



independent competition and regulatory commission

Final Decision
**Retail Prices for
Non-contestable
Electricity Customers
2011–2012**
Report 3 of 2011
June 2011

The Independent Competition and Regulatory Commission (the Commission) was established by the *Independent Competition and Regulatory Commission Act 1997* (ICRC Act) 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 ICRC Act for determining competitive neutrality complaints and providing advice about other government-regulated activities. Under the *Utilities Act 2000*, the Commission has responsibility for licensing utility services and ensuring compliance with licence conditions.

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Foreword

Full retail contestability (FRC) for electricity customers has operated in the ACT since 2003. When FRC was introduced, the Government determined that the Independent Competition and Regulatory Commission (the Commission) would, as an interim measure, determine a price direction for the transitional franchise tariff (TFT) for non-contestable (or ‘franchise’) electricity consumers using less than 100 MWh/year.

In June 2010, the Commission made a price direction¹ for the supply of electricity to franchise customers for the period 2010–12 in accordance with terms of reference issued by the Attorney-General under the *Independent Competition and Regulatory Act 1997* (the ICRC Act) in August 2009.

The terms of reference for the 2010 price direction required the Commission to:

- review the modelling of electricity costs
- investigate the price level that would result in vigorous competition in the market
- have regard to ActewAGL Retail’s costs of complying with relevant Australian Government and ACT Government policies
- have regard to the Australian Energy Market Commission review of energy markets in light of climate change policies.

This Final Decision and price direction for 2011–12 has been made in accordance with the methodology adopted in the Commission’s 2010 Final Decision. The Commission was not required to reconsider its 2010 methodology or the 2009 terms of reference in making its 2011–12 price direction.

This price direction establishes the allowable increase in the cost index for the TFT and is expressed as an X factor to be applied in ActewAGL Retail’s weighted average price cap formula. Under the direction, ActewAGL Retail must set regulated tariffs which comply with a weighted average price cap formula. The Commission ensures consistency with the price direction when it approves ActewAGL Retail’s standard customer contract for electricity supply services in accordance with section 89 of the *Utilities Act 2000*.

The Commission advised ActewAGL Retail of its approved TFT X factor for 2011–12 on Friday, 10 June 2011. The Commission received ActewAGL Retail’s proposed variation to the tariff schedule for its standard customer contract under the Utilities Act on Wednesday 15 June 2011.

Since the Attorney-General issued the 2009 terms of reference for the price direction, the Australian Energy Market Commission (AEMC) concluded its review of the effectiveness of competition in the electricity market in the ACT. The AEMC concluded that competition in the ACT electricity market was not effective due to the unique characteristics of the market. Notwithstanding this, the AEMC did recommend removing price regulation from 1 July 2012.

¹ ICRC, *Final decision – retail prices for non-contestable electricity customers 2010-2012*, June 2010.

The ACT Government is expected to deliver its response to the AEMC report later this year. ActewAGL Retail in its submission to the Commission noted that it may make an application to the Commission for a pass-through in the event that it faces additional costs as a result of being required to assist with or implement any education and awareness campaigns to improve the effectiveness of competition in the ACT.

Malcolm Gray
Acting Senior Commissioner
June 2011

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1 Introduction

1.1 Background

In the ACT, the retailing of electricity to customers consuming more than 160 megawatt hours (MWh) per year (predominantly large businesses) was made contestable from 1998. The electricity supply industry in the ACT was opened for retail competition to customers consuming more than 100 MWh/year (mainly medium-sized businesses) from 1 July 2001.²

Following the Commission's recommendation that full retail contestability (FRC) be introduced for all customers in the ACT³, the ACT Government opened the market to competition for customers using less than 100 MWh/year (those customers with an annual electricity bill of less than about \$13,000) from 1 July 2003.⁴ This allowed small businesses and households to select the electricity retailer of their choice.

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, ActewAGL Retail, if they did not wish to enter into a negotiated contract with one of the electricity retailers licensed in the ACT.

In December 2002, a reference from the Treasurer instructed the Commission to provide a price direction for the supply of electricity to franchise customers (that is, those on non-negotiated contracts) for a transitional period from 1 July 2003 to 30 June 2006. 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/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 it 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 incumbent retailer are called 'non-franchise' customers

1.2 Overview of market

The TFT does not apply to all electricity customers in the ACT; it applies only to those small customers (those consuming less than 100 MWh/year) who have not elected to enter into a negotiated contract with either the incumbent retailer, ActewAGL Retail, or an alternative electricity retailer.

In addition to the incumbent, there are 18 licensed electricity retailers⁵ in the ACT:

- Australian Power and Gas Pty Ltd
- AGL Sales Pty Ltd
- AGL Sales (Queensland Electricity) Pty Ltd

² Utilities (Non-Franchise Electricity Customers) Declaration 2001 (Disallowable instrument 2001-93).

³ ICRC, *Final report: Full retail contestability in electricity in the ACT*, July 2002.

⁴ Utilities (Non-Franchise Electricity Customers) Declaration 2003 (No. 1) (Disallowable instrument 2003-20).

⁵ As of 20 June 2011. On 6 April 2011, Endeavour Energy (formerly Integral Energy) surrendered its electricity supply licence effective from 30 June 2011.

- Aurora Energy
- Country Energy
- Dodo Power & Gas Pty Ltd
- EnergyAustralia
- ERM Power Retail Pty Ltd
- Integral Energy Australia
- Jackgreen (International) Pty Ltd
- Momentum Energy Pty Ltd
- Origin Energy Electricity Ltd
- Powerdirect
- Red Energy
- Sanctuary Energy Pty Ltd
- SUN Retail
- TRUenergy Pty Ltd
- TRUenergy Yallourn Pty Ltd.

This is the same number of licensees in place at 1 July 2010; however, few of these retailers are currently active in servicing the residential customer market.

The number of residential customers entering into negotiated contracts with either the incumbent or an alternative retailer increased steadily in the initial years of retail contestability.⁶ By 30 June 2006, 28,000 residential customers had entered into negotiated contracts, and by 30 June 2007 just over 34,000 had done so.⁷ However, the number of residential customers on negotiated contracts fell to around 30,000 by 30 June 2008.⁸ At 30 June 2009, the number had fallen again, to around 27,800, a significant decrease from June 2008.⁹ At 30 June 2010, the number was under 26,800.¹⁰

1.3 Price reset for 2011–12

The 2010 Final Decision required ActewAGL Retail to submit the following to the Commission on or before 13 May 2011:

- updated green costs for 2011–12
- full accounting of all proposed pass-throughs and
- calculation of the CPI.

⁶ Small (<100 MWh/year) non-residential customers may also be on standard rather than negotiated contracts.

⁷ ICRC, *Licensed electricity, gas and water and sewerage utilities: Compliance and performance report for 2006–07*, June 2009, p. 9.

⁸ ICRC, *Licensed electricity, gas and water and sewerage utilities: Compliance and performance report for 2007–08*, June 2009, p. 5.

⁹ The 30 June 2009 figure is based on unpublished data derived from licensed electricity supplier responses to a Commission questionnaire. The Commission collects the data annually as part of its performance and compliance monitoring and reporting regime.

¹⁰ The 30 June 2010 figure is based on unpublished data derived from licensed electricity supplier responses to a Commission questionnaire.

ActewAGL Retail was also required to submit to the Commission the updated network costs as soon as these costs were approved by the Australian Energy Regulator (AER).

2 Analysis of efficient costs

This section details the calculation of the efficient costs of the incumbent retailer using the TFT cost index methodology determined by the Commission in the 2010 Final Decision. The components of the cost index for 2011-12 are shown at table 11.1 of that decision. In addition to the X factor to be applied to the weighted average price cap formula in the price determination, the CPI to apply in determining 2011-12 costs also has to be calculated. The CPI is used to escalate energy contracting costs, energy losses and retail operating costs established in the cost index as part of the June 2010 Final Decision.

2.1 Determination of CPI

The Commission calculates the CPI figure using the following formula, populated using the ABS All Groups Index for the weighted average of eight capital cities:

$$CPI_t = \frac{CPI_{March(t-2)} + CPI_{June(t-2)} + CPI_{Sept(t-1)} + CPI_{Dec(t-1)}}{CPI_{March(t-3)} + CPI_{June(t-3)} + CPI_{Sept(t-2)} + CPI_{Dec(t-2)}} - 1$$

The formula produced a CPI figure of 2.85% to apply in 2011–12.

2.2 Energy purchase costs

The energy purchase cost represents the cost incurred by an incumbent retailer in purchasing electricity from the market to supply TFT customers. The Commission determined that this cost would be calculated from the observed forward market price adjusted to take account of the load shape for the ACT with an allowance for a hedging cost.

2.2.1 Forward price

The forward price for 2011-12 is determined using the reported 2012 financial year settlement prices for New South Wales base load electricity reported on the d-cyphaTrade website. The forward price is the numerical average of the 2012 financial settlement price over the period 1 July 2009 through to 31 May 2011. The Commission determined the forward price for 2011-12 to be \$44.866/MWh.

2.2.2 Load shape

The load shape is the average of the ratio of the load-weighted spot price to the time weighted spot price over the years 2003-04 to 2009-10 applied to the net system load profile for the ACT. The following table details the calculation of the load shape for 2011–12.

Table 1 Load-weighted and time-weighted annual spot prices, ACT net system load profile

Financial year	Load weighted (\$/MWh)	Time weighted (\$/MWh)	LW/TW ratio (\$/MWh)
2003–04	36.87	32.37	1.139
2004–05	42.99	39.33	1.093
2005–06	41.48	37.25	1.114
2006–07	78.06	58.72	1.329
2007–08	48.03	41.66	1.153
2008–09	44.11	38.85	1.135
2009–10	49.53	44.19	1.121
Average ratio for load weighted over time weighted prices 2003 through 2008 (five years)			1.165
Average ratio for load weighted over time weighted prices 2003 through 2009 (six years)			1.161
Average ratio for load weighted over time weighted prices 2003 through 2010 (seven years)			1.155

The load shape as used in the determination of the 2011–12 energy purchase cost is 1.155.

2.2.3 Hedging cost

The hedging cost is calculated taking account of the maximum value of the observed ratio of the maximum load to the average load (the load ratio), the load shape and the percentage mark-up of the forward price to the spot price. The percentage mark-up had been determined to be 5%.

The following table updates the information used to determine the load ratio.

Table 2 Ratio of maximum load to average load, 2003 to 2009, quarterly

Quarter	Maximum half-hour load in quarter (MW)	Average half-hour load in quarter (MW)	Ratio maximum load to average load	Quarter	Maximum half-hour load in quarter (MW)	Average half-hour load in quarter (MW)	Ratio maximum load to average load
Q3 2003	195.75	109.62	1.786	Q1 2004	110.46	64.91	1.702
Q3 2004	199.01	108.85	1.828	Q1 2005	113.64	65.91	1.724
Q3 2005	200.25	110.76	1.808	Q1 2006	133.63	70.79	1.888
Q3 2006	193.85	109.66	1.768	Q1 2007	133.40	70.77	1.885
Q3 2007	213.88	111.00	1.927	Q1 2008	129.23	68.34	1.891
Q3 2008	199.70	114.40	1.746	Q1 2009	159.61	70.95	2.250
Q3 2009	192.37	109.03	1.764	Q1 2010	153.26	68.54	2.236
Q4 2003	153.94	75.60	2.036	Q2 2004	189.16	93.95	2.013
Q4 2004	130.53	68.53	1.905	Q2 2005	189.87	90.06	2.108
Q4 2005	139.07	70.95	1.960	Q2 2006	214.79	104.10	2.063
Q4 2006	126.94	70.49	1.801	Q2 2007	204.16	95.03	2.148
Q4 2007	117.59	68.84	1.708	Q2 2008	176.51	94.74	1.863
Q4 2008	123.24	67.69	1.821	Q2 2009	199.16	96.66	2.061
Q4 2009	160.61	73.94	2.172	Q2 2010	206.94	94.25	2.196

The load ratio remains unchanged at 2.35 as the maximum of the ratio of the maximum load to the average load has not increased since the 2010-11 determination. Subtracting the value of the load shape from the load ratio and applying the 5% mark-up establishes a hedging cost factor of 0.05975% for 2011-12.

The following table updates the energy purchase cost.

Table 3 Final determination of the energy purchase cost

Components	2009–10	2010–11	2011–12
Forward Price (\$/MWh) (A)	49.738	47.988	44.866
Load shape (%) (C)	1.165	1.161	1.1551
Maximum load to average load ratio	2.248	2.35	2.35
Hedging cost (%) (D)	0.05415	0.05945	0.05975
Forward price uplift factor (B=C+D)	1.21915	1.22045	1.21475
Energy purchase cost (\$/MWh) (A×B)	60.64	58.57	54.50

The calculated energy purchase cost using the Commission’s methodology is \$54.50/MWh.

2.3 Energy contracting cost

The energy contracting costs allowance for 2011–12 is based on an adjustment of the 2010–11 cost allowance for movements in the CPI, this produces an allowance of \$0.78/MWh.

2.4 Green costs

As required by the Commission’s 2010 Final Decision, ActewAGL Retail submitted its updated green costs for 2011–12 to the Commission on 13 May 2011. ActewAGL Retail also submitted a commentary and a Green Cost Model to the Commission explaining its forecast green costs on 13 April 2011.

ActewAGL Retail submitted a forecast green cost for 2011-12 of \$13.88/MWh. This included a net pass-through of \$2.55/MWh due to a regulatory change event in 2010.

The Federal Government amended the Renewable Energy Target (RET) scheme on 1 January 2011. The amended scheme requires electricity retailers to surrender Small-scale Technology Certificates (STCs) in addition to Large-scale Generation Certificates (LGCs). The Commission has considered ActewAGL Retail’s regulatory event pass-through of green costs from January 2011 through June 2011 and approved an amount of \$2.55/MWh as being consistent with the approach taken in the 2010 Final Report.

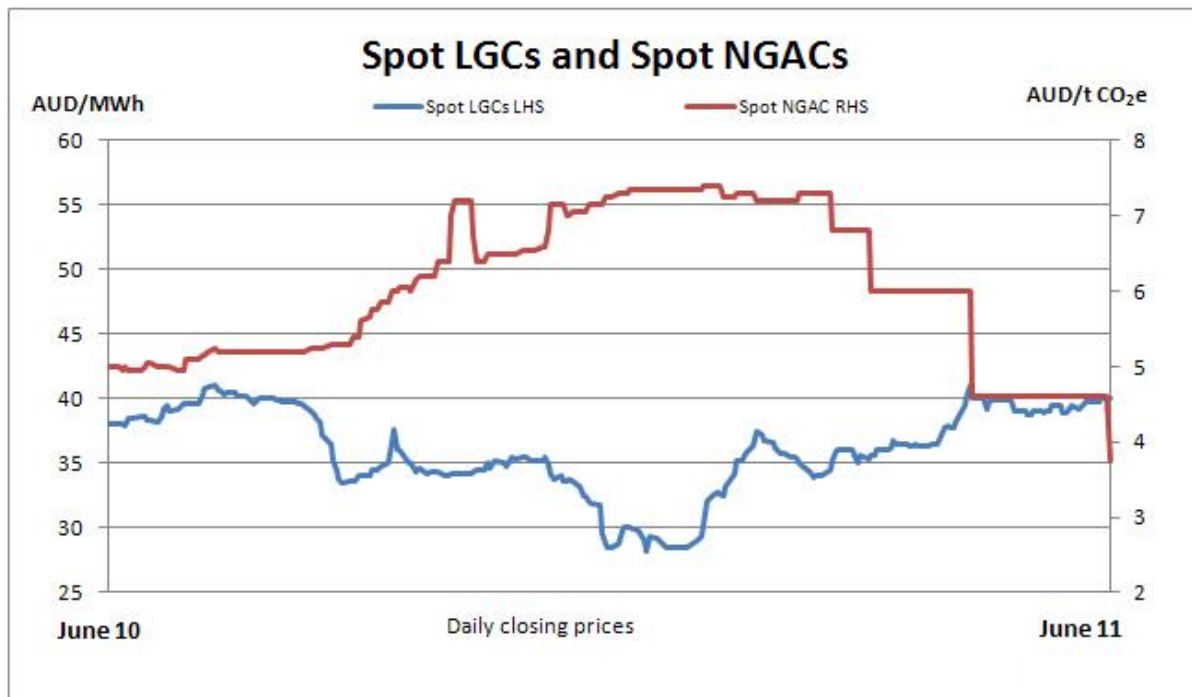
ActewAGL Retail submitted proposed green costs of \$11.33/MWh for 2011–12. This proposal used the 2011 Renewable Power Percentage and Small-scale Technology Percentage of the Office of the Renewable Energy Regulator (ORER) as required under the revised RET scheme. ActewAGL also included an estimate of the cost of a Large-scale Generation Certificate price of \$55.55 and \$48.00 for 2011 and 2012 respectively. LGC prices are determined through over-the-counter trades.

The Commission has reviewed indicative spot prices provided by Nextgen and NAB, and the settlement price of Renewable Energy Certificates (RECs) on the Sydney Futures Exchange and has

concluded that ActewAGL Retail’s forecast LGC prices for 2011 and 2012 are too high. The Commission has adopted an LGC price of \$40.00 for 2011 and \$42.00 for 2012. These prices are based on a \$40.00 spot price (as shown in the figure below) and an allowance for holding costs of 10% averaged over the year. The reasonableness of this estimate is further supported by the January 2012 REC futures contact trading at \$41.50. Applying the Commission’s LGC prices establishes a green cost of \$10.59/MWh for 2011-12.

The Commission has determined the total allowed green costs for 2011-12 to be \$13.14/MWh (\$2.55/MWh for the 2010-11 pass-through and \$10.59/MWh for 2011-12 green costs).

Figure 1 Spot LGCs and spot NGACs, daily closing prices, June 2010 – June 2011



Source: Nextgen, <http://www.nges.com.au/index.php>

2.5 Energy losses

The distribution loss factor as reported by AEMO for 2011–12 is 1.0499 or 4.99%.¹¹ The transmission loss factor (marginal loss factor) as reported by AEMO for 2011–12 is 1.0003 or 0.03%.¹² The Commission’s energy loss factor for 2011-12 is 1.0502 or 5.02%.

2.6 National Electricity Market fees

The National Electricity Market (NEM) fee allowance is the NEM fee allowance established in the 2010 Final Decision adjusted by CPI. The Commission’s allowance for NEM fees in 2011-12 is \$0.78/MWh.

¹¹ AEMO, Distribution loss factors for the 2011-2012 financial year, April 2011, page 19.

¹² AEMO, List of regional boundaries and marginal loss factors for the 2011-2012 financial year, April 2011, page 33.

2.7 Retail operating costs

The retail operating costs allowance is the retail operating costs established in 2010 Final Decision adjusted by CPI. The Commission's allowance for 2011-12 is \$10.86/MWh.

2.8 Retail margin

The Commission's 2010 Final Decision set the retail margin at 5.4%.

2.9 Network costs

On 3 June 2011, the AER amended and then approved ActewAGL Distribution's pricing proposal for 2011-12. The AER approved an increase in the maximum allowable average revenue cap for the distribution use of system of 6.96% for 2011-12. Network costs were also adjusted for increases in metering charges and TransGrid's transmission charges. TransGrid's average charges for the three ACT connection points increased by 16.6% in 2011-12. The transmission charge is passed through to retail customers as part of the network charge. (The AER approved an increase in TransGrid's revenue cap in 2011-12 of 10.61%.)

ActewAGL Distribution estimated that the impact of the increase in network and metering charges in 2011-12 on its Residential Basic Network charge as resulting in a 7.2% increase in the average charge.¹³

The TFT load is different from ActewAGL Distribution's load. ActewAGL Retail submitted network costs of \$77.17/MWh for 2011-12 for the TFT load representing an 8.02% increase. The Commission has determined that this amount is consistent with previous determinations of this cost component.

¹³ ActewAGL, *ActewAGL Distribution*, May 2011: p.46
(<http://www.aer.gov.au/content/item.phtml?itemId=746805&nodeId=c624e312cd10e13d1ce4d8aaddf7e336&fn=ActewAGL%20-%20APPROVED%20pricing%20proposal.pdf>)

3 Final decision on cost elements

The following table sets out the Commission’s final decision on the cost components used to determine the change in the TFT for 2011-12, using the methodology it adopted in the 2010 Final Decision. The Commission’s decision provides for a real increase in the TFT of 3.42% and a nominal increase of 6.37%.

Table 4 Composition of TFT retail price for 2011–12 relative to 2010–11

	2010–11 final decision	2011–12 final decision	% change
Electricity purchase cost (\$/MWh)	58.57	54.50	–6.94
Energy contracting cost (\$/MWh)	0.76	0.78	2.63
Green costs (\$/MWh)	5.15	13.14	155.15
NEM fees (\$/MWh)	0.76	0.78	2.63
Energy losses (%)	5.92%	5.02%	
Total energy purchase cost (\$/MWh)	69.01	72.60	5.20
Retail operating costs (\$/MWh)	10.56	10.86	2.85
Customer acquisition costs (\$/MWh)	-	-	
Total retail costs (\$/MWh)	10.56	10.86	2.85
Network costs (\$/MWh)	71.44	77.17	8.02
Total energy + retail + network costs (\$/MWh)	151.01	160.63	6.37
Retail margin (EBITDA, ¹ % of sales)	5.40%	5.40%	
Total retail price (\$/MWh)	159.16	169.30	6.37
X factor in CPI+X on MAR in \$/MWh (%)²		3.42	

Notes:

¹Earnings before interest, tax, depreciation and amortisation

²Maximum allowed revenue from TFT customers

Abbreviations and acronyms

ABS	Australian Bureau of Statistics
ACT	Australian Capital Territory
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
Commission	Independent Competition and Regulatory Commission (ACT)
CPI	consumer price index
EBITDA	earnings before interest, tax, depreciation and amortisation
FRC	full retail contestability
LGC	large-scale generation certificate
ICRC	Independent Competition and Regulatory Commission (ACT)
MAR	maximum allowed revenue
MW, MWh	megawatt, megawatt hour
NEM	National Electricity Market
ORER	Office of the Renewable Energy Regulator
REC	renewable energy certificate
RET	renewable energy target
STC	small-scale technology certificate
TFT	transitional franchise tariff