

Integral Energy

Interim Consultation Notice: Benchmark Retail Cost Index for Electricity 2008-09

Submission to the Queensland Competition Authority

15 October 2007

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1 Overview

Integral Energy (Integral) welcomes the opportunity to offer comments on the Queensland Competition Authority's (QCA) Interim Consultation Notice on calculation of the Benchmark Retail Cost Index (BRCI) for 2008/09.

Integral is the holder of a non-area Retail Authority in Queensland and has actively participated in the residential and small business segment of the Queensland market, since the commencement of FRC on 1 July 2007. Integral also provides customer retail services to approximately 830,000 market and non-market customers in New South Wales.

Integral recognises the limitations that necessarily applied to the QCA and its consultants in setting the BRCI for 2006/07 and 2007/08, as a consequence of the compressed timeframes for establishment. While Integral considers that this process reasonably balanced achievement of the Government's objectives with the timeframes provided for analysis and consultation, it is suggested that the BRCI for 2008/09 should:

- Revisit and review the methodologies and simplifying assumptions previously applied to determine the cost elements; and
- Include consideration as to how the QCA is satisfied, in the exercise of its delegated authority, that the Government's policy objectives have been met for the 'efficient entity' contemplated for the purposes of calculating the BRCI.

In addition to Integral's general concerns regarding the validity of the methodologies and simplifying assumptions previously applied in determining the BRCI for 2007/08, there are a number of issues that Integral believes require consideration by the QCA in determining the cost components of the BRCI for 2008/09. These include:

- The factors that will place upward pressure on LRMC, including the value of water, changes in the mix of generation, and regulatory uncertainty;
- The role of volatility in influencing contract prices and a retailer's energy purchasing costs;
- The impact of adjustments to the Aggregate Annual Revenue Requirements (AARRs) of ENERGEX and Ergon Energy as a consequence of their current pass-through applications;
- The impact on total retail operating costs of the variations in the cost of providing customer retail services to different customer segments;
- A re-examination of the QCA's allowance for customer acquisition and retention costs, which Integral believes to be too low; and
- Not establishing fixed principles at this point in time, given the risk that regulatory and market uncertainties will result in material variation between forecast and actual costs.

The remainder of this submission expands on these issues.

2 Purpose

This submission represents Integral's response to the key issues raised by the QCA in its Interim Consultation Notice on the BRCI for 2008/09, released in September 2007. Integral has not sought to respond to every question raised for consideration by the QCA in the Interim Consultation Notice, rather, in preparing this submission, Integral has focused on those issues which it believes are key to the determination of a BRCI for 2008/09 that adheres to the Queensland Government's stated policy objectives of ensuring that:

- Actual increases in (the total) electricity costs are reflected in the level of tariff increases;
- Existing retail headroom in the tariff remains relatively stable; and
- The policy of permitting small market customers to revert to the Notified Prices does not result in retailers providing customer retail services to non-market customers at a loss.

The key issues identified by Integral for response are addressed in the following sections:

Section	Purpose	Details
3	Approach to the BRCI for 2008-09	This section outlines Integral's preferred approach to the calculation of the BRCI for 2008/09.
4	Cost of Energy	This section sets out Integral's view on factors influencing the LRMC and actual energy purchase costs in 2008/09 which should be reflected in the calculation of the cost of energy component of the BRCI.
5	Network Costs	This section details Integral's view as to the manner in which revenue adjustments resulting from Ergon Energy and ENERGEX's pass-through applications should be addressed in the BRCI calculation.
6	Retail Costs	This section sets out Integral's views on factors influencing the allowance for retail operating costs, including segmentation and customer acquisition and retention.
7	Fixed Principles	This section discusses Integral's views on whether the QCA should fix principles to apply to any of the retail cost elements.

3 Approach to the BRCI for 2008/09

Integral recognises the limitations that necessarily applied to the QCA and its consultants in setting the BRCI for 2006/07 and 2007/08, as a consequence of the compressed timeframes for establishment.

Integral believes that in determining the BRCI for 2008/09:

- The methodologies and simplifying assumptions previously applied to determine the energy and retail cost elements should be reviewed (subject to the acknowledged legislative constraint that is placed on the QCA regarding the application of LRMC when determining energy costs). In particular:
 - the correlations drawn between the New South Wales and Queensland markets when determining energy costs, in order ensure that energy costs are 'Queensland-specific' by being based on the circumstances of the Queensland generation sector, Queensland load shape and recent movement in the Queensland forward curves;
 - the adjustments made to historic and forecast energy costs, in order to more accurately reflect anticipated increases in the capital and operating costs of generation in Queensland and ongoing increases and volatility in the spot and contract prices; and
 - the assumed impact on operating costs that results from the composition of the efficient retailer's customer base, in order to reflect the requirements of the *Electricity Regulation 2006* which provides that the 'efficient retailer' is assumed to have a proportion of customers, substantially the same as the proportion for the whole of the Queensland customer base.

Integral's preliminary views on the possible treatment of these issues in establishing the BRCI for 2008/09 are outlined in this submission.

- The QCA must consider whether the methodologies and assumptions adopted will result in a BRCI that meets the Government's explicit policy objectives of sustained headroom and the provision of customer retail services to non-market customers other than at a loss. Integral does not suggest that the QCA should undertake an assessment of headroom and 'cost to serve' on a retailer-by-retailer basis, but believes there should be some demonstration as to how the QCA is satisfied, in the exercise of its delegated authority, that the Government's policy objectives have been met for the 'efficient entity' that is contemplated for the purposes of the BRCI calculation.

A comprehensive review of this nature is necessary to:

- Mitigate the risk of step-change adjustments in future years in circumstances where the existing methodologies and simplifying assumptions fail to achieve their stated purpose or result in a material deviation between forecast and actual costs; and

- Secure the market's confidence that competition in Queensland will be sustainable. A failure to move the component elements of the BRCI to cost reflective levels and to maintain this cost reflectivity together with the required headroom, is likely to impact on:
 - the future viability of retailers, particularly with respect to their Queensland operations;
 - the level of retail competition in the Queensland market; and
 - the ability to attract new investment in Queensland.

While it is noted that as at the end of August 2007, approximately 53,000 customers had moved to a market contract with their current retailer or a new retailer and that 50,000 customers were pending transfer,¹ the ongoing level and stability of headroom of the Notified Prices, as determined through the BRCI, will be crucial in the continued development of effective competition in the Queensland market.

In particular:

- Unlike other NEM jurisdictions where customers generally 'default' to their local (i.e. area) retailer for supply under a regulated contract (including as to price), the regulatory framework for FRC in Queensland is unique in that the relevant financially responsible market participant (FRMP):
 - will continue to be financially responsible for energy consumed at the connection point, regardless of whether a market contract exists with the customer at the premises; and
 - is required offer supply to uncontracted small customers at the Notified Prices (under the terms of the Standard Retail Contract).

This open 'right of reversion' for small customers to the Notified Prices, regardless of whether the customer's FRMP is an area or non-area retailer, creates a direct and ongoing exposure for all retailers, not just area retailers, to the amount and stability of the headroom that is incorporated into the Notified Prices.

- The level of the Notified Prices will determine whether a market contract can be offered on a competitive and sustainable basis. For example, Integral's residential customer offer in Queensland is structured on the basis of a guaranteed discount against the Notified Prices, for a specified contract period. To the extent that headroom is either insufficient or uncertain, market contracts cannot be offered and the development of competition in Queensland will be undermined. This is discussed further in section 4.3.

¹ Taken from statistical information provided by the Department of Mines and Energy to the Queensland Post FRC Consultative Committee, 25 September 2007

4 Cost of Energy

4.1 Issue

Integral recognises the legislative constraints placed on the QCA under the *Electricity Act 1994* that require the calculation of energy costs to be based on LRMC.

In calculating the cost of energy component of the BRCI for 2007/08, the QCA:

- estimated the LRMC of energy as the basis for determining the energy cost component of the BRCI, based on the stand alone cost in a single year of the most efficient combination of generating technologies for Queensland, treated as an isolated region; and
- adjusted the LRMC to include additional factors including, the purchase cost of energy, the impact of environment schemes, market charges and ancillary service costs.

In the Interim Consultation Notice, the QCA has sought comment on:

“whether, leaving aside the method for calculating the LRMC of energy, there is an expectation that the LRMC of energy will change between 2007-08 and 2008-09;

whether there is a substantive reason why the Authority should adopt an alternative approach for adjusting the LRMC of energy to account for the short run purchase cost of energy. If so, what changes should be made?”

4.2 LRMC

Integral believes that the following factors will place upward pressure on the LRMC and should be explicitly considered by the QCA in its determination of the LRMC for 2008/09:

- The value that participants will be attributing to water resources, including as a result of:
 - required infrastructure investment to secure future supplies or improve efficiencies in use; and
 - concerns regarding the imposition of usage premiums;
- An increasing penetration of gas-fired generation, impacting the composition and profile of Queensland’s generation sector; and
- Uncertainty regarding carbon pricing, including:
 - the increased costs that will result for generation reliant on fossil fuels; and

- the extent to which this will be reflected in contract prices. In this context, it is considered that participants are unlikely to wish to solely rely on the regulatory disruption clauses contained in the standard International Swaps and Derivatives Association (ISDA) agreement.

Integral believes that these factors represent a fundamental shift in both the market's approach to contracting and its future physical composition. Integral anticipates that the emergence of these issues will place upward pressure on the cost of energy in the long-term through an increase in the capital and operating costs of generation that are applied when determining the optimal combination of capacity and dispatch to meet the Queensland load.

This in turn will be reflected in:

- The average price paid by retailers for contracts in Queensland (and to the extent that these issues are not Queensland-specific, average prices across the market); and
- In some the instances, the contract's terms. For example, the market may begin to see the introduction of caveats on the contract cover which are linked to factors such as the party's ability to generate in drought conditions.

4.3 Energy factor

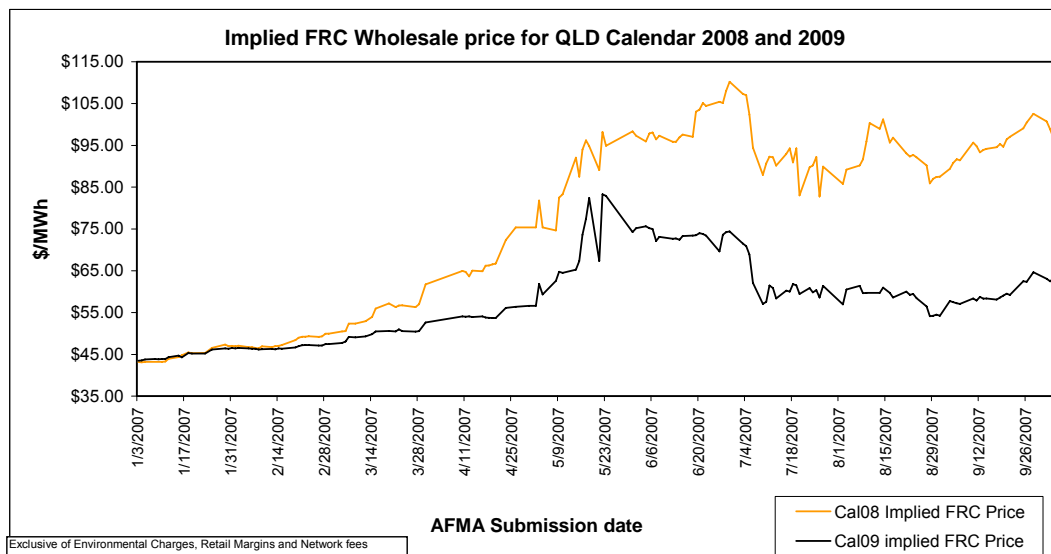
Integral supports the QCA's adjustment of the LRMC for 2007/08 in recognition of the inevitable separation between the actual energy purchase costs incurred by a retailer for any given year and the LRMC of energy.

Integral believes that a similar adjustment will be required when determining the energy costs component of the BRCI for 2008/09 as the circumstances that resulted in the application of this 'uplift factor' in 2007/08 continue to persist. Drought conditions continue to reduce available generation and influence market sentiment regarding the duration and severity of its impact on forward prices. Increases and volatility in both the spot and contract prices are therefore expected to continue.

The following graph illustrates a series of implied prices for the energy component of a retail offer in 2008 and 2009. It should be noted that this data is:

- based on the Australian Financial Markets Association (AFMA) end of day median price for 2008/09; and
- modelling based on forecast pool prices which are premised on historical outcomes and assumptions regarding escalation and the continuation of historical trends.²

² Derived by Integral Energy. While it is recognised that AFMA is survey-based, it is considered to provide a strong correlation over time with traded prices for the purposes of illustration.



Given that a retailer's market offer will generally be for a fixed period at a fixed rate, any volatility or 'creep' in the assumed energy price will reduce headroom and create the risk that the retailer's market offer will now or in the future be uncompetitive against the Notified Price. This will not only expose retailers to adverse financial consequences, but may also have negative impacts on the level of competition in the market. Concerns linked to continuing drought conditions may also drive 2009 prices higher than the implied prices above.

Other factors will also play a material role in influencing contract prices and the energy purchasing costs for 2008/09 between now and the relevant contract quarter. For example:

- In the absence of a natural hedge in the form of generation (which is not a characteristic of the 'efficient retailer' upon which the BRCI is based), a prudent retailer will never be perfectly hedged and will have an ongoing exposure to the wholesale price. This reflects the fact that:
 - it is not possible to forecast load exactly for each trading interval – demand is uncertain and can be volatile;
 - it is not always practical or economic to purchase hedges against all exposures;
 - liquidity or how much the market could be expected to move against a retailer that has to hedge an open position quickly; and
 - changes in the value of the trading book over time.
- Hedge contract prices today represent what generators will sell at given their current assessments of the market. If the market's perception of the risks changes, hedge contract prices will also change and in some instances, result in a significant step-change. For example, should high or volatile spot prices eventuate over the 2007/08 summer, this is likely to be reflected in higher contract prices for 2008/09, as a consequence of movement in market sentiment; and

- In a volatile market, decisions may need to be made by participants regarding the purchase of optionality, such as caps or collars, to guard against the risk of high losses. This will add to the retailer's energy purchasing costs.

These factors emphasise the importance of ensuring that the uplift factor for energy purchasing costs for 2008/09 is based on the specific circumstances of the Queensland generation sector, Queensland load shape and recent movement in the Queensland forward curves in response to market conditions and market sentiment.

That is, the methodology applied to the calculation for 2007/08 of relying on the similar factor calculated by IPART for New South Wales, adjusted for assumed differences, should not carry across to the calculation for 2008/09.

4.4 Other energy costs

Integral believes that risk should not be underpriced in the calculation of the energy cost component of the BRCI for 2008/09, and that the methodology applied by the QCA should explicitly account for the following:

- Regulatory uncertainty regarding the future target that will apply under MRET. An increase in the target level will drive demand and prices, and possibly result in an unanticipated separation between spot and forward prices. In these circumstances, reliance on the Australian Financial Market Association weekly market prices would not prove to be an accurate determinant of retailers' compliance costs; and
- The risk of an increase in the level of ancillary service charges as a corollary to market conditions in Queensland, in particular, the factors impacting energy purchasing costs (e.g. the drought and narrowing reserve margin). That is, the current assumptions regarding the relative stability over time in ancillary service charges (based on 2005/06 and 2006/07 data) should be revisited.

It is suggested therefore, that when determining average costs, historic costs should be adjusted to reflect the market and regulatory conditions that are expected to apply in the period that is the subject of the BRCI calculation.

5 Network Costs

5.1 Issue

In calculating the BRCI for 2007/08, the QCA recognised adjustments to the revenue requirements for ENERGEX and Ergon Energy, that has occurred since the release of its *Final Determination – Regulation of Electricity Distribution (April 2005)* (2005 Final Determination).

Integral notes that these adjustments included:

- The pass-through of costs associated with an additional \$720 million in capital expenditure by ENERGEX during the current regulatory period that was approved by the QCA in March 2007; and
- The re-smoothed revenue requirements for Ergon Energy.

In the Interim Consultation Notice, the QCA has sought comment on:

“whether there are any issues that the Authority should consider in measuring network costs.”

5.2 Pass-through applications

Integral believes that the BRCI for 2008/09 should fully reflect any upward pressure in network costs. In this context, Integral notes that the QCA is currently conducting public consultation on:

- ENERGEX’s supplementary submission in support of its February 2007 pass-through application for costs associated with the introduction of FRC. This submission is seeking a revised pass-through of \$82.7 million for the current regulatory control period (adjusted down from the \$117 million sought by ENERGEX’s in its February 2007 application);³ and
- Ergon Energy’s pass-through application for the costs associated with Tropical Cyclone Larry of \$29.33 million for 2008/09.⁴

It is noted that there are a range of pass-through, re-opening and error correction mechanisms available to ENERGEX and Ergon Energy under the 2005 Final Determination, including for the approval of additional capital costs. To the extent that the AARRs for ENERGEX and Ergon Energy increase for 2008/09 as a consequence of the application of these mechanisms, this increase should be reflected in the BRCI.

³ ENERGEX, *Full Retail Competition Supplementary Cost Pass-through Submission (October 2007)*, at page 10

⁴ Ergon Energy, *Ergon Energy Pass Through Application: Severe Tropical Cyclone Larry (May 2007)*, at page 11

Integral believes therefore that, with respect to the calculation of the network cost component of the BRCI for 2008/09, the following should be clarified:

- The QCA's anticipated timing for a decision on ENERGEX's FRC pass-through application. In particular, whether this will align with the Draft and Final Decisions on the BRCI.

Integral suggests that, in circumstances where a decision has yet to be made, the full increase to the AARR for 2008/09 sought by ENERGEX under the pass-through application of \$42.6 million should be assumed when calculating the network cost component in the Draft Decision; and

- Whether any smoothing of ENERGEX or Ergon Energy's AARRs are likely to occur as a consequence of the current pass-through applications or any proposed pass-through applications with expected revenues impacts in 2008/09.

Integral suggests that smoothing of the AARR for the remainder of the regulatory control period would only be required in circumstances where the approved adjustments are likely to result in a material change to the existing allowances of year-on-year revenue.

6 Retail Costs

6.1 Issue

In calculating the benchmark retail costs for 2006/07 and 2007/08, the QCA determined operating costs largely on the basis of the prevailing regulatory decisions on retail costs in the other NEM jurisdictions, adjusted for labour costs, FRC related costs and customer acquisition costs.

At the time that this analysis was undertaken, the QCA's consultants noted that constraints of available time and data precluded a more 'bottom-up' approach by customer segment and cost category as appeared to be envisaged by the Electricity Regulation⁵.

In the Interim Consultation Notice, the QCA has sought comment on:

“whether the retail cost components set out in the legislation should be considered individually or in total;

how customer acquisition costs should be estimated.”

6.2 Cost Components

Integral does not believe that it is necessary for the QCA to pursue a 'bottom-up' approach that considers all cost components on an individual basis when determining retail costs, provided that the methodology applied is capable of accurately reflecting variations to the overall cost as a consequence of changes in a component part.

Integral suggests however that the impact of the following should be expressly considered by the QCA when determining the retail cost component of the BRCI for 2008/09:

- The assumed composition of the efficient retailer's customer base; and
- The costs of customer acquisition and retention.

6.2.1 Segmentation

Section 109 of the Electricity Regulation provides that the 'efficient retailer' for the purposes of calculating retail costs under the BRCI is assumed to have a:

“...proportion of customers, separated into customer types defined by their consumption level within particular consumption bands, that is substantially the same as the proportion for the bands for the whole Queensland customer base.”

⁵ CRAI, *Calculation of the Benchmark Retail Cost Index for 2006-07 and 2007-08, Final Report (May 2007)*, at page 43

Integral believes that the impact of this regulatory assumption on the efficient retailer's operating costs should be analysed by the QCA in its calculation of the retail costs to apply 2008/09, for the purposes of identifying the relative cost to serve that exists between 'types' of customers.

Integral suggests that this would involve the QCA:

- Confirming the broad consumption bands that should apply and the proportion of customers within each band.

While Integral agrees that customer size appears to be an appropriate means of classifying customers for this purpose, it is considered that the examples of consumption bands provided in section 109 of the *Electricity Regulation 2006* should be refined to reflect a balance between:

- The regulatory thresholds which influence the systems and processes that need to be developed to support the classification of 'small' and 'large' NMIs (i.e. <100MWhs per annum vs ≥100MWhs per annum) and to a lesser extent, differentiation between 'business' customers and 'residential' customers within the small customer classification; and
 - The characteristics of the customer's load that will necessarily influence the customer's cost to serve but which, although broadly linked to size, will not directly correlate to regulatory thresholds for tranches of contestability. For example, a classification on the basis of 'residential', 'small to medium enterprises' (SMEs) and 'commercial and industrial' (C&I).
- Identifying the factors that drive the variability in costs between bands.

In Integral's experience, the average cost per customer of undertaking the following activities will vary, and in all likelihood increase, relative to the 'size' (i.e. segment) of customer:

- Customer creation and transfer;
 - Retail billing;
 - Revenue management;
 - Service order management; and
 - Energy purchasing costs.
- Identifying an efficient cost of providing customer retail services to the customers in each segment.

This process should recognise the limitations that may exist in interstate benchmarking by virtue of the fact that 'costs to serve' are traditionally related to residential or 'small' customers.

It is not suggested that this level of detailed analysis would be required for each future year in which the QCA calculates the BRCI. Rather, the QCA should undertake this analysis to determine the level and relative costs that exist between customer segments, with subsequent adjustments for year-on-year increases on costs and regulatory change.

6.2.2 Customer acquisition and retention

Integral considers the QCA's allowance of \$2 per customer in the BRCI calculation for 2007/08, to be an inadequate reflection of the efficient costs of retaining scale and believes that the methodology upon which this figure is based should be re-examined when determining the retail cost component to apply in 2008/09.

Integral notes that IPART in its Final Determination, established an accepted allowance for customer acquisition costs (2006/07 \$/customer) of:

- \$42 per business customer; and
- \$34 per residential customer.⁶

Integral believes that these figures represent a minimum of allowable costs for customer acquisition, reflecting the lower end of the both the range of costs and amortisation periods recommended by IPART's consultants.⁷ However, even adjusting this figure to accommodate a retailer with existing scale, the IPART allowance remains significantly higher than that allowed by the QCA in 2007/08.

More recently, the retailer survey supporting the AEMC's First Draft Report on the Review of Competition in the Gas and Electricity Retail Markets, released on 4 October 2007, identified the following average costs for acquisition and retention, on a per annum basis, derived from ranges of costs that were provided by surveyed retailers:⁸

Average cost	First Tier	Second Tier
Acquisition:		
• Domestic	\$137	\$136
• Business	\$250	\$217
Retention:		
• Domestic	\$83	\$65
• Business	\$109	\$70

Source: Wallis Consulting Group

⁶ IPART, *Final Report and Final Determination – Promoting retail competition and investment in the NSW electricity industry. Regulated electricity retail tariffs and charges for small customers 2007 – 2010 (June 2007)*, at page 102

⁷ Ibid, at page 102

⁸ Wallis Consulting Group, *AEMC Review of Competition in the Gas and Electricity Retail Markets Retailer Study Research Report (October 2007)*, at page 32

Integral notes that these findings identified higher acquisition and retention costs for:

- Business customers than for residential customers, thought to be due to the channels used and the number of contacts required; and
- First tier retailers (i.e. retailers with 'scale') than for second-tier retailers, particularly with respect to retention costs. This was thought to be due to larger infrastructure and the need to modify existing systems and databases.

Integral suggests that, regardless of whether customer acquisition costs are separately determined and 'added on' to the retailer's operating costs (as in IPART's recent determination) or derived as a proportion of the underlying operating costs (an alternative suggested by the QCA's consultants in informing the QCA's Draft Decision on the BRCI for 2007/08), the QCA should recognise:

- Variations in costs across customer segments;
- The higher costs faced by retailers with scale;
- That a retailer with scale will incur costs both in an effort to retain its existing customers as well as in acquiring customers to replace those it will inevitably lose. It is not reasonable to assume that effort will be focused on customer retention alone;
- A level of customer churn for 2008/09 that reflects active competition. This would be consistent with the Government's and market's expectation regarding the development of competition; and
- Amortisation of costs over a period that is consistent with active competition – i.e. in a competitive market, customers on average can be expected to be retained over a shorter period.

7 Fixed Principles

7.1 Issue

In delegating the calculation of the BRCI to the QCA, the Minister for Energy has also delegated the Minister's power under section 95 of the *Electricity Act 1994* to fix future principles to apply to a retail benchmark cost element.

In the Interim Consultation Notice, the QCA has sought comment on:

“whether the Authority should fix any of the principles to apply to any (or all) of the benchmark retail cost elements and if so, what fixed principles should be applied to which elements and for how long.

whether any adjustments should be made after the expiry of the period of a fixed principle.”

7.2 Market and regulatory risk

While Integral recognises the potential benefits of the certainty and reduced costs of regulation that are provided through the establishment of fixed principles, it does not support fixing any component part of the retail cost calculation at this time.

Integral believes that there is currently too high a level of market and regulatory risk to support a forecast rate of growth (or decline) in the retail cost elements, with confidence that any deviation from actuals will be immaterial. These risks include:

- Recent upward pressure in energy costs and market uncertainty as to the impact that this will have on generation investment and forward contract prices.

The risks in forecasting wholesale electricity prices were recently recognised in New South Wales where spot and contract prices moved significantly following the issue by IPART of its Draft Determination on the regulated electricity retail tariffs and charges for the period 2007-2010. In response to this and retailer concerns, IPART adopted a revised approach in its Final Determination, by establishing an annual review over the three year determination period of the market-based energy purchasing cost allowance. IPART stated that:

“The Tribunal’s purpose in setting prices for three years, is to provide regulatory certainty, provide incentives for the businesses to pursue efficiency gains, and reduce the costs associated with regulation. On the other hand, given the current market environment, and the significant volatility in input prices coupled with a fixed selling price, retailers clearly face significant risk.

On balance, and in recognition of the difficulty in forecasting wholesale electricity prices, the Tribunal has decided to include in its final determination annual reviews of the market-based electricity purchase cost component of the energy cost allowance.⁹

- The national regulatory framework for the provision of customer retail services that is being developed through the Ministerial Council on Energy's Retail Policy Working Group and the inevitable impact that its introduction (and the accompanying transition from jurisdictionally-based regulatory arrangements) will have on retailers' operating costs and margins; and
- Anticipated changes to State and Commonwealth environmental schemes, including scheme targets, duration and co-existence.

A material separation between actual and forecast costs will directly and immediately impact the level of competition in Queensland. While retailers will continue to be bound by legislation and licence to offer the Notified Prices to all small customers and to large non-market customers for whom they are the FRMP, these same retailers may withdraw from the competitive market (i.e. cease offering market contracts) as a means of minimising their exposure and risk.

7.3 Mechanisms for 'review'

In circumstances where the QCA was to contemplate the introduction of a fixed principle(s), Integral believes this should only occur if accompanied by a transparent mechanism for review and adjustment. Review mechanisms could include:

- An automatic mid-term review in which the assumptions underpinning the fixed principle are reviewed and confirmed;
- A trigger for the re-opening of the fixed principle in circumstances where a materiality threshold specific to the fixed principle was breached; or
- A mechanism for the within period pass-through of additional costs incurred as a result of an exogenous event. It is queried however whether a recommendation of this nature would be within the scope of the QCA's authority under the current Certificate of Delegation.

Importantly:

- A direct mechanism to reflect any material variation (or anticipated material variation) between forecast and actuals should occur in preference to a 'true-up' or adjustment at the end of the period for which the fixed principle is applied. This would ensure that the BRCI and Notified Prices more closely reflect changes in the cost of electricity, as they occur; and
- Any mechanism should be administratively simple, transparent and use a publicly available reference point.

⁹ IPART, *Final Report and Final Determination – Promoting retail competition and investment in the NSW electricity industry. Regulated electricity retail tariffs and charges for small customers 2007 – 2010 (June 2007)*, at page 86