ACT Retail electricity price investigation: 2020-24

ACTEWAGL SUBMISSION TO THE INDEPENDENT COMPETITION AND REGULATORY COMMISSION ISSUES PAPER

11 October 2019

ActewAGL for you

Table of Contents

Glossary

Term	Definition
ACCC	Australian Competition and Consumer Commission
ACT	Australian Capital Territory
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
ASX	Australian Securities Exchange
CARC	Customer Acquisition and Retention Costs
CPI	Consumer Price Index
CTS	Cost to Serve
DMO	Default Market Offer
EBITDA	Earnings before interest, tax, depreciation and amortisation
EEIS	Energy Efficiency Improvement Scheme
EME	Energy Made Easy
EPC	Energy Purchase Cost
ESC	Victorian Essential Services Commission
EY	Ernst and Young
GDP	Gross Domestic Product
ICRC	Independent Competition and Regulatory Commission
IPART	Independent Pricing and Regulatory Tribunal
LRET	Large-scale Renewable Energy Target
MWh	Megawatt hour
NEM	National Electricity Market
NSW	New South Wales
OTTER	Office of the Tasmanian Economic Regulator

p.a.	per annum
QCA	Queensland Competition Authority
REPI	Retail Electricity Pricing Inquiry
ROC	Retail Operating Cost
SA	South Australia
SRES	Small-scale Renewable Energy Scheme
WACC	Weighted Average Cost of Capital
VDO	Victorian Default Offer

1 Introduction

ActewAGL Retail (hereafter 'ActewAGL') welcomes the opportunity to provide a submission on the Independent Competition and Regulatory Commission's (ICRC's) Issues Paper, published on 2 September 2019, on standing offer prices for the supply of electricity to small customers from 1 July 2020[1]. The Issues Paper is a key step in determining ACT retail electricity prices from 1 July 2020 to 30 June 2024. In addition, the Issues Paper begins a conversation about improvements in the transparency and comparability of retail electricity offers in the ACT. This submission presents ActewAGL's view on the matters raised in the ICRC's Issues Paper. The key themes in this submission are listed below.

- Competition in the ACT retail electricity market has increased significantly in the past five years and can no longer be characterised as a market with limited competition.
- Setting the contract position on the basis of five years of historic data will understate half-hourly spot price volatility and hence understate the level of hedging an efficient retailer would adopt. In ActewAGL's view, a benchmark contract position should be adopted.
- The averaging period for scaling spot prices should be consistent with the averaging period used to determine contract prices. A 23-month averaging period smooths out fluctuations in prices and hence results in more stable regulated retail prices for customers.
- In ActewAGL's view, benchmarking suggests that the ICRC's current estimate for Retail Operating Costs (ROC) is consistent with benchmarking results, particularly considering the small scale of the ACT. However, the ICRC's current approach to excluding Customer Acquisition and Retention Costs (CARC) from retail costs is inconsistent with regulatory decisions in other jurisdictions and market data.
- ActewAGL is keen to work closely with the ICRC to evaluate options to improve transparency and comparability of electricity offers for ACT customers.

The structure of this document is outlined below.

- Section 2 sets out background information including steps undertaken by the ICRC in the lead-up to the release of the Issues Paper (including the recent review of the model and methodology) and upcoming steps to finalise the price investigation. It also sets the scene in relation to competition in the ACT and monitoring of retail information.
- Section 3 outlines ActewAGL's responses in relation to the pricing model and inputs.

[1] ICRC 2019, Standing offer prices for the supply of electricity to small customers from 1 July 2020, September. Available here: https://www.icrc.act.gov.au/energy/electricity/retail-electricity-prices-2020-24

- Section 4 presents responses related to transparency and comparability of electricity offers in the ACT.
- Attachment 1 contains a summary of ActewAGL's responses to the ICRC's Issues Paper.

The boxes shaded in blue throughout this submission directly respond to the questions posed in the ICRC's Issues Paper.

2 Background

This section outlines the steps undertaken by the ICRC in the lead-up to the release of the Issues Paper (including the recent review of the model and methodology) and upcoming steps to finalise the ICRC's retail price investigation for the 2020-24 period. It also sets the scene in relation to competition in the ACT and monitoring of retail information.

2.1 Retail price investigation for 1 July 2020 to 30 June 2024

During 2018 and 2019, the ICRC undertook a review "to ensure that the ICRC's pricing model is accurate, reflects current market conditions and retailer practices, and is consistent with the ICRC's obligations under the *Independent Competition and Regulatory Commission Act 1997*."[2]

Following the release of an issues paper in October 2018 (in which the ICRC sought stakeholder submissions), a technical paper in February 2019 and a draft decision in April 2019, the ICRC released a final report in May 2019 indicating that while the current model was sound, there were some methodological improvements that could be made to some of the cost components. Details of these changes are summarised in Table S.1 of the ICRC's final report.[3]

On 28 May 2019, the ICRC received a terms of reference[4] from the ACT Treasurer to determine a price direction for standing offer prices for the supply of electricity to small customers who consume less than 100 MWh of electricity over any period of 12 consecutive months. The price direction will be for the period 1 July 2020 to 30 June 2024.

On 2 September 2019, the ICRC released an Issues Paper[5] outlining its proposed approach to the 2020-24 electricity price investigation ("price investigation"). This document is ActewAGL's submission to the Issues Paper.

Following the Issues Paper, the ICRC will release a draft report in February 2020 (to which submissions can be made), and a final report in June 2020.

2.2 Competition in the ACT

Competition in the ACT electricity market has increased significantly over the past five years, with a number of retailers increasing their presence in the ACT market, including Origin Energy, Energy Australia, Red Energy, Energy Locals, Simply Energy, Next Business Energy and Powerclub. Competition for market share has been intense, with retailers competing with multiple offer combinations including:

[2] ICRC, *Final Report – Electricity Model and Methodology Review 2018-19*, Report 5 of 2019, May 2019, page 1.

[3] ICRC, *Final Report – Electricity Model and Methodology Review 2018-19*, Report 5 of 2019, May 2019, page 2.

[4] ACT Government 2019, ICRC (Price Direction for the Supply of Electricity to Certain Small Customers on Standard Retail Contracts) Terms of Reference Determination 2019, Disallowable Instrument DI21019-72, https://www.legislation.act.gov.au/View/di/2019-72/current/PDF/2019-72.PDF

[5] ICRC 2019, Standing offer prices for the supply of electricity to small customers from 1 July 2020, September. Available here: https://www.icrc.act.gov.au/energy/electricity/retail-electricity-prices-2020-24

- various standing offer rates;
- discounts off usage;
- total bill discounts;
- various payment arrangements;
- premium solar feed-in tariff credits;
- bundling with gas for a higher discount;
- bundles linked to appliance upgrades; and
- locked-in low prices for up to three years.

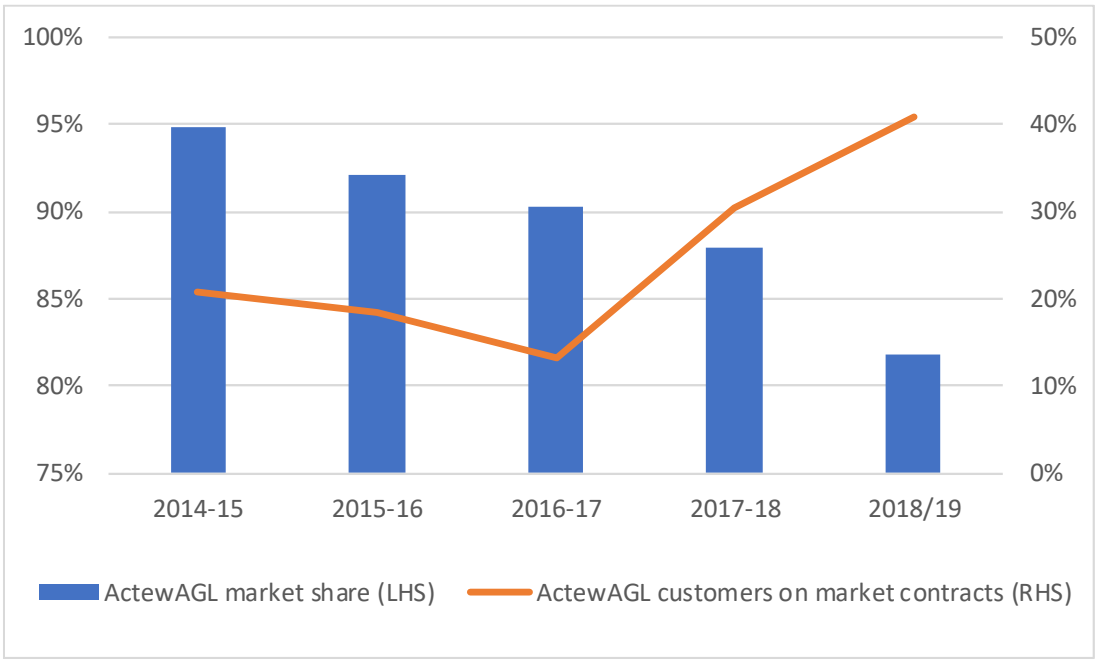
This has resulted in a significant decline in ActewAGL's market share over a short period of time, an increasing number of customers on market offers, and increased rates of switching between retailers. ActewAGL's market share has fallen from 95 per cent in 2014/15[6] to 82 per cent at the end of 2018/19[7], a fall of 13 percentage points in five years. Over the same period, the share of ActewAGL's customers on market offers has increased by 20 percentage points from 21 per cent in 2014/15 to 41 per cent at the end of 2018/19 (see below). The percentage of customers switching electricity retailers has also increased significantly in the ACT from 0.5 per cent of customers per month in September 2017 to 0.91 per cent in March 2019 (see Figure 2 below).

The ACT retail electricity market can no longer be characterised as a market with limited competition.

[6] AER 2019, Retail Performance Data, Schedule 2, June.

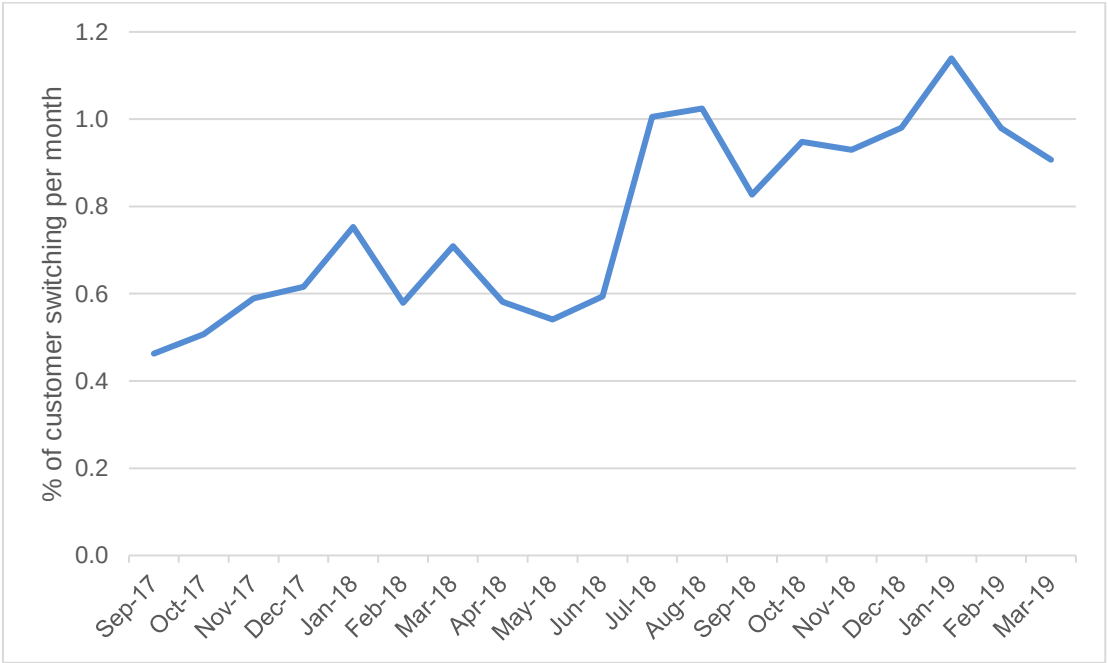
[7] ActewAGL calculations for 2018/19. Note, that at the time of writing this submission, the AER has not released 2018/19 data.

Figure 1. Market share and market contracts for residential and small business customers



Source: AER Schedule 2 – Q3 2018/19 Retail Performance Data for results up to 2017/18 and ActewAGL calculations for 2018/19

Figure 2. Switching for residential and small business ACT customers



Source: AER Schedule 2 – Q3 2018/19 Retail Performance Data

2.3 Monitoring retail information

The level of monitoring of retail information has increased substantially in recent years. ActewAGL, along with other retailers, receive information requests such as those from the Australian Competition and Consumer Commission (ACCC) in regards to the public inquiry that is monitoring prices, profits and margins in the supply of electricity in the National Energy Market (NEM)[8] and from the Australian Energy Regulator (AER) in regards to retail performance data. These mandatory information requests generally require regular updates on a quarterly or six-monthly basis. In addition, ad hoc requests are received from a range of agencies including the Australian Energy Market Commission (AEMC). There are substantial costs associated with compliance to these reporting requirements.

[8] The ACCC's monitoring functions follows the ACCC's Retail Electricity Pricing Inquiry (REPI), which concluded on 30 June 2018.

3 Pricing model and inputs

This section provides ActewAGL's response to the issues and questions raised in section 2 of the ICRC's Issues Paper on the pricing model and inputs used to determine the maximum allowable price change across ActewAGL's basket of regulated tariffs in each year of the four year regulatory period from 1 July 2020 to 30 June 2024.

3.1 Form of price control

In relation to the form of price control, the ICRC states that, as part of its investigation, it will review the amount of discretion that ActewAGL has in applying the maximum percentage increase to its standing offer tariffs[9]. In doing so, the ICRC will consider whether changes would contribute to improving transparency and comparability of electricity offers in the ACT. As an example, the ICRC suggests that it will consider whether the regulated standing offer rates should be used as reference prices in the ACT and whether the ICRC should determine those rates.

In ActewAGL's view, the consideration of any changes to improve transparency and comparability of electricity offers should be done in a holistic and sequential manner, and in consultation with key stakeholders. Before examining any potential changes, it is ActewAGL's view that the ICRC should undertake the analysis proposed in section 3.1 of the Issues Paper to determine the extent to which a transparency and comparability problem exists in the ACT and, if there is a problem, identify the key sources. It is only after the problem and its sources have been clearly identified that potential solutions can be investigated. If a problem is identified, then the full range of potential solutions should be considered and the benefits and difficulties with each should be assessed against a clear set of criteria.

If the ICRC's analysis supports the introduction of a reference price, ActewAGL considers that the existing application of the form of price control should be maintained.

There would be significant difficulties associated with the ICRC removing ActewAGL's discretion to set individual prices within the tariff basket. ActewAGL faces different costs for different tariffs, particularly in terms of the network component. The current form of control provides the flexibility to align tariffs with underlying costs within the overall constraints of the weighted average price cap. Removing this discretion would eliminate ActewAGL's ability to ensure tariffs are set in line with costs.

The main objective of a reference price is to provide a common point of comparison for customers to evaluate retail offers. Achieving this objective does not require the reference price to be set at a particular level, and therefore the current arrangement whereby ActewAGL proposes regulated standing offer prices, which are then assessed by the ICRC, should continue. ActewAGL does not believe that transparency and comparability would be improved if the level of the reference price were determined by the ICRC.

[9] ICRC 2019, Issues paper: Standing offer prices for the supply of electricity to small customers from 1 July 2020, September, p.6.

ActewAGL provides further comments on the issue of transparency and comparability in section 4 of this response.

ICRC question 1

How much discretion should ActewAGL have when applying the maximum percentage increase, as determined by the Commission, to its suite of regulated tariffs? How would this contribute to improving the transparency and comparability of electricity offers?

ActewAGL response

ActewAGL supports the ICRC's proposal to undertake the analysis set out in Section 3.1 of its Issues Paper. If this analysis supports the introduction of a reference price, ActewAGL considers that the existing application of the form of price control should be maintained – there would be no benefits from the level of the reference price being set by the ICRC.

3.2 Pricing model

The ICRC's Issues Paper seeks views on different components of the pricing model that determine the maximum average percentage change that ActewAGL can apply to its suite of regulated tariffs on an annual basis. The model involves estimating the individual cost components that would be incurred by an efficient standalone incumbent retailer in the same position as ActewAGL in providing electricity supply services to customers on regulated tariffs. This section sets out ActewAGL's views on each of the cost components.

3.2.1 Energy Purchase Cost

The ICRC's final decision in its 2018/19 electricity model and methodology review was to adopt a hedging strategy that includes base swaps, peak swaps and cap contracts (mixed derivative approach)[10]. ActewAGL supports the ICRC's overall approach to estimating the energy purchase cost (EPC) of an efficient electricity retailer in the same position as ActewAGL. The mixed derivative approach is more reflective of the actual hedging approach an efficient retailer would adopt compared with the ICRC's previous model, which used a base swaps only hedging strategy. While the implementation of the mixed derivative model is significantly more complex than the ICRC's previous model, ActewAGL has implemented the proposed approach and is confident that the model is replicable and transparent.

CONTRACT POSITION

In the Issues Paper, the ICRC states that it intends to develop a suitable heuristic for the ACT using a similar method as adopted by other regulators[11]. The ICRC states that this

[10] ICRC 2019, Electricity model and methodology review, Final report, Report 5 of 2019, May, p15.

[11] ICRC 2019, Issues paper: Standing offer prices for the supply of electricity to small customers from 1 July 2020, September, p11.

will involve running a model over five years of demand data to get an average efficient contract position.

Approach used by other regulators

The Essential Services Commission of Victoria (ESC), the Queensland Competition Authority (QCA) and the AEMC all engaged consultants with proprietary software to estimate the efficient contract position.

Essential Services Commission

For the purposes of determining the Victorian Default Offer (VDO), the ESC engaged Frontier Economics ("Frontier") to estimate the wholesale energy cost, including the contract position. To estimate the hedging position a prudent retailer is likely to adopt, Frontier used its portfolio optimisation model, *STRIKE*, to determine the efficient mix of hedging products. Frontier describes the *STRIKE* model as follows[12]:

> *STRIKE applies a Minimum Variance Portfolio approach to the task of hedging a retailer's exposure to wholesale spot prices. STRIKE incorporates an estimate of a retailer's exposure to the wholesale spot market, which is determined by the retailer's load and wholesale spot prices. There is an expected return and a variance associated with this. STRIKE also incorporates the types of hedging products that are typical in the electricity industry. These contracts – swaps and caps – generate cashflows that also have an expected return and a variance. Instead of assessing the expected return and associated risk for each asset in isolation, STRIKE applied the concepts of portfolio theory to evaluate the contribution of each asset to the risk of the portfolio as a whole. Based on this approach, STRIKE calculates efficient hedging strategies.*

STRIKE calculates an efficient frontier, which represents the contracting positions that provide the lowest EPC for a given level of risk. The contract position that Frontier uses to calculate the wholesale energy cost is based on the most conservative contracting position on the efficient frontier, which is the point with the lowest risk (but highest cost).

Queensland Competition Authority

For the purpose of determining regulated retail electricity prices in regional Queensland for 2019/20, the QCA engaged ACIL Allen to estimate wholesale energy costs, including the appropriate contract position. ACIL Allen's approach to finding the optimal contract position involves:

- producing multiple annual simulations (around 500) of half-hourly load and spot prices*;*
- estimating the quarterly contract prices for the relevant year;
- using its hedge model, calculating the annual half-hourly settlements and payments given a contract strategy, contract prices and a set of simulated half-hourly spot prices and loads;

[12] Frontier Economics 2019, Wholesale Electricity Costs, A report for the Essential Services Commission, April, p.27.

- testing a range of contract strategies by running the hedge model (*PowerMark)* for each contract strategy across all 500 simulations to produce 500 EPC estimates per strategy;
- finding the 95th percentile EPC for each contract strategy; and
- finding the minimum of the 500 95th percentile EPC estimates and choose the associated contract strategy and EPC as the final estimate.

Australian Energy Market Operator

The AEMC engaged Ernst and Young (EY) to estimate the wholesale market costs for its 2018 residential electricity price trends review. EY describes its market modelling as a procedure that involves running many market simulations with its *2-4-C* model to arrive at a final set of outcomes. The process involves determining a set of input assumptions, creating an initial market simulation and iterative modelling to achieve a final simulation[13]. In relation to the hedging strategy itself, EY applies an exponential book build hedging strategy to reflect the way retailers progressively build up their hedge book over time. The hedge portfolio is constructed with standard contract types including base swap, peak swap and $300/MWh cap contracts[14]. EY states that the objective of the retail portfolio optimisation is to determine a level of hedging that provides a consistent, weekly electricity cost, based on the calculated contract strike prices, and the forecast demand, regardless of the volatility of the wholesale market price. A gradient descent algorithm is employed to optimise each portfolio[15].

ACT Context

The above approaches all involve running hundreds of market simulations to arrive at a wide range of possible market outcomes. This approach ensures that potential market volatility is taken into account when determining the optimal contract position.

Rather than assessing the optimal contract position against hundreds of possible futures, the ICRC's proposed approach involves running a model over five years of historic data to get an average efficient contract position[16]. This approach will result in a contract position that is optimal for the specific five year period being examined and will not take into account potential market volatility, which is the reason retailers hedge. Setting the contract position on the basis of five years of historic data will understate half-hourly spot price volatility and hence understate the level of hedging an efficient retailer would adopt.

Rather than using five of years of historic data to determine the contract position, it is ActewAGL's view that the ICRC should adopt a benchmark contract position. Consistent with the previous EPC model and actual hedging strategies used by retailers, the benchmark should involve hedging 105 per cent of the maximum load per

[13] Ernst and Young, 2018, Residential electricity price trends – wholesale market costs modelling 2018, December, p.1.

[14] Ibid, p.15.

[15] Ibid, p.16.

[16] ICRC, p. 11.

quarter. In ActewAGL's view, a reasonable split of contract volumes is set out as follows.

- Setting the base swap volume to equal the 70th percentile of the off-peak period hourly demands for the quarter.
- Setting the peak swap volume to equal the 90th percentile of the peak period hourly demands minus the base contract volumes for the quarter.
- Setting cap contract volume at 105 per cent of the annual peak demand for the quarter minus the base and peak contract volumes.

ICRC question 2

The Commission is seeking feedback on its approach to estimating the heuristic (i.e. rules) for determining an appropriate contract position.

ActewAGL response

The ICRC's proposed approach of using five years of historic data to determine the contract position will understate spot price volatility and hence the level of hedging an efficient retail would adopt. Instead, it is ActewAGL's view that the ICRC should adopt a benchmark contract position. Consistent with the previous EPC model, it should be assumed that an efficient retailer would hedge 105 per cent of the maximum load per quarter. A reasonable split of contract volumes can then be set. In ActewAGL's view, the splits determined by ACIL Allen for the QCA are reasonable, although ActewAGL notes that the level of the EPC is not particularly sensitive to this split.

CONTRACT PRICES

ActewAGL supports the ICRC's proposal to use the 23-month averaging period between 1 June and 30 April. The 23-month averaging period provides consumers with price stability and is consistent with current regulatory practice in Australia. The averaging period of 1 June to 30 April brings forward the averaging period by one month compared with the ICRC previous approach, which used 1 July to 31 May. In ActewAGL's view, this approach will not only assist the ICRC to finalise the cost-index model ahead of its final decision in June each year but will also provide ActewAGL with more time to prepare for customer price change notifications and the implementation of changes to the billing system, which previously have been undertaken within an extremely tight timeframe.

ICRC question 3

Do you have any comments on the proposed dates for the averaging period?

ActewAGL response

ActewAGL supports the ICRC's proposed 23-month averaging period between 1 June and 30 April. This provides both the ICRC and ActewAGL more time to finalise and implement annual price changes.

PROFILE LOAD AND SPOT PRICES

ActewAGL supports the ICRC's approach to using the most recent five calendar years of load and spot price data from AEMO. This approach ensures that the model is transparent and replicable. ActewAGL also supports the ICRC's proposed approach to scaling the half-hourly spot prices for each quarter to the average base swap forward price for the quarter less the forward price margin. The use of a five per cent margin appears reasonable given that this is consistent with the ICRC's previous model and is also used by other regulators in Australia.

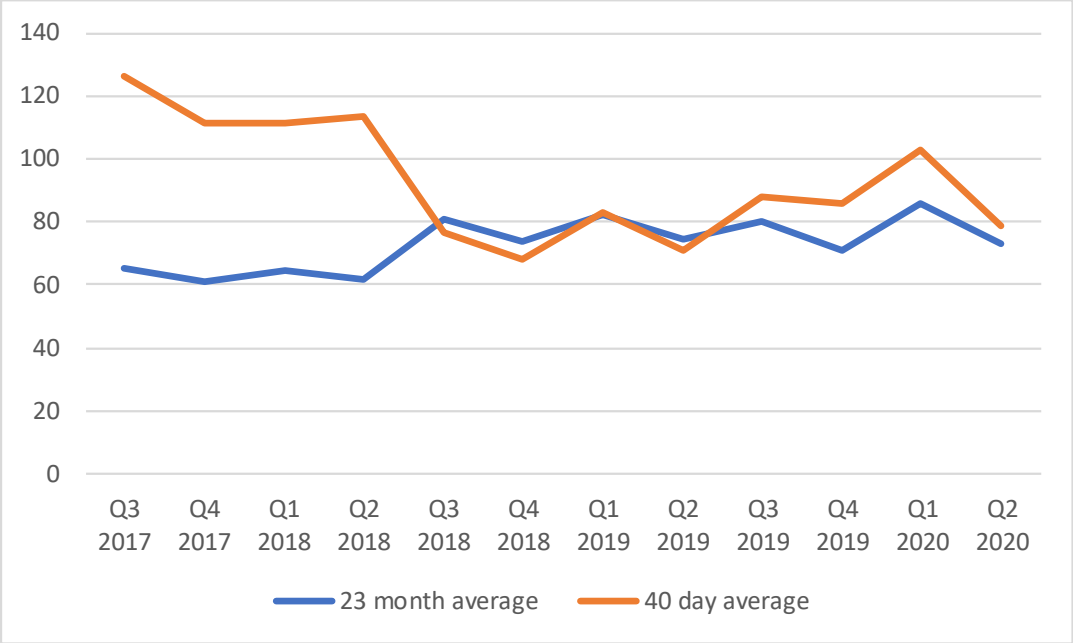
In relation to the averaging period for determining the forward price for scaling purposes, this should be consistent with the averaging period used for determining contract prices. Using a short averaging period close to the start of the regulatory period will introduce the potential for highly volatile spot prices, which would then be reflected in the EPC and regulated retail prices. To demonstrate this, **Error! Reference source not found.** below presents the base swap prices for the period 2017/18 to 2019/20 based on a 23-month and 40-day averaging period. The 23-month averaging period is the period 1 July to 31 May relevant to each regulatory year, while the 40-day averaging period is the 40 days to 31 May relevant to each regulatory year. As shown in this figure, the base swap price using the 40-day averaging period can be highly volatile and over the past three years has been well in excess of the base swap price using the 23-month averaging period, particularly during 2017/18.

Frontier recommended the 40-day averaging period to the ESC for the purposes of estimating the VDO. This is consistent with Frontier's preference for the mark-to-market approach (proxied with the use of a 40-day averaging period) to calculating contract prices, which it explained in advice to the ICRC in the context of the 2018/19 model and methodology review[17]. In that case, the ICRC concluded that it would maintain the 23-month averaging period. In doing so, the ICRC noted that the 23-month averaging period smooths out large fluctuations in prices (both upwards and downwards) and consequently in the wholesale energy purchase costs and retail prices[18]. In ActewAGL's view, the same rationale holds for the scaling that is applied to the spot prices.

[17] Frontier Economics 2019, Energy purchase cost review, A report for the ICRC, January, p.14-15.

[18] ICRC 2019, Final Report, Electricity Model and Methodology Review 2018-19, Report 5 of 2019, May, p.16-17.

Figure 3. Quarterly base swap prices, 23-month vs 40-day averaging period



Source: ASX Energy data

ICRC question 4

What is the appropriate period for averaging forward prices for the purposes of scaling spot prices?

ActewAGL response

The averaging period for scaling spot prices should be consistent with the averaging period used to determine contract prices. A 23-month averaging period smooths out fluctuations in prices and hence results in more stable regulated retail prices for customers.

VOLATILITY ALLOWANCE

ActewAGL supports the inclusion of a volatility allowance in the ICRC's cost model to account for residual risk and proposes that a simple benchmark approach be adopted given that the impact on regulated prices will be minimal. The volatility allowance is very small relative to other elements of the cost stack and, if applied consistently over the regulatory period, will make no material difference to the allowed year-on-year percentage change in ActewAGL's regulated prices. Therefore, ActewAGL proposes adopting a benchmark volatility allowance of $0.175 per MWh based on the volatility allowances calculated by Frontier for the ESC. The simple average of the volatility allowance calculated by Frontier across the five Victorian entities is $0.178 for residential customers and $0.164 for business customers[19]. Applying ActewAGL's residential and business

[19] Frontier Economics 2019, Wholesale electricity costs, A report for the Essential Services Commission, April, p.49.

weights (measured in MWh using 2018/19 volumes to March 2019) of 78 per cent and 22 per cent respectively, results in a volatility allowance of $0.175 per MWh (see Table 1).

Table 1. Volatility allowance benchmark, $ per MWh

	Residential	Business
Citipower	0.180	0.170
Powercor	0.160	0.100
TXU	0.160	0.190
Untied	0.190	0.190
VIC AGL	0.200	0.170
Simple average	0.178	0.164
Weights (ActewAGL)	78%	22%
Weighted average	0.175	

Source: Frontier Economics and ActewAGL calculations

ActewAGL also seeks clarification on how the ICRC proposes to update the volatility allowance annually during the regulatory period. The allowance could be indexed to inflation or, if the above method is accepted, could be updated in line with the annual VDO estimates.

ICRC question 5

What benchmarks should the Commission consider in determining the volatility allowance?

ActewAGL response

The ICRC should adopt a simple benchmark approach for the volatility allowance given the relatively minor impact this will have on year-on-year price changes. ActewAGL suggests adopting the average of the Frontier estimates used for Victoria.

3.2.2 Large Renewable Energy Target (LRET) and Small Renewable Energy Scheme (SRES)

ActewAGL agrees with the ICRC's market-based approach for determining efficient LRET and SRES costs and adopting holding costs consistent with the ICRC's ACT water and sewerage decision.[20] However, it is unclear why the ICRC is proposing to use the cost of debt rather than the weighted average cost of capital (WACC) to determine the financing costs associated with holding certificates between the purchase date and the surrender date. Specifically, it is unclear why the ICRC assumes that an efficient retailer would fund holding costs from debt alone, when the regulated benchmark cost of capital is a weighted average of both debt and equity financing.

[20] ICRC 2018, Regulated Water and Sewerage Services Prices 2018-23, Report 1 of 2018, May.

ActewAGL proposes that the ICRC adopt the WACC parameters from its water and sewerage decision with the exception of the equity beta, which should be specific to retail electricity. For the equity beta, the ICRC could adopt the same value as adopted by the ESC for the purposes of the VDO (i.e. an equity beta of 1.00).

For 2019/20, this approach would deliver a WACC of 6.56 per cent (see Table 2 below), which is similar to the base WACC used by the ESC of 6.55 per cent[21]. ActewAGL also seeks clarification on whether the ICRC intends to update the cost of debt annually in line with the annual updates to the cost of debt for water and sewerage.

Table 2. Proposed rate of return parameters

Parameter	Value	Source
Risk free rate	2.79%	ICRC Final Decision for Water & Sewerage
Market risk premium	6.50%	ICRC Final Decision for Water & Sewerage
Equity beta	1.00	ESC VDO
Cost of equity	9.29%	Calculated
Cost of debt	4.74%	ICRC Final Decision for Water & Sewerage, updated for 2019/20 cost of debt
Gearing	60%	ICRC Final Decision for Water & Sewerage
WACC	6.56%	Calculated

ICRC question 6

Is the regulatory cost of debt for the ACT's water business an appropriate indicator of the cost of debt for an efficient electricity retailer in the ACT? What other cost of debt measures could the Commission use?

ActewAGL response

The WACC should be used to calculate the holding costs of certificates. ActewAGL suggests that the ICRC adopt the WACC parameters from its water and sewerage decision with the exception of the equity beta. For equity beta, the ICRC should adopt a figure relevant to retail electricity such as the value of 1.00 adopted by the ESC in Victoria.

3.2.3 Energy losses

ActewAGL supports the ICRC's approach to calculating energy losses.

3.2.4 NEM fees

ActewAGL supports the ICRC's approach to calculating NEM fees.

[21] Frontier Economics 2019, Retail costs and margin, A report for the Essential Services Commission, April, p.25.

3.2.5 Network costs

ActewAGL supports the ICRC's approach to taking network costs as determined by the Australian Energy Regulator (AER).

3.2.6 Retail costs

ActewAGL supports the ICRC's benchmarking approach to estimating retail costs. However, ActewAGL is strongly of the view that the ICRC should include an allowance for customer acquisition and retention costs (CARC) in its estimate of retail costs, consistent with regulatory practice in other jurisdictions. The ACT market is increasingly competitive (see section 2) and continuing to exclude the significant costs associated with customer acquisition and retention is inconsistent with the cost recovery requirements of the *ICRC Act 1997*.

In terms of relevant benchmarks for determining the appropriate level of retail costs, ActewAGL proposes the ICRC consider the following three sources:

- Frontier findings – in April 2019, Frontier undertook a comprehensive benchmarking exercise of retail operating costs (ROC) and CARC for the ESC[22]. This provides a useful starting point to identify the range of benchmark retail costs from regulatory decisions, market data and the ACCC's Retail Electricity Pricing Inquiry (REPI).
- ESC final VDO decision – following the Frontier review, the ESC released its final decision for the VDO to apply from 1 July 2019, and the reasons for this decision. This decision, which takes into consideration feedback on the Frontier review, is the most recent regulatory decision on retail costs and is therefore an important consideration for benchmarking.
- ACCC - in September 2019, the ACCC released its August 2019 report on the Inquiry into the National Electricity Market[23], which provides actual retail costs for 2017/18 and is therefore an important consideration in setting benchmark retail costs.

FRONTIER FINDINGS

The most recent and comprehensive benchmarking of ROC and CARC was undertaken by Frontier for the ESC in the context of determining the VDO to apply from 1 July 2019. At the outset, Frontier notes some shortcomings of the benchmarking approach, particularly the lack of disaggregated information to adjust for any differences in costs between the characteristics of the benchmark firms or jurisdictions[24]. Frontier did note the significant difference in costs found by the ACCC in its REPI Final Report, where the size of the retailer went some way to explaining the significant differences in ROC between the big three retailers and other retailers.

[22] Ibid.

[23] ACCC 2019, Inquiry into the National Electricity Market, August. Available here: https://www.accc.gov.au/system/files/Inquiry%20into%20the%20National%20Electricity%20Market%20report%20-%20August%202019.pdf

[24] Ibid, p.5.

Notwithstanding these shortcomings, Frontier presents ROC and CARC estimates based on benchmarking of regulatory decisions, market data and the ACCC's REPI Final Report.

For ROC, Frontier finds that:

- based on regulatory decisions in Australia since 2007, the regulatory allowance for ROC has been between $89 and $129 per customer per year[25];
- in more recent regulatory decisions since 2013, the regulatory allowance for ROC has been between $122 and $129 per customer per year;
- the most recent market data from AGL indicates a ROC of $84 per customer per year and from Origin Energy a ROC of $126 per customer per year. However, Frontier notes that these estimates are likely to be significantly affected by differences in the way that costs are reported;
- the ACCC's REPI indicates that the NEM-wide ROC has been between $78 and $119 per customer, although the lower bound was for 2007/08 and has not been lower than $93 per customer per year since; and
- the most recent NEM-wide ROC is $93 per customer per year.

Overall, Frontier identified a reasonable range for benchmark ROC for Victoria of $90 to $114 per customer per year (real 2018/19 dollars)[26].

For CARC, Frontier finds that:

- the more recent regulatory decisions, since 2013, have provided an allowance for CARC between $44 and $49 per customer per year;
- the most recent market data from AGL is for CARC of $62 per customer per year and from Origin Energy is for CARC of $47 per customer per year;
- the ACCC's REPI Final Report indicates that NEM-wide CARC has historically been between $34 and $50 (being the most recent estimate) per customer per year. The most recent estimates of CARC for Victoria are $61 per customer per year.

Developing a range for CARC on a similar basis as the range for ROC, Frontier suggests a reasonable range for benchmark CARC is between $47 and $62 per customer per annum (2018/19 dollars). However, Frontier noted that this may not be consistent with a 'modest' allowance for CARC as required under the VDO.

ESC FINAL DECISION

On ROC, the ESC received a number of submissions on its draft report suggesting that at least some of the ROC figures reported in the ACCC's REPI Final Report exclude an allocation for shared costs. Given the ESC did not have a complete set of data from all retailers and had not undertaken a detailed review of the data or internal cost allocation

[25] These estimates exclude ESCOSA and OTTER decisions given that these allowances include both ROC and CARC.

[26] Ibid, p.14

approaches of individual retailers, it was reluctant to rely on the cost data provided by retailers as the basis for its recommended allowance. Instead, it decided to rely more heavily on previous regulatory benchmarks rather than the ACCC REPI data or retailer provided data. Specifically, the ESC adopted the ICRC's 2017 decision of $124 per customer per year, which it stated corresponds with the figure proposed by amaysim – a small to mid-sized retailer[27]. The ESC added an allowance for additional costs for new regulatory obligations in Victoria of $10 per customer per year to arrive at a total ROC of $134 per customer per year.

For CARC, the ESC decided to base its modest allowance for CARC on the NEM-wide average for 2013/14 adjusted for inflation on the basis that this is the most robust data currently available that also limits the impact of the 'arms race' observed in recent years. On this basis, the ESC's final decision was to include CARC of $38 per customer per year.

ACCC INQUIRY INTO THE NATIONAL ELECTRICITY MARKET – AUGUST 2019 REPORT

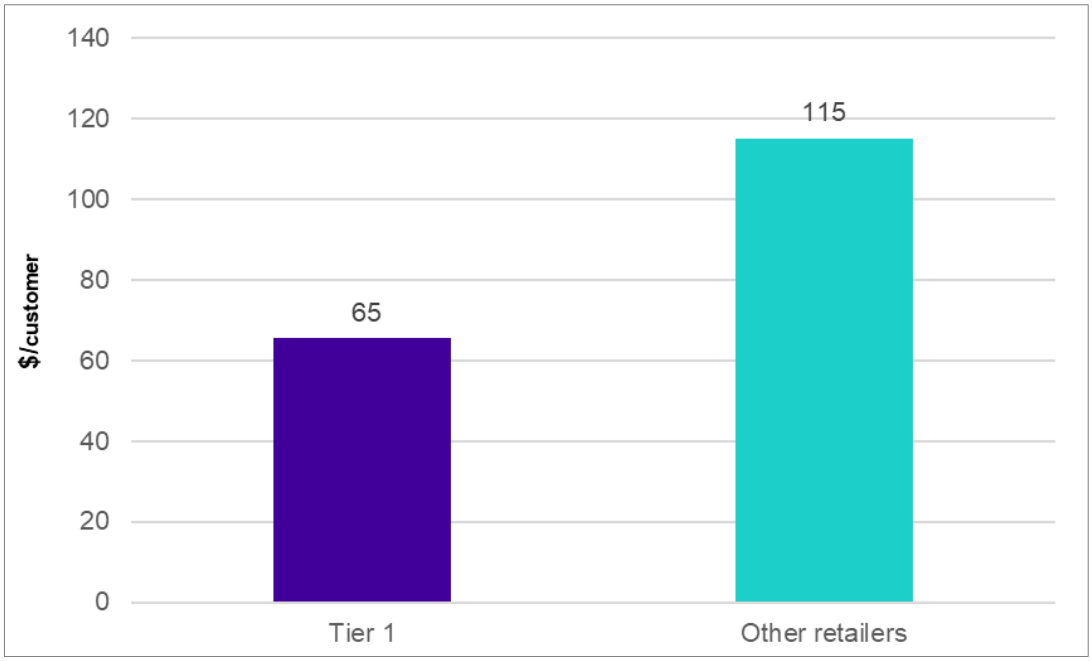
In September 2019, the ACCC released its August 2019 Report for the Inquiry into the National Electricity Market[28]. In this report, the ACCC provides updated estimates of retail costs (Cost to Serve or CTS and CARC).

At the NEM-wide level, the ACCC found that CTS had fallen in 2017/18 to $77 per residential customer per year (2017/18 real dollars), but with a significant difference in costs by retail tier, with Tier 1 retailers having a CTS of $65 per customer per year and other retailers having a CTS of $115 per customer per year (both in 2017/18 dollars, see Figure 4 below). The ACCC noted that this was not necessarily a surprising result given that the top three Tier 1 retailers generally have a larger customer base and so costs are spread such that the CTS (for example, billing system and IT costs) per customer will be lower.

[27] ESC 2019, Victorian Default Offer to apply from 1 July 2019, Advice to Victorian Government, May, p.65

[28] ACCC 2019, Inquiry into the National Electricity Market, August. Available here: https://www.accc.gov.au/system/files/Inquiry%20into%20the%20National%20Electricity%20Market%20report%20-%20August%202019.pdf

Figure 4. NEM-wide CTS by retail tier, 2017/18, $ per residential customer



Source: ACCC 2019, Inquiry into the National Electricity Market, August 2019 Report, p.108

At the NEM-wide level, the ACCC reported an increase in CARC from $49 per customer in 2016/17 to $63 per customer in 2017/18 (both in 2017/18 dollars). Across jurisdictions, CARC ranged from $56 per customer in NSW to $80 per customer in South East Queensland. The ACCC also reported a large disparity in CARC by retail tier, with Tier 1 retailers having a CARC of $50 per customer and other retailers having a CARC of $103 per customer.

SUMMARY

It is ActewAGL's position that retail costs should include both ROC and CARC. Relevant benchmarks compared with the ICRC's allowance for 2019/20 are presented in Table 3 below.

Table 3. ROC and CARC benchmarks

	ROC	CARC
ICRC 2019/20 allowance	$125.55 per customer[1]	$0 per customer[1]
Recent regulatory decisions	$122-$129 per customer[2]	$44-$49 per customer[2]
ESC final decision for VDO	$134 per customer	$38 per customer
Recent market data	$115 per customer[3]	$103 per customer[3]

Notes: 1. 2019/20 dollar, 2. 2018/19 dollars, 3. 2017/18 dollars (non-Tier 1)

In ActewAGL's view, benchmarking suggests that the ICRC current estimate for ROC is consistent with benchmarking results, particularly considering the small scale of the ACT. However, the ICRC's current approach to excluding CARC from retail costs is inconsistent with regulatory decisions in other jurisdictions and market data. Benchmarking suggests

that the ICRC should include an allowance for CARC of between $38 per customer per year and $103 per customer per year (adjusted appropriately for inflation).

ICRC question 7

What benchmarks should the Commission consider in determining the retail operating cost allowance?

ActewAGL response

As discussed above, the ICRC should consider all relevant evidence, which includes the benchmarking analysis recently completed by Frontier covering recent regulatory decisions, market data and the ACCC's REPI Final Report as well as the ESC's final decision on the VDO to apply from 1 July 2019 and the ACCC's most recent report for the inquiry into the NEM.

These benchmarks suggest that the ICRC's current ROC estimate is reasonable but the ICRC's exclusion of CARC is inconsistent with regulatory decisions in other jurisdictions and market data.

3.2.7 Energy Efficiency Improvement Scheme (EEIS)

ActewAGL supports the ICRC's approach to calculating EEIS.

3.2.8 Retail margin

ActewAGL supports the ICRC's proposed benchmarking approach to determine the retail margin. In determining the appropriate benchmarks, consideration should be given to the same sources of data as for retail costs. ActewAGL does not believe it is appropriate to include retail margins from other industries in the consideration of benchmarks for retail electricity. Other industries will face inherently different risks to a retail electricity business and hence cross-industry comparisons are not likely to be helpful. In addition, it is important to ensure consistency between different elements of the cost stack. Other industries may allocate costs differently than the approach used for retail electricity and hence the margins in other industries may include or exclude costs that should be excluded or included in the retail electricity margin.

FRONTIER FINDINGS

Frontier[29] argued that it was not appropriate to benchmark the retail margin against market data for electricity retailers or against data in the ACCC's REPI Final Report. Frontier argued that, given fluctuations in spot prices, observed margins in any one year will not reflect the 'efficient' margin required in order to attract the capital needed to provide a retailing service. Further, observed margins may be higher than the 'efficient' margin, for instance, if there were evidence that the market was not operating competitively. On this basis, Frontier only benchmarked against other regulatory allowances.

Frontier found that most recent regulatory decisions from the QCA, the ICRC, OTTER and IPART provide for a retail margin of 5.7 per cent of total costs including the retail margin.

[29] Frontier Economics 2019, Retail costs and margin, A report for the Essential Services Commission, April, p.20.

This corresponds to a retail margin of 6.04 per cent of total costs excluding the retail margin (which is how the margin is applied by the ICRC). Frontier concludes that this seems the obvious choice when benchmarking the retail margin. However, Frontier also notes that each of the allowances is ultimately based on IPART's allowance of 5.7 per cent chosen from within a range for the retail margin of 5.3 per cent and 6.1 per cent (including the retail margin)[30]. This suggests that a retail margin from within this range would also be reasonable.

Frontier also estimates the retail margin using an expected returns approach. The methodology used by Frontier is summarised as follows[31].

1 Derive an estimate of the benchmark WACC for a notional retailer.

2 Forecast the future cash flows and returns of the notional retailer under different economic conditions.

3 Forecast the future returns of the market in different states of the market.

4 Use the forecast returns of the notional retailer and the market to compute the implied systematic risk of the notional retailer.

5 Solve for the retail margin that equalises the systematic risk implied by the retailer's forecast cash flows and the systematic risk associated with the benchmark WACC.

Frontier calculates 81 potential scenarios using three values for WACC (low, base and high provided by the ESC) and allowing different values for market volatility, demand (GDP) volatility and the share of total costs represented by fixed costs. In addition to the base scenario (base values for all four variables), Frontier considers a reasonable range for the EBITDA margin to encompass the middle third of the rank-ordered estimated margins derived in the 81 scenarios.

The resulting retail margin estimates are presented in Table 4 below both in ex-post terms (including the retail margin) and ex-ante terms (excluding the retail margin).

Table 4. Frontier retail margin range

	Low	Base	High
Ex-post margin	4.80%	5.40%	6.10%
Ex-ante margin	5.04%	5.71%	6.50%

ESC FINAL DECISION

The ESC's final decision for the VDO from 1 July 2019 was to use a benchmark approach based on recent decisions by Australian energy regulators, resulting in an EBITDA retail operating margin of 5.7 per cent (equivalent to an ex-ante margin of 6.04 per cent). The ESC notes that this margin is comparable to, and within the feasible range of, the margin estimated by Frontier using the expected returns approach.

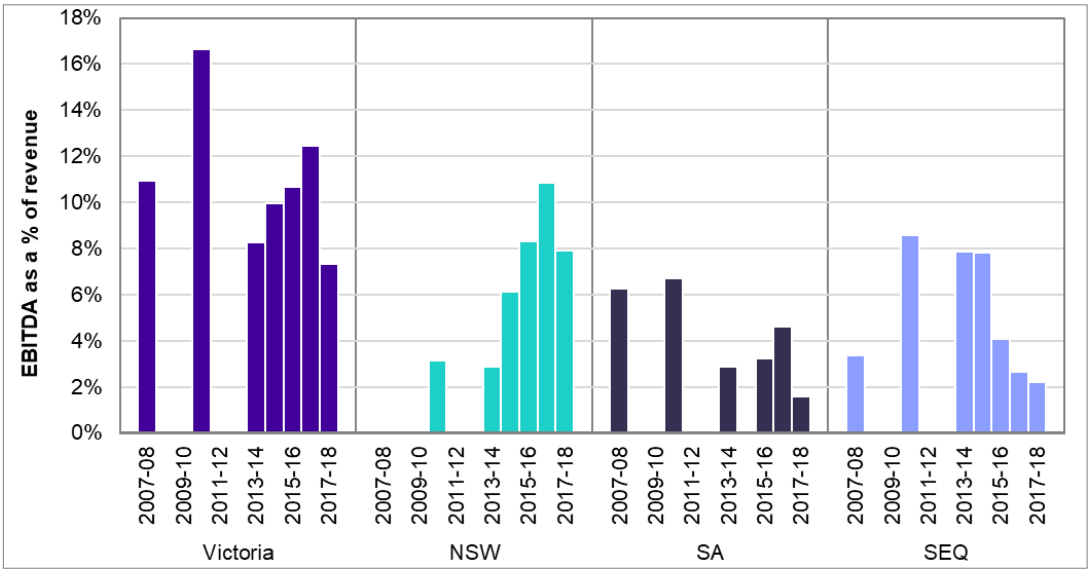
[30] The corresponding range in ex-ante terms (i.e. the margin calculated on the cost-stack excluding the margin) is 5.60 to 6.50 per cent.

[31] Frontier Economics 2019, Retail costs and margin, A report for the Essential Services Commission, April, p24. Further details of the methodology are provided in this report.

ACCC INQUIRY INTO THE NATIONAL ELECTRICITY MARKET – AUGUST 2019 REPORT

The ACCC found that the retail margin varies significantly by state (see Figure 5 below), with Victoria and NSW having the highest retail margin in 2017/18 while SA has the lowest retail margin[32]. The ACCC also found that, for residential customers, all regions experienced decreases in EBITDA as a percentage of revenue in 2017/18. At the NEM level, the retail margin (EBITDA) was 6 per cent of the customer's bill, corresponding to an ex-ante margin of 6.31 per cent.

Figure 5. EBITDA for residential customers by state, 2007/08 to 2017/18



Source: ACCC, Inquiry into the National Electricity Market, August 2019 Report, p. 102.

SUMMARY

The ICRC currently adopts a retail margin of 5.3 per cent, which is applied on an ex-ante basis – it is applied to the cost stack excluding the retail margin. In ex-post or EBITDA terms, the ICRC's current margin is 5.03 per cent. This makes the ICRC's current margin below that used in other Australian regulatory decisions, below Frontier's base case expected returns estimate and below the NEM-wide retail margin for 2017/18.

In ActewAGL's view, the ICRC should adopt a benchmark consistent with the relevant available evidence, which suggests an ex-ante retail margin of at least 6 per cent.

- Recent regulatory decisions suggest that an appropriate margin is 5.7 per cent in ex-post terms or 6.04 per cent in ex-ante terms.
- Recent regulatory decisions are based on an earlier IPART allowance chosen from a range of 5.3 per cent to 6.1 per cent in ex-post terms and 5.60 per cent to 6.50 per cent in ex-ante terms. Frontier suggests that a retail margin from within this range would also be reasonable.

[32] ACCC 2019, Inquiry into the National Electricity Market, August 2019 Report, p.102-103.

- Frontier's base case expected returns approach results in a margin of 5.4 per cent in ex-post terms and 5.71 per cent in ex-ante terms.
- The ACCC's August 2019 report for the Inquiry into the NEM finds a NEM-wide retail margin of 6 per cent (EBITDA or ex-post terms) corresponding to an ex-ante margin of 6.4 per cent.

ICRC question 8

What are the appropriate benchmarks for determining the retail margin for an efficient electricity retailer? Is there other information that the Commission should use to inform its decision on the retail margin?

ActewAGL response

The ICRC should have regard to relevant evidence when determining the appropriate benchmark for the retail margin. This includes the Frontier review of recent regulatory decisions and the expected returns approach. In addition, the ESC's final decision for the VDO to apply from 1 July 2019 and the margins reported in the latest ACCC Inquiry into the NEM are also relevant evidence, which should be considered by the ICRC.

In ActewAGL's view, the relevant evidence suggests a benchmark retail margin of at least 6 per cent (applied in ex-ante terms) is appropriate.

3.2.9 Other matters

ActewAGL suggests that metering costs be considered by the ICRC, and notes the ongoing provision for the pass through of costs associated with unexpected events. These matters are discussed below.

METERING COSTS

It is important that all costs are included in the cost stack to ensure that retail electricity offers are comparable for ACT customers. That is, customers should be able to make comparisons between offers on a like-for-like basis. The cost stack currently does not include smart metering costs. As smart meters continue to be introduced in the ACT, the total cost of installing, maintaining and data processing associated with smart meters will continue to escalate, and these costs should be considered for inclusion in the cost stack. The inclusion of smart meter costs in the cost stack would simplify ActewAGL's standing offers, which currently have two versions of each supply charge – one that includes a smart charge, and one that excludes smart meter charges.[33] Adding smart meter-related costs into the cost stack would simplify the tariff structure and improve the comparability of retail offers in the ACT.

Given that a reference price may be considered for the ACT, the inclusion of smart metering becomes essential to ensure that all ACT retail electricity offers are comparable. If smart metering costs were not included in the cost stack, then advertising discounts based on a reference price will be complex and confusing to consumers. ActewAGL welcomes the opportunity to discuss the inclusion of smart metering costs in the cost stack with the ICRC.

PASS THROUGH COSTS

ActewAGL notes that the ICRC Issues Paper includes provision for the pass through of costs associated with unexpected events (beyond ActewAGL's control) that occur after the ICRC's final decision for the 2020-24 period.[34] ActewAGL also notes Power of Choice implementation costs[35] are being recovered (via a pass through application) over a five year period from 2018/19 to 2022/23.[36]

[33] The application of the supply charge depends on the customer's metering equipment.

[34] ICRC 2019, Standing offer prices for the supply of electricity to small customers from 1 July 2020, September, p. 6.

[35] This pass through does not include the cost of installing meters.

[36] ICRC 2018, Retail electricity price recalibration 2018-19 – Final decision, Report 3 of 2018, June, p. 19-20.

4 Transparency and comparability of electricity offers in the ACT

ActewAGL supports the ICRC's proposal to undertake an assessment of the transparency and comparability of retail electricity offers in the ACT. In undertaking this analysis, it is important that the ICRC seeks input from consumers and consumer groups to ensure it understands the problems and sources of problems that consumers are facing in relation to electricity pricing. At the ICRC's workshop on 25 September 2019 (workshop), it was apparent that the key area of concern was affordability for customers in hardship circumstances. While changes could be introduced to improve the transparency of plans and bills as well as the comparability of plans across retailers, it is not clear that such changes would address the key concerns raised by consumer groups at the workshop.

Further, participants at the workshop raised concerns about the ability of some consumer groups to engage (particularly online) and, more generally, the lack of awareness and engagement by consumers on electricity pricing. The introduction of changes to improve transparency and comparability of electricity offers is only useful if consumers are engaged, and the potential benefits will depend on the level of engagement.

While the ICRC has yet to undertake the analysis proposed in section 3.1 of its Issues Paper, there appeared to be a presumption at the workshop that comparability of offers across retailers in the ACT was a key problem and that the introduction of a reference price was the preferred solution. ActewAGL encourages the ICRC to take a holistic approach when assessing potential transparency and comparability problems and the range of possible solutions. The introduction of references prices in other jurisdictions does not necessarily mean that this is appropriate for the ACT, particularly given that reference prices have only recently been introduced and the effects are yet to be fully understood. Other potential solutions may better address the issues specific to ACT customers, such as improvement to the presentation and communication of pricing information.

ActewAGL is keen to work closely with the ICRC and other stakeholders to evaluate a range of options to improve transparency and comparability of electricity offers for ACT customers. ActewAGL would support the concept of a reference price, if the ICRC found that:

- comparability of retail offers in the ACT is a key problem for ACT consumers;
- a reference price is the best solution to addressing this issue in the ACT;
- ACT customers are sufficiently engaged to make the introduction of a reference price an effective solution; and
- overall, the potential benefits of introducing a reference price outweigh the potential difficulties (particularly in terms of introducing further confusion for customers and the potential implications for competition).

The remainder of this section provides responses to the ICRC's specific questions.

ICRC question 9

Do you have any comments on the Commission's proposed approach to examining how offers and discounts are marketed in the ACT?

ActewAGL response

ActewAGL supports the ICRC's proposed approach to examining how offers and discounts are marketed in the ACT. However, when examining activities in other jurisdictions the ICRC should remain aware of a number of factors.

First, there is a considerably smaller range between the least and most expensive offers in the market in the ACT compared to other jurisdictions. This partly reflects the sustained regulation of prices in the ACT market.

Second, innovative and cost reflective tariff structures introduced in the ACT, such as the demand and time-of-use (TOU) tariffs, are more difficult for consumers to understand if all pricing offers must be benchmarked back to the 'average' customer. For example, some plans appear uncompetitive when benchmarked to the average customer, even if they are the best value plan for the segment they are intended.

Third, electricity usage by the "average" ACT electricity customer is likely to change over coming years under the ACT Government's Climate Strategy[37]. Under this strategy, gas would be phased out leading to a rise in average electricity consumption. As customers transition from dual-fuel to electricity only it will be difficult to market offers that are benchmarked to "average" annual consumption (see analysis in response to question 10).

Finally, the regulation of conditional discounting is currently being examined by the AEMC in response to a proposed rule change from the Minister for Energy and Emissions Reduction.[38] ActewAGL made a submission to the AEMC on 19 September 2019, advocating for the existing marketing regulations continue, which include safeguards for vulnerable customers.[39] ActewAGL awaits a decision from the AEMC on the rule change proposal, and the outcomes from this decision should be taken into account as part of the ICRC's review.

[37] ACT Government 2019, ACT Climate Change Strategy 2019-25. Available here: https://www.environment.act.gov.au/__data/assets/pdf_file/0003/1414641/ACT-Climate-Change-Strategy-2019-2025.pdf/_recache

[38] AEMC 2019, National Energy Retail Amendment (Regulating Conditional Discounting) Rule, August. Available here: https://www.aemc.gov.au/sites/default/files/2019-08/Regulating%20Conditional%20Discounting%20-%20Final%20Consultation%20paper_0.pdf

[39] https://www.aemc.gov.au/sites/default/files/2019-09/Rule%20Change%20SubmissionRRC0028%20-%20ActewAGL%20-%2020190919.PDF

ICRC question 10

Should the Commission consider any other factors when assessing the transparency and comparability of offers in the ACT?

ActewAGL response

If the ICRC decides to introduce a reference price, then it is important that the design of the reference price takes into account analysis of potential customer impacts. ActewAGL has given this some consideration below.

Some of ActewAGL's tariffs have been designed to suit particular usage profiles. Table 5 below shows the annual retail electricity bill in 2019/20 for ActewAGL customers on the Home and Home Saver Plus offers, under two usage profiles.

Table 5. 2019/20 Annual bills by ActewAGL tariff and consumption ($)

	Average consumption (7,000 kWh/year)	High consumption (14,000 kWh/year)
Home	2,162	3,929
Home Saver Plus	2,214	3,770
Difference in bills by plan type	52	-159

Residential ACT customers used an average of 7,000 kWh in the year to 31 March 2019. Customers on the Home Saver Plus offer averaged 14,000 kWh in the same period. A customer with an average level of consumption (7,000 kWh p.a.) is better off on the Home plan compared to the Home Saver Plus plan, with an annual saving of $52. However, a high-usage customer (consuming 14,000 kWh p.a.) is better off on the Home Saver Plus plan with their annual bill being $159 lower than the Home plan. This is because some of ActewAGL's tariffs are designed for specific customer usage profiles. Introducing a reference price that is based on an average consumption level (i.e. 7,000 kWh p.a.) would mean that customers without an average consumption profile may be confused as to the best offer for them. This would undermine the intention of the reform.

ICRC question 11

What do you think are the main factors that make it difficult for consumers to compare offers and choose the offer best suited to their circumstances?

ActewAGL response

There are many factors that could potentially make it difficult for consumers to compare offers and choose an offer best suited to their circumstance, including the following.

- Different annual consumption figures being used for an "average customer" – for example, the ICRC uses 8 MWh for residential and 30 MWh for small business customers on a standing offer, while some retailers use different consumption figures in their advertising materials, and other retailers make no mention of consumption figures.
- The customer's actual consumption level could be vastly different to the advertised consumption level, making it difficult to accurately compare offers.
- Some retailers offer discounts off consumption charges whereas others have discounts off the total bill.
- There are certain offers for which it is not practical to make a comparison against a standing offer or another retailer's offer.
- Some retailers apply conditions, and other benefits or bonuses to an offer, while others do not.
- The Energy Made Easy (EME) website does not incorporate more cost reflective tariffs, such as demand tariffs, for customer comparison purposes.

ICRC question 12

Do you have any suggestions for how to improve the transparency and comparability of offers in the ACT? Please explain how your suggested options would improve transparency and help consumers compare offers and choose the best offer for them.

ActewAGL response

ActewAGL is keen to work closely with the ICRC to evaluate a range of options to improve transparency and comparability of electricity offers for ACT customers. This range of options should be developed in consultation with consumer groups to ensure that the solutions considered adequately address the issue of transparency and comparability. ActewAGL expects that these options may include both simple, easy-to-implement solutions as well as solutions that may be more arduous to implement.

The ICRC may consider improvements to the presentation and communication of pricing information to improve transparency of offers (with the current Rules). This option would contribute to an improvement in the comparability of offers.

The ICRC's analysis may find that the introduction of a reference offer would provide a net benefit to ACT customers. However, the ICRC needs to consider the potential difficulties associated with the introduction of a reference offer, such as adding confusion for customers with non-typical levels of annual consumption or metering configurations. (See response to question 10.)

ICRC question 13

Are there any other issues that the Commission should consider?

ActewAGL response

As discussed in section 3.2.9, ActewAGL suggests that metering costs be considered by the ICRC, and notes the ongoing provision for the pass through of costs associated with unexpected events.

Metering costs

If a reference price is to be introduced in the ACT, it is important that all costs be included in the cost stack to ensure comparisons between offers can be made on a like-for-like basis. The cost stack currently does not include smart metering costs. As smart meters continue to be introduced in the ACT, the total cost of installing, maintaining and data processing associated with smart meters will escalate, and these costs should be considered for inclusion in the cost stack under a reference price arrangement. If smart metering costs were not included, then advertising discounts based on a reference price will be complex and confusing to consumers.

Pass through costs

ActewAGL notes that the ICRC Issues Paper includes provision for the pass through of costs associated with unexpected events (beyond ActewAGL's control) that occur after the ICRC's final decision for the 2020-24 period.[40] ActewAGL also notes Power of Choice implementation costs[41] are being recovered (via a pass through application) over a five year period from 2018/19 to 2022/23.[42]

[40] ICRC 2019, Standing offer prices for the supply of electricity to small customers from 1 July 2020, September, page 6.

[41] This pass through does not include the cost of installing meters.

[42] ICRC 2018, Retail electricity price recalibration 2018-19 – Final decision, Report 3 of 2018, June, pages 19-20.

Attachment 1: Summary of responses

ICRC Issues Paper reference	ActewAGL response
Question 1	ActewAGL supports the ICRC's proposal to undertake the analysis set out in Section 3.1 of its Issues Paper. If this analysis supports the introduction of a reference price, ActewAGL considers that the existing application of the form of price control should be maintained – there would be no benefits from the level of the reference price being set by the ICRC.
Question 2	The ICRC's proposed approach of using five years of historic data to determine the contract position will understate spot price volatility and hence the level of hedging an efficient retail would adopt. Instead, it is ActewAGL's view that the ICRC should adopt a benchmark contract position. Consistent with the previous EPC model, it should be assumed that an efficient retailer would hedge 105 per cent of the maximum load per quarter. A reasonable split of contract volumes can then be set. In ActewAGL's view, the splits determined by ACIL Allen for the QCA are reasonable, although ActewAGL notes that the level of the EPC is not particularly sensitive to this split.
Question 3	ActewAGL supports the ICRC's proposed 23-month averaging period between 1 June and 30 April. This provides both the ICRC and ActewAGL more time to finalise and implement annual price changes.
Question 4	The averaging period for scaling spot prices should be consistent with the averaging period used to determine contract prices. A 23-month averaging period smooths out fluctuations in prices and hence results in more stable regulated retail prices for customers.
Question 5	The ICRC should adopt a simple benchmark approach for the volatility allowance given the relatively minor impact this will have on year-on-year price changes. ActewAGL suggests adopting the average of the Frontier estimates used for Victoria.
Question 6	The WACC should be used to calculate the holding costs of certificates. ActewAGL suggests that the ICRC adopt the WACC parameters from its water and sewerage decision with the exception of the equity beta. For equity beta, the ICRC should adopt a figure relevant to retail electricity such as the value of 1.00 adopted by the ESC in Victoria.
Question 7	As discussed above, the ICRC should consider all relevant evidence, which includes the benchmarking analysis recently completed by Frontier covering recent regulatory decisions, market data and the ACCC's REPI Final Report as well as the ESC's final decision on the VDO to apply from 1 July 2019 and the ACCC's most recent report for the inquiry into the NEM.

ICRC Issues Paper reference	ActewAGL response
Question 8	The ICRC should have regard to relevant evidence when determining the appropriate benchmark for the retail margin. This includes the Frontier review of recent regulatory decisions and the expected returns approach. In addition, the ESC's final decision for the VDO to apply from 1 July 2019 and the margins reported in the latest ACCC Inquiry into the NEM are also relevant evidence, which should be considered by the ICRC. In ActewAGL's view, the relevant evidence suggests a benchmark retail margin of at least 6 per cent (applied in ex-ante terms) is appropriate.
Question 9	ActewAGL supports the ICRC's proposed approach to examining how offers and discounts are marketed in the ACT. However, when examining activities in other jurisdictions the ICRC should remain aware of a number of factors. First, there is a considerably smaller range between the least and most expensive offers in the market in the ACT compared to other jurisdictions. This partly reflects the sustained regulation of prices in the ACT market. Second, innovative and cost reflective tariff structures introduced in the ACT, such as the demand and time-of-use (TOU) tariffs, are more difficult for consumers to understand if all pricing offers must be benchmarked back to the 'average' customer. For example, some plans appear uncompetitive when benchmarked to the average customer, even if they are the best value plan for the segment they are intended. Third, electricity usage by the "average" ACT electricity customer is likely to change over coming years under the ACT Government's Climate Strategy[43]. Under this strategy, gas would be phased out leading to a rise in average electricity consumption. As customers transition from dual-fuel to electricity only it will be difficult to market offers that are benchmarked to "average" annual consumption (see analysis in response to question 10). Finally, the regulation of conditional discounting is currently being examined by the AEMC in response to a proposed rule change from the Minister for Energy and Emissions Reduction.[44] ActewAGL made a submission to the AEMC on 19 September 2019, advocating for the existing marketing regulations continue, which include safeguards for vulnerable customers.[45] ActewAGL awaits a decision from the AEMC on the rule change proposal, and the outcomes from this decision should be taken into account as part of the ICRC's review.

[43] ACT Government 2019, ACT Climate Change Strategy 2019-25. Available here: https://www.environment.act.gov.au/__data/assets/pdf_file/0003/1414641/ACT-Climate-Change-Strategy-2019-2025.pdf/_recache

[44] AEMC 2019, National Energy Retail Amendment (Regulating Conditional Discounting) Rule, August. Available here: https://www.aemc.gov.au/sites/default/files/2019-08/Regulating%20Conditional%20Discounting%20-%20Final%20Consultation%20paper_0.pdf

[45] https://www.aemc.gov.au/sites/default/files/2019-09/Rule%20Change%20SubmissionRRC0028%20-%20ActewAGL%20-%2020190919.PDF

<table>
<tr><th>ICRC Issues Paper reference</th><th>ActewAGL response</th></tr>
<tr><td></td><td>Third, the make-up of the “average” ACT electricity customer is likely to change over coming years if the ACT Government’s Sustainable Energy Policy 2020-25 is implemented. Under this policy, gas would be phased out in favour of all-electric premises. This means average electricity consumption is likely to rise considerably in coming years, and the number of customer segments will also rise as customers transition from being dual-fuel to electricity only. According to Evoenergy, around 45 per cent of the energy distributed in the ACT is in the gas network. In response to a potential gas phase out, ActewAGL would need to market offers to different customer groupings, including high consumption electricity-only premises, as well as dual-fuel premises which have not yet switched. Marketing offers for these various customer groups is likely to be more difficult when all offers need to be benchmarked to the “average” customer (see analysis in response to question 10).

Finally, the regulation of conditional discounting is currently being examined by the AEMC in response to a proposed rule change from the Minister for Energy and Emissions Reduction.[46] ActewAGL made a submission to the AEMC on 19 September 2019, advocating for the existing marketing regulations continue, which include safeguards for vulnerable customers.[47] ActewAGL awaits a decision from the AEMC on the rule change proposal, and the outcomes from this decision should be taken into account as part of the Commission’s review.</td></tr>
<tr><td>Question 10</td><td>If the ICRC decides to introduce a reference price, then it is important that the design of the reference price takes into account analysis of potential customer impacts. ActewAGL has given this some consideration below.

Some of ActewAGL’s tariffs have been designed to suit particular usage profiles. Table 5 below shows the annual retail electricity bill in 2019/20 for ActewAGL customers on the Home and Home Saver Plus offers, under two usage profiles.

Table 6. 2019/20 Annual bills by ActewAGL tariff and consumption ($)

<table>
<tr><th></th><th>Average consumption (7,000 kWh/year)</th><th>High consumption (14,000 kWh/year)</th></tr>
<tr><td>Home</td><td>2,162</td><td>3,929</td></tr>
<tr><td>Home Saver Plus</td><td>2,214</td><td>3,770</td></tr>
<tr><td>Difference in bills by plan type</td><td>52</td><td>-159</td></tr>
</table>
</td></tr>
</table>

[46] AEMC 2019, National Energy Retail Amendment (Regulating Conditional Discounting) Rule, August. Available here: https://www.aemc.gov.au/sites/default/files/2019-08/Regulating%20Conditional%20Discounting%20-%20Final%20Consultation%20paper_0.pdf

[47] https://www.aemc.gov.au/sites/default/files/2019-09/Rule%20Change%20SubmissionRRC0028%20-%20ActewAGL%20-%2020190919.PDF

ICRC Issues Paper reference	ActewAGL response
	Residential ACT customers used an average of 7,000 kWh in the year to 31 March 2019. Customers on the Home Saver Plus offer averaged 14,000 kWh in the same period. A customer with an average level of consumption (7,000 kWh p.a.) is better off on the Home plan compared to the Home Saver Plus plan, with an annual saving of $52. However, a high-usage customer (consuming 14,000 kWh p.a.) is better off on the Home Saver Plus plan with their annual bill being $159 lower than the Home plan. This is because some of ActewAGL's tariffs are designed for specific customer usage profiles. Introducing a reference price that is based on an average consumption level (i.e. 7,000 kWh p.a.) would mean that customers without an average consumption profile may be confused as to the best offer for them. This would undermine the intention of the reform.
Question 11	There are many factors that could potentially make it difficult for consumers to compare offers and choose an offer best suited to their circumstance, including the following. • Different annual consumption figures being used for an "average customer" – for example, the ICRC uses 8 MWh for residential and 30 MWh for small business customers on a standing offer, while some retailers use different consumption figures in their advertising materials, and other retailers make no mention of consumption figures. • The customer's actual consumption level could be vastly different to the advertised consumption level, making it difficult to accurately compare offers. • Some retailers offer discounts off consumption charges whereas others have discounts off the total bill. • There are certain offers for which it is not practical to make a comparison against a standing offer or another retailer's offer. • Some retailers apply conditions, and other benefits or bonuses to an offer, while others do not. The Energy Made Easy (EME) website does not incorporate more cost reflective tariffs, such as demand tariffs, for customer comparison purposes.
Question 12	ActewAGL is keen to work closely with the ICRC to evaluate a range of options to improve transparency and comparability of electricity offers for ACT customers. This range of options should be developed in consultation with consumer groups to ensure that the solutions considered adequately address the issue of transparency and comparability. ActewAGL expects that these options may include both simple, easy-to-implement solutions as well as solutions that may be more arduous to implement. The ICRC may consider improvements to the presentation and communication of pricing information to improve transparency of offers (with the current Rules). This option would contribute to an improvement in the comparability of offers.

ICRC Issues Paper reference	ActewAGL response
	The ICRC's analysis may find that the introduction of a reference offer would provide a net benefit to ACT customers. However, the ICRC needs to consider the potential difficulties associated with the introduction of a reference offer, such as adding confusion for customers with non-typical levels of annual consumption or metering configurations. (See response to question 10.)
Question 13	As discussed in section 3.2.9, ActewAGL suggests that metering costs be considered by the ICRC, and notes the ongoing provision for the pass through of costs associated with unexpected events. *Metering costs* If a reference price is to be introduced in the ACT, it is important that all costs be included in the cost stack to ensure comparisons between offers can be made on a like-for-like basis. The cost stack currently does not include smart metering costs. As smart meters continue to be introduced in the ACT, the total cost of installing, maintaining and data processing associated with smart meters will escalate, and these costs should be considered for inclusion in the cost stack under a reference price arrangement. If smart metering costs were not included, then advertising discounts based on a reference price will be complex and confusing to consumers. *Pass through costs* ActewAGL notes that the ICRC Issues Paper includes provision for the pass through of costs associated with unexpected events (beyond ActewAGL's control) that occur after the ICRC's final decision for the 2020-24 period.[48] ActewAGL also notes Power of Choice implementation costs[49] are being recovered (via a pass through application) over a five year period from 2018/19 to 2022/23.[50]

[48] ICRC 2019, Standing offer prices for the supply of electricity to small customers from 1 July 2020, September, page 6.

[49] This pass through does not include the cost of installing meters.

[50] ICRC 2018, Retail electricity price recalibration 2018-19 – Final decision, Report 3 of 2018, June, pages 19-20.