

**FINAL REPORT**

# **Review of the Retail Electricity Form of Price Control**

**Report 7 of 2021, April 2021**



The Independent Competition and Regulatory Commission is a Territory Authority established under the *Independent Competition and Regulatory Commission Act 1997* (the ICRC Act). We are constituted under the ICRC Act by one or more standing commissioners and any associated commissioners appointed for particular purposes. Commissioners are statutory appointments. Joe Dimasi is the current Senior Commissioner who constitutes the Commission and takes direct responsibility for delivery of our outcomes.

We have responsibility for a broad range of regulatory and utility administrative matters. We are responsible under the ICRC Act for regulating and advising government about pricing and other matters for monopoly, near-monopoly and ministerially declared regulated industries, and providing advice on competitive neutrality complaints and government-regulated activities. We also have responsibility for arbitrating infrastructure access disputes under the ICRC Act.

The Commission is responsible for managing the utility licence framework in the ACT, established under the *Utilities Act 2000* (Utilities Act). We are responsible for the licensing determination process, monitoring licensees' compliance with their legislative and licence obligations, and determination of utility industry codes.

Our objectives are set out in section 7 and 19L of the ICRC Act and section 3 of the Utilities Act. In discharging our objectives and functions, we provide independent robust analysis and advice.

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# Executive summary

The Independent Competition and Regulatory Commission decided to review its form of price control during its 2020-24 retail electricity price investigation. The 'form of price control' refers to the approach we use to regulate retail electricity prices.

In our 2020–24 price investigation, we found that the 2020-21 increase of 5.4 per cent in the network cost pass through for regulated tariffs was significantly higher than the AER approved network price increase of 2.0 per cent for Evoenergy's corresponding regulated tariffs. The difference was caused by a change in the mix of network charges incurred by ActewAGL, which was caused by a change in the mix of consumers on standing offers.

In this review, we have focused on the compositional changes in ActewAGL's customer base—their causes, how they are treated in the Commission's price modelling, and their implications for the ongoing effectiveness of the form of price control.

## Final decisions

We have decided to amend the methodology for the network cost pass-through so it is consistent with the way the maximum allowed price change is calculated in our 'tariff basket' formula. This means the calculation will use the same weights—measured using the most recent customer numbers and usage measures—for both years in the network cost calculation.

We have decided to implement the change during the current regulatory period (2020-24). We will use the revised cost estimation method in the annual retail electricity price recalibration for 2021–22.

## Reasons for the final decision

The current practice of using different weighting methods for calculating the network cost change and the weighted average price change is inconsistent. Currently, changes in the mix of customers on ActewAGL's standing offers affect network costs but are excluded from our tariff basket approach to the weighted average price change.

Under the current method of calculating network costs, compositional changes affect both the change in average network costs calculated by ActewAGL and the revenue raised by ActewAGL—effectively 'double-counting' the effects of compositional changes. Depending on the nature of the compositional change in any particular year, this can result either in ActewAGL raising more revenue than it needs to recover its network costs or not enough revenue to recover its network costs.

The revised method will allow ActewAGL to recover its efficient costs, based on calculations for the hypothetical efficient retailer.

While we typically do not alter our regulatory methodology between price investigations, we consider that a timely resolution of this issue is necessary.

The distortion caused by the inconsistency between the calculation methods results in inaccurate estimates of network costs, which affects the accuracy of our determination of the maximum allowed average price increase for ActewAGL's standing offer prices.

We are conscious of the current affordability pressures on electricity consumers. We are also conscious that ActewAGL needs certainty that it can consistently recover its prudent and efficient costs over time, without over-recovery in some years and over-recovery in other years. For these reasons, we have concluded that it would be in the best interests of stakeholders if the calculation method were changed as part of the 2021-22 price recalibration.

**Next steps**

Our final decision will take effect on 1 July 2021 when we recalibrate prices to apply from 1 July 2021.

# 1. Introduction

We have reviewed the form of price control we use to regulate retail electricity prices. In the retail electricity price investigation for 2020-24, we made a reset principle in the price direction to review the form of price control. In this review, we have considered current and potential market developments that may have implications for the effectiveness of the current form of price control.

## 1.1 Background to the review

The Commission is the Australian Capital Territory's (ACT) independent economic regulator, which regulates prices, access to infrastructure services and other matters in relation to regulated industries in the ACT. We also have functions under the *Utilities Act 2000* (Utilities Act) for licensing electricity, natural gas, water, and sewerage utility services and making industry codes. We undertake price investigations in accordance with sections 15, 16 and 17 under Part 3 of the *Independent Competition and Regulatory Commission Act 1997* (ICRC Act), and make price directions under Part 4 of the ICRC Act.

Under our form of electricity price control, we regulate the maximum weighted average price change that ActewAGL can apply across its 'basket' of standing offer tariffs from one year to the next. Under this form of price control, ActewAGL has the flexibility to determine the number of standing offer tariffs and to adjust the prices of those tariffs as long as the weighted average price across all tariffs does not exceed the weighted average price change that we have determined.

We calculate the maximum weighted average price change using a pricing model, which estimates the individual cost components that would be incurred by an efficient retailer in a similar position as ActewAGL when providing electricity services to customers on regulated tariffs. The individual cost components in our pricing model can be grouped into three broad categories:

- wholesale costs—the costs associated with purchasing electricity from the wholesale market, representing 44 per cent of total costs
- network costs—the cost of transmitting and distributing electricity from generators to consumers, representing 43 per cent of total costs
- retail costs—costs faced by retailers in providing services to customers and the retail margin, representing 13 per cent of total costs.

We allow ActewAGL to pass on the network costs that it incurs when providing electricity services to standing offer customers. ActewAGL calculates the network cost pass-through amount and submits it to us for verification. Network charges are regulated by the Australian Energy Regulator (AER), which determines the maximum revenue that a network business (Evoenergy in the ACT) can recover from customers each year. ActewAGL uses network charges approved by the AER when calculating the network cost pass-through amount. After we have verified the network cost pass-through amount, we include it in our pricing model to calculate the regulated price change. As the network cost component is a large cost component, it has a significant effect on the regulated price change that we determine.

In our final report for the 2020-24 retail electricity price investigation, we noted that the increase in the network cost pass-through amount corresponding to regulated tariffs for 2020-21 (5.4 per cent) was significantly higher than the AER approved network price increase for Evoenergy's corresponding regulated

tariffs (2.0 per cent). The difference reflected a change in the mix of network charges incurred by ActewAGL, which had come about because of a change in the mix of consumers on standing offers.

We said in our final report that the way in which network costs are allocated to customers on different tariff types may become increasingly important as the number of standing offer customers continues to change. We therefore made a reset principle in the price direction for 2020-24 to review the form of price control. Reset principles are principles governing the redetermination of prices in a regulated industry and can provide the opportunity to assess and update, if necessary, aspects of the methodology or approach that we will use in future.

## 1.2 The scope of the review

In this review, we have examined the causes of compositional changes in ActewAGL's customer base, how compositional changes have been dealt with in our pricing approach, and implications of compositional changes for the ongoing effectiveness of the form of price control.

We have considered whether changes are needed to how the network cost pass-through is calculated to make sure the form of price control remains effective. This report sets out our final decisions related to the changes of network cost calculation and the proposed implementation timeline.

We reviewed the other cost components of our pricing model during our 2018-19 Electricity Model and Methodological Review.

## 1.3 The process for the review

We undertook a public consultation process for the review. As part of the public consultation, we released an issues paper on 16 October 2020 and invited interested parties to make submissions.

We held two workshops to give stakeholders details of the issues for the review and to invite feedback and views on our draft decisions. The first workshop was on 17 November 2020 and the second was on 12 March 2021. We considered all written submissions to the draft report and the views expressed at workshops when making our final decisions. We have summarised the submissions and views given to us, and how we have addressed the submissions and views, in this final report.

The timeline for the review is in Table 1.



**Table 1: Timeline for this review**

Task	Date
Release of issues paper	16 October 2020
Workshop I	17 November 2020
Submissions on issues paper close	27 November 2020
Draft report	26 February 2021
Workshop II	12 March 2021
Submissions on draft report close	26 March 2021
Final report	30 April 2021

## 1.4 Our role and objectives

In carrying out our functions under the ICRC Act, we have the following objectives, which are set out in sections 7 and 19L of the ICRC Act (Box 1.1).

### Box 1.1: Sections 7 and 19L: Our objectives

Section 7:

- (a) to promote effective competition in the interests of consumers.
- (b) to facilitate an appropriate balance between efficiency and environmental and social considerations.
- (c) to ensure non-discriminatory access to monopoly and near-monopoly infrastructure.

Section 19L:

To promote the efficient investment in, and efficient operation and use of regulated services for the long-term interests of consumers in relation to

When making a price direction, in addition to the terms of reference and legislative objectives, we must also have regard to the provisions in section 20(2) of the ICRC Act (Box 1.2).

### Box 1.2: Section 20(2): Our considerations under the ICRC Act

- (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.
- (b) standards of quality, reliability, and safety of the regulated services.
- (c) the need for greater efficiency in the provision of regulated services to reduce costs to consumers and taxpayers.
- (d) an appropriate rate of return on any investment in the regulated industry.

- (e) the cost of providing the regulated services.
- (f) the principles of ecologically sustainable development mentioned in subsection (5).
- (g) the social impacts of the decision.
- (h) considerations of demand management and least cost planning.
- (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.
- (j) the effect on general price inflation over the medium term.
- (k) any arrangements that a person providing regulated services has entered into for the exercise of its functions by some other person.
- (l) any arrangements that a person providing regulated services has entered into for the exercise of its functions by some other person.

Section 19L of the ICRC Act (provided in Box 1.1) requires us to make pricing decisions that promote efficient investment in, and efficient operation of, regulated services in the long-term interests of consumers. Following from this, an important consideration in this review has been to ensure that our final decisions continue to allow ActewAGL the opportunity to recover the efficient costs of providing electricity services to standing offer customers.

## 1.5 Structure of the final report

The remainder of this report is structured as follows:

- Chapter 2 summarises recent developments in the Australian electricity market.
- Chapter 3 discusses the form of price control and the Commission's pricing model.
- Chapter 4 sets out our final decision on the approach to calculate network costs and the reasons for the decision.
- Chapter 5 sets out our final decision on when we will apply the new method and the reasons for the decisions.
- Appendix 1 presents Evoenergy's network charges associated with ActewAGL's standing offer tariffs.

## 2. Developments in the Australian electricity market

The Australian electricity market is undergoing a rapid transition. In the wholesale market, the generation mix is undergoing a rapid transition from a centralised system of large fossil fuel generators to smaller scale, dispersed renewable generation. In the ACT retail electricity market, and in retail markets in other jurisdictions, customers are moving from standing offer contracts to market offers reflecting affordability pressures, increased competition, and calls by governments and regulators to shop around for cheaper offers. The take-up of smart meters in the ACT is also increasing following the introduction of the Australian Energy Market Operator's (AEMO) Power of Choice reforms and the increasing prevalence of rooftop solar panels. This chapter presents a summary of recent market developments and their implications for this review.

### 2.1 Developments in the wholesale market

The energy generation mix in the Australian electricity market is changing rapidly. Previously, the Australian electricity generation system was characterised by a centralised system of large fossil fuel (mainly coal) generators. As ageing coal generators exit the market, the generation system is now moving to a decentralised system of widely dispersed, relatively small-scale renewable (mainly wind and solar) generators.

Wholesale electricity prices in the National Electricity Market (NEM) have been falling over the past few years reflecting, in part, the increased supply of renewable energy. Prices across the NEM averaged \$41 per MWh in the March quarter of 2021 compared to around \$85 per MWh over 2017.<sup>1</sup> In NSW, electricity spot prices have decreased from \$82 in January 2017 to \$39 in March 2021 (Figure 2.1).

According to the AER, average electricity prices in the March quarter of 2021 were the lowest in Victoria (\$27/MWh), followed by Tasmania (\$34/MWh), NSW (\$39/MWh), and Queensland (\$45/MWh). The highest quarterly prices were in South Australia (\$53/MWh).<sup>2</sup> The AER said the relatively high quarterly price in South Australia was caused by a fire in the Torrens Island substation in March 2021.<sup>3</sup>

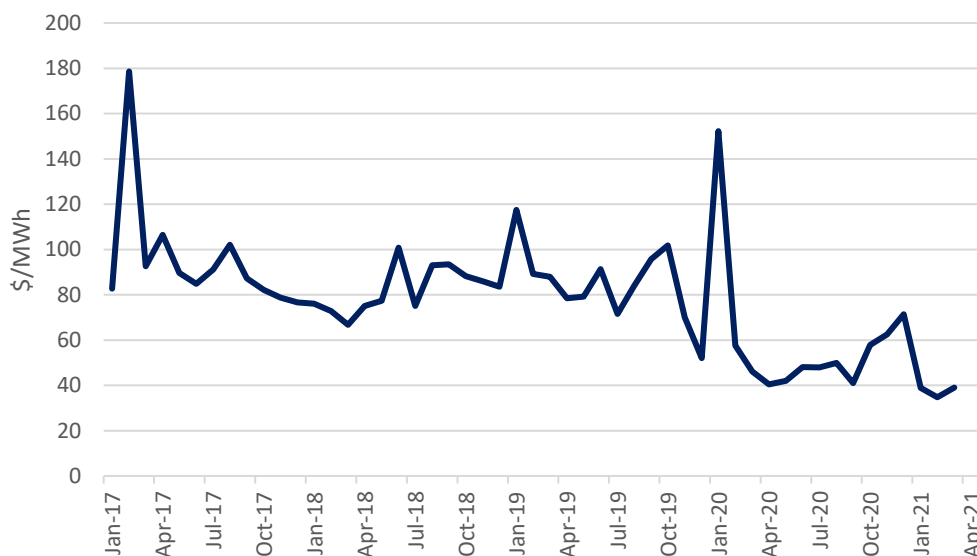
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<sup>1</sup> Details at: <https://aemo.com.au/en/energy-systems/electricity/national-electricity-market-nem/data-nem/data-dashboard-nem>.

<sup>2</sup> <https://www.aer.gov.au/wholesale-markets/wholesale-statistics>.

<sup>3</sup> <https://www.aer.gov.au/wholesale-markets/wholesale-statistics>; <https://www.aer.gov.au/system/files/7%20-13%20March%202021%20Electricity%20weekly%20report.pdf>.

**Figure 2.1 Average monthly wholesale electricity prices in NSW (\$ per MWh)**



Source: Commission’s calculation using AEMO data.

Wholesale electricity prices are generally high in summer when demand for air conditioning is highest.<sup>4</sup> In January 2020, wholesale prices in NSW, Victoria and South Australia spiked for a number of reasons including extremely high temperatures on some days which led to very high demand for electricity, lower electricity supply as a result of a plant failure at Victoria’s Loy Yang A coal power plant, lower output from wind farms, and a failure at the Heywood transmission infrastructure which links Victoria and South Australia.<sup>5</sup> In February 2017, wholesale prices in NSW spiked due to high temperatures over several consecutive days.<sup>6</sup>

Integrating high volumes of renewable energy into the electricity network has been challenging for three main reasons.<sup>7</sup>

First, much of this new generation is in sunny or windy areas far from the main transmission network (also known as the grid). Therefore, this energy is fed into the main grid via long and less efficient transmission lines, resulting in high rates of energy losses during transmission.<sup>8</sup>

Second, the traditional fossil fuel generators provide technical stability services that keep the power system reliable and secure. For example, fossil fuel generators can generate electricity continuously within defined technical limits. The ability of wind and solar generators to provide these services has been limited to date.

<sup>4</sup> AER 2020, p 41.

<sup>5</sup> Details at: <https://www.aer.gov.au/communication/aer-reports-on-high-wholesale-electricity-prices-in-january-2020>.

<sup>6</sup> Details at: <https://www.aer.gov.au/wholesale-markets/performance-reporting/prices-above-5000-mwh-6-february-2017-nsw-and-qld>.

<sup>7</sup> AER 2020, p 13.

<sup>8</sup> As energy flows through across a network of poles and wires, some of it is lost as heat. The energy loss is higher the further it travels and the weaker the transmission lines.

This is because wind and solar farms use different technologies than the ones used by fossil fuel generators.<sup>9</sup>

Third, because the output of wind and solar generators is dependent on weather conditions, supply gaps have to be filled when the weather is unfavourable for generation. Weather driven volatility requires backup energy that can quickly discharge to the grid when needed, from sources such as gas-fired generators or increasingly from battery storage, to have an uninterrupted supply of energy and reduce the risk of black-outs in parts of the network.

Government bodies, including the Council of Australian Governments (COAG) Energy Council, Australian Energy Market Operator (AEMO), the Australian Energy Market Commission (AEMC) and the Energy Securities Board (ESB), are taking a range of actions to smooth this market transition.

The AEMC undertakes the coordination of generation and transmission investment (COGATI) review every two years, as requested by the COAG Energy Council, to examine the drivers that could impact future transmission and generation investment.<sup>10</sup> The first COGATI review, completed in December 2018, recommended reforms to the way investment and generation are coordinated. The second COGATI review is expected to conclude in June 2021.

AEMO has prepared a long-term integrated system plan, which has identified investment choices and made recommendations on essential actions to optimise consumer benefits amid Australia's rapid transition in the energy sector. The investment choices identified in the plan include new grid projects, improvements to the existing grid infrastructure and establishing Renewable Energy Zones. Establishing Renewable Energy Zones would involve developing new grid infrastructure in renewable energy-rich areas so that several generators can be located in one zone and connected to the grid efficiently.<sup>11</sup>

The ESB is developing a post-2025 market design for the NEM. As part of this market design, the ESB is considering the energy supply chain, all aspects of risks in the energy system and cost recovery arrangements.<sup>12</sup> The ESB released a consultation paper on the market design in September 2020<sup>13</sup> and a Directions paper in January 2021.<sup>14</sup> The Directions paper sets out the reforms to be pursued to the next stage of the ESB's national electricity market redesign project. The ESB is developing detailed designs for each of the reforms for further consultation in March, before final recommendations are made to energy ministers in mid-2021.

These actions are expected to bring long term benefits to electricity consumers. For example, AEMO estimates that if the integrated system plan is properly implemented in that the associated investments and recommended changes to grid infrastructure are made, consumers will gain around \$11 billion in net market benefits over the next 20 years.<sup>15</sup>

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<sup>9</sup> More information on technical stability services can be found in AER 2020 p 48.

<sup>10</sup> AEMC 2020, p i.

<sup>11</sup> More information on renewable energy zones can be found in AEMC 2019b.

<sup>12</sup> COAG Energy Council 2019, p 6.

<sup>13</sup> COAG Energy Council 2020.

<sup>14</sup> COAG Energy Council 2021.

<sup>15</sup> AEMO 2020, p 9.

## 2.2 Developments in the retail market

Developments in the wholesale markets discussed above have already had effects on the ACT retail electricity market. For example, our electricity price determination in June 2020 meant that a typical customer on ActewAGL's standing offer contracts was expected to see a 2.56 per cent reduction in retail electricity prices in 2020-21. The price decrease largely reflected falling prices in the wholesale electricity market. A key driver of these lower wholesale prices was the growth in renewable energy generation.<sup>16</sup>

A range of other factors have affected the retail electricity market in the ACT recently. First, there has been a steady increase in the number of customers moving from standing offers to market offers. Standing offers are 'default' contracts that consumers enter into if they do not select a market offer. We regulate the prices of these offers, and minimum terms and conditions for these offers are set by government.<sup>17</sup> These offers provide a safety net for those consumers who do not or cannot shop around for better offers.

Market offer rates can sometimes be more price competitive. They generally have terms and conditions that are set by the retailer rather than through regulation. For example, retailers can change market offer prices more frequently than they can change prices for standing offers.

The increased take-up of market offers in the ACT reflects a range of factors, including affordability pressures which have encouraged consumers to shop around for better deals, increased competition among retailers, and government calls to shop around for cheaper electricity offers. In the December quarter 2019, around 50 per cent of ActewAGL's residential electricity customers were on standing offers. However, within a year, this share declined to 39 per cent (in the December quarter 2020; see Figure 2.2). The share of standing offer customers in the ACT is still high relative to that in NSW (11.1 per cent) and Victoria (6 per cent).<sup>18</sup> Therefore, there is still potential for more ACT customers to shift away from standing offers to market offers.

Second, competition in the ACT retail electricity market has increased. ActewAGL is the dominant retailer with a high market share. However, based on AER data,<sup>19</sup> its market share declined from nearly 81 per cent in the December quarter 2019 to around 78 per cent in the December quarter 2020 (see Figure 2.2). Origin Energy appears to be the main competitor to ActewAGL; it increased its market share from around 15 per cent to around 16 per cent between the December quarter 2019 and the December quarter 2020. Energy Australia is the other main retailer with around 4 per cent of the market. Increased competition has potential to put downward pressure on prices of unregulated market offers in the ACT.

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<sup>16</sup> AER 2020, p 14.

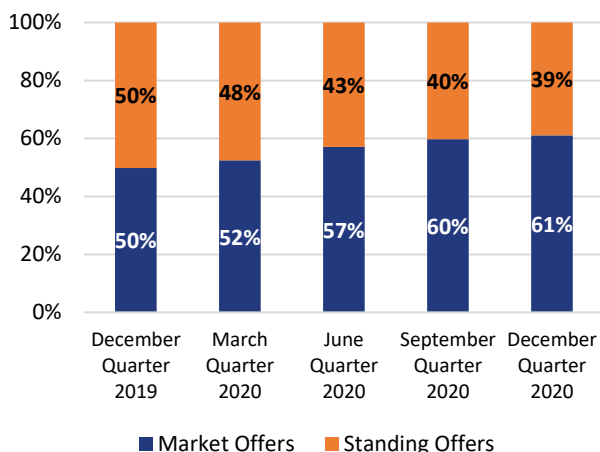
<sup>17</sup> The minimum terms and conditions are set by the National Energy Customer Framework which was developed by State, Territory and Commonwealth Energy Ministers through the COAG Energy Council.

<sup>18</sup> The value for NSW is from AER 2021 and the value for Victoria is from ESC 2021.

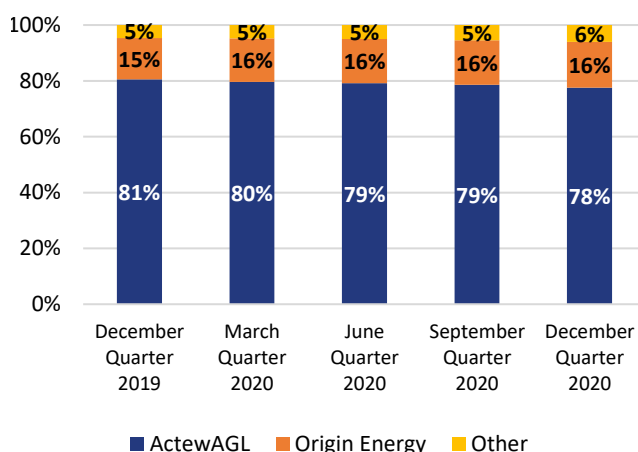
<sup>19</sup> AER 2021.

Figure 2.2 Changes in the ACT retail market

Panel 1: Changes in ActewAGL's customer mix



Panel 2: Changes in market share



Source: AER 2021

Third, the proportion of consumers on time-of-use tariffs or demand tariffs compared to flat rate tariffs has increased. Flat rate tariffs have a daily supply charge and a single rate for the amount of electricity consumed regardless of when the electricity was used. This means flat rate customers pay the same usage rate whatever time of the day electricity is used. In contrast, customers on time-of-use tariffs pay a fixed supply charge and different usage rates depending on the time of the day when energy is used. Demand tariffs have a fixed supply charge, a usage charge, and a demand charge based on how much electricity is used within the daily peak time period set by the retailer. A customer's demand charge will be higher when many appliances are used at the same time during the daily peak time period. More information about different tariffs is on the Australian Government's Energy Made Easy website.<sup>20</sup>

The trend towards time-of-use and demand tariffs in the ACT reflects increased take-up of smart meters and the 'tariff assignment policies' of some electricity retailers (such as ActewAGL) that require all smart meter customers to be on these tariffs.

The take-up of smart meters in the ACT has increased due to the Power of Choice reforms introduced by the AEMC in late 2017. The Power of Choice reforms require all new electricity meters for residential and small business customers to be smart meters. The installation of rooftop solar panels has also resulted in an increased take-up of smart meters in the ACT because the installation of solar panels also requires installation of a smart meter.<sup>21</sup>

The type of retail tariff that a customer has access to depends on whether they are a residential or business customer and the type of meter they have. For example, until recently, ActewAGL customers with a smart meter were automatically placed on a retail demand tariff and had an option to switch to a time-of-use tariff but were not able to access flat rate tariffs. This practice reflected ActewAGL's tariff assignment policy. These policies vary by retailer and are not regulated. ActewAGL changed its tariff assignment policy

<sup>20</sup> <https://www.energymadeeasy.gov.au/article/electricity-tariffs>.

<sup>21</sup> <https://energysaver.nsw.gov.au/households/understand-your-usage/smart-meters>.

from 1 July 2020, and customers with smart meters are now automatically placed on time-of-use tariffs and can opt to move to a retail demand tariff.<sup>22</sup> A factor influencing a retailer's tariff assignment policy is the tariff assignment policy of the network operator (discussed below).

## 2.3 Implications of market developments for network tariffs

As noted in chapter 1, the AER is responsible for regulating prices charged by network businesses such as Evoenergy. The AER undertakes an investigation (usually every five years) to determine the maximum allowable revenue that a network business may recover and the policies that the business uses to assign network charges to consumers.

In determining the maximum allowable revenue, the AER considers the efficient and prudent costs of owning and operating the network. During the regulatory period, the network business proposes prices to the AER. The AER may approve the prices if they are compliant with the revenue allowance, a side constraint and rules set by the AEMC (details below).

Evoenergy and the AER must follow rules set by the AEMC when setting network prices and network tariff assignment policies. For example, one of the AEMC's rules requires network prices to be cost reflective. This means that the AEMC requires network prices to reflect the efficient cost of providing network services to individual consumers so that consumers can make more informed decisions about their electricity usage.<sup>23</sup>

For Evoenergy, there is a two percent side constraint that applies to revenue recovered at the tariff class level (that is, residential, low voltage commercial and high voltage customers). This means that the increase in revenue from each tariff class cannot exceed two percentage points above the maximum allowable percentage increase in revenue determined by the AER.

As noted in chapter 1, we allow ActewAGL to pass on the network costs it incurs when providing electricity services to standing offer customers. ActewAGL uses network charges approved by the AER when calculating the network cost pass-through amount. After we have verified the network cost pass-through amount as complying with the AER decision, we include it in our pricing model to calculate the regulated price change. The network cost approval process is illustrated in Figure 2.3.

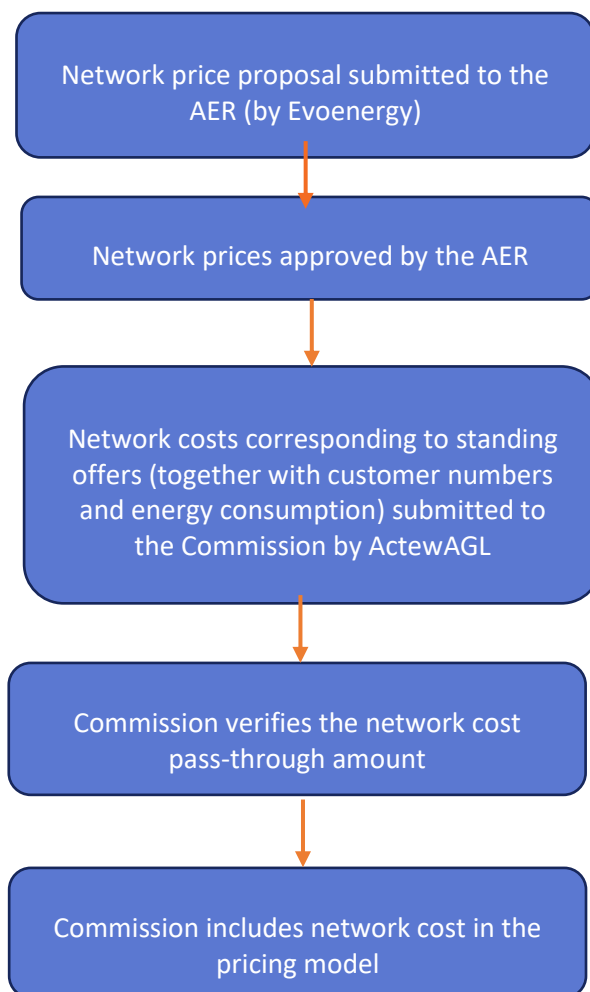
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<sup>22</sup> ActewAGL's schedule of charges from 1 July 2019 and 1 July 2020 available at <https://www.actewagl.com.au/plans-and-connections/pricing-information/act-home-prices>.

<sup>23</sup> AEMC 2014, p vii.



Figure 2.3 Network cost approval process



Each of ActewAGL’s standing offers has a different set of network charges. Network charges differ depending on the type of customer (residential versus business customers) and the type of electricity meter used by the customer (smart meter versus basic meter), because Evoenergy sets network prices to be cost reflective and create an incentive to encourage efficient network use.<sup>24</sup>

Evoenergy has developed its tariff assignment policy to send price signals to retailers about the costs of running the network, particularly during peak periods. For example, a key cost of running the electricity network is network augmentation (expansion) to accommodate growth in peak demand. The demand network tariff and time-of-use network tariff charged by Evoenergy to retailers are higher peak periods to send a signal to the retailer that it should encourage its customers to be mindful of their electricity usage in that period.

<sup>24</sup> Evoenergy 2020, p 4.

Evoenergy automatically assigns consumers to network demand tariffs if they have a smart meter (regardless of their retailer or retail tariff) to send a price signal to the retailer.<sup>25</sup> The retailer can choose to pass this price signal onto the consumer (by encouraging the consumer to have a retail demand tariff) or not (by allowing them to choose different tariff types). Retailers have some scope to change their consumers' underlying network tariffs within Evoenergy's tariff assignment policy. For example, a retailer can change the network tariff for smart meter customers from the network demand tariff to a time-of-use network tariff. However, retailers cannot assign a flat rate network tariff as an underlying network tariff for smart meter customers.<sup>26</sup>

ActewAGL's tariff assignment policy appears to be strongly influenced by the network tariff assignment policy of Evoenergy. ActewAGL appears to largely pass on the price signals that it receives from Evoenergy to its consumers.<sup>27</sup>

However, retailers are not required to reflect the tariff assignment policies of the network operators in their retail tariffs. Some retailers in the ACT have chosen not to pass on some price signals from Evoenergy. For example, Origin Energy and Energy Australia offer flat rate retail tariffs to smart meter customers despite customers' underlying network tariffs being demand or time-of-use network tariffs.<sup>28</sup>

The market developments described in sections 2.1 and 2.2 have implications for the network cost component of our pricing model and, therefore, the appropriateness and effectiveness of the form of price control. As described in chapter 1, a change in the mix of standing offer customers led to an increase in the network costs (when expressed in terms of dollars per MWh) incurred by ActewAGL in 2020-21 above the AER approved increase in network prices corresponding to standing offer tariffs.

This is because different network tariffs have different charges. The full list of network tariffs associated with standing offers is available in Appendix 1. Network charges for business customers are generally higher than the network charges for retail customers. Therefore, if ActewAGL's residential customers move away from standing offers, ActewAGL's resulting standing offer customer base will have a higher proportion of business customers, which will result in a higher average network cost per MWh for customers on standing offers. Details on how the network cost component of our pricing model is calculated are in chapter 3.

The trends discussed in this chapter are likely to continue in the future. For example, as discussed in section 2.2, there is still potential for more ACT customers to shift away from standing offers to market offers. Competition in the ACT market has the potential to increase over time and the smart meter take-up is likely rise as more basic meters are replaced with smart meters.

## 2.4 Submissions to the issues paper

ActewAGL noted the recent declining trend in wholesale electricity prices. It noted that the reduction in wholesale prices is passed through to customers in the wholesale energy cost component of our electricity pricing model.

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<sup>25</sup> Evoenergy 2018, p 17.

<sup>26</sup> Evoenergy 2018, p 18.

<sup>27</sup> As noted in section 2.2, ActewAGL changed its tariff assignment policy for smart meter customers so that customers with smart meters are automatically placed on time-of-use tariffs rather than the demand tariff.

<sup>28</sup> Based on information from retailer websites in October 2020.

ActewAGL highlighted that our background paper on the developments in the electricity market recognised the considerable uncertainty about future wholesale market developments. Given the ongoing uncertainty, ActewAGL did not provide further comments on potential future trends relevant to wholesale electricity prices.

ActewAGL considers competition to be the main driver of compositional changes in the retail market, in particular the number of consumers on standing offers. It expects competition to continue to drive compositional changes in the retail market as new retailers enter the market and existing retailers continue to evolve their offers. ActewAGL was not aware of any other changes in the Australian energy market that are likely to have implications for the current review.

ACTCOSS noted the information in our background paper on the recent declining trend in the wholesale electricity prices due to the increased supply of renewable energy. ACTCOSS submitted that, while it hopes this trend continues, there remain significant challenges in transitioning to 100 per cent renewable electricity generation across the NEM. As a member of the National Consumer Roundtable on Energy, ACTCOSS has participated in government consultations on actions to smooth the transition in the electricity market.

ACTCOSS expects to see an increasing number of ACT energy consumers move from standing offers to market offers, and from flat rate tariffs to time-of-use and demand tariffs. ACTCOSS believes this trend will continue and possibly accelerate over coming years. ACTCOSS expects more customers to move from standing offers to market offers because the ACT Government has committed to implement our recommendations to increase the comparability and transparency of electricity offers. ACTCOSS also expects an increasing number of customers to move from flat rate tariffs to time-of-use or demand tariffs due to the ongoing rollout of smart meters under the national Power of Choice reforms as well as the increasing installation of rooftop solar panels and other distributed energy resources like batteries and electric vehicles.

## 2.5 Submissions to the draft report

ACTCOSS stated that many customers do not adequately understand how demand and time-of-use tariffs are calculated or do not even know that they are on such a tariff. ACTCOSS said this means the tariffs do not send an effective price signal to consumers.<sup>29</sup>

## 2.6 Our conclusions

The submissions to the issues paper and the draft report largely agreed with our findings on the changes taking place in the electricity market, with some stakeholders highlighting that there is uncertainty about future developments. We concluded that addressing the implications of these developments on the ACT electricity market is warranted. We have addressed the implications by making changes to our network cost methodology.

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<sup>29</sup> ACTCOSS 2021, p 3.

## 3. Current form of price control

### 3.1 Our current approach

We regulate retail electricity prices faced by small customers on ActewAGL's standing offer tariffs. Small customers are defined as customers who consume less than 100MWh of electricity over any period of 12 consecutive months. Small customers are usually residential customers or small business customers. Standing offers are default offers that provide a safety net for those customers who do not shop around for unregulated market offers (see chapter 2).

We regulate ActewAGL's standing offer prices by determining the maximum allowable percentage price change that ActewAGL can apply across its 'basket' of standing offer tariffs from one year to the next. This is called a 'tariff basket' form of price control. Section 3.2 below explains how we calculate the maximum allowable percentage price change.

ActewAGL's basket of standing offer tariffs (regulated tariffs) contains different standing offers available to residential and small business customers. There are a variety of standing offers with different characteristics, such as flat rate tariffs, time-of-use tariffs and demand tariffs (see chapter 2). In 2020-21, ActewAGL's basket of regulated tariff has 16 such tariffs in total for residential and business customers, each with a different set of charges and/or pricing structure. Evoenergy has a range of network tariffs and ActewAGL's standing offer tariff structures and assignment policy often reflect Evoenergy's tariff structures and assignment policy.

Our tariff basket form of price control allows ActewAGL to adjust individual prices for its different standing offers, as long as the average adjustment across the basket of standing offers does not exceed the maximum allowable percentage change that we determined. Under this approach, we do not set the maximum prices that ActewAGL can charge for its standing offers.<sup>30</sup> We only control the average change across the basket of standing offer tariffs.

In our final decision for the 2020-24 electricity price investigation, we found that the tariff basket approach is the most appropriate form of price control in the ACT for customers on regulated retail tariffs given the range of tariffs available. We concluded that ActewAGL should retain discretion to set individual tariffs in the regulated tariff basket. The current approach gives ActewAGL flexibility in setting tariffs so that ActewAGL can adjust prices to meet market conditions and ensure that tariffs are cost reflective.

#### **Verifying ActewAGL's compliance with the price direction**

Under our form of price control, the weighted average annual price change in ActewAGL's basket of regulated tariffs must not exceed the maximum allowable percentage change that we determined.<sup>31</sup> Every year, we check that ActewAGL's standing offer prices meet this requirement.

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<sup>30</sup> Under an individual price cap form of price control, the regulator sets the maximum level of individual prices.

<sup>31</sup> The maximum allowable percentage price change is calculated for each year of the regulatory period in the annual price recalibration (or annual price reset), using the method set out in the price direction.

The weighted average price change for a given year is calculated using ActewAGL’s proposed standing offer prices (charges) for a particular year compared to the previous year, and weights for each charge.

The weights in the weighted average price calculation are customer numbers and electricity consumption in the 12 months to 31 March for the latest year available. ActewAGL’s electricity offers have a supply charge (a fixed daily rate per customer) and variable rates per unit of energy consumed.<sup>32</sup> Weights are determined by customer numbers for the supply charge and by energy consumption for the variable charge.

The prices used in this calculation differ across the two years, but the weights remain unchanged from one year to the next. For example, when calculating the weighted average price change for 2020-21, the prices used are the charges for 2020-21 and 2019-20, and the weights are the customer numbers and electricity consumption values for the 12 months to 31 March 2020.

The same weights are used in both the year in question and the previous year so that the calculated average across the tariff basket only measures the average change in prices from one year to the next.

The mathematical formula for the Commission’s price control is presented in Box 3.1.

### Box 3.1: Our price control formula

ActewAGL’s regulated retail tariffs should comply with the following formula:

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

$$\text{subject to } 1.02 + Y^t \geq \frac{\sum_{j=1}^m P_{ij}^t Q_{ij}^{t-1}}{\sum_{j=1}^m P_{ij}^{t-1} Q_{ij}^{t-1}}, \text{ for each } i.$$

#### where:

- ActewAGL has  $n$  regulated retail tariffs that each have up to  $m$  components;
- $t$  denotes a financial year;
- $i$  denotes a regulated tariff and  $j$  denotes a component of tariff  $i$ ;
- $Y^t$  is the maximum average percentage increase in regulated retail tariffs determined in accordance with the Commission’s pricing model;
- $P_{ij}^t$  is the price that ActewAGL proposes to charge for component  $j$  of regulated tariff  $i$  for year  $t$ ;
- $P_{ij}^{t-1}$  is the price that ActewAGL charges for component  $j$  of regulated tariff  $i$  in the year  $t-1$ ; and
- $Q_{ij}^{t-1}$  is the reference quantity for component  $j$  of the regulated tariff  $i$  defined as the actual quantity (in both customer numbers and megawatt hours) as reported by ActewAGL for the 12-month period ending 31 March in year  $t-1$ .

The form of price control also has a side constraint to ensure that the weighted average price increase of any single tariff does not differ too much from the maximum allowed percentage change (Box 3.2).

<sup>32</sup> The number of variable rates in each tariff depends on the tariff type. For example, a flat rate tariff has a single rate per energy consumed across the day (and night) and time-of-use tariffs have multiple rates depending on the time of the day. ActewAGL is permitted to change the fixed and variable charges in each tariff type.

### Box 3.2: Side constraint

The form of control includes a 2 percentage point upper bound side constraint that ensures that the weighted price increase of any single tariff does not differ significantly from the allowed percentage change. This means that the weighted average price change for any individual standing offer tariff must be within 2 percentage points above the weighted average price change determined by the Commission. This restriction is an upper bound because the constraint does not limit smaller price increases or price reductions. ActewAGL can choose to increase any individual tariff by less than the maximum allowed price change determined by the Commission plus 2 percentage points.

We introduced the side constraint in the 2020-24 retail price investigation because we considered that there would be benefits to consumers by limiting how much ActewAGL can change prices of individual tariffs in any single year. This is because limiting price increases in any single year will ensure the bill increments for an average electricity customer will be close to the weighted average price change that we determined, and hence provide greater price stability for consumers.<sup>33</sup>

We have examined the form of price control used by the AER, Queensland Competition Authority (QCA), Essential Services Commission in Victoria (ESC), and the Office of the Tasmanian Economic Regulator (OTTER) when regulating retail electricity prices. None of those regulators use a tariff basket approach. Therefore, the methods used by those regulators to regulate prices are not directly comparable to the method we use. The methods used by other regulators to calculate the network cost component are summarised in Appendix 2 of our issues paper.

## 3.2 Our pricing model

We use a pricing model to determine the maximum allowable percentage price change that ActewAGL can apply to its basket of regulated tariffs each year. The pricing model estimates the individual cost components that would be incurred by an efficient retailer in a similar position as ActewAGL when providing electricity services to ACT customers on regulated tariffs.

Our pricing model contains three main cost categories:

- wholesale electricity costs, which comprise energy purchase costs, Large-scale Renewable Energy Target (LRET) and Small-scale Renewable Energy Scheme (SRES) costs, energy losses, and National Electricity Market (NEM) fees
- network costs, which include transmission and distribution costs and jurisdictional scheme costs (which include the feed-in-tariff schemes)
- retail costs, which comprise retail operating costs, smart meter costs and Energy Efficiency Incentive Scheme (EEIS) compliance costs.

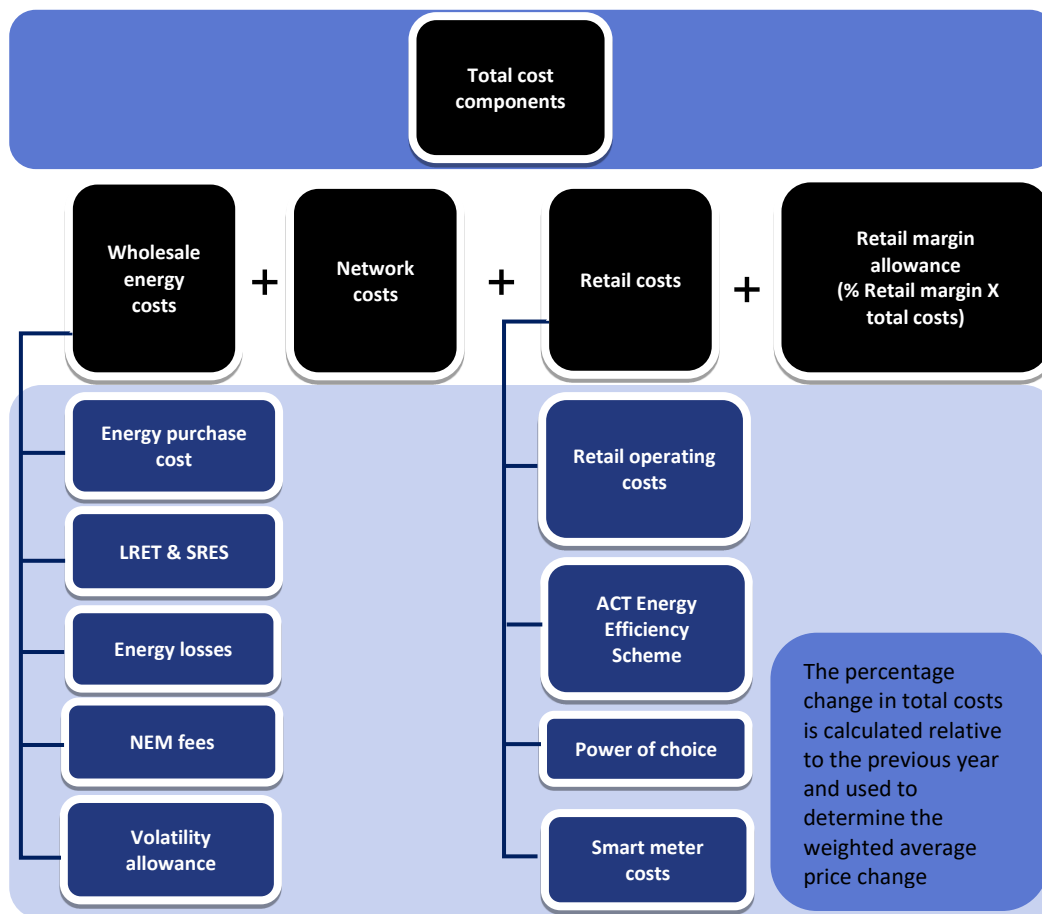
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<sup>33</sup> ICRC 2020b, p 18.

A large portion of costs are not within the control of the retailer and hence we do not regulate them. These include wholesale costs (except for the hedging strategy used by the retailer) and network costs. The costs that are within the control of the retailer include retail operating costs and the retail margin.

Once the cost categories are estimated, they are added together and multiplied by a retail margin (to provide a profit allowance) to produce total costs to be recovered in dollars per megawatt hour (\$/MWh). The total costs are then compared to the total costs calculated for the previous year. This produces a maximum allowable percentage increase that ActewAGL can apply to its basket of regulated retail tariffs. The cost categories are shown in Figure 3.1.

Figure 3.1 The Commission's pricing model



### 3.3 Network cost pass-through

The network cost pass-through amount for a particular year is calculated as a weighted average network cost (expressed in \$/MWh terms) for standing offer customers. A weighted average is used because there are different network charges for different standing offers (see chapter 2).

In the weighted average network cost calculation, the network prices (or charges) are the regulated charges for each network tariff. The weights are ActewAGL's standing offer customer numbers and their electricity usage for each standing offer in the 12 months to 31 March. As with retail tariffs, network tariffs have a

daily supply charge per customer and variable charge per energy consumed. Therefore, both the customer numbers and the energy consumed are needed when calculating the network cost pass-through amount. ActewAGL gives us data on the weights on a commercial in confidence basis.

When calculating the weighted average annual change in network costs, ActewAGL currently uses different network charges for each year and different weights (customer numbers and energy usage) for each year. That is, the network cost pass-through amount can change year to year for two reasons:

- if there are changes in the AER approved network prices
- if there are changes in the weights.

The weights can change when ActewAGL's mix of standing offer customer changes from year to year (for example, if there is a change in the proportion of customer on different tariff types). To put it another way, the increase in the network cost amount used in our pricing model includes the effect of compositional changes in ActewAGL's customer base in addition to the effect of price changes that are approved by the AER.

In contrast, our form of price control (see section 3.1) calculates the weighted average price change by keeping the weights fixed year to year. This means that the weighted average price change in our form of price control reflects price changes only, whereas the method used to calculate the change in network costs reflects price changes as well as changes in ActewAGL's standing offer customer mix.



## 4. Network costs

### 4.1 Issue for this review

In this review, we considered whether the difference between ActewAGL's network cost calculation method and our form of control (see section 3.3) is appropriate and consistent.

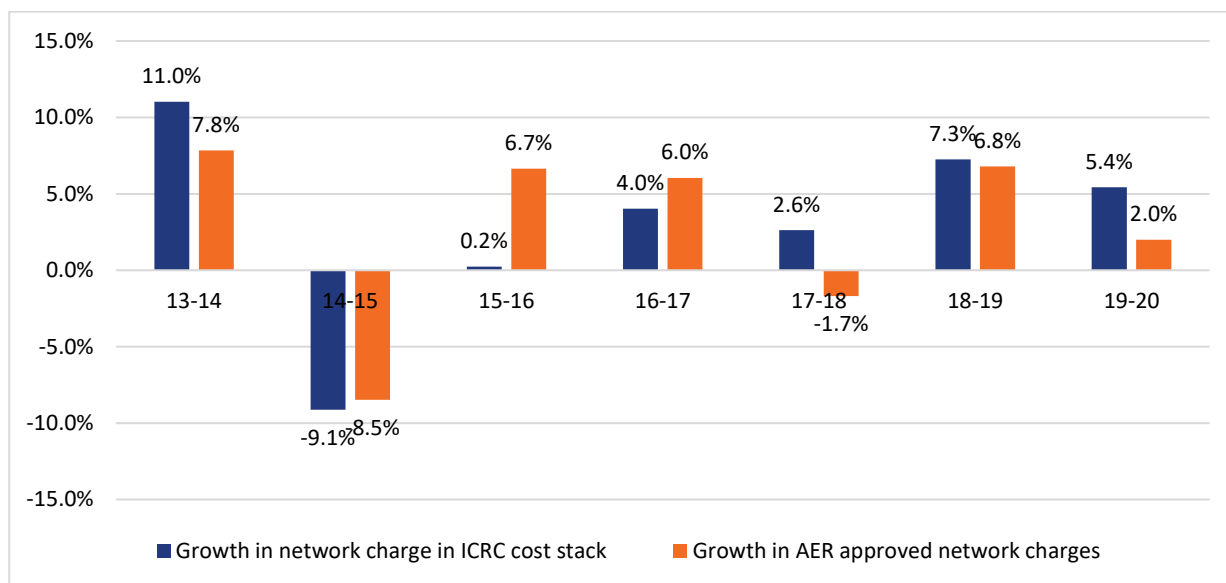
The network cost component in the Commission's pricing model recorded a 5.4 per cent annual increase in 2020-21 compared to the AER approved increase in network prices of 2.0 per cent (see chapter 1). The change in the customer mix resulted from an increase in customers, especially residential customers, changing retailers or moving from a standing offer to a market offer. This caused the proportion of standing offer customers on tariffs with relatively low network costs (residential tariffs) to fall and the proportion of customers with high network costs (business tariffs) to rise.

The network cost increase also reflected a change in the mix of standing offer business customers. The weighted average network cost (expressed in dollar per MWh terms) for business customers increased by significantly more than the average network price increase of 2.0 per cent. This is because there was a higher proportion of standing offer business customers on more expensive network tariffs. For example, the number of standing offer customers on the business demand tariff (a tariff with a relatively high weighted average network cost) increased due to an increase in businesses with smart meters. At the same time, the number of business customers on other business tariffs decreased.

Figure 4.1 shows that, since 2017-18, ActewAGL's calculation of average network costs for standing offer customers has increased by more than AER approved network prices in each year.

Before 2017-18, the change in the weighted average network costs calculated by ActewAGL (and used in our pricing model) was sometimes higher and sometimes lower than the average change in the AER approved network charges. For instance, in 2015-16, the average network cost calculated by ActewAGL increased by 0.2 per cent and the AER approved increase in network prices was greater at 6.7 per cent. In 2013-14, the average network cost calculated by ActewAGL increased by more than the AER approved increase in network prices (11.0 per cent compared to 7.8 per cent).

**Figure 4.1 Network charge growth comparison**



Source: Commission's calculations.

Our analysis in chapter 2 indicates that the forces driving the discrepancy between ActewAGL's network cost change and the AER approved network price change are likely to continue. This discrepancy is caused by differences between the calculation methods used in our form of price control and by ActewAGL in calculating the network cost pass-through amount. The inconsistency between the two calculations arises because of the different approaches taken to determining the weights (see chapter 2).

The implication of this inconsistency is that the network cost pass-through amount does not reflect changes in network prices alone. ActewAGL's calculation results in both changes in the underlying network prices as well as changes in the mix of its standing offer customers being incorporated in its network cost pass-through, which ultimately is incorporated in our overall maximum allowable weighted average price change. This is inconsistent with our methodology for the form of price control, which is to regulate changes in price only.

The mathematical formula used by ActewAGL to calculate the weighted average network cost change from one year to the next is presented in Box 4.1.

#### Box 4.1 Weighted Average Price Change

$$1 + Y_{network}^t = \frac{\sum_{i=1}^n \sum_{j=1}^m P_{ij}^t Q_{ij}^{t-1}}{\sum_{i=1}^n \sum_{j=1}^m P_{ij}^{t-1} Q_{ij}^{t-2}} * \frac{[Total\ usage\ in\ year\ t-2]}{[Total\ usage\ in\ year\ t-1]}$$

where:

- ActewAGL pays Evoenergy for  $n$  network tariffs that each have up to  $m$  components;
- $t$  denotes a financial year;
- $i$  denotes a regulated tariff and  $j$  denotes a component of tariff  $i$ ;
- $Y_{network}^t$  is the change in the network cost components (in percent) in the Commission's pricing model;
- $P_{ij}^t$  is the network price for component  $j$  of network tariff  $i$  for year  $t$ ;
- $P_{ij}^{t-1}$  is the network price for component  $j$  of network tariff  $i$  for year  $t-1$ ;
- $Q_{ij}^{t-1}$  is the quantity for component  $j$  of the regulated tariff  $i$  defined as the actual quantity (in both customer numbers or megawatt hours) as reported by ActewAGL for the 12-month period ending 31 March in year  $t-1$ ;
- $Q_{ij}^{t-2}$  is the quantity for component  $j$  of the network tariff  $i$  defined as the actual quantity (in both customer numbers or megawatt hours) as reported by ActewAGL for the 12-month period ending 31 March in year  $t-2$ ;
- Total usage in year  $t-1$  is the total actual electricity usage in megawatt hours by ActewAGL's standing offer customers in year  $t-1$ ; and
- Total usage in year  $t-2$  is the total actual electricity usage in megawatt hours by ActewAGL's standing offer customers in year  $t-2$ .

## 4.2 Issues paper submissions

ActewAGL stated that the formula used to calculate the annual change in the network cost allowance and the price control formula used to demonstrate compliance with the overall price constraint are not consistent.<sup>34</sup>

ActewAGL submitted that compositional changes in customer mix explain the difference between the network cost increase in our pricing model and the average increase in Evoenergy's network prices. ActewAGL noted that the current method for determining the annual change in the network cost allowance can result in the allowance being less than or greater than the change in Evoenergy network prices, depending on the year-on-year change in the composition of the standing offer customer base.

ActewAGL submitted that the energy industry is evolving at a rapid pace and that it supports our focus on ensuring the cost-index model remains relevant and fit for purpose.

<sup>34</sup> ActewAGL 2020, p 2.

ACTCOSS expressed concerns about the way the network cost pass-through amount is calculated because the method may not be equitable, especially across residential and business customers.<sup>35</sup> ACTCOSS noted that the current method could result in residential customers on ActewAGL's standing offer tariffs being made worse off due to the higher network costs of business standing offer tariffs pushing up prices across the tariff basket. ACTCOSS also noted that the current approach reduces the stability and predictability of standing offer prices due to significant variation and difference between our network cost allowance and the AER's approved network price increase.<sup>36</sup>

ACTCOSS submitted that it is critical to ensure that default offers provide a safety net for all residential and small business customers in the ACT regardless of the retailer. While ACTCOSS acknowledged that ActewAGL's regulated tariffs influence the prices of other market rates due to the dominance of ActewAGL's regulated tariffs in the retail electricity market, it was concerned that this influence would be diminished as ActewAGL's dominance declines.

In this context, ACTCOSS also submitted that it previously recommended that the ACT Government consider the development of a 'Basic Service Offer' that would determine a fair and affordable price for electricity which all retailers would be required to offer to customers as a default. ACTCOSS saw a Basic Service Offer as playing a similar role to that played by the AER's Default Market Offer in NSW, south-east Queensland and South Australia, and the Victorian Government's Victorian Default Offer.

## 4.3 Our draft findings

We considered whether the difference between the network cost calculation method and the form of control is appropriate and consistent. Our draft conclusion was that the difference in the weighting methods between network costs and the weighted average price change is not appropriate.

By calculating the change in network costs using the change in network prices as well as the change in the composition of customers on Evoenergy's network, the current method of calculating the weighted average annual change in network costs is actually calculating the change in the amount ActewAGL pays to Evoenergy for using the network to supply standing offer customers in the ACT. Put another way, this is the revenue ActewAGL must earn from its standing offer customers to pay Evoenergy for using the network to supply these customers.

In our draft report, we considered that this method of calculating the change in total network costs is not consistent with our tariff basket form of price control. The tariff basket approach is not used to set a cap on the revenue ActewAGL can raise from its customers to recover its costs. The tariff basket approach is a method to check that ActewAGL has complied with the maximum allowable price change that we determined. We determine a maximum allowable price change that allows ActewAGL to recover its prudent and efficient costs.

The revenue ActewAGL will raise from its standing offer customers each year results from its retail prices and actual supply volumes (customer numbers and usage) for standing offer customers in that year. Each year, its standing offer customer numbers and their total electricity usage will reflect the compositional changes in its standing offer customers that have been discussed in this report.

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<sup>35</sup> ACTCOSS 2020, p 14.

<sup>36</sup> ACTCOSS 2020, p 15.

## Achieving consistency between the form of price control and the network cost calculation

We found that holding the weights constant in the network cost calculation would remove the current inconsistency between the tariff basket formula and the formula for calculating network costs.<sup>37</sup>

Applying the same approach as used in the tariff basket formula—that is, weighting network costs in both years by the most recent usage and customer figures—would achieve consistency and exclude compositional changes from the calculation of the average network cost change.

## Ensuring ActewAGL can recover its network costs

We considered that any change to the network cost calculation formula must result in ActewAGL being able to recover its network costs.

We undertook modelling to check that a hypothetical efficient retailer using the proposed weighting method described above would be able to recover its efficient costs. The modelling results confirmed that this is the case. This is because the revenue recovered by the retailer will reflect changes in the composition of its standing offer customers and their electricity usage. It is not necessary to include these compositional changes in calculating network costs because the revenue raised by the retailer will reflect these compositional changes and, depending on the standing offer prices the retailer sets,<sup>38</sup> allow it to raise enough revenue to recover its costs.

We found that the current method of calculating network costs results in compositional effects affecting both the change in average network costs calculated by ActewAGL and the revenue raised by ActewAGL—effectively ‘double-counting’ the effects of compositional changes. Depending on the nature of the compositional change in any particular year, this can result either in ActewAGL raising more revenue than needed to recover its network costs or not enough revenue to recover its network costs.

## 4.4 Our draft decision

Our draft decision on the network cost calculation method was to require ActewAGL to amend its calculation methodology so that the network cost pass-through is calculated in a manner consistent with our weighted average price change formula.

Our draft decision would require ActewAGL to use the most recent weights (customer numbers and usage) for both years in the network cost calculation to exclude composition changes in its standing offer customer mix. The revised formula is shown in Box 4.2.

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<sup>37</sup> Our proposed method would see the network cost pass-through amount calculated using the most recent usage and customer figures as the weights to be applied to network prices for the two consecutive years under consideration. This would require re-calculating the earlier years’ weighted average network cost with the updated weights. This method is consistent with how the weighted average price change is determined; that is, the weighted average retail price calculated by ActewAGL is re-calculated each year for the new weights.

<sup>38</sup> Within the maximum allowable price change set by our tariff basket.

### Box 4.2 Proposed Method for Determining Network Cost Pass-Through

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

where:

- ActewAGL pays Evoenergy for  $n$  network tariffs that each have up to  $m$  components;
- $t$  denotes a financial year;
- $i$  denotes a regulated tariff and  $j$  denotes a component of tariff  $i$ ;
- $Y_{network}^t$  is the change in the network cost components (in percent) in the Commission's pricing model;
- $P_{ij}^t$  is the network price for component  $j$  of network tariff  $i$  for year  $t$ ;
- $P_{ij}^{t-1}$  is the network price for component  $j$  of network tariff  $i$  for year  $t-1$ ; and
- $Q_{ij}^{t-1}$  is the quantity for component  $j$  of the regulated tariff  $i$  defined as the actual quantity (in both customer numbers or megawatt hours) as reported by ActewAGL for the 12-month period ending 31 March in year  $t-1$ .

This equation replaces all references to financial year  $t-2$  in the current formula (presented in Box 4.1) with financial year  $t-1$ .

## 4.5 Submissions to the draft report

ActewAGL, ACTCOSS and ACAT supported our draft decision.

ActewAGL submitted that the proposed approach reduces the volatility of network cost changes. It also pointed out that despite the technical nature of the issue, our solution is easy to implement, simple to understand and transparent for customers.<sup>39</sup>

ACAT submitted that our revised method:<sup>40</sup>

- will allow ActewAGL to recover its efficient costs
- will remove an inequitable facet of price control where ActewAGL could sometimes recover more than its efficient costs, and will be to the benefit of consumers.

## 4.6 Our final decision

We have decided to confirm our draft decision on the revised network cost calculation method. This requires ActewAGL to amend its calculation methodology.

<sup>39</sup> ActewAGL 2021, p 2.

<sup>40</sup> ACAT 2021

## 5. Timing and implementation

Our final decision to amend the calculation method that ActewAGL must use to estimate network costs is important for ensuring that only efficient and prudent costs are recovered through regulated prices. We have also made a final decision to implement the decision on the network cost calculation method from the next annual price recalibration in the current regulatory period.

### 5.1 Our draft findings

#### The timely resolution of this issue will benefit all stakeholders

In our draft report, we acknowledged that we typically do not alter our regulatory methodology between price investigations because certainty and predictability in the operating environment for regulated entities is important. However, we considered that the timely resolution of this issue is necessary to ensure that the prices we set allow ActewAGL to recover no more or less than its prudent and efficient costs.

We found that the distortion caused by the inconsistency between the calculation methods results in inaccurate estimates of network costs, which affects the accuracy of our determination of the maximum allowed average price increase for ActewAGL's standing offer prices. In the past, the estimates of network costs were sometimes too high and sometimes too low but recent market developments have caused a trend for estimates that are too high.

We were conscious of the affordability pressures currently being experienced by electricity consumers. And that ActewAGL needs certainty that it can consistently recover its prudent and efficient costs over time, without over-recovery in some years and over-recovery in other years. For these reasons, we found that it would be in the best interests of stakeholders if the calculation method were changed as part of the 2021-22 price recalibration.

#### Price direction can be varied under the ICRC Act

Section 4(b) of the ICRC Act allows for the variation of a price direction in certain circumstances.

In deciding whether to vary the network cost calculation formula before the end of the current price direction, we considered the criteria listed under section 20(2) of the Act and found that the proposed change will promote the objectives in criteria (a), (c), (e), and (g):

- (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
- (c) the need for greater efficiency in the provision of regulated services to reduce costs to consumers and taxpayers
- (e) the cost of providing the regulated services
- (g) the social impacts of the decision

Without this change, the current method of calculating network costs may lead to ActewAGL recovering more or less than its prudent and efficient costs in any particular year, because of compositional changes in its mix of standing offer customers. This outcome is not consistent with our legislative objectives to protect consumers, promote efficiency in the delivery of regulated services, and allow ActewAGL to recover its costs in providing regulated electricity services.

In particular, we found the current method is not consistent with section 20(2)(e) as it can cause the prices for standing offers to differ from the prices that would allow for the recovery of the cost of providing the regulated services.

ACTCOSS highlighted this concern in its submission, stating that the current method could lead to the retailer recovering more than efficient costs in some situations, resulting in an inequitable form of price control that may also compromise the stability and predictability of standing offers for residential and small business customers.<sup>41</sup> We consider this outcome would be inconsistent with section 20(2)(g) which requires us to have regard to the social impacts of our price decisions.

We considered whether we would need to vary the 2020-24 price direction under section 4(b) of the ICRC Act to give effect to our decision to amend the network cost calculation method. While the calculation of network costs informs the determination of the maximum allowable average price change that is included in the price direction, the calculation method is not described in the price direction. We found that the calculation formula can be varied without varying the price direction and this change can be made during the 2021-22 electricity price reset.

Nevertheless, we decided to follow the same process in this review as if we were varying the price direction under Section 4(b) of the ICRC Act. Doing this ensured that stakeholders would have enough opportunity to give their input into our decision.

Under section 4(b), we would be required to release a draft report, allow not less than 20 business days for submissions, and release a final report. We followed this process in this review. The timeline for the review shown in table 1 of this report was based on this process.

## 5.2 Our draft decision

Our draft decision was to implement our draft decision on amending the network cost calculation method during the annual retail electricity price recalibration for 2021–22.

## 5.3 Submissions to the draft report

ActewAGL, ACTCOSS and ACAT supported our draft decision to amend the network cost calculation method during the annual retail electricity price recalibration for 2021–22.

ACTCOSS supported our draft decision on the understanding that it will not be detrimental to ActewAGL's residential, not-for-profit, and small business standing offer customers.<sup>42</sup>

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<sup>41</sup> ACTCOSS 2020, p 14.

<sup>42</sup> ACTCOSS 2021, p 2.



ACAT submitted that although it is unusual for us to alter our regulatory methodology between price investigations, it agrees that a timely resolution of the issue discussed in our draft report is necessary.<sup>43</sup>

## 5.4 Our final decision

We have decided to confirm our draft decision on the timing of implementing the decision on the network cost calculation method. This means that we will use the amended network cost method during the annual retail electricity price recalibration for 2021–22.

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<sup>43</sup> ACAT 2021

# Appendix 1 – Network charges associated with ActewAGL’s standing offer tariffs

This appendix presents Evoenergy’s network charges associated with ActewAGL’s standing offer tariffs.

**Table A.2: 2020-21 Network prices for residential customers\***

Customer class	Network price
<b>Residential Demand Network</b>	
Supply charge (c/day)	36.91
Direct debit supply charge (c/day)	36.91
Energy (c/kWh)	3.22
Maximum demand (c/kW/day)	15.55
<b>Basic Residential Network</b>	
Supply charge (c/day)	41.44
Direct debit supply charge (c/day)	41.44
Energy (c/kWh)	8.04
<b>Residential 5000 Network</b>	
Supply charge (c/day)	63.82
Direct debit supply charge (c/day)	63.82
Energy (<60 kWh/day) (c/kWh)	6.66
Energy (>60 kWh/day) (c/kWh)	8.04
<b>Residential Heat Pump Network</b>	
Supply charge (c/day)	108.90
Direct debit supply charge (c/day)	108.90
Energy (<165 kWh/day) (c/kWh)	5.08
Energy (>165 kWh/day) (c/kWh)	8.04
<b>Residential TOU Network</b>	
Supply charge (c/day)	41.44
Direct debit supply charge (c/day)	41.44
Peak Energy (c/kWh)	14.43
Shoulder Energy (c/kWh)	6.54
Off-peak Energy (c/kWh)	3.20
<b>Off-Peak Night Network</b>	
Energy (c/kWh)	2.21
<b>Off-Peak Day &amp; Night Network</b>	
Energy (c/kWh)	3.40

Notes: \* Network prices presented in this table are provided to the Commission by ActewAGL and are based on Evoenergy’s network prices approved by the AER. The Commission applies standing offer customer numbers and energy consumptions to these prices to estimate network costs on \$/MWh basis.

**Table A.3: 2020-21 Network prices for business customers\***

Customer class	Network price
<b>LV demand network</b>	
Supply charge (c/day)	66.76
Energy (c/kWh)	4.76
Maximum demand (c/kW/day)	45.77
<b>General Network</b>	
Supply (c/day)	74.67
Energy (<330 kWh/day) (c/kWh)	12.27
Energy (>330 kWh/day) (c/kWh)	15.94
<b>General TOU Network</b>	
Supply (c/day)	74.67
Business (c/kWh)	19.34
Evening (c/kWh)	8.76
Biz Off-Peak (c/kWh)	3.96
<b>LV TOU kVA Demand Network</b>	
Supply (\$/day)	250.61
Business (c/kWh)	7.28
Evening (c/kWh)	4.02
Biz Off-Peak (c/kWh)	2.19
Maximum Demand (c/kVA/day)	46.06
<b>Streetlighting</b>	
Supply (c/day)	74.99
Energy (c/kWh)	8.52
<b>Small Unmetered Loads</b>	
Supply (c/day)	41.23
Energy (c/kWh)	12.48

Notes: \* Network prices presented in this table are provided to the Commission by ActewAGL and are based on Evoenergy's network prices approved by the AER. The Commission applies standing offer customer numbers and energy consumptions to these prices to estimate

# Abbreviations and acronyms

ACAT	ACT Civil and Administrative Tribunal
ACT	Australian Capital Territory
ACTCOSS	ACT Council of Social Service
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
COAG	Council of Australian Governments
Commission	Independent Competition and Regulatory Commission
EMMR	Electricity Model and Methodology Review
ESB	Energy Securities Board
ESC	Essential Services Commission
MWh	Megawatt hour
NEM	National Electricity Market
OTTER	Office of the Tasmanian Economic Regulator
QCA	Queensland Competition Authority

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