



independent competition and regulatory commission

Draft Decision  
**Retail Prices  
for Non-contestable  
Electricity Customers**

**Report 6 of 2007  
May 2007**

The Independent Competition and Regulatory Commission (the Commission) was established by the *Independent Competition and Regulatory Commission Act 1997* to determine prices for regulated industries, advise government about industry matters, advise on access to infrastructure and determine access disputes. The Commission also has responsibilities under the Act for determining competitive neutrality complaints and providing advice about other government-regulated activities. Under the *Utilities Act 2000* the Commission also has responsibility for licensing utility services and ensuring compliance with licence conditions.

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# Foreword

The Attorney-General has made a reference to the Independent Competition and Regulatory Commission (the Commission) to provide a price direction for the supply of electricity to franchise customers for the period from 1 July 2007 to 30 June 2008. The Minister's reference is made under sections 15 and 16 of the *Independent Competition and Regulatory Commission Act 2000* (ICRC Act).

In the ACT, the retailing of electricity to customers consuming more than 160 megawatt hours (MWh) per year was made contestable from 1998.<sup>1</sup> The electricity supply industry in the ACT was opened for retail competition to customers consuming more than 100 MWh/year from 1 July 2001.<sup>2</sup> Following the recommendation that full retail contestability (FRC) be introduced for all customers in the ACT, the government opened the market for customers using less than 100 MWh/year to competition from 1 July 2003.<sup>3</sup> While the government decided to open the market to all customers, certain transitional arrangements were maintained. These were intended to ensure that customers consuming less than 100 MWh/year were able to remain on non-negotiated contracts with the incumbent retailer. A regulated maximum tariff was applicable to such customers for a period of three years from 1 July 2003 to 30 June 2006. During the designated transitional period, the government undertook to consider whether these arrangements would need to be extended for an additional period.

In that investigation, the Treasurer sought advice from the Commission on the need for the transitional arrangements to continue and, if so, the form of price protection that should apply to franchise contracts in future and the duration of such protection. The Commission released an issues paper in November 2005 and considered the submissions received on that paper in reaching its draft decision. The Commission issued its final decision in April 2006. The regulated maximum tariff applicable to such customers was extended for a period of one year from 1 July 2006 to 30 June 2007. The government, through the Attorney-General, has now sought a determination from the Commission on what the transitional franchise tariff should be for a further 12 months.

In developing the price direction for the regulated maximum tariff applicable to customers eligible for these transition arrangements for the period from 1 July 2007 to 30 June 2008, the Commission is required to have regard to a number of matters, including:

- the requirements of section 20 of the ICRC Act
- the need to have a final report in sufficient time to allow ActewAGL Retail to make necessary administrative arrangements to its billing system and to provide information on the new tariff to customers.

This report sets out the Commission's draft price direction and reasons for the particular arrangements embodied in the direction.

Paul Baxter  
Senior Commissioner  
May 2007

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<sup>1</sup> *Utilities Act 2000*.

<sup>2</sup> Disallowable Instrument 2001–93.

<sup>3</sup> Independent Competition and Regulatory Commission, *Final report: Full retail contestability in electricity in the ACT*, July 2002. Disallowable Instrument 2003–20.



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# 1 Introduction

## 1.1 Background

The Commission received a reference from the Attorney-General on 16 April 2007, instructing the Commission to provide a price direction for the supply of electricity to franchise customers for 1 July 2007 to 30 June 2008. The Commission has made two previous price directions for this class of retail electricity customers. The first was released in May 2003 and covered the period from 1 July 2003 to 30 June 2006, and the second covered the period from 1 July 2006 to 30 June 2007.

The Commission's first price direction was made at the time of the initial opening of the retail electricity market to competition for small customers (those consuming less than 100 MWh per year). Thus, at the beginning of that price direction all small customers were on the regulated retail tariff. The initial reference to the Commission instructed the Commission to provide a three-year price direction. The Commission termed the resulting tariff from that price direction the 'transitional franchise tariff' (TFT). Customers who chose to remain on the regulated tariff are called 'franchise customers', and customers who opted for a negotiated tariff with an alternative retailer or with the standard retailer, ActewAGL Retail, are called 'non-franchise customers'.

The Commission's first price direction allowed a 4.5% real increase in the franchise revenue for the first year and a 0.5% real increase for each of the remaining two years.<sup>4</sup> The Commission made this determination based upon a rigorous examination of the costs incurred by ActewAGL Retail in the provision of retail electricity services to franchise customers. That price direction also allowed for a variety of pass-through events, including changes in network operating costs.

The reference the Commission received to initiate the second price direction instructed the Commission to determine first whether it were necessary for the TFT to continue. If the Commission determined that the TFT should continue, the Commission was to determine a new price direction. The Commission's final report, issued in April 2006, recommended that the TFT cease to exist. The Commission concluded that there was evidence that the retail market in the ACT was sufficiently competitive to support the removal of the TFT. However, the Commission was concerned at that time that the removal of the TFT could affect the status of the standard customer contract that covered all franchise customers by default. Thus, the Commission determined that the TFT should continue for the period from 1 July 2006 to 30 June 2007 to allow the ACT Government to make legislative changes to the *Utilities Act 2000* to preserve the conditions of the standard customer contract.

The Commission's final decision, released in April 2006, allowed for a Consumer Price Index (CPI) increase in franchise revenue for the period from 1 July 2006 to 30 June 2007.<sup>5</sup> Thus, customers could expect no real increase in prices at that time. The final decision did not contain a

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<sup>4</sup> ICRC, *Final determination: Investigation into retail prices for non-contestable electricity customers in the ACT*, Report 5 of 2003, May 2003.

<sup>5</sup> ICRC, *Final report: Retail prices for non-contestable electricity customers*, Report 8 of 2006, April 2006.

complete build-up of the costs of retail electricity services in the ACT. The Commission's analysis at that time was that the offer of only a CPI adjustment to franchise revenue was reasonable, and that the CPI increase for 2006–07 represented an appropriate balance between the retail margin to sustain a competitive market and a reasonable outcome for consumers.

The Commission is now required to extend the TFT for a further period of one year, given the recent reference from the government. As part of the Commission's current analysis, the Commission is again undertaking a rigorous evaluation of the build-up of retail costs.

## **1.2 Structure of the draft decision**

This draft decision outlines the Commission's process for conducting this determination, and explains the context of the review and the key issues the Commission will consider in making the determination.

Chapter 2 outlines the draft decision in terms of the overall cost build-up used by the Commission and some of the major cost movements that have contributed to the Commission's decision on prices.

Chapter 3 summarises in more detail the cost build-up used to determine the TFT.

Chapter 4 summarises some of the safety net arrangements that will apply to protect consumer interests.

Chapter 5 summarises the Commission's conclusions, setting out the Commission's draft decision on the TFT.

A draft price direction is provided in Appendix 2.



## 2 Overview of the draft decision

In the ACT, customers who choose not to use an electricity tariff offered by a competing electricity retailer or opt for a contract from the incumbent retailer, ActewAGL Retail, remain on a regulated retail tariff (called a ‘transitional franchise tariff’, or TFT) provided by the incumbent retailer. The obligations imposed on the Commission in determining the changing levels for the TFT are described in the *Independent Competition and Regulatory Commission Act 1997* (the ICRC Act). In particular, the provisions of section 20 of the ICRC Act provide guidance to the Commission on how to balance its regulatory obligations for price directions. A price direction needs to balance a number of conflicting objectives, including the need for reliable supply services of a defined quality, the need for efficient delivery of services with incentives to reduce costs, the need to encourage participation in the retail electricity sector by allowing financially viable service provision, and the need to have regard to the social impacts of the tariff levels and general price inflation.

The Commission’s approach to the determination of retail electricity prices for ActewAGL Retail customers who choose to stay on the TFT has been to draw on benchmark cost information available in the marketplace or in other regulatory decisions within the electricity retail sector in Australia. This benchmark information has been used to arrive at a reasonable estimate of the economically efficient cost base of an incumbent electricity retailer providing retail electricity supply services to a regulated customer segment. It is worth emphasising that all electricity retailers operate as aggregators of energy demand from small, medium and large consumers of electricity who benefit from collective purchasing of energy from generators in a competitive electricity market. While the retailer profits from this aggregation, each customer is better off because their collective bargaining power and their ability to hedge energy price volatility is significantly enhanced through joining with a retailer, rather than accessing the electricity market directly.

Having arrived at an economically efficient cost base for the incumbent electricity retailer using the guidance of section 20 of the ICRC Act, the Commission has converted that cost base into an incentive-based regulatory framework which has the form of a weighted average price cap. The weighted average price cap allows ActewAGL Retail to rebalance the TFT towards the efficient cost base underlying each of those tariffs subject to regulation. ActewAGL Retail is allowed to set prices for the regulated customer base through the TFT up to the level set by the weighted average price cap defined in the Commission’s price direction for the 2007–08 regulatory year.

In considering the determination of an appropriate TFT for the 2007–08 year, the Commission has revisited the cost build-up and other information used in setting the TFT over the past four years. The following sections of this report describe the various cost components of an incumbent electricity retailer and the economically efficient cost levels which the Commission believes should be incorporated into the revenue yield cap for 2007–08.

### 2.1 Summary of the retail costs underlying the draft decision

The Commission has reviewed the main activities of electricity retailers and, through examination of its previous TFT decisions, publicly available industry information and recent regulatory draft and final decisions, has arrived at an estimate of the economically efficient cost base of an incumbent electricity retailer operating in an environment similar to that of ActewAGL Retail.

Table 2.1 summarises the main retail cost elements and compares them to the values recently published by the Independent Pricing and Regulatory Tribunal (IPART) in its draft determination<sup>6</sup> for electricity retailers in New South Wales.

Table 2.1 Summary of estimated efficient retail costs, ICRC and IPART

	ICRC 2007-08	IPART 2007-08
<b>Energy purchase costs</b>		
Electricity purchase cost (\$/MWh)	58.04	56.50
Energy contracting cost (\$/MWh)	0.70	-
Green costs (\$/MWh)	2.83	4.30
NEM fees (\$/MWh)	0.71	0.71
Energy losses	4.97%	6.40%
<b>Total energy purchase cost (\$/MWh)</b>	<b>65.38</b>	<b>65.45</b>
Retail operating costs (\$/customer)	94.91	75.00
Customer acquisition costs (\$/customer)	15.09	35.00
<b>Total retail costs (\$/customer)</b>	<b>110.00</b>	<b>110.00</b>
Retail margin (% of sales, EBITDA)	4.00%	5.00%

The estimates of efficient retail costs presented in Table 2.1 are those costs which are added at the retail level. The additional costs which are recovered in the TFT are the pass-through of the regulated transmission costs into the regulated distribution costs, and the pass-through of the combined regulated distribution and transmission costs as network use of system costs recovered from all consumers at the retail level. While the overall weighted average price cap applied by the Commission at the retail level for TFT customers allows for the recovery of efficient costs of retail supply to TFT customers, the nature of the cap allows the retailer to improve its overall productivity through efficiency improvements that result in cost savings. These cost savings are only available from those cost elements which are able to be influenced by the activities of the retailer. Thus, for example, government taxes and charges placed on the retailer are simply passed-through costs, as are network use of system costs. However, general 'back room' billing costs and costs associated with winning new customers are able to be influenced by the retailer's own decisions and behaviour.

One concern of the Commission relating to the reference requirement for the TFT to be set for a 12-month period is that a large increase in the volatility of the energy purchase cost resulting from supply-demand imbalances in the wholesale electricity market cannot be passed through to consumers immediately by the incumbent retailer. This reflects problems forecasting the duration and extent of energy cost changes, and the desire of the retailer not to increase prices radically if possible. In such circumstances, there may be a need for a further reference from government to allow the TFT to be adjusted in a timely manner to respond to large changes in the wholesale cost of energy, since an unchanged TFT might no longer meet the legislated requirements of the ICRC Act. Indeed, large increases in energy cost which cannot be passed through by the incumbent

<sup>6</sup> IPART, *Draft report and draft determination No. 1 of 2007, Promoting retail competition and investment in the NSW electricity sector, Regulated electricity retail tariffs and charges for small customers 207 to 2010*, April 2007.

supplier to TFT customers under the provisions of a particular TFT determination reduce economic efficiency (s. 20(2)(c) of the ICRC Act<sup>7</sup>) because tariffs no longer allow recovery of efficient costs, reduce the success of demand side management (s. 20(2)(h)) through muting the price signals seen by consumers, inhibit sustainable financial viability (s. 20(2)(i)) by limiting the incumbent retailer from passing through costs which it has limited opportunity to control, and reduce its ability to meet its contracted functional obligations in the national electricity market (NEM), which is a breach of the ICRC Act (s. 20(2)(k)). As discussed below in Section 3.2.1 of this draft decision, the issue of wholesale energy market volatility is extremely important in the decision about the TFT level. The short-term nature of the terms of reference set for the Commission only exacerbates the problem faced by the Commission in setting a TFT that meets all the requirements of the Act.

In this context, the Commission is considering the need for the application of an energy cost pass-through device in the TFT calculation, particularly in a period in which there is high volatility in generation prices, as is evident at this time.

## 2.2 Cost changes affecting the draft decision

In determining the cost estimates presented in Table 2.1, the Commission has used the retail operating cost estimates which underlie its earlier decision for the TFT from 2003–04 to 2005–6 and escalated those costs by the CPI calculated on a historical basis to arrive at estimates for the 2007–08 financial year. It has also separately identified the customer acquisition costs (not previously included in the cost base). The Commission has separately estimated the likely green costs, including the mandatory renewable energy target (MRET) and greenhouse gas abatement scheme (GGAS) costs mandated by legislation<sup>8</sup>, and the NEM fees using public information on the fee structures and estimates of ActewAGL Retail’s likely operating circumstances in 2007–08. Likewise, the distribution loss factors provided by NEMMCO and relied upon for many tariff calculations show a slow reduction in the distribution loss factors for ACT distribution tariff consumers.<sup>9</sup> The Commission has adopted a slightly higher retail margin (of 4%) than has been used in previous TFT determinations. It is at the lower end of the range considered by IPART in its most recent draft determination, although that determination will not apply in the first year under IPART’s three-year glide path adjustment process, so the Commission’s draft determination for the single 2007–08 year is more in line with the IPART approach.

The major change from the cost structure used in previous price directions prepared by the Commission is that the wholesale energy price observed in the electricity pool has increased during 2007, with dramatic increases in recent months. Table 2.2 lists the average annual regional reference price (RRP) for New South Wales from 1998–99 through 2006–07.<sup>10</sup>

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<sup>7</sup> References to s. 20 in this report refer to that section of the ICRC Act.

<sup>8</sup> *Renewable Energy (Electricity) Act 2000* (Cwth) and *Renewable Energy (Electricity) Regulations 2001*.

<sup>9</sup> NEMMCO, *Distribution loss factor reports for 2005–06, 2006–07 and 2007–08*, Appendix D.

<sup>10</sup> The 2006–07 prices are through 7 May 2007. Data sourced from NEMMCO and available at <http://www.nemmco.com.au>.

Table 2.2 Average yearly RRP for New South Wales (\$/MWh)

1998–99	1999–00	2000–01	2001–02	2002–03	2003–04	2004–05	2005–06	2006–07
33.13	28.27	37.69	34.76	32.91	32.37	39.33	37.24	41.7

While there was a slight increase in the average yearly RRP in 2006, the effect did not become dramatic until 2007. Table 2.3 shows the average and the median RRP for New South Wales for the first five months of 2007.<sup>11</sup>

Table 2.3 Average and median monthly RRP for 2007 (\$/MWh)

	January	February	March	April	May
Average (\$/MWh)	55.91	44.76	51.28	78.21	59.23
Median (\$/MWh)	35.22	36.91	42.08	75.98	64.01

As can be seen, average prices for 2007 are much higher than previous average RRP, with average RRP in April reaching \$78.21 per MWh. Median prices are also included to demonstrate that the increase in the pool price is driven by a change in underlying fundamentals and not generated by large one-off shocks to the market.<sup>12</sup>

Information from NEMMCO and from ActewAGL Retail suggests this general uplift in the pool price results from water storages in the Snowy Mountains, Victoria and Tasmania falling nearly to their minimum run capacities. This has resulted in the steady withdrawal of capacity from the Snowy, Victorian and Tasmanian hydro plants as the water fuel source nears depletion. In addition, some of the thermal base-load plants in Queensland are having to withdraw capacity from the market because they cannot access sufficient cooling water from local rivers and storage facilities to allow full-capacity operation. The base-load plant appears to be dispatching at between 30% and 50% of its rated capacity, which is significantly less than in previous years. While some of this plant provides peaking capacity, other facilities provide base load. Both peak and base-load capacity need to be replaced by power from higher cost thermal plants using coal, gas or diesel fuels.

The Commission is aware that good practice in electricity retail business management suggests that these pool prices should be hedged to a certain extent by contracts between the retailers and the generation companies (including bilateral, caps, swaps and other contracts), and in the financial futures markets. While this would limit the impact in 2007–08 of the energy price rise seen by retailers in recent months, the eventual result is likely to be that the pool prices will influence contract prices over the mid-term (two to three years), such that the energy cost for ActewAGL Retail (and other retailers in the ACT) will rise substantially in 2008–09 and possibly subsequent years.

The Commission has factored these changes into its draft decision on the price direction. The approach it has used to calculate an energy cost is described in Section 3.2.1.

<sup>11</sup> May prices based on the first seven days in May.

<sup>12</sup> The average monthly RRP for November 2004 also exceeded \$70/MWh. That high average was driven by an average daily price of \$1115.75/MWh for 30 November 2004. The median RRP for November 2004 was \$30.85/MWh.

## 2.3 Market outcomes and retail competition

The Commission believes that the development of the competitive interconnected electricity market in the eastern and southern states of Australia has delivered significant benefits to the broader Australian economy and to electricity consumers of all sizes. Such benefits include increases in network service charges and energy prices at a rate that has been less than the broader inflation rate in the economy.

Under the competition and market reforms of the past decade, the balancing of supply and demand for electricity in the wholesale electricity market has provided a mechanism for achieving the lowest reasonable cost of electricity in an economically efficient manner. The outcomes of this market will always depend on the availability of reasonably priced fuels for the generators. If one form of fuel has price rises greater than another, then the generator using cheaper fuel will be 'dispatched' for supply purposes before the generator using a more expensive fuel type. As a result, consumers have enjoyed prices for electricity which have been relatively low and have risen at rates commensurate with the general inflation rate. When the pool price for energy rises (that is, the overall market price set by demand and supply signals), there is a price signal to encourage investment in new generation capacity, the enhancement of existing generation (for example, investment in closed cooling cycles) and/or the replacement of existing generation with alternative, cheaper fuel types. The Commission has a concern that, after around seven years of stable and generally lower energy prices, the shortage of water for hydro generation has started a process of re-rating the cost of water as a fuel resource, which may have a medium-term impact on the price of electricity in the NEM. This does not alter the benefits flowing to consumers who continue to have access to the lowest price available from a market. However, it does mean that prices for electricity will rise.

One concern of the Commission is that the benefits of the energy market need to flow to consumers, particularly small consumers. This is best achieved where consumers directly access the retail market and exercise their right of choice of retailer. Shopping around for a retailer to supply their needs at the lowest price is the best way for smaller consumers to reap the benefits of competition.

While the TFT, which is regulated by the Commission, seeks to balance the objectives of section 20 of the ICRC Act, the regulatory mechanism cannot develop prices which are as responsive to demand and supply signals as a competitive and open marketplace. Where an open market is operating (as it does for the generation of electricity), prices will fluctuate with changes in factors affecting that market (much as it does for the supply of crude oil or fresh fruit and vegetables). The Commission needs to allow for the pass-through of those changes in costs to avoid a situation in which retailers can no longer afford to subsidise the supply of electricity to their customers. Similarly, the Commission would seek to reduce prices where the generation costs are falling. The issue for the Commission is one of timing, as the regulatory process is time consuming and does not respond as quickly as the marketplace.

The Commission encourages all consumers using TFTs to exercise their choice of retailer and to seek lower prices of electricity supply where they are available. At the same time, it must be recognised that major shifts in the underlying generation costs will flow through to retail prices at all levels.

## 2.4 Recent regulatory decisions

The jurisdictional regulators which have most recently commenced processes to review the prices for customers who have not yet exercised their right to enter the contestable retail market are IPART and the Queensland Competition Authority (QCA). The IPART draft report and draft determination was released in April 2007. Table 2.1 summarises the IPART draft decision as it relates to Energy Australia.<sup>13</sup> The IPART report is based on electricity generation forecasts prepared by Frontier Economics which pre-date March 2007<sup>14</sup>, when there was a notable shift in generation prices.

The Commission notes that the market-based cost of electricity estimated by Frontier Economics for 2007–08 has a cost price of electricity for peak periods of between \$70.50/MWh and \$116.90/MWh, for shoulder periods between \$49.60/MWh and \$76.70/MWh, and for off-peak periods between \$28.30/MWh and \$31.50/MWh. The resulting all-periods weighted average price lies between \$49.10/MWh and \$57.80/MWh<sup>15</sup>.

The IPART draft findings on the allowance for energy costs to use in the New South Wales regulated retail tariff controls are \$49.80/MWh for Country Energy, \$56.50/MWh for Energy Australia and \$58.90/MWh for Integral Energy. These prices include a volatility allowance for volatility in the electricity pool price.

The QCA released a draft report on its Benchmark Retail Cost Index on 8 May 2007.<sup>16</sup> In its report, and to meet the requirements of the Queensland legislation, the QCA has had to consider the long-run marginal cost (LRMC) of electricity generation in that state. In its draft decision, the QCA has determined a cost of energy of \$56.00/MWh, which includes an ‘energy purchase’ cost element designed to reflect the retailers’ load shape, the volatility of spot prices and the correlation between spot prices and load.

The generation cost estimate for Queensland is calculated using methods that derive the LRMC of energy based on a combination of generation technologies during a single year. The LRMC of energy in Queensland is projected to increase from \$43.30/MWh in 2006–07 to \$44.00/MWh in 2007–08. These costs are before taking into account various other costs such as Queensland’s 13% Gas Scheme, MRET and NEM fees, and the ‘energy purchase’ costs.

The Commission notes that the weighted average RRP<sup>17</sup> for April 2007 is \$78.20/MWh, which is above Frontier Economics’ forecast for the ‘all periods’ weighted average for 2007–08 and above the allowance provided by IPART in its draft report. The RRP for April is also above the energy cost included in the QCA draft decision, although the Queensland estimate has been built around a requirement to set the Benchmark Retail Cost Index based on the LRMC of generation. The Commission notes that these draft decisions still need to be confirmed following public comment on the drafts. Furthermore, the draft decision in New South Wales is based on a three-year price path which incorporates a smoothed transition to the higher generation costs. In Queensland, the requirement to use a long-run marginal estimate also implies a longer term approach to setting the TFT requirement.

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<sup>13</sup> IPART, April 2007, extract of Table 8.1.

<sup>14</sup> Frontier Economics, *Energy costs*, final report, March 2007.

<sup>15</sup> See also IPART, April 2007 report, Table 6.5, page 56.

<sup>16</sup> QCA *Draft decision: Benchmark Cost Index for electricity: 2006–07 and 2007–08*, May 2007

<sup>17</sup> As reported by NEMMCO on its website, <http://www.nemmco.com.au> .

For reasons which are described more fully in Section 3.2.1 of this report, the Commission has adopted a higher energy purchase cost in its analysis. In part, this reflects the requirement that the Commission consider section 20 of the ICRC Act, and the single-year, one-off nature of the price determination that the Commission is to provide. The Commission cannot ignore the evidence that appears to support a rise in electricity prices at the current time, although it is not possible to determine the full extent of this rise or the likelihood of any price reduction in the near future to levels more consistent with the LRMC estimates prepared by the QCA. The Commission has therefore adopted an energy purchase cost of \$58.04/MWh that excludes an energy contracting/management cost of \$0.70/MWh, which has been added separately to the cost base. This is broadly consistent with the energy costs included in the IPART draft determination.





## 3 Analysis of efficient costs

In developing its price direction for 2007–08, the Commission must ensure that it has regard to the provisions of section 20 of the ICRC Act. This is required by the Act and by the reference provided by the Attorney-General. The Commission believes that these provisions provide a list of issues (sometime considered as objectives) that it needs to address in determining the weighted average price cap under which the TFT levels for 2007–08 will be developed.

One of the objectives of the Commission’s analysis is to ensure that the retail services are delivered in a reasonably efficient manner (s. 20(2)(c)) to reduce the costs paid by consumers, without the exploitation of monopoly power (s. 20(2)(a)), which might otherwise raise costs for consumers. However, the costs it considers (s. 20(2)(e)) for ActewAGL Retail must also allow for an appropriate rate of return (s. 20(2)(d)) and a financially viable outcome for the service provider (s. 20(2)(i)). There is tension between these objectives. In part, the Commission balances these objectives through the consideration of both actual cost information provided by ActewAGL Retail and through building a cost base from benchmark data derived from public sources or from market data. In practice, the Commission relies heavily on the latter information to address the information asymmetry that can arise between the incumbent and the regulator.

The following subsections of the report describe the build-up of the estimates of the various cost components of retail electricity supply in the ACT. The Commission currently considers that the cost base for TFT customers should be based on the costs to an incumbent to service these customers. The Commission is not tied to the need to estimate the costs of a new entrant retailer, although it will have strong regard for the costs that such competitive players might experience in the marketplace.

The Commission notes that, in a period of volatility in energy prices, new entrants may be less inclined to enter a new market as a retail electricity supplier. Given that the terms of reference for this review have specified a 12-month TFT, the Commission is not able to transition price changes over a number of years, as is possible under the IPART determination. However, the Commission is not constrained in having to use an estimate of the LRMC for electricity generation, but rather must address the short-run market that is serviced primarily by incumbent retailers who are competing in the ACT market and, in the case of ActewAGL Retail, providing services to franchise customers.

### 3.1 Section 20 criteria

Section 20(2) of the ICRC Act states:

- 20 (2) In making a decision under subsection (1), the commission must have regard to—
  - (a) the protection of consumers from abuses of monopoly power in terms of prices, pricing policies (including policies relating to the level or structure of prices for services) and standard of regulated services; and
  - (b) standards of quality, reliability and safety of the regulated services; and
  - (c) the need for greater efficiency in the provision of regulated services to reduce costs to consumers and taxpayers; and
  - (d) an appropriate rate of return on any investment in the regulated industry; and
  - (e) the cost of providing the regulated services; and

- (f) the principles of ecologically sustainable development mentioned in subsection (5);
  - (g) the social impacts of the decision; and
  - (h) considerations of demand management and least cost planning; and
  - (i) the borrowing, capital and cash flow requirements of people providing regulated services and the need to renew or increase relevant assets in the regulated industry; and
  - (j) the effect on general price inflation over the medium term; and
  - (k) any arrangements that a person providing regulated services has entered into for the exercise of its functions by some other person.
- (3) Also, in making a decision under subsection (1), the commission must allow a declared fee under section 4C (Declared fees to be passed on to consumers) to be passed on in full to consumers of the service.
- (4) In a price direction, the commission must indicate to what extent it has had regard to the matters referred to in subsection (2).
- (5) For subsection (2) (f), ecologically sustainable development requires the effective integration of economic and environmental considerations in decision-making processes through the implementation of the following principles:
- (a) the precautionary principle—that if there is a threat of serious or irreversible environmental damage, a lack of full scientific certainty should not be used as a reason for postponing measures to prevent environmental degradation;
  - (b) the inter-generational equity principle—that the present generation should ensure that the health, diversity and productivity of the environment is maintained or enhanced for the benefit of future generations;
  - (c) conservation of biological diversity and ecological integrity;
  - (d) improved valuation and pricing of environmental resources.

In this draft decision, the Commission does not believe there is a need to place specific emphasis on the issues raised by subsection 20(2)(b) which relate to service quality and subsections 20(2)(f) and 20(5) which relate to ecologically sustainable development. Neither of these objectives or issues are central to the question of the reasonable pricing of retail electricity to TFT customers.

However, the Commission recognises that the green costs factored into the retail cost base (such as MRET and GGAS) have begun to address increasingly widespread concerns that the consumption of fossil fuels comes at an environmental cost in air quality, increased carbon emissions to the atmosphere and, potentially, increased global warming. To the extent the MRET and GGAS costs are included in the price, there is a potential to dampen the demand for electricity and thereby contribute to ecologically sustainable development.

The Commission also recognises that demand side management (s. 20(2)(h)) is better served when the price of the electricity consumed is based on the best estimate of the costs to provide electricity. This is especially so when, and if, the cost of energy in the wholesale pool rises in accordance with demand and supply conditions. Indeed, when the electricity price is kept artificially low, the price signals to encourage reduced consumption are muted. Excess consumption has a negative emissions impact, as well as an adverse impact on the economically efficient delivery of retail electricity services.

## 3.2 The electricity retail cost elements

The costs of retail electricity supply can be grouped into the following categories:

- energy costs grouped by:
  - energy purchase costs
  - energy hedging, contract and management costs
  - green costs (MRET and GGAS fees)
  - energy losses
- retail costs grouped by:
  - retail operating costs
  - customer acquisition and retention costs
- network costs:
  - distribution network costs
  - transmission network costs.

The Commission has examined external benchmarks and market information to arrive at the cost values it believes should be used for each of these retail costs, which will be recovered under a weighted average price cap from the regulated TFT customers.

### 3.2.1 Electricity purchases

For the draft decision on the price direction, the Commission has used current market data and a number of assumptions about an ideal electricity retail hedging strategy to assist in understanding the reasonable electricity purchase costs which might be faced by an incumbent retailer during 2007–08.

The hedging assumptions used are summarised as follows.

- a The retailer seeks to have more than 100% of its forecast load from the TFT customer base hedged at least six months before delivery (specifically, hedge to 105% of the forecast load).
- b The retailer begins to build its hedge portfolio a minimum of 24 months prior to delivery. The proportion of the forecast load which is hedged for each six-month period of future delivery is provided in Table 3.1, assuming the retailer has achieved this by 30 June 2007.

Table 3.1 Assumptions about hedged contracts

Six-month delivery period (ending date)	31 December 2007	30 June 2008	31 December 2008	30 June 2009
Percentage of forecast load hedged by contract	105%	80%	50%	25%

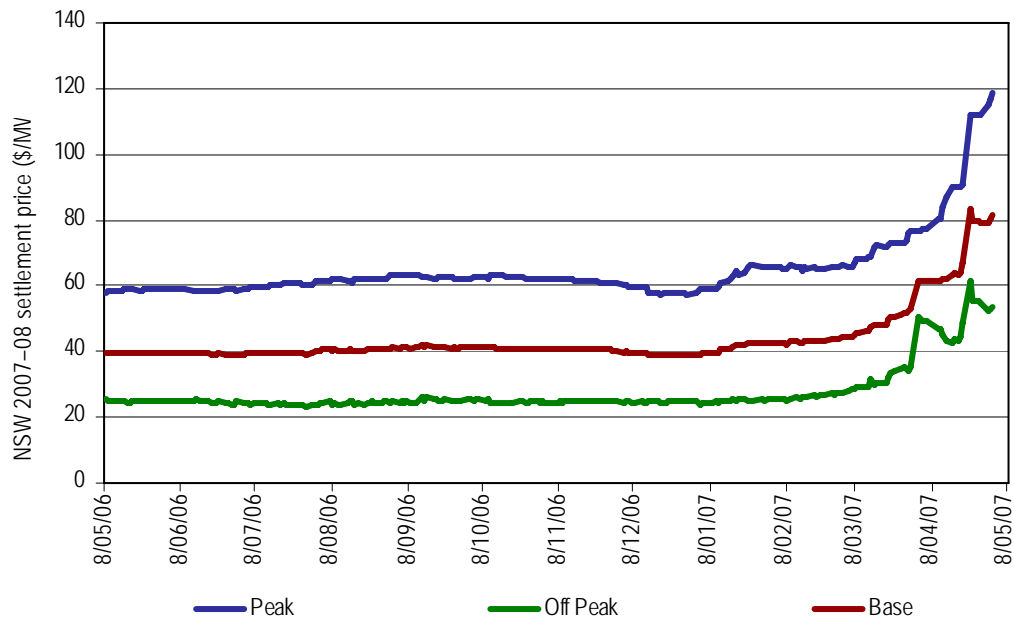
- c The load profile shape and pool price profile for TFT customers served by ActewAGL Retail is the same as the annual average of the load profile and the pool price profile for the New South Wales region for the 2006 calendar year, as sourced from NEMMCO. The annual average pool price data is used to define the average period of the day experiencing peak, shoulder and off-peak prices. Table 3.2 provides the assumed block profile of energy purchase requirements for the TFT customer group.

Table 3.2 Block profile of energy purchase requirements

Approximate pricing profile	Hours/day	% time
Peak	6.5	27.10%
Shoulder	8.5	35.40%
Off-peak time	9	37.50%
<b>Total</b>	<b>24</b>	<b>100.00%</b>

- d The cost of bilateral contracts is typically arrived at during confidential negotiations between retailers and generators. The Commission has reviewed the publicly available data on electricity futures for New South Wales. While these are financial instruments, they should reflect the confidential marketplace for bilateral, swaps, collars, caps and other electricity hedging contracts, albeit adjusted for differences in the risks borne in each contract. If this were not the case, there would be arbitrage opportunities and any differences between the two markets would soon be traded away. The Commission has assumed that the futures prices observed in the marketplace are likely to be slightly higher than those in the negotiated market for reasons including the lower liquidity experienced in the developing futures market. Also, it is unlikely that ActewAGL Retail could or would want to purchase all its hedging requirements through the futures market. Nonetheless, the Commission believes that the prices seen in this market serve as a reasonable benchmark for developing the energy purchase costs for TFT customers. Figure 3.1 shows the implied futures settlement prices for base-load delivery and the breakdown of this into peak and off-peak load delivery.

Figure 3.1 Implied futures settlement price, 8 May 2006 to 2 May 2007



- e The price for the proportions of the hedge book shown in Figure 3.1 are then taken from the graph of the pricing data, with the assumption that the 'base' futures price is the price available for delivery during shoulder periods of the load profile. Table 3.3 shows the dates between which the futures prices are averaged to develop the price for that block of load to be delivered to TFT customers in the future.

Table 3.3 Assumed periods for futures price averaging

Six-month delivery period (ending date)	31 December 2007	30 June 2008	31 December 2008	30 June 2009
Dates for averaging price data	June and July 2006	November and December 2006	January 2007	23 April and 2 May 2007

- f The cost of a \$300 cap on peak prices was excluded from the analysis, but would be prudent operating practice for this type of customer base.

Based on these assumptions and analysis, the Commission has calculated the weighted average hedge portfolio cost resulting from the average prices being weighted by time-of-day profile and delivery period and proportion of the hedged forecast load. This has provided an average cost for delivery in each of the four six-month periods to 31 December 2009. The two cost data points for the six-month periods ending 31 December 2007 and 30 June 2008 were used as the estimate of the 2007–08 electricity purchase costs. The Commission found that its estimate of the electricity purchase costs was \$58.04/MWh for 2007–08. The Commission notes that using the same methodology the electricity purchase costs for 2008–09 are estimated to be \$79.10/MWh. While this estimate is not central to its analysis for the 2007–08 year, the Commission observes that the electricity marketplace does not believe the recent price increases seen in the energy pool price are to be short-lived, and participants are actively hedging to secure lower energy prices than might otherwise be available in the pool.

In undertaking this analysis using independent market data, and a simplified (but hopefully robust) approach to hedging the risks of purchasing wholesale energy from a competitive market pool, the Commission has drawn the primary balance between the social imperatives of the provision of reliable electricity to TFT customers (ss. 20(2)(b) and (g)), the reduction of market power through the setting of the lowest efficient prices in an open market pool (ss. 20(2)(a), (c), (h), (i) and (k)), and the need for the financially sustainable continuation of the TFT offer by the incumbent retailer in the ACT (ss. 20(2)(d), (e), (i) and (j)).

The Commission reminds stakeholders in retail electricity service delivery that the TFT is not intended to be a ‘safety net’ to be used for social or targeted support to smaller consumers. Other mechanisms mandated and funded through government and community programs are in place to fulfil that need (see Section 4.2, below). Under the requirements of section 20 of the ICRC Act, the Commission cannot allow the imposition of cross-subsidies between contestable and non-contestable customer groups, particularly in the costs associated with the purchase of electricity, which constitutes a large proportion of the retail costs of electricity. The allowance of significant cross-subsidies associated with underpricing the costs of TFT would severely impede the offering of alternative tariffs by competing retailers, increase the barriers to entry of new-entrant retailers, accelerate the rate of electricity cost increases in the medium term, and potentially limit the equitable flow of benefits of reform in the electricity sector to all consumers in the ACT.

### 3.2.2 Energy risk management costs

In its prior decisions on the TFT, the Commission factored the costs of managing an energy trading desk and the other costs of hedging the retailer’s forecast load into the electricity purchase cost. Given that the estimates of the electricity purchase cost in this report are based on market measures of cost which do not factor in those costs, the Commission has added a separate estimate of energy-purchase risk-management costs. It is reasonable that the retailer recover such costs, as this is the prime risk reduction function that the retailer carries out on behalf of its aggregate customer base. While the costs of undertaking this function are small, its value underpins the retail margin that the retailer expects because of complexity of the function. The Commission has canvassed market information and has adopted \$0.70/MWh as the reasonable cost base for this activity. The recovery of these costs meets the economic efficiency objective in s. 20(2)(c), as well as the cost recovery provisions of s. 20(2)(e).

### 3.2.3 Green costs

During the annual rate adjustments to the TFT under the weighted average price cap imposed by the Commission, ActewAGL Retail is required to calculate costs of its MRET and GGAS obligations using the methodology prescribed by Commonwealth law.<sup>18</sup> The Commission has taken ActewAGL Retail’s approved estimates for 2006–07 and escalated them by the change in the renewable power percentage mandated in Regulation 24 of the Commonwealth’s Renewable Energy (Electricity) Regulations 2001 to arrive at values for 2007–08. Table 3.4 shows the estimated outcomes for 2007–08, along with the IPART and QCA outcomes provided in those regulators’ recent draft determinations.

While the estimates are based on data from ActewAGL Retail, the approach used is mandated by law and is checked annually by the Commission. The Commission feels that the estimates are reasonable for the 2007–08 year and, being cost based and having not been unduly overstated, balance the requirements of s. 20(2)(i) on cost recovery and s. 20(2)(a) on avoidance of misuse of monopoly power. As expected, due to the size and load shapes of the comparative customer base, the green costs estimates for ActewAGL Retail differ from the IPART estimates for Energy Australia.

Table 3.4 Green costs (\$/MWh)

	ICRC 2007–08	IPART 2007–08	QCA 2007–08
NRET	n/a	0.2	n/a
MRET	1.45	0.9	1.08
GGAS	1.38	3.2	2.21 <sup>a</sup>
<b>Total green costs</b>	<b>2.83</b>	<b>4.3</b>	<b>3.29</b>

a 13% gas scheme

<sup>18</sup> *Renewable Energy (Electricity) Act 2001* (Cwth).

### 3.2.4 NEM fees

The Commission has not received a submission from ActewAGL Retail which provides its estimates of the NEM general participation fees and FRC fees and the costs of ancillary services likely to be applicable in 2007–08. To produce a timely report, the Commission has adopted the values used by IPART in its recent draft determination for 2007–08, but will work to verify the best estimate of these fees for its final price direction. The values used are provided in Table 3.5.

	ICRC 2007–08	IPART 2007–08
<b>Market fees</b>		
Participant	0.35	0.35
FRC	0.06	0.06
Ancillary services	0.30	0.30
<b>Total NEM fees</b>	<b>0.71</b>	<b>0.71</b>

The Commission recognises that the recovery of NEM fees meets the objective of ss. 20(2)(d), (e) and (i). The payment of ancillary services fees assists NEMMCO in providing for safe and reliable delivery of electricity to all consumers, which supports the objectives of s. 20(2)(b).

### 3.2.5 Energy losses

Before the beginning of each financial year, NEMMCO publishes its report of distribution loss factors so that distribution and retail businesses can factor the impacts of distribution losses into the tariff structures that they apply to various customer segments. The loss factors are used in the estimate of the electricity purchase costs to allow the retailer to recover the costs of energy losses as the energy is delivered across the distribution network to its customers. Ultimately, the customer pays for the energy lost in delivery to their take-off point. Table 3.6 shows the loss factors used by the Commission.

The Commission has extracted the distribution loss factors for the ACT provided in the NEMMCO reports to assist with its estimate of the weighted average price cap which applies to the TFT. It also uses the values to estimate the total network costs in 2006–07 and the likely energy demand requirements for TFT customers for 2007–08.

	ICRC 2005–06	ICRC 2006–07	ICRC 2007–08
Energy losses	5.19%	5.06%	4.97%

The Commission recognises that the recovery of these energy losses meets the objective of ss. 20(2)(d), (e), (h) and (i) by ultimately requiring customers to pay for the energy they consume. As this approach to energy losses in the distribution system is mandated in the NEM framework, the objectives of s. 20(2)(k) are also met through this approach.

### 3.2.6 Retail operating costs

In the past, the Commission has preferred to rely on industry benchmarks and regulatory precedent to guide the estimate of retail operating costs. The Commission has taken its estimate of those costs from its previous price direction report<sup>19</sup> and escalated them by the CPI to arrive at an estimate of \$94.91 per customer per year (or \$9.70/MWh) for the 2007–08 financial year. This is somewhat higher than the regulatory number adopted by IPART (\$75 per customer), but the impact of the recovery of similar fixed costs across a larger customer base could account for some of the difference.

<sup>19</sup> ICRC, May 2003.

### 3.2.7 Customer acquisition and retention costs

While its original decision did not separately identify costs associated with the ‘new entrant’ activity of acquiring new customers, the Commission believes that the development of competition would likely be fostered by allowing these costs into the cost recovery for the TFT customer base. This would support the objective of s. 20(2)(c) by reducing the barrier to entry for competing electricity retailers, which would allow competing price discounts to be offered to the TFT customer base.

The Commission accepts that ActewAGL Retail pays operating costs when it takes previous non-TFT customers back onto the TFT, even when it has paid no advertising costs to encourage such customer return. In addition, the gradual erosion of the TFT customer base by competition means that the fixed costs of the provision of services to this customer group (or retention costs), must rise in \$/MWh terms to allow the recovery of its efficient costs (ss. 20(2)(e) and (i)). While the CPI adjustment to the original retail operating costs assists with this cost recovery, the Commission recognises that the loss of approximately 20% of the customer base to competitive tariff offerings requires the inclusion of additional per-unit costs associated with loss and churn of TFT customers. The Commission does not accept that this cost is as high as the costs for a new-entrant electricity retailer, because there is no need to advertise for these customers.

The Commission has compared the external regulatory benchmark of \$110 per customer per year provided in the recent IPART draft determination with its understanding of the approximate percentage market share lost from regulated/franchise tariffs to arrive at an estimate of customer acquisition/retention costs of \$15.09/MWh for ActewAGL Retail. The Commission notes that the QCA has allowed a rate of \$20.00/MWh for these costs. However, the total retail operating costs allocated by the QCA are lower than those proposed by the ICRC and IPART.

For its draft price direction, the Commission adopts the overall value of \$110 per customer for the combined costs of retail operating and customer acquisition/retention. The Commission recognises that the use of an external benchmark for those costs supports the aims of ss. 20(2)(a), (e), (i) and (j).

### 3.2.8 Network tariffs

The Commission has utilised the outcomes of its March 2004 price direction relating to ActewAGL Retail’s network tariffs<sup>20</sup> to derive a network cost for 2007–08. In arriving at the network cost estimate, the Commission has used the approved tariffs for 2006–07, the forecasts of customer numbers and energy usage (MWh) for the retail TFT adjustments for 2006–07, the average customer loss rate and average energy growth rate from 2004–05 to 2006–07, the CPI estimate for 2007–08, and a 0% X factor. While ActewAGL Retail has only recently delivered its annual pricing report<sup>21</sup>, which describes the proposed network tariff adjustment application for 2007–08, the Commission has not yet had sufficient time to critically examine that submission. Therefore, the Commission prefers to rely on the forward escalation of prior approved numbers for this draft price direction. The Commission believes this approach supports the objectives of

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<sup>20</sup> ICRC, *Final decision: Investigation into prices for electricity distribution services in the ACT*, March 2004.

<sup>21</sup> Dated 4 May 2007 and received by the Commission on 7 May 2007.



s. 20(2)(a) through arm's length acceptance of cost data otherwise delivered by a regulated entity, while at the same time accepting that the recovery of network cost pass-throughs is a legitimate activity for the retailer, which meets the objectives of ss. 20(2)(c), (d), (e), (i) and (k).

There is one exception to this approach, relating to a distribution network pass-through of \$4.70/MWh. The Commission has included this amount for the draft price direction, but with the proviso that the amount may be dropped or altered once the Commission has examined the network tariff adjustment application for 2007–08. The Commission believes this approach supports the objectives of s. 20(2)(e) without the danger of regulatory capture to the detriment of objective s. 20(2)(a).

### 3.2.9 Retail margin

In its previous price direction for 2003–04 to 2005–06, the Commission adopted a retail margin of 3% of the retail sales value. Benchmarks against recent regulatory draft decisions suggest that this value may now be too low for the current stage of development of competitive markets.

The Commission believes that issues such as the higher unit costs associated with a reduced regulated TFT customer base, and a recovery of fixed costs (albeit at a reduced cost allocation), require a rise in the allowed retail margin for the regulated TFT. Therefore, the Commission proposes to adopt a 4% retail margin into the average revenue cap for 2007–08. This is in the range proposed by IPART but recognises that the IPART proposal will be transitional over three years, whereas the 4% proposal by the Commission will apply immediately in 2007–08. The Commission believes this approach meets the objectives of ss. 20(2)(d) and (i).

## 3.3 Summary of cost elements

Based on the benchmark cost analysis in Section 3.2, the Commission believes the cost breakdown provided in Table 3.7 provides the reasonable cost base for development of the weighted average price cap to be applied to the TFT for the 2007–08 year.

The Commission believes that these costs are reasonable for an efficient incumbent retailer providing services to the TFT customer base in the ACT. As efficient costs, these costs meet the objectives of s. 20(2)(c) and allow the correct price signals to be seen by end-users of the TFT, which meets the objective of s. 20(2)(h) while protecting TFT consumers from excessive price increases, which would not support the objective of s. 20(2)(a).

Table 3.7 Composition of TFT retail price

	2007–08
<b>Energy purchase costs per customer (\$/MWh)</b>	
Electricity purchase cost (\$/MWh)	58.04
Energy contracting cost (\$/MWh)	0.70
Green costs (\$/MWh)	2.83
NEM fees (\$/MWh)	0.71
Energy losses	4.97%
<b>Total energy purchase cost (\$/MWh)</b>	<b>65.38</b>
Retail operating costs (\$/MWh)	9.70
Customer acquisition costs (\$/MWh)	1.54
<b>Total retail costs (\$/MWh)</b>	<b>11.24</b>
<b>Network costs (\$/MWh)</b>	<b>57.19</b>
<b>Total retail costs (\$/MWh)</b>	<b>133.81</b>
Retail margin (% of sales, EBITDA)	4.00%
<b>Total retail price (\$/MWh)</b>	<b>139.16</b>
Assumed CPI change, 2006–07 to 2007–08	3.40%
<b>X factor in CPI+x on MAR in \$/MWh</b>	<b>10.85%</b>

### **3.4 Weighted average price cap outcome**

The Commission has generated the same cost estimates for the 2006–07 year and compared these to the cost estimates for 2007–08 to generate the required X factor in the weighted average price cap to be imposed on ActewAGL Retail for its TFT customers. As shown in Table 3.7, the X factor preferred by the Commission for its draft price direction is 10.85%.

Based on the regulatory CPI estimate of 3.4% for 2007–08, the Commission proposes that, in order for ActewAGL Retail to recover its efficient costs and to meet the objectives of the section 20 of the ICRC Act, the weighted average price cap for 2007–08 must allow average price increases of 14.25% for TFT customers.

## 4 Other aspects of the transitional franchise tariff

### 4.1 Safety net provisions

In its previous reports<sup>22</sup>, the Commission has stated that ‘the TFT was never intended to be a safety net measure for more vulnerable customers’. The Commission is still of this view. In other industries and for other goods and services, a competitive retail market is usually considered to offer the best guarantee against price gouging or exploitation of consumers. In a market where there is a degree of volatility, as there is in the electricity market, a competitive retail market will help to smooth out that volatility as retailers seek to minimise the churn of customers that can occur when prices change rapidly and regularly.

In setting the TFT for 2007–08, the Commission has sought to set a price which does not reflect the short-term marginal cost (although this might be the price that a new retail entrant might charge if they had not hedged in advance of the current price increases), while at the same time recognising that prices will need to rise as the underlying price of electricity generation rises.

In these circumstances, the TFT provides a degree of certainty and stability for consumers’ likely electricity costs over the next 12 months. To ensure security of supply and to avoid any potential for events such as those in California, where retail prices were set below generation costs, forcing retailers to leave the market and suppliers to fail, the Commission has recognised the need for significant price increases to take effect from 1 July 2007. This, in itself, represents a form of ‘safety net’ for security of supply to consumers. At the same time, it comes at a cost, which is reflected in the higher charges that will apply in 2007–08.

The Commission notes that a competitive market already exists for electricity supply in the ACT. Should generation costs decline during 2007–08, competition between suppliers for the growing number of households that have converted to a non-franchise competitive supplier will force the early pass-through of those price reductions. As discussed further below, the Commission has decided to provide an added protection for consumers by way of a possible price adjustment arrangement midway through the year. This will provide greater supply certainty should prices continue to rise, and will ensure that price restructures are passed through to franchise customers should generation costs reduce during the year.

The Commission continues to support current arrangements for more vulnerable customers, including the targeted use of community service obligations; rebates and concession arrangements for welfare benefit and pension recipients; and the consumer advocacy and support services provided by the Essential Services Consumer Council, Care Financial Counselling Service (Care ACT), the ACT Council of Social Service and other support agencies.

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<sup>22</sup> ICRC, April 2006, page 2 and Section 4.4.1, pages 25–28.

The Commission notes that the government has already made some additional funding available to provide support for customers who are affected by the introduction of the government's Network Facilities Tax, which will take effect from 1 July 2007 and will add around \$60 per year to an average household customer's electricity bill in 2007–08. The Commission notes that there is likely to be an accumulation of higher utility charges in 2007–08 as a result of tax changes in the ACT, increasing generation costs for electricity and possible higher water charges. These additional costs will have an impact on those in the community who are less well off, and appropriate funding of support programs by the government is required to address this issue.

## 4.2 Pass-through arrangements

The Commission's determination is for a 12-month period. However, the Commission is conscious that fluctuations in generation costs might be greater than expected. Not only is there a possibility of a further long-term increase in the underlying price for generated electricity in response to the drought and other external events, but there is also a possibility that prices will return to levels more in line with those experienced over recent years (for example, should the drought break).

To make provision for possible changes in underlying costs over which the incumbent supplier has little direct control, the Commission will provide for consideration of a possible pass-through of certain costs. As this is a 12-month determination, the Commission will provide a single opportunity for ActewAGL Retail to bring to the Commission a proposal for a cost pass-through of this type.

Not before 15 November 2007 and not later than 4 December 2007, ActewAGL may submit to the Commission a request for a pass-through of unforeseen costs. If the Commission permits a pass-through of those costs, an adjustment to the TFT will be made for the period from 1 January 2008 to 30 June 2008.

The Commission may consider a pass-through for:

- changes in wholesale market conditions
- significant increases in:
  - NEMMCO fees and charges
  - MRETs/greenhouse levies
  - other fees, taxes and imposts.

The Commission considers that the pass-through of changes in the wholesale market should be symmetrical. Hence, the Commission reserves the right to investigate a pass-through event if there are reductions in wholesale market prices.

## 5 Conclusion on the draft direction

In this draft decision, the Commission has considered the build-up of efficient costs for the provision of retail electricity services by ActewAGL to customers on the regulated retail tariff. In coming to its determination, the Commission has considered ActewAGL's likely costs for 2007–08, especially taking into account the recent increases in the electricity pool price. The Commission is also mindful of the requirements of section 20 of the ICRC Act, and its obligation to balance the requirement for prices that reflect the costs of supply against the social implications of price increases.

The Commission has determined that ActewAGL's franchise tariff revenue may increase by up to the CPI plus 10.85%. The Commission has determined that the appropriate value of the CPI is 3.40%. In making this determination for one year, the Commission has not changed the form of regulation faced by ActewAGL.

The Commission is seeking comments from interested parties on this draft price direction for the year from 1 July 2007 to 30 June 2008 as it applies to ActewAGL Retail.

The Commission is operating to an extremely short deadline for the development of this price direction, for the finalisation of which it proposes the following timeline:

<b>Activities</b>	<b>Dates</b>
Release of the draft direction	Friday, 11 May 2007
Final submissions to the ICRC	Friday, 8 June 2007, 5.00pm
Final report and final price direction	Friday, 15 June 2007
ActewAGL Retail implementation of tariff changes	From 1 July 2007

Submissions may be mailed to the Commission at:

The Independent Competition and Regulatory Commission  
GPO Box 296  
CANBERRA CITY ACT 2601

Alternatively, submissions may be emailed to the Commission at [icrc@act.gov.au](mailto:icrc@act.gov.au).

The secretariat may be contacted at the above addresses, by telephone on 6205 0799, or by fax on 6207 5887. The Commission's website is at [www.icrc.act.gov.au](http://www.icrc.act.gov.au).

# Appendix 1      Terms of reference

Australian Capital Territory

**Independent Competition and Regulatory Commission (Price Direction for the Supply of Electricity to Franchise Customers) Terms of Reference Determination 2007 (No. 1)**

**Disallowable instrument DI2007—96**

made under the

***Independent Competition and Regulatory Commission Act 1997, ('the Act'), section 15 (Nature of industry reference) and section 16 (Terms of industry references)***

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## ***Reference for investigation under section 15.***

Pursuant to subsection 15(1) of the Act, I refer to the Independent Competition and Regulatory Commission (the 'Commission') the provision of a price direction for the supply of electricity to franchise customers for the period from 1 July 2007 to 30 June 2008.

## ***Terms of reference for investigation under section 16***

Under the Act, section 16(1), I require that the Commission consider the following matters in relation to the conduct of the investigation:

1. In undertaking the review, the Commission should have regard to the requirements of section 20 of the Act.
2. The Commission must produce its final report in time sufficient to allow ActewAGL Retail to make any necessary administrative changes to its billing system and to provide information on the new tariff to customers.

Simon Corbell MLA

Attorney-General

16 April 2007

## Appendix 2 Draft price direction

This appendix contains the Commission's draft price direction in respect of the transition franchise tariff (TFT) for the period from 1 July 2007 to 30 June 2008. The Commission has had regard to section 20(2) of the *Independent Competition and Regulatory Commission Act 1997* in making this draft price direction.

### 1 Period of the direction

The provisions below will apply to the period from 1 July 2007 to 30 June 2008.

### 2 Revenue control for retail electricity services

Subject to the operation of clause 4, the maximum total amount of revenue that may be earned by ActewAGL Retail from franchise customers is set out in the following formula:

Franchise revenue 2007–08 = franchise revenue 2006–07  $\times$  (1 + CPI + X)

where CPI = 3.40% and X = 10.48%

### 3 Individual tariff control

The Commission will not apply any constraints to the change in individual tariffs or the components of individual tariffs. The Commission retains the capability to disallow changes to individual tariffs where the Commission believes that those changes are excessive for that particular tariff class.

### 4 Pass-throughs

Not before 15 November 2007 and not later than 4 December 2007, ActewAGL Retail may submit to the Commission a request for a pass-through of unforeseen costs. If a pass-through of those costs is permitted by the Commission, an adjustment to the TFT will be made for the period from 1 January 2008 to 30 June 2008.

The Commission may consider pass-throughs for the following events:

- changes in wholesale market conditions
- significant increases in:
  - NEMMCO fees and charges
  - MRETS/greenhouse levies
  - other fees, taxes and imposts.

The Commission considers that the pass-through of changes in wholesale market conditions should be symmetrical. Hence, the Commission reserves the right to investigate a pass-through event if there are reductions in wholesale market prices.

## Glossary and abbreviations

ACT	Australian Capital Territory
ActewAGL	ActewAGL Retail
Commission	Independent Competition and Regulatory Commission
CPI	Consumer Price Index
FRC	full retail contestability
GGAS	greenhouse gas abatement scheme
ICRC Act	<i>Independent Competition and Regulatory Commission Act 1997 (ACT)</i>
IPART	Independent Pricing and Regulatory Tribunal (NSW)
LRMC	long-term marginal cost
MRET	mandatory renewable energy target
MWh	megawatt hours
NEM	national electricity market
QCA	Queensland Competition Authority
RRP	regional reference price
TFT	transitional franchise tariff
Utilities Act	<i>Utilities Act 2000 (ACT)</i>