ELECTRICITY MODEL AND METHODOLOGY REVIEW 2018-19

ACTEWAGL RETAIL SUBMISSION TO THE INDEPENDENT COMPETITION AND REGULATORY COMMISSION DRAFT REPORT

2 May 2019

ActewAGL for you

Contents

1 Introduction

ActewAGL Retail (AAR) welcomes the opportunity to provide a submission on the Independent Competition and Regulatory Commission's (ICRC's) Draft Report, published on 4 April 2019, on the electricity model and methodology used for setting regulated electricity retail prices for small customers in the Australian Capital Territory (ACT) on standing offers.[1] The Draft Report sets out the ICRC's proposed approach to determining each component of the cost index model to be implemented from 1 July 2020.

The Draft Report follows the ICRC's Issues Paper released on 15 October 2018 and the Technical Paper on energy purchase costs (EPC) released on 1 February 2019, to which AAR responded on 26 February 2019.

The purpose of the Draft Report is to provide "…*an opportunity for stakeholders to give feedback and views on the Commission's draft decisions on the model and methodology it intends to use in making its decision on regulated retail electricity prices during the price investigation for the next regulatory period. It will also ensure that relevant information and views are made public and the Commission can consider relevant information and views in making its final decision on the model and methodology*."[2]

This submission presents AAR's views on the ICRC's Draft Report.

In summary, it is AAR's view that:

- the ICRC has not demonstrated that the positive features of the current EPC methodology will be retained or that the benefits of the new, mixed derivative, approach clearly exceed those foregone;
- if the ICRC is to adopt the new EPC approach then its Final Report should clarify the process for determining the benchmark contract position and it should adopt an approach to determining the load profile and spot prices that is simple, transparent and replicable;
- the ICRC's draft decision to move green scheme administrative costs and energy contracting costs (ECC) to the retail operating cost (ROC) component of the cost-index model requires a fully transparent approach to ensure that a hypothetical efficient retailer in the same position as AAR can fully recover its costs as required under the ICRC Act 1997 (the Act); and
- the green scheme holding costs should be retained with the costs of the green schemes and not be included in the ROC as proposed in the ICRC's draft decision.

Table 1 below summarises the ICRC's draft decision with AAR's response for each cost component of the model.

[1] ICRC (2019) Electricity Model and Methodology Review 2018-19, Draft Report, Report 3 of 2019, April
[2] ICRC (2019), p.iii

Table 1: ICRC's draft decision and AAR's response

Model component	ICRC's draft decision	AAR response
EPC	Calculate forward prices averaged over a 23 month period.	Support.
	Use the last 5 years prior to the price direction to determine an appropriate load profile and spot prices.	Use the last 5 years prior to each annual recalibration to determine an appropriate load profile and spot prices.
	Consider using a mix of derivatives in the hedging strategy (with an appropriate contract position to be determined in the next price investigation).	If the ICRC is to adopt the mixed derivative approach, it should clarify the process for determining the benchmark contract position and it should adopt an approach to determining the load profile and spot prices that is simple, transparent and replicable.
National green scheme costs	Maintain the current approach but do not add holding and administrative mark-up costs.	Maintain the current approach except: • retain holding costs with national green scheme costs. • provided that the methodology is transparent and consistent with the cost recovery requirements of the Act, include administration costs in the ROC.
Energy losses	Maintain the current approach that uses data externally determined by the Australian Energy Market Operator (AEMO).	Support.
National Electricity Market (NEM) fees	Calculate ancillary fees using a 52-week averaging period and determine NEM fees using observed AEMO cost data for the first year of the regulatory period, with subsequent years indexed by the CPI.	Support.
ECC	Review during the next price investigation when the inputs to the model are determined and consider whether these costs are included in ROC.	AAR considers that the ECC is not currently included in the ICRC's ROC allowance. Going forward the ECC could be moved into the ROC provided sufficient allowance is made for its recovery.

Model component	ICRC's draft decision	AAR response
ROC	Maintain the current benchmarking methodology and consider the appropriate benchmarks to use during the next price investigation.	AAR supports continued use of hybrid bottom-up and benchmarked costs. The ICRC's draft decision to move green scheme administrative and holding costs and ECC to the ROC requires careful consideration of benchmarks to reflect a hypothetical retailer in the same position as AAR. AAR will provide further response when ICRC has assessed new information from the concurrent regulatory investigations.[3] AAR requests allowances for customer acquisition and retention costs (CARC) and economies of scale to be included.
Retail margin	Maintain the current benchmarking methodology and consider the appropriate benchmarks to use during the next price investigation.	The current ex-ante retail margin of 5.3 per cent is inconsistent with Australian regulatory practice and the retail margin recommended by SFG. The retail margin should be within the range of 5.6 per cent to 6.5 per cent.
Energy Efficiency Improvement Scheme (EEIS) costs	Maintain the current approach.	Support.
Network costs	Maintain the current approach that uses data externally determined by the Australian Energy Regulator (AER).	Support.

2 Wholesale electricity costs

2.1 Energy purchase costs

While AAR supports some of the ICRC's draft decisions in relation to the estimation of the EPC, it remains concerned with key aspects of the mixed derivative approach. In particular, the implementation of the mixed derivative approach is more complex than the current model and the ICRC's proposed Monte Carlo simulation approach to estimating the load profile and spot prices would increase complexity, reduce transparency and make it difficult for stakeholders to replicate. If the ICRC does adopt the mixed derivative methodology in its final decision, AAR recommends an alternative method to determining the load profile and spot prices and a number of processes that could improve stakeholder confidence in the new approach.

[3] Including AER (30 April 2019) Final Determination of Default Market Offer Prices in 2019-2020; ACCC (March 2019) Electricity Market Monitoring – March 2019 Report and; ESC Electricity and gas retail markets review implementation 2018 (Victorian Default Offer)

Hedging strategy

The ICRC's draft decision does not provide a firm view on whether it will retain the existing EPC model, which is a base swaps only hedging strategy, or adopt the approach recommended by Frontier Economics (Frontier), which involves modelling the EPC based on a mixed derivative hedging strategy (a mix of base swaps, peak swaps and base cap contracts).

The ICRC's Draft Report acknowledges the benefits of retaining the existing EPC model, stating that the current model is long established, has been widely consulted upon and provides substantial regulatory certainty.[4] In addition, the ICRC notes that Frontier found the current model to be methodologically sound, simple and transparent.[5]

However, the ICRC Draft Report states that adopting an approach to modelling the EPC based on a mixed derivative hedging strategy is likely to better reflect current retailer practices and risk policies.[6]

In weighing-up the relative benefits of each approach, the ICRC states:

On balance, the Commission is inclined to consider adopting Frontier Economics' recommendation to include a mix of derivatives in the hedging strategy because it more accurately reflects retailer hedging strategies and current regulatory practice. However, some practical questions would need to be resolved if the Commission were to adjust its methodology along the lines recommended by Frontier Economics, including, importantly, which benchmarks to use for setting the contract position.

The Commission intends to give further consideration to these practical implementation questions and seeks stakeholder feedback to assist it in coming to a final decision.[7]

AAR has reviewed the illustrative spreadsheet provided by the ICRC on 18 February 2019, showing one way to calculate the EPC component under Frontier's alternative approach (EPC spreadsheet). AAR has also attempted to implement Frontier's proposed approach, adopting the same underlying assumptions as the ICRC in terms of the contract position and the selected time period for load and spot prices. Based on this exercise, it is AAR's view that the proposed methodology is significantly more complex than the current model and, to date, AAR has been unable to fully reconcile the differences between its results and those in the ICRC's EPC spreadsheet.

AAR also notes that the ICRC's EPC spreadsheet adopted the simplistic assumption of using a single year of historic load and spot price data. The ICRC's Draft Report proposes a more complex and less transparent approach that involves running hundreds of Monte Carlo simulations to determine a 'representative' year of load and spot prices.

The ICRC's EPC spreadsheet also adopted a placeholder benchmark contract position, reflecting the contract position estimated by ACIL Allen for Energex in Queensland. Although the ICRC identifies the benchmark contract position as an important input to implementing the mixed derivative approach, it defers a decision on the methodology for determining the benchmark to the next retail electricity price investigation.

Overall, it is AAR's view that the ICRC has not clearly demonstrated that the positive features of the current model will be retained or that the benefits of the mixed derivative approach clearly exceed those foregone. Specifically, AAR remains concerned that:

[4] ICRC (2019), p.14
[5] ICRC (2019), p.14
[6] ICRC (2019), p.14
[7] ICRC (2019), p.14-15

- the implementation of the mixed derivative model is significantly more complex than the current model and AAR has been unable to reconcile differences in inputs and results with the ICRC;
- the proposed Monte Carlo simulation approach for determining the load and spot price profile adds complexity to the model and reduces transparency of the inputs; and
- the ICRC has provided no detail in relation to the methodology for determining the contract position under the mixed derivative model.

If the ICRC is to adopt the mixed derivative approach in its final decision, it is AAR's view that the above concerns should be addressed. AAR's suggested approach to doing this is outlined in the following sections.

Contract position

If the ICRC is to adopt the mixed derivative approach then AAR supports the ICRC's draft decision to adopt a benchmark contract position and agrees that the basis for determining the benchmark should be clear, transparent and appropriate to demand characteristics of the ACT.[8]

However, the ICRC has deferred providing details in relation to the methodology for determining the contract position until the next retail electricity price investigation. Given the contract position is an important input to the mixed derivative methodology, this lack of detail gives rise to some uncertainty and concern around the mixed derivative approach.

AAR seeks clarity from the ICRC around the process for determining the benchmark contract position. In particular, AAR would anticipate the opportunity to provide its view on the appropriate approach and feedback on the ICRC's proposed position prior to this being finalised.

Forward price averaging period

AAR supports the ICRC's draft decision to continue to apply a 23-month averaging period for the forward price calculation. This approach provides consumers with price stability and is consistent with current regulatory practice in Australia. AAR assumes that this approach will be adopted regardless of whether the ICRC's final decision is to retain the existing model or adopt the mixed derivative approach.

Load profile and spot prices

The ICRC's draft decision on the load profile and spot prices differs depending on which hedging strategy is adopted in its final decision:

- If the current model is retained, the ICRC proposes to use the five years prior to the price direction to calculate an appropriate load profile for the ACT.[9]
- If the mixed derivative approach is adopted, the ICRC's draft decision is to use a Monte Carlo simulation to generate a 'representative' year of loads and spot prices using actual data from the most recent five financial years prior to the price direction.[10]

As discussed above, AAR is concerned that the Monte Carlo simulation approach would increase the complexity of the approach and would reduce the transparency around one of the key model inputs. In AAR's view, the Monte Carlo approach is not necessary for implementation of the mixed derivative approach and the ICRC could instead use the most recent five years of historical data without any manipulation or

[8] ICRC (2019), p.15
[9] ICRC (2019), p.20
[10] ICRC (2019), p.20

discretion applied. Given that the ICRC has found that the past five years are representative, AAR recommends that the full five years of historical data be used to calculate settlement payments, difference payments and the resulting EPC. While this approach would be data intensive in the initial set-up of the model, on an ongoing annual basis, it would only require the oldest year of data to be dropped and the latest year added. The major benefits of this approach are that it removes the complexity of the Monte Carlo simulation approach while also maintaining transparency and replicability, which are key benefits of the current approach.

Whichever approach is adopted in the final decision, AAR seeks clarity on how the ICRC proposes to scale the half-hourly spot prices to the ASX Energy contract price. Frontier recommended that the selected half-hourly pattern of spot prices be scaled to the ASX Energy forward price adjusted to account for an assumed 5 per cent contract premium.[11] AAR did not observe any adjustment in the ICRC's EPC spreadsheet.

AAR notes that the ICRC's Draft Report proposes to update the load profile and spot prices at the time of the price direction.[12] AAR is concerned that this approach would result in relying on outdated data by the end of the price direction period. This is particularly concerning in a market that is changing quickly. AAR proposes that the load and spot price data be updated annually at the time of the price recalibration, regardless of whether the ICRC retains the current model or adopts the mixed derivative approach.

Processes to improve stakeholder confidence

If the ICRC's final decision is to adopt the mixed derivative approach, then AAR believes that stakeholder confidence in the new approach could be improved by holding a workshop focused on implementation issues, possibly facilitated by Frontier. This would ensure that all parties are given the opportunity to gain a full understanding of how the model should be implemented and can seek clarification about any aspects of the methodology that remain unclear. Such a workshop could take place prior to the ICRC's next price investigation process by adopting placeholder assumptions around key inputs such as the benchmark contract position and undertaking the calculation for a historical year.

Given the additional complexity associated with implementing the mixed derivative approach, stakeholder confidence could also be improved by the ICRC making its EPC model publicly available on an annual basis and having the model independently audited.

Volatility allowance

The ICRC states that the current EPC model provides an allowance for volatility by adopting the maximum load ratio since 2003/04 and by adding a value of 0.1 to the load ratio in the uplift factor.[13] It is unclear whether the ICRC intends to continue using this approach if it retains the current EPC methodology or if any adjustment is required given the shorter, five year time period proposed for the load profile.

If the ICRC is to adopt Frontier's recommended approach for estimating the EPC, then the ICRC proposes to capture the residual risk of high volatility via the benchmark contract position.[14] As discussed above, AAR seeks clarification on the process for determining the benchmark contract position, including the opportunity that AAR and other stakeholders will be given to provide their views on the proposed approach, including the treatment of residual risk associated with high volatility in spot prices.

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[11] Frontier Economics (2019), Energy Purchase Cost Review – A report for the Independent Competition and Regulatory Commission, January, p.33
[12] ICRC (2019), p.20
[13] ICRC (2019), p.20
[14] ICRC (2019), p.21

Cost of carbon

AAR notes the ICRC's draft decision to continue to set the carbon cost component in the model to zero.

2.2 National green scheme costs

The ICRC recognises that *"there are legitimate costs associated with holding certificates and related administration costs. These costs mainly relate to the financing costs associated with holding certificates up to their surrender and related administration costs."*[15]

The ICRC's draft decision is that the holding and administrative costs associated with purchasing green certificates *"are already accounted for in the retail operating cost allowance and therefore should not be included as part of the green scheme cost."*[16]

Holding costs

To inform its review of holding and administrative costs, the ICRC undertook a cross-jurisdictional comparison and concluded that it is the only regulator that allows for the recovery of holding costs and administrative costs in the green scheme cost component. On this basis, the ICRC's draft decision is that holding costs are already accounted for in the ROC allowance and therefore should not be included as part of the green scheme cost allowance.

In AAR's view, the ICRC's analysis and resulting conclusion are incorrect for the following reasons:

- The value of certificates can be set to either forward prices or spot prices. Certificates bought at the forward price are typically settled at the scheme compliance dates. Certificates bought at the spot market price are typically settled within one business day.
- The Queensland Competition Authority (QCA) used the forward prices to value the green certificates in their regulatory model. [17] The Independent Pricing and Regulatory Tribunal (IPART, NSW) used spot prices plus holding costs for small-scale renewable energy scheme certificates.[18]
- The current ICRC model uses the spot market prices for the certificates and adds holding costs separately to compensate the retailer for the costs it incurs in holding certificates up to the scheme compliance dates.
- If the ICRC were to use spot prices without adding holding costs, then it would be assuming that the full quantity of certificates are purchased on the last day when they are surrendered but priced at the spot market price averaged over eleven months. Such an approach would be clearly incorrect and inconsistent with the approach used in other jurisdictions.
- The ROC currently used by the ICRC is based on an indexation of IPART's 2013 estimate.[19] Based on AAR's understanding of IPART's methodology, there are no green scheme holding costs included in the IPART ROC benchmark. Consequently, there are no green scheme holding costs included in the ICRC's

[15] ICRC (2019), p.24
[16] ICRC (2019), p.24
[17] QCA (2019) Regulated retail electricity prices for 2019-20 Draft Determination p.34-37; ACIL Allen (Dec 2015) Estimating Efficient Retail Operating Costs and Margin p.10-15; ACIL Allen (June 2015) Estimating Energy Costs 2015-16 Retail Tariffs, p.34-36
[18] IPART (June 2013) Review of Regulated Retail Prices and Charges for Electricity Final Report p.80; Frontier Economics (June 2013) Energy Purchase Cost: Final Report to IPART, p.86-87, 90
[19] IPART (June 2013), p.105

current ROC estimate and therefore no double-counting under the current methodology.

It is AAR's view that the holding costs should be included with the greens costs rather than moved to the ROC, consistent with the ICRC's approach to the EPC where hedging costs are included with the wholesale price of electricity.

Administration costs

"The Commission's draft view is that the administration costs associated with purchasing certificates are already accounted for in the retail operating cost allowance."[20]

AAR is not necessarily opposed to the inclusion of administration costs in the ROC component of the ICRC's model, provided that the methodology is transparent and consistent with the cost recovery requirements of the Act.

2.3 Energy losses

The ICRC's draft decision on energy losses is to retain the current approach, which relies on the most recent available data published by AEMO for distribution and transmission loss factors. AAR supports the ICRC's draft decision on energy losses.

2.4 National Electricity Market fees

AAR supports the ICRC's proposed approach to change the methodology for forecasting the NEM fees cost component of the model. The ICRC's proposed approach is to adopt the QCA approach for 2020/21 which averages the preceding 52 weeks of ancillary services fees, and uses 2020/21 AEMO forecasts for other fees[21], which would then be indexed by CPI for the following two years.

2.5 Energy contracting costs

The ICRC's draft decision is to reflect ECC in the ROC:

"The Commission considers that energy contracting costs are part of administrative costs. The costs associated with administration have already need incorporated in the Commission's retail operating cost allowance (see section 4.1.1 of Chapter 4 of this report). As such, recovering energy contracting costs as a separate allowance may result in double counting. The Commission's draft decision is therefore to review this component of retail operating costs when it determines inputs to the retail operating cost allowance during the next price investigation".[22]

The ICRC initially introduced a separate allowance for ECC in 2007/08 when it was separated from the EPC because the methodology for estimating the EPC was changed to reflect market measures of costs, which did not include the cost of managing energy trading.[23]

AAR considers that the ECC is not currently included in the ICRC's ROC allowance. Going forward, the component for ECC could be moved into the ROC provided sufficient allowance is made for its recovery in the cost index model.

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[20] ICRC (2019), p.24
[21] NEM management fees, full retail contestability fees, national transmission planner fees, ECA fees
[22] ICRC (2019), p.30
[23] ICRC (2007) Final Decision- Retail prices for non-contestable electricity customers, p.35

3 Retail costs

3.1 Retail operating costs

The ICRC draft decision is that the *"current approach, using hybrid of bottom-up and benchmarked costs, is long established, has been widely consulted upon, and provides substantial regulator certainty. The Commission has not received information or views during its consultation process for this Review that suggest an alternative methodology is more appropriate."*[24] *"Based on the currently available information, the Commission considers that the current methodology for calculating the ROC allowance is reasonable and reflects current best practice."*[25]

The ICRC also notes *"work currently being undertaken by other Australian regulators may provide insights and benchmarking information on ROC that could inform the inputs for the Commission's methodology."*[26]

AAR supports the ICRC's continuation of the current approach to use a hybrid of bottom-up and benchmarked costs to calculating ROC. However, AAR also notes that the ICRC's draft decision involves moving a number of cost components to the ROC, including green scheme holding and administrative costs and energy contracting costs. In AAR's view, this approach requires careful consideration of benchmarks for reflecting the ROC of a hypothetical efficient retailer in the same position as AAR.

In particular, the benchmark information from other Australian regulators is unlikely to be directly comparable to the full range of costs that the ICRC is seeking to include in the ROC in the next price investigation. This increases the importance of ensuring that the approach to determining the inputs to the ROC in the next price investigation is fully transparent and consistent with the cost recovery requirements of the Act.

As stated in AAR's November 2018 response to the ICRC Issues Paper, AAR will provide a further response after the ICRC has assessed any new information from these concurrent regulatory investigations.

As requested by AAR in the response to the Issues Paper in November 2018, AAR re-iterates the request to include allowances for CARC and economics of scale in the ACT.

CARC

The ICRC's draft decision is that *"an allowance for CARC is not warranted….In the Commission's view the current retail operating cost allowance recovers reasonable costs relating to retail competition activities that recognise the circumstances in the ACT. The ACT retail electricity market is characterised by little competition and a high proportion of customers on standing offers."*[27]

In AAR's view, the ICRC's characterisation of the ACT retail electricity market is inaccurate. The market is increasingly competitive, with AAR's market share of residential and small business customers in the ACT declining from 96 per cent in June 2014 to 85 per cent in December 2018.[28] In addition, the proportion of customers

[24] ICRC (2019), p.32
[25] ICRC (2019), p.34
[26] ICRC (2019), p.34
[27] ICRC (2019), p.33
[28] AER (Nov 2017) Annual Report on Compliance and Performance of the Retail Electricity Market 2016-17: Retail Performance Data Quarterly 2016-17 and AER (March 2019) 2018-19 Retail Performance Data

(residential and small business) on market offers across all retailers in the ACT has increased from 25 per cent in 2014/15 to 49 per cent in December 2018.[29]

In AAR's view, a CARC allowance should be added to retail costs at a sufficient level to allow a hypothetical efficient retailer in the same positon as AAR to recover the costs associated with engaging in competition. Such an approach is consistent with the draft determinations of the Essential Services Commission (ESC) in Victoria for the Victorian Default Offer (VDO) and of the AER for all unregulated jurisdictions.

Economies of scale

The ICRC's *"assessment is that AAR's position as the dominant retailer in the ACT with a stable customer base reduces any potential cost disadvantages associated with lower economies of scale. From the ACCC's 2018 report, there is no consistent evidence to suggest that economies of scale affect retail operating costs."*[30]

AAR considers that the Australian Competition and Consumer Commission's 2018 analysis demonstrates the presence of economies of scale for the big three retailers, as their customer costs to serve are, on average, 15 per cent lower than the average of state retailers on a per customer basis.[31]

Given the retail market in the ACT is one of the smallest in the NEM, unit costs are necessarily higher than in larger jurisdictions. The relatively high unit costs faced by a hypothetical retailer in the same position as AAR are exacerbated by the ICRC's treatment of retail costs as fully variable with respect to customer numbers. As competition intensifies and AAR's customer numbers fall, the ICRC's methodology assumes a corresponding fall in retail costs, which leaves fixed retail costs under-compensated.

3.2 Retail margin

The ICRC's draft decision is *"to continue to adopt a benchmarking approach to determine the retail margin".*[32] The ICRC states that the inputs used to determine the retail margin will be informed by ongoing regulatory investigations and analyses by national and state regulators.[33]

While AAR supports the use of a benchmarking approach to determine the retail margin, the ex-ante allowance provided by the ICRC of 5.3 per cent is lower than current regulatory practice in other jurisdictions. The Office of the Tasmanian Economic Regulator allows 5.7 per cent margin[34] rolled forward to 2020/21[35], QCA's current margin is 5.7 per cent [36] and ESC's draft determination on the VDO is 5.7 per cent (which converts to 6.04 per cent using the ICRC ex-ante approach).[37] IPART allowed a retail margin of 5.7 per cent of earnings before interest, taxes, depreciation and amortisation (EBITDA) (which converts to 6.04 per cent using the ICRC ex-ante approach) when it regulated New South Wales retailers.[38]

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[29] AER (Nov 2017) Annual Report on Compliance and Performance of the Retail Electricity Market 2016-17: Retail Performance Data Quarterly 2016-17 and AER (March 2019) 2018-19 Retail Performance Data
[30] ICRC (2019), p.33
[31] ACCC (2018) Retail Electricity Pricing Inquiry – Final Report, p.224
[32] ICRC (2019), p.36
[33] ICRC (2019), p.36
[34] OTTER (2016) Final Report – 2016 Standing offer pricing investigation, p.48
[35] OTTER (2019) Guideline - Standing offer approval process in accordance with the 2016 Standing Offer Determination, 26 February 2019, p.2
[36] QCA (2016) Final Determination – Regulated retail electricity prices for 2016-17, May 2016, p.24, 121
[37] ESC (2019) Victorian Default Offer to apply from 1 July 2019 Draft Advice, p.57-58
[38] IPART (2013) Review of regulated retail prices and charges for electricity from 1 July 2013 to 30 June 2016, p.89

In its Draft Report, the ICRC argued that its use of an ex-ante margin of 5.3 per cent was within the range recommended by SFG. Specifically, the ICRC's Draft Report states that, on an ex-ante basis, SFG's recommended retail margin range varied from a low of 4.1 per cent to a high of 7.5 per cent and the retail margin of 5.3 per cent is within the range estimated by SFG.[39]

AAR agrees that the EBITDA margins estimated by SFG using the individual expected returns, benchmarking and bottom-up approaches range from 4.1 per cent to 7.5 per cent on an ex-ante basis. However, this is not the range recommended by SFG. The reasonable range estimated by SFG is the average of the three upper and lower bounds from each estimation technique with an equal weight applied to all three approaches.[40] This translates to an ex-post EBITDA margin of 5.3 per cent to 6.1 per cent (5.6 per cent to 6.5 per cent in ex-ante terms). This is consistent with how IPART interpreted the SFG report when selecting an appropriate (ex-post) margin within the feasible range:

"SFG's recommended range for the retail margin provided by the 3 approaches discussed above is 5.3% to 6.1% of a retailer's total electricity sales (EBITDA). SFG's recommended retail margin is 5.7%. This is based on an average of the margins estimated from all 3 approaches.

While it could be argued that any value chosen within this range is reasonable, we consider the best way to select the appropriate retail margin is to weight the estimates provided by each approach equally. Therefore, we agree with SFG's recommendation to use the average."[41]

In AAR's view, the ICRC's current ex-ante retail margin of 5.3 per cent is inconsistent with Australian regulatory practice and with the retail margin recommended by SFG. In AAR's view, the ex-ante retail margin should be selected from SFG's reasonable range of 5.6 per cent to 6.5 per cent.

3.3 Energy Efficiency Improvement Scheme costs

The ICRC's draft decision is to maintain the current approach for estimating EEIS costs for the next regulatory period commencing 1 July 2020. AAR supports this draft decision.

4 Network costs

Given that network costs are separately regulated, AAR supports the ICRC's draft decision to maintain the current approach for passing through the network costs determined by the AER.

[39] ICRC (2019), Electricity model and methodology review 2018-19, Report 3 of 2019, April, p.36
[40] SFG Consulting 2013, Estimation of the regulated profit margin for electricity retailers in New South Wales, June, p.6
[41] IPART (2014) Review of regulated retail prices and charges for electricity from 1 July 2013 to 30 June 2016, Final Report, June, p.94