

Interim Consultation Notice

Calculation of the 2007-08 Benchmark Retail Cost Index

Introduction

The Queensland Government has decided to introduce full retail competition (FRC) into Queensland energy markets from 1 July 2007. With the introduction of FRC, electricity and gas retailers will be able to offer electricity and gas to all consumers, including those who are currently on regulated prices.

While gas retail prices will be fully deregulated, regulated electricity prices (notified prices) will remain an important feature of the Queensland electricity market. In particular, customers who are not offered a market contract or who choose not to accept an offer will remain on a notified price. In addition, customers who have accepted a market contract may revert to a non-market contract at the notified price at some point in the future, subject to any contractual conditions that may apply.

In the past, notified prices for retail electricity have generally varied each year with changes in the consumer price index, subject to the approval of the Minister for Mines and Energy (the Minister). With the commencement of FRC, the Government has developed a new method for revising notified prices each year. From 1 July 2007 onwards, the notified price of electricity will be adjusted annually according to the cost of providing electricity. An electricity benchmark retail cost index (BRCI) will be used to adjust notified electricity prices each year.

Many components of the BRCI have been set out in legislation or will soon be incorporated into regulations. However, there will remain a number of issues that will need to be considered in calculating the BRCI for any particular year.

The legislative framework that underpins the introduction of FRC allows the Minister to delegate the calculation of the BRCI to the Queensland Competition Authority (the Authority). On 16 March 2007, the Minister wrote to the Authority advising that he had delegated this responsibility to the Authority, subject to certain conditions. The delegation certificate can be viewed on the Authority's website (www.qca.org.au/electricity).

The FRC legislative framework sets out the consultation process that the Authority must follow in preparing advice for the Minister on the expected change in the BRCI that will be used to adjust the notified price of electricity for the following financial year. In normal circumstances, the Authority would provide an extensive opportunity for stakeholders to respond to an Interim Consultation Notice and subsequent Draft Decision prior to advising the Minister of any change in the BRCI, as the legislation requires. However, given the time available to determine the change in the BRCI from 2006-07 to 2007-08, the Authority will be required to adjust its analysis and the public consultation process to the minimum requirements of the legislation. In particular, some of the potential pricing issues that could be considered by the Authority, such as fixed principles, will not be considered on this occasion. However, the Authority will ensure that the process to consider any price adjustment in 2008-09 will provide for a thorough examination of all issues relating to the calculation of the BRCI.

Timetable to review the adjustment to notified prices to apply from 1 July 2007

- | |
|--|
| <ul style="list-style-type: none">• Interim Consultation Notice issued and call for submission on 27 March 2007• Submissions close 10 April 2007• Workshop to discuss submissions mid April (date to be advised)• Draft Decision released 8 May 2007• Submissions close 23 May 2007• Advice provided to Minister for Mines and Energy on 13 June 2007 |
|--|

Key issues

To assist interested parties in preparing a submission, the Authority has identified a number of key issues that will need to be considered in calculating the Benchmark Retail Cost Index for 2006-07 and 2007-08 (see **Attachment**). The issues that have been identified are not exhaustive and are provided as guidance only. Submissions received on issues other than those identified will be fully considered.

Relevant documents

In addition to the Ministerial delegation mentioned previously, the following references provide important information regarding the legislative framework that the Authority is required to consider in calculating the Benchmark Retail Cost Index. These documents are available from the Department of Mines and Energy website through the links provided below:

The *Electricity and Other Legislation Amendment (EOLA) Act 2006* amended the *Electricity Act 1994* for the purpose of introducing FRC and can be obtained from:

- http://www.energy.qld.gov.au/electricity_and_other_legislation_amendment_act.cfm

A draft regulation setting out much of the detailed requirements of the Benchmark Retail Cost Index can be obtained from:

- http://www.energy.qld.gov.au/electricity_industry_code_consultation_papers.cfm#cp8.

Please note: The Department of Mines and Energy is undertaking a separate consultation process in relation to the draft regulation. Please refer to the Energy Competition Committee website (<http://www.energy.qld.gov.au/ecc>) for more information. Submissions to this Interim Consultation Notice should be restricted to those issues regarding the application of the FRC legislative framework to the calculation of the Benchmark Retail Cost Index. Any comments submitted in relation to Government policy are not able to be considered by the Authority.

Submissions should be directed to:

Chief Executive
Queensland Competition Authority
GPO Box 2257
Brisbane QLD 4001
Telephone (07) 3222 0555
Fax: (07) 3222 0599
Email: electricity@qca.org.au

Submissions must be received by 5 pm Tuesday **10 April 2007**.

For further enquiries contact Moston Neck on (07) 3222 0511

Key issues in determining the Benchmark Retail Cost Index

In broad terms, the legislation requires that the BRCI for a particular year be calculated by dividing the total retail cost of electricity in Queensland in the relevant year by the load for Queensland in the previous calendar year. The total retail cost of electricity is to include:

- the cost of energy;
- network costs;
- retail costs; and
- any other relevant costs.

Below is a brief discussion on each BRCI component and issues to assist interested parties in preparing their submissions on the implementation of the BRCI approach.

Cost of energy

The legislation requires that the forecast cost of energy must be based on the long run marginal cost (LRMC) of energy and that the method to be used should be generally recognised and understood in economic theory and include specific recognition of the following matters:

- the efficient combination of generating plant to meet the Queensland load;
- the demand profile (or 'NEM load shape') formed over each half hour electricity trading period of Queensland over the previous calendar year;
- the Queensland 13 per cent Gas Scheme;
- the requirements of the *Renewable Energy (Electricity) Act 2000*; and
- the cost of ancillary services needed to meet the Queensland load.

Issues

1. How should the LRMC of energy be defined? What methods could be used to measure the LRMC of energy? Should a different method be used for different fuel sources, such coal, gas, renewable energy, etc?
2. Is there any evidence or argument to suggest that the LRMC of energy may change between 2006-07 and 2007-08?
3. What is the efficient combination of generating plant to meet the Queensland load?
4. How should the impact of the 13 per cent Gas Scheme be measured in the LRMC of energy?
5. What level and mix of renewable generation should be assumed in the long run?

6. Which ancillary services should be included in the determination of the LRMC of energy? How should the LRMC of these ancillary services be measured? How can double counting of ancillary services to be avoided, especially if these costs are recovered directly from customers?

Network Costs

The legislation requires that network costs must reflect the revenue requirements for transmission and distribution networks in Queensland.

For the purpose of calculating the BRCI, the Authority is required to smooth Ergon Energy's annual aggregate revenue requirement (AARR) over the current regulatory period (2005-06 to 2009-10) so that the network costs included in the BRCI increase by the same percentage each year.

The Australian Energy Regulator (AER) is responsible for determining Powerlink's transmission costs in 2007-08 and has not yet made a final determination.

Issues

7. Are there any issues that the Authority should consider in measuring either distribution or transmission costs? For example, how should adjustments for under and over-recovery be treated? Should pass-through amounts be re-smoothed or included in the same year that the pass-through amount was incorporated into prices?
8. Are there any implications stemming from the required treatment of Ergon Energy's AARR for Energex?
9. In the absence of a Final Decision by the AER regarding Powerlink's 2007-08 revenue requirement, what would be a reasonable approach to estimating this cost?

Retail Costs

The legislation requires that retail costs must reflect the likely cost of providing retail services to Queensland customers connected to the national grid, based on an efficient hypothetical retailer. Retail costs comprise operating costs and a retail (profit) margin.

The legislation and the draft regulations require the Authority to assume the efficient hypothetical retailer has a significant share of Queensland's electricity retail market and that it has a mix of customers that reflects the mix of Queensland electricity customers as a whole.

The Authority is required to consider the costs related to various retail functions such as billing, customer call centres, credit management, energy trading, corporate overheads and information technology systems.

The legislation requires the Authority to allow the retailer to earn a reasonable retail margin. In considering what a reasonable retail margin may be, the certificate of delegation requires the Authority to be mindful of two policy objectives of the Queensland Government, specifically, that the existing retail margin in the notified prices at the date of the delegation remain relatively stable and that the policy of enabling small market customers to revert to notified prices should not result in a retailer providing customer retail services to non-market customers at a loss.

Issues

10. What is the existing retail margin? What constitutes a relatively stable retail margin?
11. Under what circumstances would a customer reverting to prices result in a retailer making a loss? Is this likely? How can this be avoided?
12. Would the retail functions of an efficient hypothetical retailer differ from the incumbent retailers, Origin and AGL? What costs could an efficient hypothetical retailer expect to recover directly and what costs are compensated for through the retail margin?
13. Should additional retail costs be included in the BRCI for 2007-08 given the introduction of FRC on 1 July 2007?

Queensland Load

The Queensland load is to be calculated from the loads supplied at each transmission connection point to the regulated networks of Ergon Energy and Energex. Isolated distribution networks and customers directly connected to the transmission network are to be excluded from the Queensland load.

Issues

14. Are there any issues the Authority should consider in calculating Queensland load? For example, how should embedded generators be treated in calculating the NEM load?