



INTERNATIONAL

## FINAL REPORT: REMADE DECISION

**Prepared for:**

Queensland Competition Authority

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# Calculation of the Benchmark Retail Cost Index 2008-09: Remade Decision

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## 1. INTRODUCTION

### 1.1. BACKGROUND AND PURPOSE OF THIS REPORT

The Queensland Competition Authority's (Authority) Final Decision on the Benchmark Retail Cost Index (BRCI) for 2008-09 was published in May 2008. In August and September 2008, AGL Energy Limited and Origin Energy Retail Limited respectively commenced separate proceedings in the Queensland Supreme Court against the Authority and the Minister for Mines and Energy, challenging the decision of the Authority regarding the 2008-09 BRCI and the notified prices of electricity that followed from it, and seeking that the decision be set aside.

The Court handed down its decision on the matter on 28 April 2009. The Court decided that:

- *In working out the benchmark retail cost for both the relevant tariff year (2008-09) and the preceding tariff year (2007-08), the Authority did not form a view of the likely total costs to be incurred during that year to purchase energy to supply the NEM load of the State for that year, as required by s92(1) of the Electricity Act 1994; and*
- *In working out the total benchmark retail cost for the preceding year, the Authority used data which had not been used in working out that cost when the year to 30 June 2008 had been the relevant tariff year, and which the Authority was not otherwise entitled to use in this decision.*

The Court concluded that "the Authority will have to recalculate the benchmark retail cost index for the year to 30 June 2009".

This report provides calculations of the various components of the BRCI that are affected by the Court's decision, and a re-calculation of the BRCI that conforms with the Court's decision for use by the Authority in its Remade Decision on the BRCI for the relevant tariff year (2008-09) and the preceding tariff year (2007-08).

### 1.2. SCOPE AND CONTENTS OF THIS REPORT

This report reviews each of the components of the BRCI calculation in the same order in which they were addressed in CRA's Addendum Report on the BRCI for 2008-09,<sup>1</sup> which provided CRA's final input to the Authority's Final Decision on the BRCI for 2008-09.

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<sup>1</sup> *Calculation of the Benchmark Retail Cost Index for 2007-08 and 2008-09, Addendum, CRA, 26 May 2008*

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This report only addresses those matters which are relevant to the re-calculation of the BRCI for the relevant tariff year (2008-09) and the preceding tariff year (2007-08), in accordance with the Supreme Court decision. The report identifies whether each component is affected by the Court's decision. For those components that are affected by the Court's decision, the report describes how the calculation of that component is affected, provides any additional information required about changes in data inputs or processing procedures, and reports the re-calculated value of the component.

- Section 2 of this report gives an overview of the basis of the Authority's Final Decision on the BRCI for 2008-09;
- Section 3 discusses how each component of the BRCI is affected by the Court's decision; and
- Section 4 provides the results of the calculation of all the components that are to form the basis of the Authority's Remade Decision for the relevant tariff year (2008-09) and the preceding tariff year (2007-08).

This report does not re-visit the details of the methodological approaches that have been used in assessing the various components of the BRCI that are unaffected by the Court's decision. Readers interested in these aspects of the BRCI are directed to the Certificates of Delegation on the calculation of the BRCI from the Minister to the Authority, the various reports published previously by the Authority and its consultants, and the submissions of stakeholders. All of these documents are available from the Authority's website.

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## 2. BASIS OF THE AUTHORITY'S FINAL DECISION ON THE BRCI FOR 2008-09

The Authority's Final Decision on the BRCI for 2008-09 was based on the calculations in Table 26 of CRA's Addendum Report for 2008-09 that were predicated on:

- Using the latest available data for both 2007-08 and 2008-09;
- Energy purchase costs including directly connected customers; and
- LRMC trended costs.

Those calculations that formed the basis of the Authority's Final Decision for 2008-09 are shown in Table 1 below.

**Table 1: BRCI calculation results that formed the basis of the Authority's Final Decision for 2008-09**

Cost Item	2007-08	2008-09
Cost of Energy (\$/MWh)	\$49.40	\$52.11
NEM Load (L) (MWh)	36,263,205	37,039,715
Total Cost of Energy (\$)	<b>\$1,791,560,582</b>	<b>\$1,930,220,896</b>
Retail Costs (\$/customer)	\$106.09	\$107.62
Customer Numbers	1,885,727	1,928,620
Total Retail Costs <i>excluding retail margin</i> (\$)	<b>\$200,057,758</b>	<b>\$207,549,501</b>
Total Network Costs (\$)	<b>\$1,974,500,000</b>	<b>\$2,131,100,000</b>
Other Relevant Costs (\$)	<b>\$0</b>	<b>\$0</b>
Total Benchmark Retail Cost <i>excluding retail margin</i> (\$)	<b>\$3,966,118,340</b>	<b>\$4,268,870,397</b>
Margin on Revenue (%)	5.00%	5.00%
Margin on Revenue (\$)	<b>\$208,743,071</b>	<b>\$224,677,389</b>
Total Benchmark Retail Cost (R) <i>including retail margin</i> (\$)	<b>\$4,174,861,411</b>	<b>\$4,493,547,786</b>
BRCI for the Year (equals R / L) (\$/MWh)	<b>\$115.13</b>	<b>\$121.32</b>
BRCI for the Year (equals R / L) (¢/kWh)	<b>11.51</b>	<b>12.13</b>
Implied year-on-year increase in the BRCI (%)		<b>5.38%</b>

Source: CRA's Addendum Report on the BRCI for 2008-09, Table 26

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Table 2 below shows the composition of the cost of energy in these calculations.

**Table 2: Summary of the cost of energy (\$/MWh) in the BRCI calculations that formed the basis of the Authority's Final Decision for 2008-09**

Cost Item	2007-08	2008-09
LRMC	\$41.98	\$42.61
Energy purchase costs	\$48.86	\$52.91
<b>Energy: results of weighting LRMC (50%) with energy purchase costs (50%)</b>	<b>\$45.42</b>	<b>\$47.76</b>
<b>RECs</b>	<b>\$1.04</b>	<b>\$1.35</b>
<b>GECs</b>	<b>\$2.22</b>	<b>\$2.29</b>
<b>NEM fees</b>	<b>\$0.34</b>	<b>\$0.32</b>
<b>Ancillary services</b>	<b>\$0.39</b>	<b>\$0.39</b>
<b>Total cost of energy (\$/MWh)</b>	<b>\$49.40</b>	<b>\$52.11</b>

Source: CRA's Addendum Report on the BRCI for 2008-09, Tables 13, 16, 17, 18, 21, 22 and 23

Table 3 below shows the composition of the retail costs in these calculations.

**Table 3: Summary of retail costs (\$/customer) that formed the basis of the Authority's Final Decision for 2008-09**

Cost Item	2007-08	2008-09
<b>Retail costs benchmark excluding customer acquisition costs (CAC)</b>	<b>\$77.96</b>	<b>\$80.96</b>
<b>CAC for transfers between retailers</b>	<b>\$19.02</b>	<b>\$20.08</b>
<b>CAC for transfers to a market contract with the same retailer</b>	<b>\$9.11</b>	<b>\$6.57</b>
<b>Total retail costs (\$/customer)</b>	<b>\$106.09</b>	<b>\$107.62</b>

Source: CRA's Addendum Report on the BRCI for 2008-09, Tables 20 and 24

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### 3. HOW EACH COMPONENT OF THE BRCI IS AFFECTED BY THE COURT'S DECISION

#### 3.1. RELEVANCE OF TABLE 25 IN CRA'S ADDENDUM REPORT FOR 2008-09

The judgement required the Authority to remake its Final Decision for 2008-09 based on using only data that was available when the BRCI calculation for 2007-08 was undertaken the previous year, and calculating energy purchase costs based on excluding directly connected customers.

With some exceptions, which are considered by component in this report section, the Authority's Remade Decision for 2008-09 is to be based on the calculations in Table 25 of CRA's Addendum Report for 2008-09 that were predicated on:

- Using only data that was available when the BRCI calculation for 2007-08 was undertaken the previous year;
- Energy purchase costs excluding directly connected customers; and
- LRMC trended costs.

Those calculations are shown in Table 4 below.

**Table 4: Previous BRCI calculation results that are to form the basis of the Authority's Remade Decision – with some exceptions that are discussed later in this report**

Cost Item	2007-08	2008-09
Cost of Energy (\$/MWh)	\$47.92	\$56.42
NEM Load (L) (MWh)	36,263,205	37,039,715
Total Cost of Energy (\$)	<b>\$1,737,898,173</b>	<b>\$2,089,895,298</b>
Retail Costs (\$/customer)	\$105.87	\$107.62
Customer Numbers	1,885,727	1,928,620
Total Retail Costs <i>excluding retail margin</i> (\$)	<b>\$199,633,469</b>	<b>\$207,549,501</b>
Total Network Costs (\$)	<b>\$1,974,500,000</b>	<b>\$2,131,100,000</b>
Other Relevant Costs (\$)	<b>\$0</b>	<b>\$0</b>
Total Benchmark Retail Cost <i>excluding retail margin</i> (\$)	<b>\$3,912,031,642</b>	<b>\$4,428,544,800</b>
Margin on Revenue (%)	5.00%	5.00%
Margin on Revenue (\$)	<b>\$205,896,402</b>	<b>\$233,081,305</b>
Total Benchmark Retail Cost (R) <i>including retail margin</i> (\$)	<b>\$4,117,928,044</b>	<b>\$4,661,626,105</b>

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Cost Item	2007-08	2008-09
<b>BRCI for the Year (equals R / L) (\$/MWh)</b>	<b>\$113.56</b>	<b>\$125.85</b>
<b>BRCI for the Year (equals R / L) (¢/kWh)</b>	<b>11.36</b>	<b>12.59</b>

Source: CRA's Addendum Report on the BRCI for 2008-09, Table 25

Table 5 below shows the composition of the cost of energy in these calculations.

**Table 5: Summary of the cost of energy (\$/MWh) in the BRCI calculations that formed the basis of the calculations in Table 4 above**

Cost Item	2007-08	2008-09
LRMC	\$41.98	\$42.61
Energy purchase costs	\$46.07	\$61.53
<b>Energy: results of weighting LRMC (50%) with energy purchase costs (50%)</b>	<b>\$44.02</b>	<b>\$52.07</b>
<b>RECs</b>	<b>\$1.07</b>	<b>\$1.35</b>
<b>GECs</b>	<b>\$2.20</b>	<b>\$2.29</b>
<b>NEM fees</b>	<b>\$0.32</b>	<b>\$0.32</b>
<b>Ancillary services</b>	<b>\$0.31</b>	<b>\$0.39</b>
<b>Total cost of energy (\$/MWh)</b>	<b>\$47.92</b>	<b>\$56.42</b>

Source: CRA's Addendum Report on the BRCI for 2008-09, Tables 13, 16, 17 and 18

Table 6 below shows the composition of the retail costs in these calculations.

**Table 6: Summary of retail costs (\$/customer) in the BRCI calculations that formed the basis of the calculations in Table 4 above**

Cost Item	2007-08	2008-09
<b>Retail costs benchmark excluding customer acquisition costs (CAC)</b>	<b>\$77.74</b>	<b>\$80.96</b>
<b>CAC for transfers between retailers</b>	<b>\$19.02</b>	<b>\$20.08</b>
<b>CAC for transfers to a market contract with the same retailer</b>	<b>\$9.11</b>	<b>\$6.57</b>
<b>Total retail costs (\$/customer)</b>	<b>\$105.87</b>	<b>\$107.62</b>

Source: CRA's Addendum Report on the BRCI for 2008-09, Table 20

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The remainder of this section now considers the effects of the Court's decision on each component of the BRCI calculations.

## **3.2. COST OF ENERGY**

### **3.2.1. The LRMC of energy**

The calculation of the LRMC was not affected by the Court's decision. The values to be used for the LRMC of energy in the Remade Decision remain the same as in the Authority's Final Decision for 2008-09, as shown in Table 2 above.

### **3.2.2. Cost of purchasing energy**

The calculation of the cost of purchasing energy was affected by the Court's decision, and needs to be amended so that it uses only data that was available when the BRCI calculation for 2007-08 was undertaken the previous year, and excludes directly connected customers.

The figures for energy purchase costs shown in Table 5 above comply with these requirements. However, the Authority has decided to adopt a change in framework to use load data excluding directly connected customers provided by ACIL Tasman rather than load data provided by CRA.<sup>2</sup> Because of this, new calculations have been undertaken, based on this framework change. These calculations have comprised for both 2007-08 and 2008-09:

- Re-estimation of the hedging contracts that the retailer would buy each year;
- Re-calculation of the pool price forecasts for each year; and
- Re-calculation of the energy purchase costs that the retailer would incur in settlement based on its NEM load purchases, its hedge positions, and the outturn pool prices.

### **3.2.3. Other energy costs**

The calculations of the following other energy cost components were affected by the Court's decision, and needed to be amended so that they use only data that was available when the BRCI calculation for 2007-08 was undertaken the previous year:

- Mandatory Renewable Energy Target (MRET);
- Queensland 13% Gas Scheme;

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<sup>2</sup> The Authority consulted on this framework change on 15 May 2009. See [www.qca.org.au/electricity-retail/NEP0910/ConsulPapNEM.php](http://www.qca.org.au/electricity-retail/NEP0910/ConsulPapNEM.php).

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- Participant and FRC fees; and
- Ancillary services charges.

The figures for each of these energy cost components shown in Table 5 above comply with these requirements, and therefore those figures are now used in the Remade Decision.

### 3.2.4. NEM load

The calculation of the NEM load was not affected by the Court's decision. The values to be used for the NEM load in the Remade Decision remain the same as in the Authority's Final Decision for 2008-09, as shown in Table 2 above.

### 3.2.5. Summary of results for the cost of energy to be used in the Remade Decision

Table 7 below shows the composition of the cost of energy to be used in the Remade Decision.

**Table 7: Summary of the cost of energy (\$/MWh) to be used in the Remade Decision**

Cost Item	2007-08	2008-09
LRMC	\$41.98	\$42.61
Energy purchase costs	\$48.26	\$58.00
<b>Energy: results of weighting LRMC (50%) with energy purchase costs (50%)</b>	<b>\$45.12</b>	<b>\$50.31</b>
<b>RECs</b>	<b>\$1.07</b>	<b>\$1.35</b>
<b>GECs</b>	<b>\$2.20</b>	<b>\$2.29</b>
<b>NEM fees</b>	<b>\$0.32</b>	<b>\$0.32</b>
<b>Ancillary services</b>	<b>\$0.31</b>	<b>\$0.39</b>
<b>Total cost of energy (\$/MWh)</b>	<b>\$49.02</b>	<b>\$54.66</b>

Source: CRA analysis

## 3.3. RETAIL COSTS AND MARGINS

### 3.3.1. Customer numbers

The calculation of customer numbers was not affected by the Court's decision. The values to be used for customer numbers in the Remade Decision remain the same as in the Authority's Final Decision for 2008-09, as shown in Table 2 above.

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### 3.3.2. Retail operating costs – excluding customer acquisition costs

The calculation of retail operating costs excluding customer acquisition costs for 2008-09 was not affected by the Court's decision. The value to be used for retail operating costs excluding customer acquisition costs for 2008-09 in the Remade Decision remains the same as in the Authority's Final Decision for 2008-09, as shown in Table 2 above.

The calculation of retail operating costs excluding customer acquisition costs for 2007-08 was affected by the Court's decision, and needs to be amended so that it uses only data that was available when the BRCI calculation for 2007-08 was undertaken the previous year.

The figure for retail operating costs excluding customer acquisition costs shown in Table 6 above for 2007-08 does comply with these requirements. Although it was stated in CRA's Addendum report for 2008-09 that the figure of \$77.74/customer had been used in the calculation of the BRCI for 2007-08, in fact the figure that had been used for 2007-08 was \$77.54/customer, and therefore the figure of \$77.54/customer is now to be used in the Remade Decision, in order to comply with the Court's decision.

### 3.3.3. Customer acquisition costs

In this section, a customer moving to another retailer is referred to as "churn", and a customer moving to a market contract with the same retailer is referred to as "switching".

The calculation of customer acquisition costs for 2008-09 was not affected by the Court's decision. The value to be used for customer acquisition costs for 2008-09 in the Remade Decision remains the same as in the Authority's Final Decision for 2008-09, as shown in Table 2 above.

In the BRCI calculation for 2007-08, an allowance for a reduction in scale economies due to the loss of customers under Full Retail Competition (FRC) was determined to be \$2/customer. This figure of \$2/customer was to be applied across all customers across the whole customer base of the theoretical retailer. No particular estimate of churn or switching lay behind this figure.

In the BRCI calculation for 2008-09, the BRCI for 2007-08 was re-calculated based on customer acquisition costs and an actual churn rate (approximately 11%) that had been observed to date since FRC had been introduced at 1 July 2007. This re-calculation determined the allowance for 2007-08 to be equivalent to \$28.13/customer across the customer base, comprising \$19.02/customer to cover the costs of churn, and \$9.11/customer to cover the costs of switching.

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The Authority has now directed us to calculate the remade BRCI for 2008-09 using a value of 5% for the total rate of churn and switching combined in 2007-08. It has further directed that the 5% total figure be comprised of a 2.75% rate of churn, and a 2.25% rate of switching. This composition of 2.75% and 2.25% is consistent with the ratio of churn to switching that was proposed for 2007-08 in the original calculation of the BRCI for 2008-09. These churn and switching rates now translate to costs of \$4.71 and \$2.25 per customer respectively to be applied across the entire customer base.

### 3.3.4. Summary of results for retail costs to be used in the Remade Decision

Table 8 below shows the composition of retail costs to be used in the Remade Decision.

**Table 8: Summary of retail costs (\$/customer) to be used in the Remade Decision**

Cost Item	2007-08	2008-09
Retail costs benchmark excluding customer acquisition costs (CAC)	\$77.54	\$80.96
CAC for transfers between retailers	\$4.71	\$20.08
CAC for transfers to a market contract with the same retailer	\$2.25	\$6.57
<b>Total retail costs (\$/customer)</b>	<b>\$84.50</b>	<b>\$107.62</b>

Source: CRA analysis

### 3.3.5. Retail margin

The calculation of retail margin was not affected by the Court's decision. The retail margin in the Remade Decision remains the same as in the Authority's Final Decision for 2008-09, as shown in Table 2 above. This means that it is still calculated as 5% of revenue. However, the \$ value of the retail margin will still change consequentially as other cost factors change and influence the \$ value of the revenue.

## 3.4. NETWORK COSTS

The calculation of network costs for 2008-09 was not affected by the Court's decision. The value to be used for network costs for 2008-09 in the Remade Decision remains the same as in the Authority's Final Decision for 2008-09, as shown in Table 2 above.

The calculation of network costs for 2007-08 was affected by the Court's decision, and needs to be amended so that it uses only data that was available when the BRCI calculation for 2007-08 was undertaken the previous year.

The figure for network costs of \$1,974,500,000 shown in Table 4 above for 2007-08 does not comply with these requirements. Instead, the value of \$1,979,800,000 which was used in the calculation of the BRCI for 2007-08 is now to be used in the Remade Decision, in order to comply with the Court's decision.

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### **3.5. OTHER RELEVANT COSTS**

The calculation of other relevant costs was not affected by the Court's decision. The values to be used for other relevant costs in the Remade Decision remain the same as in the Authority's Final Decision for 2008-09, as shown in Table 2 above.

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#### 4. RESULTS TO FORM THE BASIS OF THE AUTHORITY'S REMADE DECISION

Table 9 below shows the BRCI calculation results that are to form the basis of the Authority's Remade Decision.

**Table 9: BRCI calculation results that are to form the basis of the Authority's Remade Decision**

Cost Item	2007-08	2008-09
Cost of Energy (\$/MWh)	\$49.02	\$54.66
NEM Load (L) (MWh)	36,263,205	37,039,715
<b>Total Cost of Energy (\$)</b>	<b>\$1,777,554,880</b>	<b>\$2,024,530,502</b>
Retail Costs (\$/customer)	\$84.50	\$107.62
Customer Numbers	1,885,727	1,928,620
<b>Total Retail Costs excluding retail margin (\$)</b>	<b>\$159,337,070</b>	<b>\$207,549,501</b>
<b>Total Network Costs (\$)</b>	<b>\$1,979,800,000</b>	<b>\$2,131,100,000</b>
<b>Other Relevant Costs (\$)</b>	<b>\$0</b>	<b>\$0</b>
<b>Total Benchmark Retail Cost excluding retail margin (\$)</b>	<b>\$3,916,691,950</b>	<b>\$4,363,180,003</b>
Margin on Revenue (%)	5.00%	5.00%
<b>Margin on Revenue (\$)</b>	<b>\$206,141,682</b>	<b>\$229,641,053</b>
<b>Total Benchmark Retail Cost (R) including retail margin (\$)</b>	<b>\$4,122,833,632</b>	<b>\$4,592,821,056</b>
<b>BRCI for the Year (equals R / L) (\$/MWh)</b>	<b>\$113.69</b>	<b>\$124.00</b>
<b>BRCI for the Year (equals R / L) (¢/kWh)</b>	<b>11.37</b>	<b>12.40</b>
<b>Implied year-on-year increase in the BRCI (%)</b>		<b>9.06%</b>

Source: CRA analysis