



ICRC

independent competition and regulatory commission

Proposed price direction
**Standing offer prices for
the supply of electricity
to small customers**

1 July 2014 to 30 June 2017

Report 2 of 2014

February 2014

The Independent Competition and Regulatory Commission is a Territory Authority established under the *Independent Competition and Regulatory Commission Act 1997* (the ICRC Act). The Commission is constituted under the ICRC Act by one or more standing commissioners and any associated commissioners appointed for particular purposes. Commissioners are statutory appointments and the current Commissioners are Senior Commissioner Malcolm Gray and Commissioner Mike Buckley. We, the Commissioners who constitute the Commission, take direct responsibility for delivery of the outcomes of the Commission.

We have responsibilities for a broad range of regulatory and utility administrative matters. We have responsibility under the ICRC Act for regulating and advising government about pricing and other matters for monopoly, near-monopoly and ministerially declared regulated industries, and providing advice on competitive neutrality complaints and government-regulated activities. We also have responsibility for arbitrating infrastructure access disputes under the ICRC Act. In discharging our objectives and functions, we provide independent robust analysis and advice.

Our objectives are set out in section 7 of the ICRC Act and section 3 of the Utilities Act.

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Part A Preliminary

1 Proposed price direction¹

This Price Direction is set out in accordance with the *Independent Competition and Regulatory Commission Act 1997* (ICRC Act or the Act) and the terms of reference issued by the referring authority for an investigation into, and the making of, a price direction for standing offer prices for the supply of electricity to small customers consuming under 100 MWh per consumption period of 12 consecutive months.² The terms of reference further set out that this Price Direction is to apply to ActewAGL Retail for the period stipulated below in clause 2.

The Price Direction consists of:

Parts A through C, the clauses and subclauses in those parts, the tables in those parts, and one attachment.

The parts are set out as follows:

- Part A – Preliminary.
- Part B – Price regulation method.
- Part C – Legislative provisions.

Part A sets out the preliminary information to the Price Direction.

Part B sets out the formula for the weighted average price cap to apply for the regulatory period. The part then sets out the regulatory method used to recalibrate the cap on an annual basis for the years 2015–16 and 2016–17. The regulatory method includes provisions for the inclusion of pass-throughs during the regulatory period.

Part C sets out the reset principles and trigger mechanisms for variation of the Price Direction once in force.

2 The regulatory period

This Price Direction determines, within the meaning of the ICRC Act, a maximum weighted average price cap that applies for the period 1 July 2014 to 30 June 2017.

¹ This document (ICRC Report 2 of 2014) is a proposed price direction set out pursuant to section 18(5)(a) of the *Independent Competition and Regulatory Commission Act 1997* (the Act). The use of finalised terms such as ‘Price Direction’ and ‘final Price Direction’ are used for drafting purposes and do not make this proposed price direction a final price direction as determined under Part 4 of the Act.

² Terms of reference: DI2014-10.

3 Application of the Price Direction

Pursuant to the terms of reference and section 15(4) of the ICRC Act, this Price Direction applies to **ActewAGL Retail ABN 46 221 314 841** (the partnership of ACTEW Retail Ltd ABN 23 074 371 207 and AGL ACT Retail Investments Pty Ltd ABN 53 093 631 586).

4 Section 20(2) of the ICRC Act

Under section 20(4) of the ICRC Act, the Independent Competition and Regulatory Commission (the Commission) is required to indicate in the price direction the extent to which it has had regard to the matters referred to in section 20(2) of the ICRC Act. The table in Attachment 1 indicates the extent to which the Commission has had regard to the matters referred to in section 20(2).

5 Notes and interpretation

Business days

Business days are all days other than Saturday, Sunday and ACT public holidays.

Dates outlined in the Price Direction that require a specified action that fall on a non-business day will be deemed to fall on the first business day following the non-business day.

Monetary values

All monetary values in the Price Direction are in Australian dollars.

National Energy Retail Law (ACT)

As defined in section 6(1)(b) of the *National Energy Retail Law (ACT) Act 2012*.

Reference to years

Unless otherwise stated, a reference to a year in the form *2014–15* (as an example) means the financial year from 1 July to 30 June.

Small customer

Defined in the terms of reference as being a customer of ActewAGL Retail paying the standing offer price for the supply of electricity and who consumes less than 100 MWh of electricity per consumption year.

Standing offer prices

As described in clause 2 of the terms of reference.

Standard retail contract

Has the same meaning as in the *National Energy Retail Law (ACT)* for small customers paying the standing offer price.

Part B Price regulation method

6 Standing offer prices

ActewAGL Retail must ensure that its standing offer prices for each year of the regulatory period comply with the following weighted average price cap formula:

$$1 + Y^t \geq \frac{\sum_{i=1}^n \sum_{j=1}^m P_{ij}^t Q_{ij}^{t-1}}{\sum_{i=1}^n \sum_{j=1}^m P_{ij}^{t-1} Q_{ij}^{t-1}}$$

where:

- ActewAGL Retail has n standing offer tariffs that each have up to m price components.
- Y^t is the maximum percentage change in average standing offer prices determined in accordance with the cost-index model.
- P_{ij}^t is the price that ActewAGL Retail proposes to charge for component j of standing offer tariff i for year t.
- P_{ij}^{t-1} is the price that ActewAGL Retail charges for component j of standing offer tariff i in the year t-1.
- Q_{ij}^{t-1} is the reference quantity for component j of the standing offer tariff i defined as the actual quantity (in both customer numbers or megawatt hours) as reported by ActewAGL Retail for the 12-month period ending 31 March in year t-1.

For the 2014–15 regulatory year, Y^t is 1.18 per cent. For the 2015–16 and 2016–17 regulatory years, Y^t is calculated in accordance with clause 7.2.

6.1 Assessment of prices 2014-15

For the 2014–15 regulatory year the proposed schedule of standing offer prices will be assessed in June 2014 in accordance with the procedures set out in clauses 7.1(e) and (f).

7 Annual recalibration

For the regulatory years 2015–16 and 2016–17 the Commission will make annual recalibrations as per the timeline set out in Table 7.1 to ascertain the Y^t that will apply in the weighted average price cap formula for each year. As part of the recalibration of Y^t , the Commission will consider pass-through applications as set out in clause 8 and its sub-clauses.

Table 7.1 Annual recalibration timeline

| | Assessment process | Period price cap is set |
|-----------------------------|----------------------------|-----------------------------|
| First annual recalibration | 10 May 2015 to 7 June 2015 | 1 July 2015 to 30 June 2016 |
| Second annual recalibration | 10 May 2016 to 7 June 2016 | 1 July 2016 to 30 June 2017 |

7.1 The assessment process

Clause 7.1 sets out the assessment process for an annual recalibration. The dates set out relate to the year of the relevant assessment process. The assessment process occurs prior to the relevant regulatory year for which the weighted average price cap is set.

The assessment process will occur as follows:

- (a) On or before 10 May, ActewAGL Retail must submit to the Commission the following information:
 - (i) Calculation of costs associated with achieving environmental objectives for the year in question, including LRET, SRES and ACT energy efficiency scheme costs, and any proposed adjustments.
 - (ii) Full accounting of all proposed pass-through event costs that may be claimed under clause 8 and its sub-clauses.
- (b) ActewAGL Retail must submit to the Commission for verification the updated network costs for the regulated customer load as soon as they are approved by the AER.
- (c) As per clause 7.4, the Commission will determine the energy purchase cost component based on data available up to 31 May.
- (d) As per clause 7.2, the Commission will determine the value of Y^t , which is the percentage by which the weighted average price cap may adjust. The Commission will provide its determination to ActewAGL Retail on or before 7 June.
- (e) ActewAGL Retail must provide the Commission with its proposed schedule of standing offer prices including the associated weighted average price cap calculations.
- (f) Subsequent to clause 7.1(e) occurring, the Commission will – subject to an assessment that the proposals are consistent with the Price Direction – approve the proposed prices within two working days of receipt of the proposed schedule.

7.2 The value of Y^t

For the regulatory years 2015–16 and 2016–17 the Commission will determine Y^t using the method set out in Table 7.2.

Table 7.2 Method for determining Y^t

| Component | Method |
|-----------------------------------|--|
| Energy purchase cost (\$/MWh) | As determined by the Commission at the time of the recalibration using the energy purchase cost model |
| LRET and SRES costs (\$/MWh) | Estimates from ActewAGL Retail for the 2015–16 and 2016–17 years respectively which are verified and applied using the Commission's methodology |
| Energy efficiency scheme | Estimates from ActewAGL Retail for the 2015–16 and 2016–17 years as required, subject to a prudence and efficiency assessment with costs determined using the Commission's methodology |
| Energy losses (%) | Based on AEMO's estimates for 2015–16 and 2016–17 as appropriate |
| Energy contracting costs (\$/MWh) | Previous year's value adjusted by the change in CPI |
| NEM fees (\$/MWh) | Previous year's value adjusted by the change in CPI |
| Retail operating costs (\$/MWh) | Previous year's value adjusted by the change in CPI |
| Network costs (\$/MWh) | As determined and approved by the AER and applied by ActewAGL Retail to the standard retail contract customer load, and subsequently verified by the Commission |
| Cost pass-through (\$/MWh) | Cost pass-through verified by the Commission in current dollars as adjusted by the change in CPI |
| Retail margin (%) | 5.7 per cent of total costs |

Note: Change in the CPI is calculated as per clause 7.3.

7.3 Calculation of the change in CPI

The Commission will calculate the percentage change in the consumer price index for any relevant year t using the following formula, populated with the Australian Bureau of Statistics all groups index for the weighted average of eight capital cities.

$$\Delta \text{CPI}_t = \frac{\text{CPI}_{\text{Mar}(t-2)} + \text{CPI}_{\text{Jun}(t-2)} + \text{CPI}_{\text{Sep}(t-1)} + \text{CPI}_{\text{Dec}(t-1)}}{\text{CPI}_{\text{Mar}(t-3)} + \text{CPI}_{\text{Jun}(t-3)} + \text{CPI}_{\text{Sep}(t-2)} + \text{CPI}_{\text{Dec}(t-2)}} - 1$$

7.4 Calculation of energy purchase costs

The Commission will calculate energy purchase costs for 2015–16 and 2016–17 in the manner set out below:

$$\text{EPC}_s = \text{FP}_s \times [(1 - M_s) \times \text{LS}_s + M_s \times \text{LR}_s] + \text{C} \text{ and}$$

$$\text{EPC} = \sum_{i=1}^4 w_s \times \text{EPC}_s$$

where the following are defined for each quarter s :

- EPC_s denotes the carbon-inclusive energy purchase cost.
- FP_s denotes the carbon-exclusive forward price.

- M_s denotes the forward price margin.
- LS_s denotes the load shape.
- LR_s denotes the load ratio.
- C denotes the cost of carbon.
- w_s denotes the quarterly load weight.
- the subscript s denotes the quarter.
- EPC without the subscript denotes the annual energy purchase cost.

These components are calculated as follows for each year:

- The forward price is the simple average price of the ICAP Energy Australia's over-the-counter prices for New South Wales for the 23 month period up to 31 May prior to the regulatory year in question. The annual forward price is applied to all four quarters of the regulatory year.
- The forward price margin is set at five per cent.
- The load shape is the ratio of the load-weighted spot price to the time-weighted spot price where loads are based on the ActewAGL Distribution net system load profile as reported by the Australian Energy Market Operator (AEMO). The load shape is equal to the average load shape from 2003-04 through the latest data available. For quarters where the cost of carbon applies, the load shape will be calculated after subtracting the cost of carbon from each half-hourly price.
- The load ratio for each quarter is equal to the ratio of the maximum half-hourly load in the quarter to the average half-hourly load in the quarter. The load to be used is the net system load profile for ActewAGL Retail as reported by the AEMO. The load ratio to be applied for quarter s is equal to the maximum load ratio observed to date plus 0.1.
- The cost of carbon is equal to the product of the carbon reference price as determined under the Australian Government's *Clean Energy Act 2011 (Cth)* (the Clean Energy Act) multiplied by the national average carbon intensity. The average carbon intensity is equal to the average of the daily emissions intensity factor across the most recent available 365 days on 31 May prior to the regulatory year in question for the National Electricity Market as reported by the AEMO in its Carbon Dioxide Equivalent Intensity Index.
- The load weights for each quarter are equal to the historical average load in that quarter divided by the sum of the historical average load for all four quarters. The historical average load for a quarter is the simple average of the average loads for that quarter for the period from 2003-04 through the latest data available. The load to be used is the net system load profile for ActewAGL Distribution as reported by the AEMO.

8 Pass-through events

8.1 Regulatory change and tax change events

8.1.1 Application for a pass-through event

ActewAGL Retail may make an application to the Commission for consideration of a pass-through event as part of the annual recalibration process as per clause 7. Applications may be made for the following events:

- (a) Regulatory change event (clause 8.1.5); or
- (b) Tax change event (clause 8.1.6).

8.1.2 Application may be accepted, rejected or amended by the Commission

Consideration by the Commission under clause 8 and its sub-clauses of an application for a pass-through event may result in a pass-through event application being accepted, rejected or amended. If the Commission amends a pass-through application, the amended costs are those that are passed through in the annual recalibration. The Commission will provide a statement of reasons if it rejects or amends a pass-through event.

8.1.3 Further information

The Commission may seek further information from ActewAGL Retail in relation to an application for a pass-through event.

8.1.4 Commission may initiate pass-through event

The Commission may initiate one or more pass-through events set out under clauses 8.1.5 and 8.1.6 without an application from ActewAGL Retail. The initiation and determination by the Commission (and result of such determination on the weighted average price cap) will occur as if ActewAGL Retail made the application for the pass-through event/s under clause 8.1.1.

8.1.5 Regulatory change event

A regulatory change event is a decision made on or after 31 May 2014 and before 30 June 2017 by any ACT or Commonwealth ‘Authority’ (any government or any minister, agency or department, instrumentality or other authority of government and the Commission, the AEMC, the AER or AEMO) that has the extent of materially

varying the nature, scope, standard or risk of providing services to small customers, or the manner in which those services are provided. A regulatory change event includes obligations in respect of:

- any customer hardship program;
- retailer of last resort events;
- environmental schemes including the LRET and SRES schemes and the Energy Efficiency Improvement Scheme; or
- changes in distribution or transmission charges.

A regulatory change event does not include obligations in respect of:

- any decision, determination or ruling in relation to energy loss factors; or
- smart metering trials.

8.1.6 Tax change event

A tax change event means the imposition of a relevant tax, the removal of a relevant tax, or a change in the way a relevant tax is interpreted or calculated where the outcome of the change affecting ActewAGL Retail occurs on or after 31 May 2014 and before 30 June 2017. A relevant tax is any tax, levy, impost, deduction, charge, rate, duty or withholding tax that is levied on ActewAGL Retail by any Authority (as defined above) and is payable by ActewAGL Retail, other than:

- income tax and capital gains tax;
- stamp duty;
- AEMO fees;
- fees payable by ActewAGL Retail in respect of its retail licence;
- penalties, charges, fees and interest on late payments, or deficiencies in payments, relating to any tax; or
- any tax that replaces or is equivalent or similar to any of the taxes referred to above (including any state-equivalent tax).

8.1.7 Materiality threshold

A pass-through event application for regulatory change and tax change events may only be made where ActewAGL Retail incurs materially higher or lower costs in providing services regulated under this Price Direction such that the aggregate impact of the pass-through event or events on costs is greater than 0.25 per cent of ActewAGL Retail's revenue from the regulated standing offer prices in the 12 months to March of the most recent year. In making the application for the pass-through, ActewAGL Retail must provide evidence to the Commission to confirm the materiality threshold has been reached as per this clause.

8.1.8 Calculation of a regulatory change or tax change event

General matters

The Commission will calculate the pass-through amount when considering a pass-through event as part of an annual recalibration process having regard to the following matters:

- the implications for the efficient costs of ActewAGL Retail’s actions, including whether ActewAGL Retail has taken or omitted to take any action where such action or omission has increased the magnitude of the costs incurred;
- the need to ensure that ActewAGL Retail does not recover costs to the extent that provisions have already been made or otherwise taken into account;
- the need to ensure that ActewAGL Retail only recovers any actual or likely increment in efficient costs to the extent that such an increment is solely as a consequence of a pass-through event;
- in the case of a regulatory change event, any costs that ActewAGL Retail has incurred prior to, but in preparation for, the occurrence of that regulatory change event; and
- in the case of a tax change event, any change in the way another tax is calculated, or the removal or imposition of another tax which in the Commission’s opinion is complementary to the tax change event concerned.

In addition:

- In considering any pass-through event, the Commission may consult with affected stakeholders to the extent the Commission considers appropriate.
- For the avoidance of doubt, the Commission will not have regard to the time value of money when establishing the amount of any pass-through.

Regulatory change and tax change event pass-through mechanism

As specified in Table 7.2, for a regulatory change or tax change pass-through event that occurs during 2014–15 or 2015–16, when determining Y^i , the Commission will include the value of the pass-through event, which can be either negative or positive, in the cost-index model.

8.2 Carbon price event

8.2.1 Commission may initiate pass-through event

The Commission may initiate a pass-through review for a carbon price event at any time within a regulatory year.

8.2.2 Timing of pass-through event outcome

Where a pass-through event is initiated by the Commission during 2014–15, 2015–16 or 2016–17, the Commission may require ActewAGL Retail to implement the outcome of a pass-through event at a particular date or in a particular manner. This is to ensure that the timing of any price adjustment arising from a pass-through review is consistent with *National Energy Retail Law* requirements.

8.2.3 Carbon price event

A carbon price event means any change made on or after 31 May 2014 and before 30 June 2017 to the price on carbon arrangements set out in the Clean Energy Act.

8.2.4 No materiality threshold

A carbon price event (clause 8.2.3) is not subject to a materiality threshold.

8.2.5 Determination of a carbon price pass-through event

General matters

In considering a carbon price pass-through event, the Commission may consult with affected stakeholders to the extent the Commission considers appropriate.

Pass-through mechanism

For a within-year event, the Commission will calculate the required percentage change to apply to ActewAGL Retail’s standing offer prices using the formula below. The Commission will notify ActewAGL Retail of the required percentage change. ActewAGL Retail must then ensure that all components of its standing offer prices are adjusted by this percentage change.

$$CA^t = \left(\frac{CETC^t}{CITC^t} - 1 \right) \times 100$$

where:

- CA is the percentage adjustment due to the removal of the price on carbon to be applied to all components of ActewAGL Retail’s standing offer prices.
- CETC is the total cost in dollars per MWh from the Commission's cost-index model using a carbon-exclusive energy purchase cost.
- CITC is the total cost in dollars per MWh from the Commission's cost-index model using a carbon-inclusive energy purchase cost.

Part C Legislative provisions

Nothing in this Part C limits the provisions of the ICRC Act.

9 Price Direction variation trigger events

Pursuant to sections 20A(3)(c) and 24F(2) of the ICRC Act, the following events are price variation trigger events, the occurrence of which allows the Commission to initiate, at its discretion, a reference for the variation of the Price Direction:

- (a) an act of terrorism;
- (b) a major natural disaster;
- (c) a significant change to ActewAGL Retail's financial or corporate structure;
- (d) an unforeseen or *force majeure* event that severely restricts ActewAGL Retail's ability to provide services; or
- (e) a change/s made on or after 31 May 2014 and before 30 June 2017 to the price on carbon arrangements set out in the Clean Energy Act where the change/s cannot be passed through under Part B and its sub-clauses.

10 Reset principles

Pursuant to section 20B of the ICRC Act, the future reset principle is:

- (a) The Commission will seek a reference from the relevant minister regarding services covered by this Price Direction 18 months prior to the expiry of the regulatory period set out in clause 2 of this Price Direction.

Attachment 1 Compliance with section 20(2)

Compliance with section 20(2) of the ICRC Act

| Section 20(2) | Requirement | Draft report chapter | Comments |
|---------------|--|----------------------|---|
| (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 | 2, 3, 5 | The Commission applies a weighted average price cap form of control to ActewAGL Retail's suite of regulated retail electricity tariffs. The price cap is based on the recovery of efficient costs. Together these actions protect consumers from the abuses of monopoly power in terms of prices. |
| (b) | Standards of quality, reliability and safety of the regulated services | 3, 5 | The Commission's retail electricity cost-index model, and in particular the retail operating cost component, is designed to cover the efficient costs of providing retail electricity services. This includes the costs of meeting quality, reliability and safety standards. As a specific example, the payment of ancillary services fees, which is captured in the cost-index model, assists AEMO in providing for safe and reliable delivery of electricity to all consumers. |
| (c) | The need for greater efficiency in the provision of regulated services to reduce costs to consumers and taxpayers | 3, 5 | The Commission's retail electricity cost-index model is based on the efficient costs of providing retail electricity services in the ACT. As an example, to determine the energy purchase cost allowance, the Commission has adopted an approach based on independent and verifiable market data and a range of assumptions based on industry standards to provide a reasonable estimate of the cost of purchasing wholesale energy from a competitive market pool. |
| (d) | An appropriate rate of return on any investment in the regulated industry | 2, 3, 5 | The Commission is proposing a retail margin of 5.7 per cent of the total efficient cost of providing retail electricity services. The Commission is confident that this provides an appropriate rate of return on investment in the retail electricity industry. |
| (e) | The cost of providing the regulated services | 3, 4, 5 | The Commission's retail electricity cost-index model is designed to recover the efficient costs of providing retail electricity services in the ACT. The Commission considers that the allowance granted for retail operating costs is a reasonable balance between the need to allow cost recovery and the need to require the incumbent to operate efficiently. |
| (f) | The principles of ecologically sustainable development | 3, 5 | The Commission's retail electricity cost-index model includes the efficient costs of various environmental measures such as the price on carbon, the national LRET and SRES schemes and the ACT energy efficiency schemes. These costs reflect to some extent the environmental costs incurred in the consumption of electricity that the Australian Government and ACT Government consider should be passed through to consumers. |
| (g) | The social impacts of the | 3, 4, 5 | Social considerations are taken into account first by |

| Section 20(2) | Requirement | Draft report chapter | Comments |
|---------------|--|----------------------|--|
| | decision | | <p>ensuring that the regulated price is based on efficient costs. The Commission also considers submissions from consumer rights organisations and the ACT community and considers the impacts of proposed price changes on customer electricity bills.</p> <p>In addition, the Commission has had regard to the social impacts of its decisions by not including a competition allowance. This was on the basis that the Commission considers the introduction of a competition allowance in the ACT to be a high risk strategy because there is a strong possibility that any benefits it may produce will be long delayed, and therefore of little present value, and a distinct possibility that it will not produce benefits even in the long term.</p> |
| (h) | Considerations of demand management and least-cost planning | 3, 5 | The ACT Government's energy efficiency scheme has a demand management element. The costs of this scheme are accounted for in the cost-index model. |
| (i) | The borrowing, capital and cash flow requirements of people providing regulated services and the need to renew or increase relevant assets in the regulated industry | 3, 5 | The Commission's retail electricity cost-index model provides for the efficient costs of providing retail electricity services in the ACT. This includes a retail margin of 5.7 per cent of the total efficient cost. The Commission is confident that this provides sufficient room to meet the borrowing, capital and cash flow requirements and meet the retail industry investment requirements. |
| (j) | The effect on general price inflation over the medium term | 3, 5, 6 | The Commission ensures that only efficient costs are applied in the cost-index model. A number of components of the model are adjusted each year by the change in the consumer price index. |
| (k) | Any arrangements that a person providing regulated services has entered into for the exercise of its functions by some other person | 3, 5 | The recovery of energy losses in the cost-index model is mandated in the NEM framework and therefore meets the 20(2)(k) requirement. |

Abbreviations and acronyms

| | |
|------------------|---|
| ACT | Australian Capital Territory |
| AEMC | Australian Energy Market Commission |
| AEMO | Australian Energy Market Operator |
| AER | Australian Energy Regulator |
| Clean Energy Act | <i>Clean Energy Act 2011 (Cth)</i> |
| Commission | Independent Competition and Regulatory Commission |
| CPI | consumer price index |
| ICRC | Independent Competition and Regulatory Commission |
| ICRC Act | <i>Independent Competition and Regulatory Commission Act 1997 (ACT)</i> |
| LRET | Large-scale Renewable Energy Target |
| MWh | megawatt hours |
| NEM | National Energy Market |
| SRES | Small-scale Renewable Energy Scheme |