good or service being provided by a single entity, a monopoly service provider. Electricity distribution is generally cited as an example of a business where government intervention increases economic efficiency.

The Commission's view, as expressed in its FRC Report, adheres to the principles above; government intervention in markets should generally be avoided and, if it is necessary, should be as light-handed as possible considering the circumstances, because competitive markets are considered to represent the most efficient method of resource allocation.

The retail market for electricity in the ACT before the introduction of FRC has been a monopoly market regulated by the Commission. With the introduction of FRC to the ACT electricity market, there is a concern that it may take some time for 'newly contestable' customers (customers using less than 100 MWh per annum of electricity) to decide whether they wish to enter a contestable contract and which retail supplier they would prefer. As noted in section 3 above, newly contestable customers are smaller consumers, predominantly residential customers. The TFT arrangements have been determined by the ACT Government to provide more security for previously regulated customers to exercise their right of choice. Under the TFT arrangements, a newly contestable customer is able to obtain electricity supply at a regulated tariff provided by ActewAGL until such time as the customer opts to exercise choice and move to a contestable retail tariff offered by another licensed ACT retailer, or a competitive tariff offering made by ActewAGL Retail, during the next three years.

The TFT arrangements thus seek to address potential adverse effects on these customers which may arise due to the contestable retail electricity market being at an early stage of development. Such effects may otherwise represent a form of market failure – albeit market failure of a less material form than that conventionally associated with monopolistic supply. Market failure of the kind that warrants Government intervention in markets would be generally evidenced by a firm:

- incurring an inefficient level of costs;
- charging prices to customers above efficient cost-reflective levels; and
- offering a lower standard of service than an equivalent firm operating in a competitive market.

By basing the prices in its direction on efficient costs, the Commission is seeking to provide an outcome that is consistent with a competitive market outcome and with the requirements of section 20 of the *ICRC Act* which are focussed on the achievement of efficient outcomes for regulated services. The Commission's direction is designed to address the first two forms of market failure noted above.

### **4.4 Statutory Requirements**

Section 20(1) of the *ICRC Act* requires the Commission to give a price direction to relevant persons providing regulated services at the end of each investigation under a

reference. Under section 20(A) of the Act, a price direction must include a direction about the pricing of regulated services in the form of either or both of the following:

- (a) a price, a maximum price or both a minimum and a maximum price for each regulated service; and
- (b) a maximum total amount (revenue cap) that may be earned by a person providing regulated services from the provision of those services.

The efficient cost-based prices in the direction are considered to be consistent with the following requirements specified in section 20(2) of the *ICRC Act* that the Commission is to have regard to in conducting the investigation:

- (a) the protection of consumers from abuses of monopoly power in terms of prices, pricing policies (including policies relating to the level or structure of prices for services) and standard of regulated services; and
- (c) the need for greater efficiency in the provision of regulated services to reduce costs to consumers and taxpayers; and
- (d) an appropriate rate of return on any investment in the regulated industry; and
- (e) the cost of providing the regulated services; and
- (h) considerations of demand management and least cost planning; and
- (i) the borrowing, capital and cash flow requirements of persons providing regulated services and the need to renew or increase relevant assets in the regulated industry; and
- (j) the effect on general price inflation over the medium term.

Importantly, efficient price outcomes as embodied in the Commission's direction are not inconsistent with the other requirements set out in section 20(2) of the *ICRC Act*, to which the Commission is required to have regard namely, the following matters:

- (b) standards of quality, reliability and safety of the regulated services; and
- (f) the principles of ecologically sustainable development mentioned in subsection (4); and
- (g) the social impacts of the decision; and
- (k) any arrangements that a person providing regulated services has entered into for the exercise of its functions by some other person.

Section 20(3) of the Act provides that in making a price direction, the Commission is to indicate to what extent it has had regard to the matters referred to in section 20(2), as set out above. Detailed comments as to the basis of the determination of efficient TFT prices are presented in section 4.5 below; and as to its meeting the requirements of section 20(2) of the Act, the Commission's comments are embodied in Attachment 1.

#### **4.5 Basis to Price Direction**

The prices contained in the Commission's direction in Attachment 5 are based on efficient benchmark costs of electricity supply to TFT customers. The Commission's process for setting the prices in the direction involved determining:

- the efficient costs of supply to TFT customers in accordance with the process set out in section 4.7 and the benchmark cost values contained in Attachment 1;
- the notional revenue to ActewAGL from applying the existing franchise customer tariffs to TFT customers; and
- the variations required to the existing franchise customer tariffs in order for the notional revenue from those tariffs to reflect the benchmark costs of supply. The resulting variation factors are to be applied to the existing franchise customer tariffs to determine the TFT tariffs for the 2003/04 financial year, subject to pass through events and price review triggers.<sup>3</sup>

The price direction in Attachment 5 reflects the requirements of section 20(A)(a) of the *ICRC Act* in that, by containing annual price variation factors (with the 2003/04 factor applying to the 2002/03 franchise retail tariffs), the direction prescribes prices for regulated electricity supply to TFT customers.

It is noted that the initial (2003/04) price movement embodied in the TFT rates is largely a reflection of an increase in energy costs, of approximately 5% above current cost levels (a cost pass through in respect of these costs could have been expected to occur under existing franchise retail tariff arrangements ie notwithstanding the introduction of the TFT arrangements). Further, at 1 July 2003, the TFT rates will be affected by the pass through of changes to the network tariffs under pre-existing CPI minus 2% arrangements.

#### 4.6 ActewAGL's Proposed Prices

The prices proposed by ActewAGL in its submissions are also based on ActewAGL having taken a benchmark approach to determining costs of retail operations and energy. That is, the costs used by ActewAGL for these cost components may not in all cases reflect its actual costs, but represent benchmark amounts determined by ActewAGL.

ActewAGL's proposed benchmark energy costs are considered by ActewAGL to provide opportunity for retailers to make competitive market offers. ActewAGL's proposal is also designed to provide price certainty to customers and the industry over the transition period from 1 July 2003 to 30 June 2006.

The prices proposed by ActewAGL are argued to be below its calculated costs (based on its benchmark values) until the final year of the transition period. The TFT prices proposed by ActewAGL involve applying the annual CPI-related price variation factors as set out in the table below. The CPI-related variation for the 2003/04 financial year represents the proposed variation on existing (2002/03) franchise customer retail tariffs.

**Table 4.1: ActewAGL Proposed Price Adjustment**

Financial Year	Proposed Tariff Revenue Increase
2003/04	CPI + 9.0%
2004/05	CPI + 0.7%
2005/06	CPI + 0.6%

<sup>3</sup> See Attachment 1.

While ActewAGL's proposed price path above is designed to provide price certainty to customers, ActewAGL proposes that it should not bear the costs associated with particular events which may occur in future and that the costs associated with such events should be passed through to customers. Such pass through events, which would affect the price path set out above, comprise changes in the following factors:

- wholesale electricity market conditions affecting ActewAGL's proposed benchmark price;
- the form of market arrangements adopted in the ACT market;
- NEMMCO fees and charges<sup>4</sup>;
- MRETS/greenhouse levies<sup>5</sup>;
- FRC customer churn rates (which give rise to FRC cost recovery different to forecast levels);
- network tariff variations<sup>6</sup>; and
- other fees, taxes and imposts.

In addition, ActewAGL would seek a review of the TFT arrangements (price review triggers) if any of the following events occurs:

- there are significant changes to obligations and or costs under access arrangements, regulation or codes;
- there are significant and fundamental wholesale market adjustments affecting price, and relevant related pass-through costs allowances, such as demand forecast errors, insolvency of counter-party, and ancillary services market; and
- there are significant changes to the obligations or costs associated with the ACT RoLR arrangements or metrology procedures or policy.

#### **4.7 The Commission's Proposed Cost Components**

The Commission followed its own process for verifying and assessing the information submitted by ActewAGL. That process involved the application of a standard cost structure as set out below in modelling the efficient costs of electricity supply to TFT customers. The component cost values used by the Commission are discussed in Attachment 1. The Commission's standard cost structure is as follows:

- costs based on electricity network charges comprising transmission use of service (TUoS) charges, distribution use of service (DUoS) charges and an allowance for competitive metering;
- costs of retail operations relating to the following retail activities:
  - customer care and call centre operations;

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<sup>4</sup> NEMMCO fees are the cost of participating in the national electricity market under the management of the National Electricity Market Management Company.

<sup>5</sup> MRETS levies are the costs associated with participation in the Commonwealth Mandatory Renewable Energy Targets Scheme. MRETS is one of a number of obligations undertaken in response to the Kyoto Protocol to reduce the effect of greenhouse gasses on the global environment.

<sup>6</sup> Network tariff variations are not listed as a pass through event in the body of ActewAGL's submission of 17 January 2003, but the covering letter to the submission treats such variations as a pass through. Greenhouse levies includes levies or other charges that may arise from the development and implementation of new government policies in relation to greenhouse gas abatement. Those levies would be in addition to the MRET's obligations.

- billing and charging;
- sales and marketing, being primarily the costs of communicating the TFT arrangements;
- collection and default;
- administration (business overheads such as finance, human resource management, regulatory administration);
- retail FRC activities such as churn management
- a return on retail operations in the form of a retail margin (or return to the shareholder) at a reasonable level commensurate with the level of investment required and the risks associated with running a retail business; and
- costs of a retailer purchasing energy on behalf of its customers, covering the following:
  - the cost of purchasing energy in the NEM;
  - the cost of purchasing energy under contracts with generators
  - the cost of hedging exposure to price and quantity fluctuations
  - NEMMCO fees and ancillary service charges;
  - allowances for renewable energy costs; and
  - the effect of network losses in the ACT.

Attachment 1 discusses the details of the modelling approach in relation to the cost components identified above. The information in relation to each of these cost components as submitted by ActewAGL on 17 January 2003 and 26 March 2003 is also discussed in Attachment 1.

#### **4.8 National Electricity Law and National Electricity Code**

The context for considering the requirements of the National Electricity Law and National Electricity Code arises from the requirements of National Competition Policy. There are three agreements that form the National Competition Policy:

- the Conduct Code Agreement;
- the Competition Principles Agreement; and
- the Agreement to Implement the National Competition Policy and Related Reforms.

The Conduct Code Agreement and the Competition Principles Agreement do not have a direct bearing on the achievement of free and open markets in energy. Those pre-existing COAG reform commitments were built into the third Agreement on the Implementation of the Competition and Related COAG reforms. The Implementation Agreement combined the previous COAG reform agendas for electricity, gas, water and road transport industries with the conditions for financial transfers from the Commonwealth to the States and the Territories and the reform timetable.

The National Competition Council, established to oversight the implementation of the National Competition Policy, also assumed responsibility for ensuring that the parties to the agreements continued to deliver satisfactory progress on the whole reform package.



One of the reforms agreed to was the establishment of a competitive national electricity market. The agreements included obligations to establish a national market with appropriate regulatory infrastructure. The regulatory framework included a new National Electricity Law developed in South Australia and mirror legislation adopted in other jurisdictions, with a subsidiary regulatory code, the National Electricity Code.

The national market was formally established in 1997 with the opening of the interim National Electricity Market (NEM). The original market was made up of New South Wales, Victoria and the ACT. Queensland and South Australia entered the market as full participants with the opening of the NEM proper in December 1998.

The key requirements of the National Electricity Law in relation to retail prices, which are the focus of this investigation, are primarily met through the introduction of FRC in the ACT as determined by the ACT Government to occur on 1 July 2003.

The Commission is seeking through this direction to facilitate the development of a competitive market in the ACT pursuant to the conditions for open competition determined by the Government. The Commission's role in relation to achieving the objectives of the Law is thus more of a secondary nature to the role of Government. In relation to the National Electricity Code, because this instrument is focussed on the regulation of the natural monopoly services of electricity transmission and distribution, rather than the retail supply of electricity, the Commission's consideration of the requirements of the Code is primarily in relation to the network costs to be included in the Commission's efficient cost of supply model.

#### **4.9 Retailer of Last Resort**

In undertaking the investigation the Commission is required to have regard to the impact of the introduction of FRC and to the RoLR arrangements. As discussed in Attachment 1, the approach to setting TFT prices (based on efficient cost benchmarks, including an appropriate retail profit margin) is considered to be consistent with the development of a competitive retail market in the ACT.

The ICRC's Retailer of Last Resort Guidelines provide instructions to the RoLR with respect to the terms and conditions under which RoLR services may be provided, and to the information that they must provide customers, as well as outlining the events and the associated steps in the monitoring and customer transfer processes. In the ACT, ActewAGL Retail has assumed the role of RoLR as a condition of its electricity supply licence, issued under the *Utilities Act 2000*.

In the event of an unplanned exit or failure the ICRC is responsible for coordinating the RoLR process to ensure that customers continue to be supplied with electricity and that the market remains efficient. The ICRC will also monitor developments after the suspension date to ensure that customers are not disadvantaged, that the market returns to a competitive basis and that there is sufficient information in the market place to enable customers to make choices about alternative electricity retailers. The RoLR arrangements in place in the ACT under the Commission's Retailer of Last Resort Guidelines are not affected by the TFT price direction.

#### **4.10 Retail Prices in Other Jurisdictions**

The Commission has adopted a benchmark approach to considering the relativity of ActewAGL's TFT prices and the electricity retail prices applying to franchise customers in other States. The Commission's approach involved assessing transitional retail prices (covering deemed and standing offer tariffs) applied by selected retailers in other States, including prices applied by AGL electricity retail companies in South Australia and Victoria. ActewAGL is also a retailer in NSW, and the Commission has considered the prices that it has on offer to contestable customers consuming less than 100MWh per annum in that State. The retailers selected are not an exhaustive list of the incumbent electricity retailers in other jurisdictions but a cross section of retailers against which ActewAGL may be reasonably compared.

The Commission's investigation in this regard has covered the regulated prices of franchise or incumbent retailers. Such prices are directly comparable to TFT prices. Information on retailers' competitive offers is less readily available than information on regulated prices and such offers are more flexible, therefore more changeable, in response to market conditions.

The retail prices of each retailer were assessed on the basis of two simplified consumption profiles: a residential peak user profile of 7,500kWh per annum spread evenly over the year; and a residential profile of 4,500kWh per annum peak usage and 3,000kWh per annum off-peak usage again, assuming a flat monthly usage profile. The consumption profiles have been applied solely to provide a common basis for comparing different tariffs (where the tariffs compared have different price structures) and are not meant to represent actual average consumption profiles in any jurisdiction.

The results of the comparison are shown in Attachment 3. It can be seen from Attachment 3 that ActewAGL's TFT prices arising from the direction compare favourably against the transitional retail prices (covering deemed and standing offer tariffs) applied by selected retailers in other jurisdictions, including by AGL companies in South Australia and Victoria. In NSW, the prices offered by ActewAGL were found to reflect broadly the Home-Plan prices offered by ActewAGL in the ACT.

The prices contained in Attachment 3 provide a 'snapshot' of selected retail prices applying as at April 2003 (and cover also proposed 1 July 2003 prices in the ACT). Prices at 1 July 2003 may vary from those shown in Attachment 3. For example, the TFT prices are affected by the pass through of changes to ACT network tariffs under pre-existing CPI minus 2% price path adjustment arrangements.



#### **4.11 Social and environmental impacts**

In any price inquiry the Commission is required to consider a range of issues including the environmental and social impacts of its decisions. The Commission has been conscious that the introduction of FRC would have an impact on prices, increasing prices by a relatively small margin. The Commission's estimates of the social impact of the final determination is that most residential and small business customers using less than 100 MWh per year of electricity would pay on average between 6% and 7.5% in higher electricity prices. This increase is closely related to the estimates that the Commission considered in its advice to the Government on the introduction of FRC. It is also consistent with the impact foreshadowed in the draft report on the TFT. The Commission has included in its final direction a process and set of conditions including the impact of price proposals on consumers that will allow the Commission to ensure that there is not an unwarranted pricing impact on household consumers.

The Commission has also taken into account the contribution to that rise made by increased costs that would have flowed to customers regardless of FRC. The cost of energy has and is rising, approximately 5 percentage points of the 7 to 8 percentage points increase. The Commission is also conscious that for consumers who benefit from Government concessions in relation to the price of electricity, the introduction of FRC entails a commitment to providing additional subsidy support so that franchise customers are not subject to substantial change in their concessions.

Importantly, the Commission views the TFT in the context of the alternative offerings that will be available in the market not only from new entrants to the less than 100 MWh per year segment of the retail electricity market, but also from ActewAGL Retail itself.

The Commission concludes, on balance, that the overall social impact of the TFT price will be relatively minor particularly in the context of increases in generation costs that would have flowed through to franchise customers in 2003-04 regardless of the decision to adopt FRC. For those customers where the increase will produce particular hardship, relief will be available through the Essential Services Consumer Council safety net arrangements. The Commission is satisfied that the proposed TFT and associated pricing direction is appropriate and will not create additional social hardship beyond that which would have occurred whether or not FRC were introduced.

The Commission also considered the environmental impacts of the proposed TFT. The Commission is satisfied that the TFT reflects the costs of producing and delivering electricity to consumers. The Commission is satisfied that the TFT will provide sufficient opportunity for the retail market to attract rival suppliers to the ACT while not providing an incentive for overuse, with the inevitable consequences for the production of greenhouse gases. Competition will be stimulated but will not be at a level that would signal overuse. In addition, the incentives that are in place for environmentally responsible electricity generation and consumption, such as the MRETS scheme and any potential greenhouse gas abatement policy that may be

introduced in the ACT, will provide strong ongoing signals for responsible consumption. The Commission considers that the TFT price would have no appreciable impact on environmental sustainability.

#### **4.12 Consultation**

In undertaking this investigation, the Commission has considered submissions and views from the ACT's incumbent electricity supplier and distributor, ActewAGL, the Conservation Council of the South East Region and Canberra and the ACT Treasury in forming its views on the terms of the reference. ActewAGL's submission is discussed in section 4.6.

In its submission to the Commission of 17 January 2003, the Conservation Council emphasised its wish for:

- simultaneous introduction of greenhouse benchmarks for retailers and provision of greenhouse gas emission information disclosure on electricity bills; and
- FRC to lead to a competitive retail energy market that offers both value added energy efficiency services and price competition. In this context, the Council argues for a TFT that is sufficiently high to send appropriate market signals and a premium on efficient costs in the order of \$0.04/kWh. It is the Council's view that under such an arrangement, the needs of low income earners could be met through effective demand side management and a system of rebates, rather than simply relying on low tariffs.

In its FRC Report, the Commission noted that FRC would provide a good opportunity to implement broader environmental initiatives such as the greenhouse benchmarks suggested by the Council. The Commission has not changed its view on this matter and notes that the precise form and cost of these additional environmental initiatives would need to be brought to Government in the form of a comprehensive policy package for consideration

Ultimately decisions on special premiums for greenhouse purposes will need to be taken by the Government. However, the Commission has acknowledged the potential for such policy initiatives. Thus, in its price direction, the Commission has made provision for a pass through of MRETS and greenhouse levies which may be introduced at some future time.

In terms of the proposal for the inclusion in the TFT of a \$0.04/kWh premium on efficient costs, the Commission notes that in a fully contestable market this premium would have to be applied to all retailers, not just to ActewAGL in its role as the provider of a service under the TFT. For this option to be functional, the Government would need to capture any revenue generated by the \$0.04/kWh premium. These funds then could be allocated in part to subsidise consumers who suffer some hardship under this policy.

This option will be discussed with the Government prior to the release of the final direction.



## 5. Conclusions

Having conducted the review under the reference issued by the ACT Treasurer, and having taken into consideration the views of ActewAGL and other parties, the Commission has arrived at the following Price Direction:

<b>Financial Year</b>	<b>Permitted Tariff Revenue Increase</b>
2003/04	CPI + 4.5%
2004/05	CPI + 0.5%
2005/06	CPI + 0.5%

The direction for 2003/04 is slightly varied from that proposed in the Draft Report. This primarily reflects the availability of actual CPI figures for use in the price adjustment formula and the Commission's recalculation of supply costs based on the latest available information.

The above price variation factors are to apply to TFT prices at the commencement of each financial year of the transition period (starting with the application of the 2003/04 factor to the existing (2002/03) franchise customer tariffs to determine the TFT prices for 2003/04). The CPI to apply to the 2003/04 year is 3.4%. ActewAGL will present to the Commission its proposed TFT prices based on this price adjustment formula prior to 1 July for each of the three years of the determination. The full price direction is presented in Attachment 5.

These factors are to apply to TFT prices in aggregate subject to pass through events and price review triggers in respect of matters that are fixed at the time of the direction but may change over time, and where the retailer could not reasonably be expected to bear the cost of such events.

Importantly, variations to be permitted to individual component prices shall be subject to the Commission being satisfied that the prices contained in a price variation submission lodged by the retailer are consistent with:

- the need to protect the interests of consumers;
- the requirement for tariff structures to be economically efficient, where practicable; and
- the promotion of retail competition

In being satisfied that the prices contained in a price variation submission are consistent with the need to protect the interests of the consumers, the Commission shall assess the impact of the proposed prices on the basis of their effects on the annual bills of different customer profiles in respect of each TFT tariff.

The Commission has also taken into account certain pass through events and price variation triggers, which are outlined in Attachment 5.



## **ATTACHMENT 1: Cost Assessment**

The Commission has modelled the efficient benchmark costs of supplying electricity in the transitional electricity market in the ACT using the following costs components:

- regulated network tariffs;
- efficient operating costs and margins of electricity retail; and
- the costs of purchasing energy.

The method by which the cost of each of these cost components was determined is discussed below.

### **Network Tariffs**

ActewAGL proposes that the network component of its allowable TFT electricity supply costs should comprise its 2002/03 regulated network tariffs plus an allowance for competitive metering services.

The Commission considers that ActewAGL's electricity network tariffs – as approved by the Commission in accordance with the principles and procedures in the National Electricity Code – provide an appropriate network cost component in accordance with the requirements of section 20 of the *ICRC Act*. The Commission therefore accepts the approved regulated TUoS and DUoS charges for this purpose and accepts that an allowance is required for the costs competitive metering services, where such costs are not otherwise recovered by the regulated TUoS and DUoS charges.

Because the regulated TUoS and DUoS charges used in making the price direction are the 2002/03 rates, the TFT determined should vary by the pass through effect of variations to these regulated charges.

### **Retail Operating Costs and Margin**

ActewAGL proposes that the retail operating cost and margin components of its allowable TFT electricity supply costs should comprise:

- the amount of \$85 per customer for operating costs exclusive of retail FRC costs;
- the amount of \$8.33 per customer for retail FRC costs; and
- a gross retail margin of 5% of sales.

ActewAGL has based its operating cost amount of \$85 per customer on a review of its operations and on forecast effect on its unit costs of customer churn in the competitive market. Its FRC cost estimate is based on its estimate of fixed FRC costs per customer incurred in the ACT market, and amortisation of those costs over a fixed period. ActewAGL's proposed gross retail margin is the percentage adopted by the Essential Services Commission of South Australia (ESCOSA) in its October 2002 report into electricity standing contract prices.

ActewAGL has generally benchmarked its retail cost and margin amounts against amounts determined by ESCOSA in its October 2002 report (ESCOSA used \$80/customer for retail operating costs) and further justified its cost estimates based on its view that there would be diseconomies of scale in the ACT market relative to the South Australian market to which the ESCOSA report relates.

As discussed in section 4.2 of the report, in determining the allowable cost components to be recovered by the TFT arrangements, the Commission has adopted an efficient benchmark approach which nevertheless provides for the development of a competitive retail market in the ACT (that is, regulated prices have been developed to provide customers with efficient prices, although as the competitive market develops, retailers may be able to offer lower prices than those determined by the Commission under the TFT arrangements).

### ***Retail Operating Costs***

In determining the efficient benchmark costs of retail operations, the Commission has used information on retail operating costs contained in recent relevant regulatory decisions, specifically the following:

- \$50 to \$80 per customer – the estimated cost used by the Office of the Regulator-General, Victoria (now Essential Services Commission, Victoria (ESCV)), in its Special Investigation Electricity Supplier's Proposed Price Increases, Final Report, December 2001;
- \$40 to \$60 per customer – the estimated cost used by the Independent Pricing and Regulatory Tribunal (IPART), NSW, in its Final Report into Regulated Retail Prices for Electricity to 2004, December 2000;
- \$45-\$75 per small retail customer including an allowance for contestability costs – determined by IPART in its Mid-Term Review of Regulated Retail Prices for Electricity to 2004, Report and Determination to the Minister for Energy, June 2002; and
- \$80 per customer – as determined by ESCOSA in its Inquiry into Electricity Standing Contract Prices, Final Report and Determination, October 2002.

In its FRC Report the Commission used the upper limit of the ESCV's cost estimate (ie \$80 per customer) as the benchmark for retail operating costs per customer. As can be noted above, the estimate of \$80 per customer has also been adopted by ESCOSA. The cost range used by the ESCV estimates the costs to suppliers of providing for customer transfers and for operating a system of deemed load profiles<sup>7</sup> are between \$5 and \$10 per customer. ESCOSA's cost estimate of \$80 per customer similarly includes an allowance of \$10 for FRC costs.

While the Commission is not persuaded that it needs to depart substantially from the operating cost benchmark of \$80 per customer, inclusive of FRC costs, as used in its FRC Report, it recognises that there are likely to be diseconomies of scale in relation to the ACT market relative to the Victorian and South Australian markets from which this upper limit cost benchmark amount of \$80 per customer has been derived. The Commission notes NSW has adopted an amount of \$75 in its decision. However, IPART in reaching its decision, considered values in a range of which the \$85 was accepted by IPART as being at the upper end. On this basis, the Commission accepts ActewAGL's retail operating cost estimate of \$85 per customer. However, the Commission does not accept recovery of an additional amount of \$8.33 for retail FRC costs, which have been taken into account in the setting of the comparable benchmarks.

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<sup>7</sup> Where accumulation meters rather than interval meters are used by consumers, data on loads used by utilities to bid for power in the national market pool is based on an estimate of average use, *ie* a deemed profile, for categories of customers.

### ***Retail Margin***

The publicly available information on retail margins in contestable electricity retail markets indicate that gross profit margins on retail sales range between 1.4% and 5%. This range of margins is contained in the following key regulatory decisions:

- 1.4%, as determined by the Commission for ActewAGL in May 1999;
- 2.5% to 5%, as determined by the ESCV in its Special Investigation Electricity Supplier's Proposed Price Increases, Final Report, December 2001;
- 1.5% to 2.5%, as determined by IPART in its Final Report into Regulated Retail Prices for Electricity to 2004, December 2000;
- 1.5% to 2.5%, as maintained by IPART in its Mid-Term Review of Regulated Retail Prices for Electricity to 2004, Report and Determination to the Minister for Energy, June 2002;
- 5%, as determined by the ESCOSA in its Inquiry into Electricity Standing Contract Prices, Final Report and Determination, October 2002; and
- 1.5%, as determined by the Office of the Tasmanian Regulator, Investigation into Electricity Pricing - Final Report, November 1999.

In its FRC Report the Commission adopted 3% on sales (approximately \$30 per customer over the franchise customer base) as the benchmark value for the retail margin. The Commission notes that in proposing a 5% retail margin that ActewAGL has drawn mainly on the ESCOSA report and on comments in that report in relation to the small size of the South Australian market influencing such a high margin being adopted for that State. The Commission notes, however, that the 5% margin adopted in that case was largely justified by ESCOSA on the basis of the particular risks of operating in the peaky South Australian Market. The Commission is not persuaded that the same circumstances exist in the ACT.

Accordingly the Commission has decided not to depart from its earlier benchmark retail margin of 3% on sales and does not accept ActewAGL's estimate of 5% on sales.

### **Costs of Purchasing Energy**

As noted in section 4.7 of the report, the cost components considered by the Commission to relate to a retailer purchasing energy for franchise customers cover the following:

- the cost of purchasing energy in the NEM;
- the cost of purchasing energy under contracts with generators;
- the cost of hedging exposure to price and quantity fluctuations;
- NEMMCO fees and ancillary service charges;
- an allowance for renewable energy costs; and
- the effect of network losses in the ACT.

In its submissions to the Commission, ActewAGL specified benchmark cost amounts generally in relation to the above cost components. The benchmark amounts proposed by ActewAGL, and the Commission's views on whether to adopt those particular benchmarks in making the price direction, are discussed below.



### *Wholesale Energy Purchase Costs*

ActewAGL provided confidential information on benchmark wholesale energy purchase costs based on:

- the expected forward cost of purchasing energy at pool prices in the NEM and through contracts with generators;
- trading and hedge management costs, including the costs of dealing with 'hedge mismatch' risks; and
- an allowance for other risks, including the effect of customer churn in the ACT market.

The Commission considers that ActewAGL's broad approach for arriving at wholesale energy purchase costs is reasonable. Forward energy purchase cost estimates will, however, be dependent on value judgements on matters such as future market movements, loadshape risks and customer churn in the competitive market. Ultimately, energy purchase costs will also be affected by a retailer's purchase strategy going forward, for example in terms of whether it wishes to hedge energy cost risks, or seek to gain from energy market arbitrage opportunities.

Below we discuss, in general terms, key cost components utilised by ActewAGL in arriving at its forward wholesale energy purchase costs.

#### Flat base price

The Commission accepts ActewAGL's approach of commencing with a flat swap contract price and adding factors to reach a load weighted wholesale energy purchase cost. The flat swap prices used by ActewAGL, which embody a general forward pricing curve over the TFT period, are considered to reflect reasonable market assumptions.

#### Seasonal Factors

It is reasonable to add the costs of financial instruments (in addition to a flat swap contract) to hedge a flexing retail load against seasonal and climatic variations. In this case, the Commission has accepted the cost of load variation protection assumed by ActewAGL.

#### Pricing for cap contracts

In Victoria and South Australia, it may be reasonable for pricing cap contracts to reflect new entrant pricing given that in those States, generation capacity constraints exist in peak summer demand conditions. Such conditions are not present to the same extent on the NSW node of the NEM. The market conditions in the NSW region would suggest a limited need for a new entrant capacity in the region to meet peak capacity requirements.

#### Hedge mismatch cost

It is reasonable to add a premium to purchase costs to recognise the fact that the combination of hedging instruments available will not perfectly cover consumer demand. ActewAGL have proposed a factor for hedge mismatch risks derived from the ESCOSA October 2002 determination, which is considered reasonable in this case.

## Other risks

### *Customer Churn*

Consumers leaving, or returning to, the TFT arrangements would expose ActewAGL to additional risks to those noted above.

### *Credit Risk*

Wholesale credit risk is related to defaults on hedge contracts which retailers enter into in order to manage their wholesale market risk. A credit risk premium to compensate a wholesale market participant is best dealt with in the wholesale contract price. Screen prices quoted should generally already factor this risk in to determining the hedge contract price. In this case, the Commission considers it to be inappropriate to add an additional risk margin to the purchase price to manage this risk.

Another form of credit risk which should be factored into the retail price, is the risk of a default by the customer to the retailer. This risk is already included in retail operating costs as discussed above and should not be factored into the wholesale energy purchase cost.

### *Regulatory risk*

There are two types of regulatory risk that may be considered – wholesale market regulatory risk and retail regulatory risk. In the case of wholesale market regulatory risk, this could be expected to be priced into the hedge contract quote. It is not considered appropriate to add an additional premium for this risk to the wholesale purchase cost component. Retail regulatory risk factors are dealt with in this determination through the pass through provisions contained in the direction. It is not considered appropriate to add a factor to wholesale purchase costs for risks of this nature.

### *Force Majeure risk*

In the wholesale market, this risk relates to an FM clause in a hedge contract being exercised by the contract counterparty. Prices quoted eg by the AFMA typically relate to hedge contracts without FM clauses. The contracts in that case would not be exposed to FM risk and on that basis it is not considered appropriate to include an additional margin for FM risk. It is recognised however that FM risks will be associated with some forms of contract.

ActewAGL allowed a risk margin of 5% for ‘other risks’ of the type discussed above in accordance with the ESCOSA determination of October 2002. While credit risks and regulatory risks as discussed should have little or no weight in such a factor applied to energy purchase costs in the ACT, the Commission considers the 5% factor to be reasonable in this case.

ActewAGL also provided additional confidential material to the Commission covering forward contracting positions in the NSW market and market risk associated with providing coverage for the TFT customer load. This information supported ActewAGL’s position in relation to its estimate of wholesale energy purchase costs over the next three years. On the basis of the information submitted, and independent

inquiries and investigations made by the Commission, the Commission is satisfied that ActewAGL's wholesale cost estimates reflect reasonable assumptions about purchase costs and risks associated with supply TFT customers in the ACT. The Commission therefore accepts the wholesale energy cost benchmarks submitted by ActewAGL and notes that the application of prescribed benchmark values over the next three years will provide a degree of predictability to TFT prices and thus facilitate the development of competitive offers and competition generally in the ACT market.

The forward wholesale prices provided by ActewAGL include costs that are greater than the wholesale purchase permitted by the Commission in the current (2002/03) year. The forward wholesale prices for 2003/04 are 5% greater than for 2002/03. For the period to 2005/06, forward wholesale prices are expected to rise further, reflecting the probability that long-term contract prices negotiated in the market will be higher. The Commission has been aware of the potential for the wholesale electricity price to rise in 2003/04 and the increases that have been accepted have not been unexpected. In terms of the years 2004/05 and 2005/06, should the market experience falls in wholesale prices, competitive retail prices should reflect this price movement and will provide a less costly alternative to ACT consumers seeking to minimise their energy costs.

#### *NEMMCO Fees and Ancillary Service Charges*

In ActewAGL's submission, the following information was provided on these charges:

- *NEMMCO Fees*

NEMMCO is responsible for operating and administering the National Electricity Market in accordance with the National Electricity Code. NEMMCO recovers the costs of managing the market through fees charged to market participants. The fee is determined annually and while a 2002/03 value has not been determined, a benchmark value for the likely annual fee can be obtained from the most recent data on annual pool costs to ActewAGL.
- *Ancillary Service Charges*

In operating the power system in a safe, secure and reliable manner, NEMMCO controls the key technical characteristics of the system such as frequency, voltage, network loading and system re-start. The National Electricity Code provides for NEMMCO to purchase these services under ancillary service agreements. The cost of ancillary services depend on the services required. A benchmark value for the likely annual cost of ancillary services to ActewAGL is the average calendar year 2002 cost.

The Commission accepts a cost allowance for NEMMCO Fees and Ancillary Service Charges based on the most recent actual cost data ie ActewAGL's calendar year 2002 costs. The Commission also accepts that, given that the costs of market operation and ancillary services are passed through by NEMMCO to market participants as they are incurred, there are good grounds for variations to such costs being able to pass through in retail tariffs.

### **Renewable Energy Levy Costs**

ActewAGL is required to meet the Mandatory Renewable Energy Targets (MRET) each calendar year, as prescribed by the *Renewable Energy (Electricity) Act 2000* (Cth). The Commonwealth Government provides the percentage requirement for each year no later than 31 March in that year, otherwise a prescribed formula applies as a default. The table below outlines ActewAGL's anticipated MRETs pass through based on current percentages rates published, based on base mid point purchase price of \$47.50/MWh per annum.<sup>89</sup>

**Table A1.1: ActewAGL anticipated MRETs pass through**

<b>Calendar Year</b>	<b>Basis</b>	<b>Percentage</b>	<b>Purchase price mid point (MWh)</b>	<b>MRET Pass through</b>
2003	Actual	0.88%	\$47.50	\$0.42 /MWh
2004	Default	1.27%	\$47.50	\$0.60 /MWh
2005	Default	1.66%	\$47.50	\$0.79 /MWh
2006	Default	2.20%	\$47.50	\$1.05 /MWh

The Commission accepts the MRET cost estimate provided by ActewAGL which is based on prescribed percentage factors and the mid-point of the price range at which ActewAGL is required to purchase Renewable Energy Certificates.

### **Loss factors**

ActewAGL proposed to apply loss factor values of 1.060 for Low Voltage sites and 1.039 for High Voltage sites (based on weighted average loss factors for 2002/03).

The Commission has applied the loss factor for ActewAGL's Low Voltage sites of 1.0532 as determined by the Commission as the forward loss factor for 2003/04.

### **Price Effects**

The prices contained in the Commission's direction are based on efficient benchmark costs of electricity supply to TFT customers. The Commission's process for setting the prices in the direction involved determining:

- the efficient costs of supply to TFT customers in accordance with the process set out in section 4.7 and the benchmark cost values discussed above;
- the notional revenue to ActewAGL from applying the existing franchise customer tariffs to TFT customers; and
- the variations required to the existing franchise customer tariffs in order for the notional revenue from those tariffs to reflect benchmark costs of supply. The resulting variation factors are to be applied to the existing franchise

<sup>8</sup> ActewAGL p.1 in summary

<sup>9</sup> The Commonwealth Government imposes a penalty of \$40 per MWh on electricity suppliers not meeting their MRETs targets. The Commission has accepted ActewAGL's provision of \$47.50 for the MRETs value because it reflects the cost of purchases of renewable energy ActewAGL would be required to make to avoid the imposition of a penalty, which includes the tax effect of such penalties. Penalties are not allowable as expenses for tax purposes, consequently each \$40 actually costs approximately \$57 per MWh when the tax deduction that would have been allowed for an expense is taken into account. ActewAGL prefers to purchase the additional energy at the lower rate of \$47.50 than incur the \$57 or more penalty.

customer tariffs to determine the TFT tariffs for the 2003/04 financial year, subject to pass through events and price review triggers.

The price direction summarised below and provided in more detail in Attachment 5 reflects the requirements of section 20(A)(a) of the *ICRC Act* in that, by containing annual price variation factors (with the 2003/04 factor applying to the 2002/03 franchise retail tariffs), the direction prescribes prices for regulated electricity supply to TFT customers.

**Table A1.2: ActewAGL's Proposal**

<b>Financial Year</b>	<b>Proposed Tariff Revenue Increase</b>
2003/04	CPI + 9.0%
2004/05	CPI + 0.7%
2005/06	CPI + 0.6%

**Table A1.3: The Commission's Price Direction**

<b>Financial Year</b>	<b>Permitted Tariff Revenue Increase</b>
2003/04	CPI + 4.5%
2004/05	CPI + 0.5%
2005/06	CPI + 0.5%

The above price variation factors are to apply to TFT prices at the commencement of each financial year of the transition period (starting with the application of the 2003/04 factor to the existing (2002/03) franchise customer tariffs to determine the TFT prices for 2003/04).

These factors are to apply to TFT prices in aggregate subject to pass through events and price review triggers in respect of matters that are fixed at the time of the direction but may change over time, and where the cost of such events could not be expected to be borne by the retailer.

The Commission also has to satisfy itself that prices contained in a price variation submission are consistent with:

- the need to protect the interest of consumers;
- the requirement for tariff structure to be economically efficient where practicable; and
- the promotion of retail competition

The price variation to be allowed in the initial year of the TFT period under this final price direction (CPI+4.5%) differs from the variation for that year proposed in the draft price direction (CPI+5%) on the basis of the Commission's recalculation of supply costs based on latest available information, including finalisation of the Canberra CPI to March 2003.

## **Pass Throughs**

Changes in the following matters affecting ActewAGL's costs are pass through events:

- wholesale market conditions affecting ActewAGL's proposed benchmark price;
- the form of market arrangements adopted in the ACT market;
- NEMMCo fees and charges;
- MRETS/greenhouse levies;
- FRC customer churn rates (which give rise to FRC cost recovery different to forecast levels);
- network tariff variations; and
- other fees, taxes and imposts.

## **Price Variation Triggers**

Changes in the following matters affecting ActewAGL's costs are price variation triggers which would entitle the Commission to initiate a reference to make a variation to the price direction:

- significant changes to obligations and or costs under access arrangements, regulation or codes;
- significant and fundamental wholesale market adjustments affecting price, and relevant related pass-through costs allowances, such as demand forecast errors, insolvency of counter party, and ancillary services market; and
- significant changes to the obligations or costs associated with the ACT RoLR arrangements or metrology procedures or policy.



## • ATTACHMENT 2: References

(a)

Australian Capital Territory

### **INDEPENDENT COMPETITION AND REGULATORY COMMISSION (REFERENCE FOR INVESTIGATION)**

#### **DETERMINATION 2002 (No 3)**

#### **Disallowable instrument DI2002-227**

made under the

#### **Independent Competition and Regulatory Commission Act 1997, s15 (Nature of industry references) and s16 (Terms of industry references)**

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#### *Reference for Investigation Under Section 15*

Pursuant to subsection 15(1) of the Act, I refer to the Independent Competition and Regulatory Commission (the “Commission”) the provision of a price direction for the supply of electricity to franchise customers for the three-year period from 1 March 2003.

#### *Reference for Requirements in Relation to Investigation Under Section 16*

Pursuant to subsection 16(1) of the Act, I specify the following requirements in relation to the conduct of the investigation:

1. The Commission is to review and provide a price direction for the supply of electricity to franchise customers for the three-year period from 1 March 2003.
2. In undertaking the review, the report should have regard to the requirements of Section 20 of the Act, as well as the following:
  - (a) any applicable requirements of the National Electricity Law and the National Electricity Code;
  - (b) the impact of the introduction of Full Retail Competition for Electricity in the Territory, having regard to matters including but not limited to the arrangements for Retailer of Last Resort;
  - (c) the retail prices charged by ActewAGL in other jurisdictions; and
  - (d) the retail prices charged by incumbent retailers in other jurisdictions.

Ted Quinlan  
Treasurer  
13 December 2002



(b)

Australian Capital Territory

**INDEPENDENT COMPETITION AND REGULATORY COMMISSION  
(REFERENCE FOR INVESTIGATION)**

**DETERMINATION 2003 (No 1**

**Disallowable instrument DI2003-19**

made under the

**Independent Competition and Regulatory Commission Act 1997,  
s15 (Nature of industry references) and s16 (Terms of industry  
references)**

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I amend Determination 2002 (No.3) dated 13 December 002 by  
Substituting the date  
“1 March 2003” wherever it appears with a new date “1 July 2003”.

Ted Quinlan  
Treasurer  
14 February 2003

### ATTACHMENT 3: Retail Prices in Other Jurisdictions Standing Offer and Deemed Electricity Retail Tariffs

State	Retailer / Tariff		Service Charge	Consumption		Off Peak	Total
				Peak block 1	block 2 (where applied)		
<b>Consumption - 7,500 kWh, peak only</b>							
ACT	<u>ActewAGL Home Plan - inc GST, 1 July 2002</u>	c/day, \$/kWh	0.374	0.095			
	Chargeable quantities	days, kWhs	365	7,500			7,500
	Retail Charge - inc GST		\$137	\$710			\$846
ACT	<u>ActewAGL Home Plan - inc GST, 1 July 2003 (ActewAGL proposal)</u>	c/day, \$/kWh	0.418	0.105			
	Chargeable quantities	days, kWhs	365	7,500			7,500
	Retail Charge - inc GST		\$153	\$784			\$936
ACT	<u>ActewAGL Home Plan - inc GST, 1 July 2003 (Price Direction)<sup>1</sup></u>	c/day, \$/kWh	0.404	0.102			
	Chargeable quantities	days, kWhs	365	7,500			7,500
	Retail Charge - inc GST		\$147	\$766			\$913
NSW	<u>Integral Energy Domestic 010 - inc GST, 1 August 2002</u>	c/day, \$/kWh	0.258	0.120			
	Chargeable quantities	days, kWhs	365	7,500			7,500
	Retail Charge - inc GST		\$94	\$899			\$994
NSW	<u>Energy Australia Domestic All Time - inc GST, December 2002</u>	c/day, \$/kWh	0.224	0.107			
	Chargeable quantities	days, kWhs	365	7,500			7,500
	Retail Charge - inc GST		\$82	\$801			\$883
SA	<u>AGL Domestic Light/Power 110 - inc GST, 1 January 2003</u>	c/day, \$/kWh	0.340	0.174	0.185		
	Chargeable quantities	days, kWhs	365	1,200	6,300		7,500
	Retail Charge - inc GST		\$124	\$208	\$1,168		\$1,500
Vic	<u>AGL Residential GD/GR - inc GST, 2003</u>	c/day, \$/kWh	0.415	0.143	0.150		
	Chargeable quantities	days, kWhs	365	4,080	3,420		7,500
	Retail Charge - inc GST		\$152	\$582	\$514		\$1,248
Vic	<u>AGL Victoria Pty Ltd (formerly Pulse) Residential GD/GR - inc GST, 2003</u>	c/day, \$/kWh	0.430	0.140	0.149		
	Chargeable quantities	days, kWhs	365	4,080	3,420		7,500
	Retail Charge - inc GST		\$157	\$573	\$508		\$1,238
Vic	<u>TXU Residential GD/GR - inc GST, 2003</u>	c/day, \$/kWh	0.418	0.168	0.143		
	Chargeable quantities	days, kWhs	365	4,080	3,420		7,500
	Retail Charge - inc GST		\$152	\$683	\$488		\$1,323

1. Based on application of the Commission's aggregate tariff control formula. Individual tariffs may vary around the aggregate requirement, subject to the Commission being satisfied that the individual tariff rates are consistent with the needed to protect the interests of consumers and other requirements.

State	Retailer / Tariff		Service Charge	Consumption		Off Peak	Total
				Peak block 1	block 2		
				(where applied)			
<b>Consumption - 4,500 kWh peak, 3,000 kWh off peak</b>							
ACT	<u>ActewAGL Home Plan + Off-Peak Saver Plan- inc GST, 1 July 2002</u>	c/day, \$/kWh	0.374	0.095		0.057	
	Chargeable quantities	days, kWhs	365	4,500		3,000	7,500
	Retail Charge - inc GST		\$137	\$426		\$172	\$734
ACT	<u>ActewAGL Home Plan + Off-Peak Saver Plan- inc GST, 1 July 2003 (ActewAGL proposal)</u>	c/day, \$/kWh	0.418	0.105		0.067	
	Chargeable quantities	days, kWhs	365	4,500		3,000	7,500
	Retail Charge - inc GST		\$153	\$470		\$201	\$824
ACT	<u>ActewAGL Home Plan + Off-Peak Saver Plan- inc GST, 1 July 2003 (Price Direction)<sup>1</sup></u>	c/day, \$/kWh	0.404	0.102		0.062	
	Chargeable quantities	days, kWhs	365	4,500		3,000	7,500
	Retail Charge - inc GST		\$147	\$459		\$185	\$792
NSW	<u>Integral Energy Domestic 010 - inc GST, 1 August 2002</u>	c/day, \$/kWh	0.258	0.120		0.046	
	Chargeable quantities	days, kWhs	365	4,500		3,000	7,500
	Retail Charge - inc GST		\$94	\$540		\$139	\$772
NSW	<u>Energy Australia Domestic All Time + Controlled Load (night rate only) - inc GST, December 2002</u>	c/day, \$/kWh	0.224	0.107		0.045	
	Chargeable quantities	days, kWhs	365	4,500		3,000	7,500
	Retail Charge - inc GST		\$82	\$481		\$134	\$697
SA	<u>AGL Domestic Light/Power 110 + Off Peak Contolled Load - inc GST, 1 January 2003</u>	c/day, \$/kWh	0.409	0.174	0.185	0.070	
	Chargeable quantities	days, kWhs	365	1,200	3,300	3,000	7,500
	Retail Charge - inc GST		\$149	\$208	\$612	\$209	\$1,178
Vic	<u>AGL Residential GD/GR + Off Peak Y8 - inc GST, 2003</u>	c/day, \$/kWh	0.415	0.143	0.150	0.070	
	Chargeable quantities	days, kWhs	365	4,080	420	3,000	7,500
	Retail Charge - inc GST		\$152	\$582	\$63	\$209	\$1,005
Vic	<u>AGL Victoria Pty Ltd (formerly Pulse) Residential GD/GR + Off Peak Y8 - inc GST, 2003</u>	c/day, \$/kWh	0.430	0.140	0.149	0.082	
	Chargeable quantities	days, kWhs	365	4,080	420	3,000	7,500
	Retail Charge - inc GST		\$157	\$573	\$62	\$245	\$1,038
Vic	<u>TXU Residential GD/GR + Off Peak Y8 - inc GST, 2003</u>	c/day, \$/kWh	0.418	0.168	0.143	0.069	
	Chargeable quantities	days, kWhs	365	4,080	420	3,000	7,500
	Retail Charge - inc GST		\$152	\$683	\$60	\$208	\$1,104

1. Based on application of the Commission's aggregate tariff control formula. Individual tariffs may vary around the aggregate requirement, subject to the Commission being satisfied that the individual tariff rates are consistent with the needed to protect the interests of consumers and other requirements.

## **ATTACHMENT 4: Submissions from Interested Parties**

### **Public Submissions received on the Issues Paper**

**Contact Name**

**Organisation**

Nicola Davies

Conservation Council of the South East  
Region and Canberra

Maria Storti

ActewAGL

Ivan Slavich

ActewAGL



## ATTACHMENT 5: The Commission's Price Direction

Financial Year	Permitted Tariff Revenue Increase
2003/04	CPI + 4.5%
2004/05	CPI + 0.5%
2005/06	CPI + 0.5%

The above price variation factors are to apply to TFT prices at the commencement of each financial year of the transition period (starting with the application of the 2003/04 factor to the existing (2002/03) franchise customer tariffs to determine the TFT prices for 2003/04)<sup>10</sup>.

These factors are to apply to TFT prices in aggregate subject to:

- pass through events and price review triggers in respect of matters that are fixed at the time of the direction but may change over time, and where the costs of such events could be not reasonably expected to be borne by the retailer; and
- the Commission being satisfied that the prices contained in a price variation submission lodged by the retailer are consistent with:
  - the need to protect the interests of consumers;
  - the requirement for tariff structures to be economically efficient, where practicable; and
  - the promotion of retail competition

### Protection of the Interest of Consumers

In being satisfied that the prices contained in a price variation submission are consistent with the need to protect the interest of consumers, the Commission is to assess the impact of the proposed prices on the basis of their effects on the annual bills of different customer profiles in respect of each TFT tariff.

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<sup>10</sup> The CPI used in the adjustment is the movement in the CPI for the four quarters ending March prior to the July, from when the new prices will apply. Thus, the movement in the ACT CPI for the 2003/04 year will be the four quarters April 2002 to March 2003; the 2004/05 years would be the four quarters April 2003 to March 2004; and 2005/06 year, the four quarters April 2004 to March 2005. The movement is calculated by averaging the Canberra CPI for each of the four quarters of the year concerned and dividing the latest year by the previous year.

## **Pass Throughs**

Changes in the following matters affecting ActewAGL's costs are pass through events:

- wholesale market conditions affecting ActewAGL's proposed benchmark price;
- the form of market arrangements adopted in the ACT market;
- NEMMCO fees and charges;
- MRETS/greenhouse levies;
- FRC customer churn rates (which give rise to FRC cost recovery different to forecast levels);
- network tariff variations; and
- other fees, taxes and imposts.

## **Price Variation Triggers**

Changes in the following matters affecting ActewAGL's costs are price variation triggers which would entitle the Commission to initiate a reference to make a variation to the price direction:

- significant changes to obligations and or costs under access arrangements, regulation or codes;
- significant and fundamental wholesale market adjustments affecting price, and relevant related pass-through costs allowances, such as demand forecast errors, insolvency of counter party, and ancillary services market; and
- significant variations to the obligations or costs associated with the ACT RoLR and metrology arrangements.