



**Consultation Paper**

**Regulated Retail Electricity Prices  
2013-14  
Cost Components and Other Issues**

**December 2012**

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## SUBMISSIONS

Public involvement is an important element of the decision-making processes of the Queensland Competition Authority (the Authority). The Authority is releasing this Consultation Paper as part of its review of regulated retail electricity prices in Queensland for 2013-14, to seek stakeholders' views on the estimation of cost components of regulated retail electricity prices and other issues relevant to the review. The Authority will take account of all submissions received.

Written submissions should be sent to the address below. While the Authority does not necessarily require submissions in any particular format, it would be appreciated if two printed copies are provided together with an electronic version on disk (Microsoft Word format) or by e-mail. Submissions, comments or inquiries regarding this paper should be directed to:

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The **closing date** for submissions is **Monday 7 January 2013**.

### Confidentiality

In the interests of transparency and to promote informed discussion, the Authority would prefer submissions to be made publicly available wherever this is reasonable. However, if a person making a submission does not want that submission to be public, that person should claim confidentiality in respect of the document (or any part of the document). Claims for confidentiality should be clearly noted on the front page of the submission and the relevant sections of the submission should be marked as confidential, so that the remainder of the document can be made publicly available. It would also be appreciated if two copies of each version of these submissions (i.e. the complete version and another excising confidential information) could be provided. Again, it would be appreciated if each version could be provided on disk. Where it is unclear why a submission has been marked "confidential", the status of the submission will be discussed with the person making the submission.

While the Authority will endeavour to identify and protect material claimed as confidential as well as exempt information and information disclosure of which would be contrary to the public interest (within the meaning of the *Right to Information Act 2009 (RTI)*), it cannot guarantee that submissions will not be made publicly available. As stated in s239 of the *Queensland Competition Authority Act 1997* (the QCA Act), the Authority must take all reasonable steps to ensure the information is not disclosed without the person's consent, provided the Authority believes that disclosure of the information would be likely to damage the person's commercial activities and that the disclosure of the information would not be in the public interest. Notwithstanding this, there is a possibility that the Authority may be required to reveal confidential information as a result of a RTI request.

### Public access to submissions

Subject to any confidentiality constraints, submissions will be available for public inspection at the Brisbane office of the Authority, or on its website at [www.qca.org.au](http://www.qca.org.au). If you experience any difficulty gaining access to documents please contact the office (07) 3222 0555.

Information about the role and current activities of the Authority, including copies of reports, papers and submissions can also be found on the Authority's website.

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## 1. INTRODUCTION

Since the introduction of full retail competition (FRC) on 1 July 2007, electricity consumers in Queensland have been able to choose their electricity retailer. However, most consumers are still able to choose to be supplied by their retailer at the regulated or notified price<sup>1</sup> determined by the Authority.

To date, the Authority has determined notified prices under delegation from the relevant Minister (currently the Minister for Energy and Water Supply). While the Authority has been delegated this function since the start of FRC, amendments to the *Electricity Act 1994* (the Electricity Act) and *Electricity Regulation 2006* (the Regulation) in late 2011 significantly changed the method the Authority is required to follow in determining notified prices.

Prior to its most recent determination (the 2012-13 Determination), the Authority was required to adjust the existing notified prices annually according to its calculation of the change in the Benchmark Retail Cost Index (BRCI). Following the legislative changes mentioned above, for the 2012-13 Determination, the Authority was required to set notified prices based on a new N + R cost build-up approach where the N (network cost) component was treated as a pass through and the R (energy and retail cost) component was determined by the Authority.

This was a very different task to that undertaken previously and resulted in the introduction of a new set of retail tariffs aligned with the prevailing network tariff structure and retail prices which better reflect the cost of each customer's consumption. Given the significant change in methodology and some practical constraints on moving some customers immediately to new tariffs, the Authority implemented a number of transitional measures for certain customer groups for 2012-13. As a result, some customers continue to access tariffs that are below cost-reflective levels.

In addition, following the change of Government in the first half of 2012, the new Government decided to freeze notified prices for the standard residential tariff (Tariff 11) for the coming year, subject to the inclusion of costs associated with the carbon tax. As a result, notified prices for Tariff 11 were determined by the Minister, rather than the Authority.

On 5 September 2012, the Minister provided the Authority with its latest electricity pricing Delegation, requiring it to determine notified prices (including for Tariff 11) for a three-year period from 1 July 2013 to 30 June 2016. However, while the Delegation is for a three-year period, the Authority is still required to set notified prices on an annual basis, with the first determination to apply from 1 July 2013 to 30 June 2014 (the 2013-14 Determination).

### 1.1 Matters to consider

In accordance with section 90(5)(a) of the Electricity Act, the Delegation requires that the Authority have regard to the following in making its price determination:

- (a) the actual costs of making, producing or supplying the goods or services;
- (b) the effect of the price determination on competition in the Queensland retail electricity market; and
- (c) the matters set out in the Terms of Reference.

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<sup>1</sup> Large non-residential customers in Energex's distribution area no longer have access to notified prices.

In accordance with section 90(5)(b) of the Electricity Act, the Authority may also have regard to any other matter it considers relevant.

The Delegation includes a Terms of Reference which requires that the Authority consider a number of specific matters, including:

- (a) basing each annual price determination on a N + R cost build-up approach;
- (b) the Queensland Government's Uniform Tariff Policy (UTP);
- (c) basing the network cost component for:
  - (i) small customers on the network charges to be levied by Energex; and
  - (ii) large customers on the network charges to be levied by Ergon Energy.
- (d) transitional arrangements for the standard residential tariff (Tariff 11), the existing obsolete tariffs and customers on the large customer business tariffs introduced in 2012-13.

The Minister's covering letter and Delegation are provided in **Appendix A**.

## 1.2 Proposed approach to this review

The two key factors the Authority is required to consider when making its price determination are cost reflectivity and the impact on competition. The Authority must also consider whether and how to implement a transitional path to cost-reflective notified prices for certain customer groups (as noted above), although this is the subject of a separate consultation paper (see Section 1.3).

Unlike in some sectors (for example, electricity distribution and transmission) where barriers to entry such as high fixed costs and significant economies of scale tend to preclude the development of competition, there are no significant barriers to the development of competition in the retail electricity sector. Competition has developed considerably in the Queensland retail electricity market since it was introduced more than five years ago, although it is largely limited to South East Queensland (SEQ) as a result of the UTP. Around 70% of customers in SEQ are currently supplied under market contracts.

In light of these factors, the Authority considers that, while having regard to costs is important in setting notified prices, a key aim is to provide a transition to effective competition and eventual price deregulation, particularly in SEQ. Under the Australian Energy Market Agreement, governments (including the Queensland Government) have agreed to phase out retail price regulation if effective competition can be demonstrated<sup>2</sup>. This is a different task to regulating prices in a market where there is limited or no competition and is consistent with the Authority's decision to include an explicit allowance for headroom in its 2012-13 Determination.

### What about customers outside SEQ?

In accordance with the Queensland Government's UTP, the Authority must ensure that, wherever possible, non-market customers of the same class have access to uniform retail tariffs and pay the same notified price for their electricity supply, regardless of their geographic location.

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<sup>2</sup> So far, Victoria is the only state to remove retail price regulation.

While this means that customers will have access to the same notified prices wherever they live, most customers outside of SEQ (Ergon Energy's network area), particularly small customers, do not have access to lower priced competitive market offers because the notified prices they pay are lower than their actual costs of supply<sup>3</sup>. Only around 1% of customers outside of SEQ are supplied under a market contract. If the Authority determines notified prices in order to encourage competition in SEQ (Energex's network area) and more and more SEQ customers take up lower-priced market offers, there will be fewer and fewer SEQ customers paying notified prices.

This disparity between the lower prices paid by the majority of customers in SEQ (and available to all customers in SEQ) and the higher prices customers elsewhere must pay may be inconsistent with the intent of the UTP. This is one of the difficulties of setting prices on a uniform basis and the application of the UTP may need to be reviewed as progress is made towards deregulation in SEQ. One option might be to determine prices to apply outside SEQ by reference to SEQ market prices. The situation for large customers is quite different because, since 1 July 2012, large non-residential customers in Energex's area no longer have access to notified prices.

### 1.3 The Review Process to Date

On 21 September 2012, the Authority released an Interim Consultation Paper advising interested parties of the commencement of the review. The Authority received 23 submissions in response to the Interim Consultation Paper and the list of submissions received is provided in **Appendix B**. A copy of the Interim Consultation Paper and the submissions received can be accessed from the Authority's website.

On 2 November 2012, the Authority released a consultation paper in relation to the transitional issues the Authority is required to consider as part of this review. A copy of this paper can be accessed from the Authority's website and submissions on this paper are due by 7 January 2013. To discuss transitional issues with affected customers, the Authority held eight workshops between 19 November and 29 November in Gatton, Emerald, Bundaberg, Cairns, Mareeba, Townsville, Ayr and Mackay.

The Authority is now releasing this additional consultation paper which identifies the key issues on which the Authority particularly seeks comment from interested parties in relation to:

- (a) the cost components (network, energy and retail);
- (b) competition and headroom; and
- (c) other matters.

Interested parties should also take this opportunity to inform the Authority of any other matters they believe are relevant.

The Authority has engaged ACIL Tasman (ACIL) to provide expert advice on estimating energy costs. ACIL has prepared a draft [Estimated Energy Costs for Use in 2013-14

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<sup>3</sup> The UTP works by subsidising customers in Ergon Energy's distribution area where network costs are considerably higher than in the more densely populated SEQ. Under the UTP, the Queensland Government subsidises the notified prices payable by regional customers supplied by Ergon Energy Queensland (EEQ) via a Community Service Obligation (CSO) payment. Other retailers do not have access to the subsidy, meaning that, in most cases, they are unlikely to be able to offer competitive market contracts.

Electricity Retail Tariffs] (ACIL Report)<sup>4</sup>, which has been released by the Authority to accompany this paper.

The Authority will host a workshop on 19 December 2012 to provide for some initial discussion of the matters raised in this consultation paper, the ACIL Report and the earlier consultation paper on transitional issues. Interested parties who wish to attend the workshop should register their interest by emailing the Authority at [electricity@qca.org.au](mailto:electricity@qca.org.au) or calling (07) 3222 0555.

Submissions in response to this consultation paper, the ACIL Report and any other matters arising from the workshops are due no later than 7 January 2013. In preparing its Draft Determination, the Authority will consider all submissions received by the due date.

An indicative timetable for the remainder of the review is provided below.

**Table 1.1: Indicative Timetable**

<i>Task</i>	<i>Indicative Dates</i>
Consultation Paper on Cost Components released	12 December 2012
Workshop in Brisbane on Transitional Issues and Cost Components	19 December 2012
Submissions following workshops due	7 January 2013
Release of Draft Determination	15 February 2013
Regional and Brisbane workshops on Draft Determination	Late February 2013
Submissions on Draft Determination due	15 March 2013
Release of Final Determination	31 May 2013

<sup>4</sup> ACIL Tasman, *Estimated Energy Costs for Use in 2013-14 Electricity Retail Tariffs*, December 2012.



## 2. NETWORK COSTS

Network costs include the costs associated with transporting electricity through the transmission and distribution networks and typically account for around 50% of the final cost of electricity for small customers.

The Delegation requires the Authority to adopt a cost-reflective N+R pricing model under which the network costs (N) are to be treated as a straight pass through to customers. Further, the Delegation requires the Authority to consider basing notified prices for small customers (those consuming less than 100 megawatt hours (MWh) per year) on Energex network tariffs and notified prices for large customers (those consuming more than 100 MWh per year) in Ergon Energy's distribution area on Ergon Energy network tariffs.

The task specified in the Delegation is very similar to that carried out by the Authority for 2012-13. As a result, the Authority expects to deal with similar issues to those encountered in that process, specifically:

- (a) the suitability of Energex network tariffs for notified prices for small customers and for unmetered supplies;
- (b) the suitability of Ergon Energy network tariffs for notified prices for large customers and street lighting in the Ergon Energy distribution area; and
- (c) how best to maintain the alignment of notified prices with network prices given the timing of processes to determine both.

### 2.1 Network Tariffs for Small Customers

#### Residential Tariffs

Energex has network tariffs that provide a basis for flat, time-of-use and controlled load regulated tariffs for residential customers, as shown in Table 2.1.

Some respondents to the Authority's Consultation Papers, including Energex and Energy Australia, supported more use of time-of-use (ToU) tariffs for residential customers to manage peak demand. The Queensland Government suggested that Tariff 12 should become a viable option for some customers, as the current three-part structure (peak, off-peak and shoulder) can offer a sharper price signal than other two-part (peak and off-peak) ToU retail tariffs.

The Authority understands that only a very small number of customers have so far opted for supply under the residential ToU tariff (Tariff 12). It is difficult to say whether the apparent lack of interest in Tariff 12 relative to Tariff 11 is due to the Government's decision to freeze Tariff 11 which has distorted the relationship between the two tariffs or whether it is because the underlying network charges make Tariff 12 unattractive relative to Tariff 11 for all but a very small minority of customers. This will become clearer as the fixed and variable charges in Tariff 11 are rebalanced to cost-reflective levels by 1 July 2015, as required by the Delegation.

One stakeholder, Mr Atherton, suggested that people with solar panels do not contribute toward the capital costs of the network and suggested they be required to pay a substantial connection fee based on the capacity of their solar panels.

While network pricing is a matter for Energex and the Australian Energy Regulator (AER), the Authority expressed similar views in its Draft Report on Estimating a Fair and Reasonable Solar Feed-in Tariff for Queensland. Residential customers can no longer be

considered a homogeneous group and therefore subject to the same network charges as there has developed a clear divide between those with and without solar PV panels and a significant cross subsidy now flows from one group of residential customers (non-PV) to the other. The size of this cross subsidy is over \$200 million dollars in 2012-13. Non-PV customers will experience higher network and therefore retail prices as a result of PV customers avoiding their true network costs. In its Draft Report, the Authority considered that the total burden of the PV scheme on non-PV customers could at least be partially reduced if PV customers were required to pay PV customer-specific network charges that reflect the full costs of their connection to the network.

**Table 2.1 Network tariffs for residential customers**

<i>Retail tariff</i>	<i>Energex network tariff</i>
Tariff 11 – Residential <sup>1</sup>	8400
Tariff 12 – Residential (time-of-use)	8900
Tariff 31 - Night rate (super economy) <sup>1</sup>	9000
Tariff 33 - Controlled supply (economy) <sup>1</sup>	9100

<sup>1</sup> These tariffs also apply to residential customers using card-operated meters

### Small Business Tariffs

Energex also has network tariffs that provide a basis for flat, time-of-use and demand-based regulated tariffs for business customers, as shown in Table 2.2.

However, in response to the Authority’s Consultation Papers, many submissions from small customers raised concerns about having to move to regulated retail tariffs based on Energex network tariffs. For example, farming groups highlighted that farmers had made investment decisions based on the current tariffs and that moving to new tariffs with different structures could require considerable capital investment to adapt business processes. The key concern was that the increase in the off-peak rate and the decrease in the peak rate under Tariff 22, which was based on Energex network tariff 8800, would significantly increase electricity costs for customers relying on cheap off-peak rates and reduce the incentive for customers to use off-peak electricity.

As the Authority noted in its Final Determination for 2012-13, given that there is no time-of-use signalling in the R component of tariffs, the strength of signalling in Tariff 22 depends entirely upon that included in Energex’s network tariffs. For this reason, while noting the requirement to treat network costs as a pass through, and that the structure of network charges is a matter for Energex and the AER, the Authority encouraged Energex to review its network tariffs to ensure they are sending appropriate pricing signals to customers regarding the differential network costs associated with their time of use.

**Table 2.2: Network tariffs for small business customers**

<i>Retail tariff</i>	<i>Energex network tariff</i>
Tariff 20 – Business (flat rate)	8500
Tariff 22 – Business (time-of-use)	8800
Tariff 41 - Low voltage (demand)	8300

## 2.2 Tariffs for Large Customers

Ergon Energy has network tariffs that provide a suitable basis for several demand-based regulated tariffs for large customers in Ergon Energy’s network area. However, Ergon Energy has a set of these tariffs for each of its three pricing zones to reflect the differing distribution costs of supply in each zone (East, West and Mt Isa). In addition, within each pricing zone, there are more regions across which transmission (TUOS) charges differ.

For 2012-13, the Authority based notified prices for large customers on the network charges for Ergon Energy’s East pricing zone, which includes almost 90% of Ergon Energy’s large customers, and TUOS charges in Transmission Region one, which are similar to the average TUOS charges in the East zone.

As network charges in Ergon Energy’s East pricing zone are generally lower than elsewhere in its network, an implication of the approach the Authority used for 2012-13 is that large customers on notified prices outside the East zone are still paying less than cost-reflective network charges. This could cause retailers to incur losses supplying large Ergon Energy customers on notified prices. However, in practice, this is likely to be an issue only for Ergon Energy Queensland, which currently recoups such losses via the CSO payment from the Government.

While Ergon Energy has a number of network tariffs that provide a basis for notified prices for large customers, submissions from a number of large customers raised similar concerns to those noted above about having to move to regulated retail tariffs that provide less incentive to consume electricity during off-peak periods. In addition, some large customers currently on obsolete tariffs that do not have any demand or capacity charges will move to retail tariffs based on Ergon Energy charges that have demand and capacity charges. For customers with poor load factors, or peaky consumption, this will cause potentially large price impacts. As noted above, network costs are to be treated as a pass through and the structure of these network charges is a matter for Ergon Energy and the AER. However, the Authority notes that, in response to the Authority’s Draft Determination on Notified Prices for 2012-13, Ergon Energy indicated that it was cognisant of the need to continue to review network tariffs and price signals.

A key difficulty in setting notified prices for very large customers (those consuming more than 4 GWh per year) is that Ergon Energy has confidential, individually tailored network charges that reflect the unique circumstances of each customer in this diverse group. In setting 2012-13 notified prices, the Authority considered that it was not feasible to base notified prices on the approved network charges for these customers at that time. Instead, the Authority based the regulated retail Tariff 48 for very large Ergon Energy customers on the same network tariff (for high voltage demand customers) that Tariff 47 is based on.

The new notified prices the Authority established for 2012-13 and the Ergon Energy network tariffs they are based on are presented in Table 2.3.

**Table 2.3: Network tariffs for large customers in the Ergon Energy distribution area**

<i>Retail tariff</i>	<i>Ergon Energy network tariff</i>
Tariff 44 - Over 100 MWh small (demand)	EDST1
Tariff 45 - Over 100 MWh medium (demand)	EDMT1
Tariff 46 - Over 100 MWh large (demand)	EDLT1
Tariff 47 - High voltage (demand)	EDHT1
Tariff 48 – Over 4 GWh High voltage (demand)	EDHT1

On 4 September 2012, the Minister for Energy and Water Supply (the Minister) issued a Direction to the Authority under section 253AA of the Electricity Act 1994 to provide advice on the impact on very large customers of paying retail electricity prices based on their site-specific network charges and whether these site-specific network charges should be passed through to very large customers and how. The advice, which the Authority provided to the Minister on 30 November 2012, is available on the Authority's website. In summary, the Authority found that:

- (a) a majority of very large customers would experience significant increases in their annual bills moving to retail prices based on their site-specific network charges, although some would be better off,
- (b) passing through site-specific network charges to very large customers would enhance the cost-reflectivity of retail tariffs which would promote competition and encourage more efficient use of electricity;
- (c) while it is possible to determine notified prices based on site-specific network charges, it is unclear whether this would be consistent with the Government's uniform tariff policy, which requires customers in the same customer class to have access to the same tariffs no matter where they are located; and
- (d) cost-reflectivity may be better achieved if access to notified prices was removed and very large customers were required to move to a market contract (as has already occurred in the Energex area), with any transitioning issues addressed by, for example, direct Government subsidy on an individual customer need basis.

### **Unmetered Supplies**

Energex has a network tariff that provides a suitable basis for an unmetered regulated tariff, as shown in Table 2.4.

As notified prices for street lighting are not available in Energex's distribution area, the Authority used Ergon Energy's network tariff for street lighting as the basis for a street lighting tariff for 2012-13, as shown in Table 2.4.

**Table 2.4: Network Tariffs for Street Lighting and Other Unmetered Supplies**

<i>Retail tariff</i>	<i>Network tariff</i>
Tariff 71 – Street Lighting	EVUT1
Tariff 91 – Unmetered	9600

### Obsolete Tariffs

As discussed in the Consultation Paper on Transitional Issues, the Authority is required to consider transitional arrangements for obsolete tariffs (presented in Table 2.5). These are not determined based on the N+R approach the Authority is required to use to determine notified prices for other tariffs. As a result, there is no need to determine network prices for obsolete tariffs.

**Table 2.5: Obsolete tariffs**

<b>Previously obsolete and declining block tariffs – small and Ergon Energy large customers</b>
Tariff 21, 37, 62, 63 & 64
<b>Farming and irrigation tariffs – small and Ergon Energy large customers</b>
Tariff 65 & 66
<b>Large customers in Ergon Energy's network area</b>
Tariff 20(large), 22 (large), 41 (large), 43 & 53

**The Authority seeks information from Energex and Ergon Energy on whether they are reviewing their network charges for 2013-14 and beyond and, if so, what opportunities have been or will be available for stakeholders to have input.**

**The Authority seeks stakeholders' views on the following:**

- (a) **the suitability of Energex's network tariffs as the basis of retail tariffs for small customers and, in particular, whether the network tariffs need to provide stronger time-of-use signals;**
- (b) **the suitability of Ergon Energy's network tariffs as the basis of retail tariffs for large customers and, in particular;**
  - (i) **whether the network tariffs need to provide time-of-use signals?**

- (ii) whether notified prices for large customers should be based on network charges in Ergon Energy's East pricing zone, transmission region 1 and, if not, what should they be based on?**
- (iii) what better options, if any, are there for the network charge(s) to be used as the basis for notified prices for very large Ergon Energy customers?**

### Exporting Energy to the Network

The Australian Sugar Milling Council suggested that its role as a large exporter of energy to the network should be considered by the Authority in setting notified prices.

However, the Delegation requires the Authority to determine notified prices for customer retail services, which are defined under the Electricity Act as the sale of electricity to customers. The Authority currently has no role in setting prices for the purchase of electricity from customers and will not be considering this issue in this review.

## 2.3 Maintaining Alignment of Retail and Network Tariffs

Using an N+R approach to setting notified prices requires a formal process to ensure the ongoing alignment of network and retail tariffs to ensure the appropriate allocation of costs to (and recovery of costs from) groups of customers covered by each tariff class. Maintaining this alignment would also ensure that distributors are able to engage in effective demand management initiatives that rely on correct price signals being passed through to customers.

Under the National Electricity Rules (NER), the distributors are required to submit proposed network prices by the end of April. However, the delegation specifies that, in setting notified prices for 2013-14, the Authority must publish a draft report by 15 February and for subsequent years the Authority is required to publish a draft report by 15 December. These deadlines require the distributors to provide preliminary network prices well ahead of the AER price approval process. Energex highlighted that key input data, such as forecasts of demand and customer numbers, transmission prices and under/over recoveries of network revenue, would not be available in time to set draft network prices by 15 December, and that Energex would have to rely on preliminary estimates of these. As a result, it will be more likely that draft network prices provided for the purpose of setting draft notified prices will change before being approved by the AER.

There is also no formal limit on the time the AER can take to approve the distributors' pricing proposals and this usually occurs after 31 May which is the date by which the Authority must publish notified prices. As a result, any change in the network tariffs proposed by the distributors and approved by the AER after the Authority has published final notified prices would potentially result in a misalignment of network and retail tariffs.

In its September 2012 proposal to the Australian Energy Market Commission (AEMC), the Independent Pricing and Regulatory Tribunal (IPART) proposed changes to the NER which included a requirement that network prices be set earlier to allow greater consultation on retail price changes and for customers to receive earlier notification of the change to their prices. If this rule change was adopted, it would improve the certainty of price setting for the Authority. However, this is unlikely to occur before the Authority has to set notified prices for 2013-14. As a result, the best option for setting 2013-14 prices will most likely be to proceed as for last year and request Energex and Ergon Energy to supply the Authority with proposed network tariffs and prices when they are submitted to the AER in April and using these as the basis for notified prices to apply from 1 July.

**The Authority seeks stakeholders' views on how best to maintain alignment between network and retail tariffs.**

### 3. ENERGY COSTS

#### 3.1 Introduction

Energy costs relate to those costs a retailer incurs, either directly or indirectly, in supplying energy to cover the load of its customers. In the past, the Authority has included allowances for a range of energy costs, which can be broadly broken into three categories:

- (a) wholesale energy costs;
- (b) other energy costs, including green schemes and market fees; and
- (c) energy losses.

In determining the energy costs faced by retailers, section 90(5) of the Electricity Act requires the Authority to have regard to:

- (a) the actual costs in making, producing or supplying the goods or services;
- (b) the effect of the price determination on competition in the Queensland retail electricity market;
- (c) any matter required under the Delegation; and
- (d) any other matter the Authority considers relevant.

While the Authority is generally satisfied with the framework it adopted to determine energy costs in its 2012-13 Determination, it is open to suggestions from stakeholders on how that framework might be improved or why an alternate approach might be appropriate for the 2013-14 review. In particular, the Authority notes that it is required under the Delegation to consider whether its approach can strengthen or enhance the underlying network price signals and encourage customers to switch to time-of-use tariffs and reduce their energy consumption during peak times.

The Authority has engaged ACIL to provide advice on each energy cost component in accordance with the terms of reference (TOR) for its engagement (available on the Authority's website). The Authority is of the view that retaining the same consultant for this review as it has retained in prior years will provide continuity and certainty to stakeholders.

ACIL has prepared a preliminary report<sup>5</sup>, which outlines its preferred approach to estimating the different energy cost allowances.

#### 3.2 Judicial Review

At the time this Consultation Paper was prepared, the Authority had not received the Supreme Court's decision in relation to a Judicial Review application by Origin Energy regarding the cost of energy approach used by the Authority in making its 2012-13 Regulated Retail Pricing Determination. The case was heard by the Supreme Court in early December 2012. The results of that review may require changes to be made to the approach to be used in 2013-14.

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<sup>5</sup> ACIL Tasman, *Estimated Energy Costs for use in 2013-14 Electricity Retail Tariffs – Preliminary Draft Report*, December 2012 – can be accessed at [www.qca.org.au](http://www.qca.org.au)



### 3.3 Wholesale energy costs

Wholesale energy costs relate to the costs incurred by a retailer in supplying electricity to cover the load of its customers. While this electricity is purchased from the National Electricity Market (NEM) (the spot market), there are a range of measures that a retailer can take in order to reduce its exposure to volatile prices in the spot market, including purchasing financial derivatives (futures, swaps, options etc.), entering longer-term power purchase agreements (PPAs) with generators or investing in generation assets.

For its 2012-13 Determination, the Authority considered three alternate approaches for determining wholesale energy costs, including a hedging-based model, long run marginal cost (LRMC) and a statistical model that estimated the price a retailer might be willing to pay to enter hedging contracts (the Price Distribution approach). The Authority also considered how it might take account of PPAs held by retailers, either through the market-based approach or through LRMC. While each approach had its merits and draw-backs, the Authority decided that the hedging-based approach was the most appropriate at that time on the basis that it was principally based on publically available data, it was intuitive, and it was known and (largely) accepted as a reasonable approach by stakeholders.

#### Potential approaches for 2013-14 to 2015-16

For the 2013-14 to 2015-16 Determinations, the Authority will again have to determine the most appropriate approach for developing wholesale energy costs.

The Authority has previously made clear its preference for using a market based approach to estimating wholesale energy costs in setting regulated electricity prices and it appears as though other regulators and governments are starting to show a similar preference. For example, the Essential Services Commission of South Australia (ESCOSA) is in the process of revising its energy cost estimates to account for market-based outcomes in the NEM<sup>6</sup> and the NSW Government adjusted IPART's delegation for 2013-14 to 2016-17 to provide more weight to market-based costs<sup>7</sup>.

While some have suggested that these changes in approach were designed solely to reduce electricity prices for consumers, this was not a deciding factor in the Authority's 2012-13 decision nor is it a consideration now. Compared to an LRMC based approach, the Authority acknowledges that the market-based approach it adopted previously will in some years lead to lower energy cost estimates but in other years it will lead to higher energy cost estimates (as was the case in Queensland over the 2007 to 2010 period).

The main alternative approach is one based on LRMC. In submissions on the Authority's Interim Consultation Paper, retailers and retailer groups were of the view that the Authority should base its wholesale energy cost estimates, at least in some part, on LRMC. A number of retailers suggested that LRMC is a reasonable proxy for PPAs, which typically have a longer tenor than the quarterly contracts that are taken into account in a market-based approach. Retailers also expressed concern that the competitive market outcomes of the spot market and associated futures market, which are reflected in the market-based approach, will not be sufficient to incentivise investment in generation in the medium to long term, suggesting that this is another reason to include LRMC in retail tariffs.

In the 2012-13 Determination consultation process, stakeholders were generally dismissive of the Price Distribution approach. Many stakeholders argued that this approach was just as

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<sup>6</sup> ESCOSA, *2011-14 Electricity Standing Contract Price Determination Wholesale Energy Cost Investigation – Draft Determination*, October 2012.

<sup>7</sup> Chris Hartcher MP, *Terms of Reference for IPART's 2013-14 to 2015-16 investigation into regulated retail electricity prices*, September 2012

theoretical as LRMC and was not transparent due to the considerable “black-box” modelling it required. While the Authority acknowledges these views, it considers this approach is still an option for the 2013-14 to 2015-16 period as it is able to overcome liquidity constraints in the futures market that might arise due to carbon uncertainty leading up to and following the 2013 federal election.

As outlined in the TOR for its engagement, ACIL has been asked to provide wholesale energy cost estimates for 2013-14. In its preliminary draft report, ACIL restated its previous view that the market-based approach to estimating wholesale energy costs has the most merit of the available options. Nevertheless, ACIL has reviewed its 2012-13 methodology and has recommended two changes of note:

- (a) unlike in previous years, there are now a number of different but reputable demand forecasts for Queensland and the NEM, including forecasts in Powerlink’s Annual Planning Report (APR)<sup>8</sup>, the Australian Energy Market Operator’s (AEMO’s) Electricity Statement of Opportunities (ESOO)<sup>9</sup> and EMCa’s report to the AER<sup>10</sup>. ACIL is considering whether the ESOO is still the most appropriate data source for 2013-14; and
- (b) ACIL is considering whether it should to use the median of its 462 cost estimates (as it used for 2012-13)<sup>11</sup>, or whether a higher percentile might better reflect the volume risk faced by retailers in this period of high volume uncertainty.

The Authority will consider the merits of each approach for the 2013-14 to 2015-16 period. In addition to comments on how ACIL’s proposed approach might be improved, the Authority is interested in suggestions from stakeholders on why any alternate approach might be more appropriate for the 2013-14 to 2015-16 period.

### Enhancing time of use signals

The Delegation requires the Authority to consider whether its approach could strengthen or enhance the underlying network price signals and encourage customers to switch to time-of-use tariffs and reduce their energy consumption during peak times.

At the outset of the 2012-13 Review, the Authority considered developing energy cost estimates that could provide suitable time of use signals to consumers on time of use tariffs. However, while it was possible to calculate time of use costs under the Authority’s wholesale energy cost approach, these costs did not reflect the way in which retailers are charged for electricity by AEMO which is based on the relevant distributor’s net system load profile (NSLP).

In its submission, the Government suggested that it would be possible to send time-of-use signals in wholesale energy cost estimates despite AEMO’s use of the Energex or Ergon Energy NSLP for settlement. The Authority is interested in hearing from stakeholders that support such an approach and how this might be implemented without exposing retailers to additional price risk.

While the Authority acknowledges the important role of time-of-use signals in retail tariffs, it notes that differentials seen in Tariff 22 prior to 2012-13 (referred to in the Government submission) cannot be achieved solely through time-of-use signals in the wholesale energy

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<sup>8</sup> Powerlink, *2012 Annual Planning Report*, 2012

<sup>9</sup> AEMO, *2012 Electricity Statement of Opportunities*, 2012

<sup>10</sup> EMCa, *Powerlink Revenue Determination 2013-17, Review of Revised Demand Forecast – Report to the AER*, April 2012.

<sup>11</sup> see ACIL’s report for further detail.

costs because they do not make up a large-enough component of the tariff, as outlined in Table 3.1. For this reason, the bulk of any time-of-use signals in retail tariffs must come through the underlying network tariffs as they make up, by far, the largest component of the tariffs.

**Table 3.1: Potential time of use components in variable rates 2011-12 and 2012-13**

Component	Off peak		Peak		Potential for TOU signals
	c/kWh	% of total	c/kWh	% of total	
<b>2011-12 Tariff 22</b>	<b>9.92</b>	<b>NA</b>	<b>28.17</b>	<b>NA</b>	
<b>2012-13 Tariff 22</b>					
Network	9.304	51.4%	11.386	56.4%	Yes, but up to network businesses
Wholesale energy (ex carbon)	4.976	27.5%	4.976	24.6%	Yes, but requires smart meters
Carbon costs	2.381	13.1%	2.381	11.8%	Yes, but requires smart meters and would result in higher off-peak prices due to the higher carbon intensity of off-peak
RET and other costs	1.457	8.0%	1.457	7.2%	No basis for time of use signals
<b>Total</b>	<b>18.118</b>	<b>100.0%</b>	<b>20.200</b>	<b>100.0%</b>	

*Note: margin and headroom allocated to each cost component to reflect the way costs are derived for retail tariffs.*

### Carbon Costs

As the carbon tax has been in force for almost six months, it would appear prudent to review the methodology that ACIL applied in 2012-13 to determine whether it has provided reasonable outcomes to date.

When estimating wholesale energy costs for 2012-13, ACIL ran two modelling scenarios, one with carbon costs and one without, to estimate how the carbon tax would affect the costs faced by retailers. The difference between the two scenarios was used as the cost allowance for carbon.

In its preliminary report, ACIL has proposed to adopt the same approach to estimate carbon costs for 2013-14.

**The Authority seeks stakeholders' views on the following:**

- (a) **Is ACIL's proposed method for estimating wholesale energy costs reasonable given the requirements of the Electricity Act and the Delegation?**
- (b) **What other approaches should the Authority consider?**

- (c) **What factors should ACIL take into account when determining modelling inputs such as customer load forecasts, plant outage scenarios, hedging strategies and spot price forecasts?**
- (d) **How could appropriate time of use signals be included in energy cost estimates under the current metering and settlement arrangements?**
- (e) **Could ACIL's approach to estimating carbon costs be improved?**

### 3.4 Other Energy Costs

Retailers incur other energy costs in relation to:

- (a) the Queensland Gas Scheme;
- (b) the Small-Scale Renewable Energy Scheme (SRES);
- (c) the Large-Scale Renewable Energy Target (LRET) Scheme; and
- (d) NEM participation fees and ancillary services charges.

#### 3.4.1 Queensland Gas Scheme

The Queensland Gas Scheme was established to encourage the development of the State's gas industry and to reduce greenhouse gas emissions associated with the production of electricity in Queensland. The scheme runs on a calendar year basis and commenced on 1 January 2005 and is currently legislated to expire on 31 December 2019.

Under the scheme, retailers are required to obtain and surrender sufficient Gas Electricity Certificates (GECs) to cover a proportion of their annual customer load. This proportion is prescribed by the Queensland Government under the Electricity Act. The proportion is currently prescribed as 15% of a retailer's liable electricity load. This percentage will remain in force until the Queensland Government prescribes a different proportion. Retailers that fail to meet their annual GEC obligation incur a penalty charge for each MWh shortfall, which is effectively \$19.29<sup>12</sup>. The requirement to obtain GECs therefore creates an additional cost to retailers' in purchasing electricity for their customers.

GECs are created by accredited gas generators for each MWh of gas-fired electricity generated. The market price of a GEC is effectively capped by the level of the shortfall penalty charge. The market price for GECs is dependent on the interaction of the supply of, and demand for, GECs in the market. The market is characterised by having a single compliance date and only 56 scheme participants, some of which will only conduct a single transaction annually. As such, market data would be expected to reflect that the GEC market is characterised by a relatively small number of participants conducting infrequent transactions.

To effectively estimate the future cost of compliance with the Queensland Gas Scheme, information is required for two key variables:

- (a) the annual mandatory targets to be covered by GECs; and
- (b) the cost of obtaining GECs to meet those targets.

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<sup>12</sup> The prescribed 2011 shortfall charge is \$13.50 (the 2012 shortfall charge is due to be calculated in early 2013). However, as the shortfall charge is not tax deductible, the cost is effectively \$19.29 to retailers.

The annual mandatory targets are prescribed under the Electricity Act. In 2012, a retailer is required to obtain GECs for 15% of its annual electricity load. The Queensland Government has previously stated the mandatory target is set to increase to 18% by 2020. However, it is understood that the scheme is under review.

The Authority has a preference to use market prices to estimate costs where sufficiently robust data is available. In the early years of the Queensland Gas Scheme, market data was not sufficiently robust to use as a reliable basis for GEC costs. In these years, the Authority used the penalty price as a proxy for market outcomes. During this period, the Authority was aware that early market conditions meant that GECs were trading at close to the penalty price.

In recent years, sufficiently robust market data has become available from the Australian Financial Markets Association (AFMA). As such, the Authority based 2012-13 Queensland Gas Scheme Compliance costs on market price information.

Some retailers were in favour of estimating GEC costs based on the LRMC of a gas-fired generation plant mix needed to meet retailers' GEC liability over the determination period. The primary reason for this is that some retailers entered into long term agreements or established gas-fired generation capacity in the early years of the scheme and, they claim, the current oversupply of the market has driven prices below the level of their particular compliance costs. However, the Authority believes that an LRMC approach would be less transparent and potentially more complicated than a market-data based approach and would deny customers the benefits of lower market prices.

**The Authority seeks stakeholders' views on the following:**

- (a) How should a retailer's cost of complying with the Queensland Gas Scheme best be estimated?**
- (b) What data source(s) should the Authority use in modelling the Queensland Gas Scheme?**
- (c) Are there any other issues that should be considered in estimating this cost component?**

### **3.4.2 Enhanced Renewable Energy Target Scheme**

In August 2009, the Federal Government expanded its Renewable Energy Target (RET) scheme by increasing the annual target of electricity to come from renewable sources from 2% for each year from 2010 to 20% by 2020.

From 1 January 2011, the RET scheme changed into the Expanded Renewable Energy Target (ERET) scheme. The changes split the scheme into two categories; a SRES and a LRET scheme.

The SRES covers small-scale technologies such as solar panels and solar hot water systems installed by households and small businesses. Retailers have an obligation to purchase Small-scale Technology Certificates (STCs) based on expected rates of STC creation.

The LRET sets annual targets for the amount of electricity that must be generated by large-scale renewable energy projects like wind farms. Retailers must purchase a set number of Large-scale Generation Certificates (LGCs) which is determined on the basis of achieving the annual target, which is currently 41,000 GWh by 2020.

Retailers are required to surrender STCs and LGCs to fulfil their ERET obligations. As was the case with the previous RET scheme, if a retailer fails to meet its obligations, it will incur a penalty.

## LRET

For the 2012-13 Determination, the Authority based its estimate of 2012 LRET costs on weekly market prices for RECs, as published by AFMA, as well as the latest Renewable Power Percentage (RPP) and the latest annual LRET targets set by the Office of the Renewable Energy Regulator (ORER). In addition to this actual data, ACIL forecast its own estimate of total liable energy for 2013 and utilised the latest published LRET target to arrive at a forecast RPP.

In response to the Interim Consultation Paper, some retailers also suggested using the LRMC of renewable generation to estimate LRET costs, on the basis that some of them had purchased or established renewable generation capacity as a way of meeting LRET compliance costs.

The Authority has a preference for utilising market data in estimating costs where sufficiently robust data, such as that provided by AFMA, is available. The Authority is of the view that this approach to estimating compliance costs is more transparent and less complex than an approach based on the LRMC of renewable generation.

## SRES

In response to the Interim Consultation Paper and previous pricing determinations, retailers expressed concern at the inaccuracy of non-binding targets. These targets are set in advance of the compliance year, to provide retailers with an indication of their likely compliance costs for the upcoming year. However, previous experience has shown that future Small-scale Technology Percentage (STP) targets are often lower than the final binding STP targets upon which final compliance costs are based. For example, the non-binding STP target for 2013 is 7.94%, whereas the 2012 binding target is 23.96%. As a result, it is possible that future SRES compliance cost estimates may be understated.

Origin Energy suggested that the latest binding target be used for the entire financial year, as a way of avoiding estimation errors. However, this would be inconsistent with estimating the SRES costs for the financial year as required by the Delegation. The non-binding target still seems the most transparent estimate available.

Consumer groups raised the issue of the SRES market price being significantly lower than the clearing house price. Under the SRES scheme, certificate holders have two selling options. Firstly, they can list their certificates for sale in the STC clearing house, where they will receive a guaranteed price of \$40. However, the clearing house is currently significantly oversupplied, meaning that some certificate holders have been waiting for up to nine months to find a buyer.

Certificate holders wishing to avoid such long waiting periods have started selling their STC certificates at a discount to the clearing house price. STCs sold on the market have sold at a significant (up to 25%) discount on the clearing house price.

For the 2012-13 Determination, the Authority estimated SRES compliance costs using the binding 2012 STP target for the first half of the pricing period and the non-binding 2013 target for the second half of the pricing period. The Authority calculated the cost of meeting these targets using the clearing house price of \$40, after ACIL advised that at that time it would be difficult to estimate the proportion of STCs that were being traded outside the

market. ACIL also expected the difference between market prices and the clearing house price to be short term and diminishing over time. However, the latest survey data from AFMA indicates that STCs are still being traded at a 20% discount to the clearing house price.

**The Authority seeks stakeholders' views on the following:**

- (a) **How should the Authority estimate retailers' costs of complying with the ERET scheme?**
- (b) **What factors should be considered in forecasting the REC costs likely to be incurred by retailers in the SRES and LRET markets?**
- (c) **Do stakeholders agree with using clearing house price in estimating SRES costs, or would market prices be more appropriate? How can the proportion of STCs sold through the clearing house be calculated?**
- (d) **Do stakeholders agree with using non-binding STP targets for 2014 and future years? Are there any better forecasts that the Authority could use?**
- (e) **How should the Authority deal with variations from the STP targets used in determining 2013-14 prices?**
- (f) **Are there any other issues that should be considered in estimating this cost component?**

### **3.4.3 NEM participation fees and ancillary services charges**

Retailers are required to pay NEM participation fees and ancillary services charges to AEMO. NEM participation fees include participant fees and FRC establishment and operation fees. These fees are levied by AEMO on participants in the NEM to cover the costs of operating the market. These fees are relatively stable as they are based on the operational expenditure of AEMO and are published on AEMO's website every financial year.

Ancillary services charges cover the costs of the services used by AEMO to manage power system safety, security and reliability. These fees are published by AEMO on its website on a weekly basis.

Given that changes in NEM participation fees and ancillary services charges are relatively stable from year to year, the Authority considered it reasonable in its 201-13 Determination to use historical data in forecasting these costs. In its previous decisions, the Authority forecast NEM fees based on trends in the fees since 2004-05 and forecast ancillary services costs based on the average of costs over the preceding year.

**The Authority seeks stakeholders' views on the following:**

- (a) **How should the Authority estimate NEM participation fees and ancillary services charges incurred by retailers?**
- (b) **Are there any other issues that should be considered in estimating this cost component?**

### 3.5 Energy Losses

In delivering energy from a generator to a consumer, some losses occur. A retailer must purchase sufficient energy to supply its customers and allow for the transmission and distribution losses that will be incurred.

In the 2012-13 Review, the Authority applied transmission and distribution losses published by AEMO<sup>13</sup> to all energy cost components, which was generally supported by stakeholders.

ACIL has proposed to adopt the same approach to accounting for energy losses for 2013-14.

**The Authority seeks stakeholder's views on the following:**

- (a) **How should the Authority take account of energy losses that occur between the regional reference node and the retail customer?**
- (b) **Are there any issues other associated with the incorporation of energy losses in its energy cost estimate.**

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<sup>13</sup> As AEMO publishes its Distribution Loss Factors and Marginal (transmission) Loss Factors in September of each year, the Authority's 2012-13 determination relied on the losses for the 2011-12 year as these were the most recent available at the time. Similarly, the Authority will be required to use 2012-13 losses in its 2013-14 Determination.

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## 4. RETAIL COSTS

### 4.1 Introduction

The Delegation requires that the Authority must use the Network (N) + Retail (R) cost build-up methodology when working out notified prices. This chapter discusses retail costs and sets out stakeholders' views on an appropriate allowance for retail operating costs (ROC) and an appropriate retail margin, as well as some preliminary observations from the Authority.

### 4.2 Retail Operating Costs

ROCs relate to the costs of the services provided by an electricity retailer to its customers and typically include customer administration (including call centres), corporate overheads, billing and revenue collection, IT systems, regulatory compliance and customer acquisition and retention costs (CARC), which include costs associated with marketing, advertising and sales overheads.

#### Estimating ROC

For 2012-13, the Authority determined an appropriate allowance for ROC by considering the costs that would reasonably be incurred by an efficient, incumbent retailer. In response to the Authority's Interim Consultation Paper, some stakeholders suggested that the Authority should calculate ROC based on the costs that would be incurred by a new entrant retailer, as this would ensure that electricity retailers were able to compete in the market and deliver the benefits of competition to customers.

The Authority notes that, since it set 2012-13 notified prices, three additional retailers have commenced making market offers in Queensland and two more are preparing to do so. On this basis, it would appear that the approach the Authority took previously to setting notified prices was not one that hampered the development of competition.

For the 2012-13 Determination, the Authority adopted a benchmarking approach to estimating ROC because it did not consider that an alternative approach would necessarily produce results that were any more robust or defensible.

In response to the Authority's Interim Consultation Paper, some stakeholders questioned the use of benchmarking to set ROC. For example, Energy Australia suggested that the Authority should take a bottom-up approach, supplemented by benchmarking. Energy Australia and AGL suggested that any benchmarking needed to account for differences in costs between States such as regulatory costs. The Queensland Government was of the view that benchmarking may be a reasonable approach, but that the Authority should consider extending this analysis to other industries.

The Authority notes that benchmarking is an often-used and well-understood approach, regularly taken by other regulators in Australia. The Authority also notes that some of the benchmarks used by the Authority in setting 2012-13 prices were based on bottom-up analyses. Further, the Authority took account of cost differences between States, for example, by making specific adjustments for regulatory fees.

While using benchmarks from other industries is a possible option, the Authority questions whether this is appropriate given how different electricity retailing is from retailing in other sectors, owing to the volatility and complexity of the wholesale electricity industry. There may also be issues with data availability and comparability.

In adopting the benchmarking approach when setting 2012-13 notified prices, the Authority determined three separate ROC allowances for small, large and very large customers.

The small customer allowance was determined by reference to the allowances recently determined by regulators in other NEM jurisdictions. As it was not possible to readily compare the costs attaching to CARC between jurisdictions, the Authority based its benchmarking solely on comparable ROC allowances and maintained the 2011-12 CARC allowance.

In response to the Interim Consultation Paper, the Queensland Council of Social Service (QCOSS) suggested that CARC should be removed or reduced because customers in Ergon Energy's distribution area pay for CARC, even though there is no effective competition, and therefore no expenditure on CARC. EnergyAustralia suggested the Authority should use a different approach to setting CARC, noting that retailers may need to incur CARC for the market to be more competitive. EnergyAustralia did not set out what an alternative approach might be.

The Authority's analysis for 2012-13 notified prices suggested that the 2011-12 ROC allowance was higher than the efficient costs of supplying small customers. Based on this analysis, the Authority lowered the allowance from \$88.83 per customer to \$83.78, which was consistent with the top of the range determined by IPART.

In order to arrive at an allowance for 2012-13, the benchmark ROC allowance of \$83.78 and the CARC allowance of \$41.91 were escalated by the consumer price index (CPI). Regulatory fees of \$1.21 per customer were added, based on the Authority's estimate.

There was limited evidence upon which to determine appropriate allowances for large customers, as regulators in other jurisdictions only determine retail electricity prices for smaller customers. However, the Authority was able to draw on analysis conducted by Frontier Economics (Frontier) for the ERA in 2009 and 2011. This analysis suggested that there was a significant difference in the costs of servicing larger customers.

On the basis of Frontier's analysis, the Authority determined a ROC allowance of \$700 per large customer (those consuming between 100 MWh and 4 GWh per annum) and \$2,000 per very large customer (those consuming more than 4 GWh per annum). As with small customers, the Authority added regulatory fees of \$1.21 per customer.

The 2012-13 ROC allowances (per customer) were:

- (a) \$130.67 for residential and small customers consuming up to 100 MWh per annum;
- (b) \$701.21 for large customers consuming between 100 MWh and 4 GWh per annum; and
- (c) \$2,001.21 for large customers consuming more than 4 GWh per annum.

For the 2013-14 Determination, one option is to continue to set three separate ROC allowances to reflect the differences in the costs of servicing customers of different sizes.

AGL claimed that the 2012-13 ROC allowance understated ROC for small customers, but did not quantify by how much. The Queensland Government asked the Authority to explain why it considers its proposed ROC allowance to be reasonable and to provide a more detailed breakdown of how the particular cost components that make up ROC are determined.

The Authority considers that the benchmarks used for setting notified prices for 2012-13 are an appropriate starting point for setting notified prices for 2013-14. However, the Authority will consider whether suggestions in submissions warrant a change of approach and whether there are any significant changes since the 2012-13 Determination which would require further adjustments to be made, for instance, more recent regulatory decisions, information on any expected new costs or significant changes in current costs.

**The Authority seeks stakeholders' views on the following:**

- (a) **Is the Authority's 2012-13 approach to determining the retail operating cost allowances appropriate to use for 2013-14? If not, what is an appropriate alternative approach and why would this be superior?**
- (b) **Have there been any recent developments that would suggest a significant change in current costs has occurred?**

### **Applying ROC to tariffs**

In theory, cost-reflectivity is achieved when the costs of supply are applied to each retail tariff on the basis of the driver or cause of those costs. Such an approach should lead to more efficient use of electricity because customers would pay for the costs they cause an efficient retailer to incur. Therefore, as a general rule, the mix of fixed and variable components for each tariff should reflect the manner in which the underlying costs are incurred. Fixed costs and costs that vary with the number of customers served are best recovered as fixed charges and costs that vary with consumption are best recovered as variable charges.

In its 2012-13 Determination, the Authority could not find any evidence to suggest that retail costs vary with electricity consumption but considered there was evidence to suggest that some costs may vary with customer numbers. Therefore, the Authority decided to allocate ROC to the fixed component of each retail tariff, except for the controlled load tariffs and unmetered tariffs which did not include any ROC allowance because it was assumed that customers accessing those tariffs will also access another general supply tariff and have paid their fixed charges in that context.

The Authority is not aware of any evidence to suggest that another approach would be more cost-reflective. However, it will consider any evidence provided by stakeholders that suggests an alternative approach would be more cost-reflective.

**The Authority seeks stakeholders' views on the following:**

- (a) **Is the Authority's 2012-13 approach to allocating ROC to retail tariffs cost-reflective?**
- (b) **If not, what would be a more cost-reflective approach, and why?**

## **4.3 Retail Margin**

The retail margin represents the reward to investors for committing capital to a business and for accepting risks associated with providing retail electricity services. A retail margin which is not sufficient to compensate investors for their capital investment and exposure to systematic risks will lead to under-investment by existing retailers, deter entry into the market by new retailers and stall the development of effective competition.

## Estimating the retail margin

For the 2012-13 Determination, the Authority adopted a benchmarking approach to setting the retail margin by assessing the appropriateness of the 5% margin used under the BRCI approach against margins adopted in other jurisdictions. The Authority adopted this approach because it was not convinced that a more extensive and detailed analysis, such as a bottom-up and/or expected returns approach, would deliver significant benefits over the benchmarking approach. There was also general support for benchmarking in submissions.

The Authority considered that IPART's 2010 decision was the most relevant regulatory decision at the time. The low retail margin adopted by Office of the Tasmanian Economic Regulator (OTTER) was not considered relevant because it was determined for a retailer facing significantly lower energy price and volume risk than retailers in other NEM jurisdictions. The decisions of ESCOSA and the Independent Competition and Regulatory Commission (ICRC) were heavily reliant on benchmarking and were therefore considered less relevant than the IPART decision, where a much more comprehensive analysis was undertaken.

In determining the retail margin, IPART's objective was to compensate the regulated retailers for the systematic risks they face and it engaged a consultant to provide advice on a feasible range for the margin using three alternative approaches – expected returns, benchmarking and bottom up. Given the detailed analysis undertaken by IPART, the Authority considered that it was reasonable for the retail margin to be lifted to be the same as that adopted by IPART, but did not consider that there was any justification to raise it any higher. Therefore, the Authority increased the retail margin from its previous level of 5% to 5.4%.

In response to the Interim Consultation Paper, Origin Energy broadly supported using a benchmarking approach to estimate the retail margin but argued that the Authority needs to account for the higher risks of retailing in Queensland relative to New South Wales due, for example, to the lack of a pass-through mechanism and LRMC floor in the cost of energy. Similarly, AGL and Energy Australia argued that the retail margin cannot be considered in isolation of other cost components. Energy Australia considered that a higher retail margin was warranted if a market-based approach to determining energy costs was adopted.

The inclusion of a cost pass-through mechanism and the use of LRMC in setting energy costs are discussed in Chapters 5 and 3 respectively.

The Queensland Government accepted that retailers must receive an appropriate margin to account for risk and ensure competition is not adversely affected. However, it queried whether the retail margin should be applied to all cost components, given that network costs are treated as a pass-through. The Government also queried whether the same margin should apply to all customer groups, while Ergon Energy supported applying different margins.

While the Authority will consider these matters, it also notes that network costs in the N + R model are not necessarily a costless pass-through. There is a cash flow issue for retailers in that they may pay their network costs before they are able to recoup those costs from customers. There is also the risk that some retailers' customers will not pay their bill, meaning that the retailer will not recoup all of its network costs.

For the 2013-14 Determination, the Authority proposes to assess the appropriateness of the current retail margin of 5.4% in light of submissions and any new market developments or regulatory decisions since the 2012-13 Determination.

**The Authority seeks stakeholders' views on the following:**

- (a) Is there any evidence to suggest that the current retail margin of 5.4% should change?**
- (b) If yes, what level should the margin be set at and why?**
- (c) What information should the Authority rely upon in determining an appropriate margin?**

**Applying the retail margin to tariffs**

For the 2012-13 Determination, the Authority applied the retail margin equally (on a percentage basis) to each component (fixed, variable and demand) of each retail tariff. This meant that all customers pay the same margin as a percentage of their total bill but, in dollar terms, larger customers pay more than smaller customers. The Authority considered that this approach was appropriate because the retail margin is calculated as a percentage of total costs.

One option is to adopt the same approach for the 2013-14 Determination. The Authority will consider alternative approaches proposed by stakeholders. However, stakeholders should provide sufficient justification and explanation as to why the alternative approach is preferred and how it would apply in practice.

**The Authority seeks stakeholders' views on the following:**

- (a) Do you agree with the Authority's 2012-13 approach to applying the retail margin to retail tariffs?**
- (b) If not, what would be a more appropriate approach and how would it be applied in practice?**

## 5. COMPETITION AND OTHER ISSUES

### 5.1 Competition Considerations

In accordance with section 90(5)(a) of the Electricity Act, the Delegation requires the Authority to have regard to the effect of its price determination on competition in the Queensland retail electricity market. In its submission on the Interim Consultation Paper, the Queensland Government noted that this requirement was consistent with its policy objective that consumers, wherever possible, should have the opportunity to benefit from competition and efficiency in the market place.

As discussed in Chapter 1, unlike in some sectors of the industry (for example, electricity distribution and transmission) where barriers to entry such as high fixed costs and significant economies of scale tend to preclude the development of competition, there are no significant barriers to the development of competition in the retail electricity sector. This is evidenced in the Queensland retail electricity market where competition has developed considerably since it was introduced more than five years ago, although it is largely limited to the SEQ as a result of the UTP.

In light of these factors, while having regard to costs is important in setting notified prices, the Authority considers that a key objective of notified prices is to provide a transition to effective competition and eventual price deregulation, particularly in SEQ. Under the Australian Energy Market Agreement, governments have agreed to phase out retail price regulation if effective competition can be demonstrated<sup>14</sup>.

In particular, the Authority considers that notified prices should not act as a barrier to retailers entering the market and competing vigorously to acquire and retain customers. Notified prices should also encourage customers to exercise market choice and seek out the best deal in the competitive market. Greater customer engagement should further incentivise retailers to compete vigorously to make the best offers to attract and retain customers.

This is consistent with the Authority's decision to include an explicit allowance for headroom in the 2012-13 Determination. In their submissions to the Interim Consultation Paper, CANEGROWERS and QCOSS argued that the inclusion of headroom increases prices for little or no benefit to customers. Retailers on the other hand emphasised the importance of setting notified prices at an adequate level to ensure that competition is not eroded.

However, the preference of many retailers was to remove retail price regulation in the near future, as they considered that this would better promote competition and deliver efficient prices. In its submission, the Queensland Government was concerned that small customers may not be adequately protected from the effects of a fully deregulated market to allow for the removal of retail price regulation at this stage.

#### 2012-13 Determination on Headroom

As noted above, in its 2012-13 Determination, the Authority decided to include an allowance for headroom above the efficient costs of supply in order to sustain an actively competitive market. The Authority considered that failing to do so might see a substantial reduction in market activity and the range of offers available to customers.

In arriving at its decision on the level of headroom, the Authority first looked at evidence of the current level of headroom in tariffs, including:

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<sup>14</sup> So far, Victoria is the only state to deregulate retail electricity prices.

- (a) a breakdown of the costs of supplying customers on the most common 2011-12 retail tariffs relative to the notified price for that tariff; and
- (b) information on discounts to the notified price for the main residential tariff (Tariff 11) offered by retailers.

The Authority estimated that, on average, the level of headroom was around 6% in Tariff 11, but much higher in most other common tariffs, ranging between 12% and 23%. Given that the available headroom in Tariff 11 appeared to have been sufficient to foster a healthy amount of competition in the residential market, the Authority considered that the same level of headroom was likely to be sufficient to support competition for non-residential customers.

Based on the above considerations, the Authority decided to include an explicit allowance for headroom of 5% of cost-reflective prices.

### Approach for 2013-14 Determination

The Authority will consider the impact of the 2012-13 Determination on competition (to the extent possible). This task may be complicated by the fact that the Government decided to freeze regulated prices for the main residential tariff (Tariff 11) for 2012-13, subject to the inclusion of costs associated with the carbon tax. However, the Authority notes that, to compensate for the effects of this decision, the Government directed Energex to lower the fixed component of the network charge underpinning Tariff 11.

### Current state of competition

Some retailers have argued that competition in Queensland has stalled or is in decline since the release of the 2012-13 Determination. However, the Authority's preliminary assessment indicates that neither the Authority's 2012-13 Determination, nor the Minister's decision on Tariff 11, have negatively impacted competition.

While retailers pointed out that switching rates in Queensland dropped from July 2012 to September 2012, the Authority notes that this was also the case in other jurisdictions, which may mean that other factors not specific to Queensland were at play, such as customer uncertainty about the potential impacts of the carbon tax. Queensland switching rates increased in October and remained roughly at the same level in November<sup>15</sup>.

Furthermore, an additional three retailers have started making market offers to customers since the Authority's 2012-13 Determination was released. While the Authority does not have access to information on market offers available to business customers, the maximum discount off Tariff 11 is currently 15% (reverting to 9% after one year) and the next best discount is 11%. This compares to a maximum discount of 10% in 2011-12<sup>16</sup>.

### Should the level of headroom be adjusted?

To the extent that the Authority's analysis identifies any deficiencies in competition, adjusting the level of headroom may or may not be an appropriate response. AGL suggested that headroom should be higher than 5% to induce customers to switch retailers, while EnergyAustralia considered that it should be at least 5%. AGL also argued that headroom should be higher for small business customers than residential customers, but did not explain why.

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<sup>15</sup> Australian Energy Market Operator, *National Electricity Market – Monthly Retail Transfer Statistics*, November 2012.

<sup>16</sup> Where the discount is applied to the usage charge only, the total discount is calculated assuming annual consumption of 5,370 kWh.

Increasing the level of headroom might be considered appropriate if it encourages customers to seek out a better deal in the competitive market or if a number of retailers were withdrawing from the market because notified prices were too low. However, it is unlikely to be appropriate if customers are not actively engaging in the market simply because they are unaware that they can switch retailers, find it too difficult to compare offers or perceive that they have little control over electricity prices because they are regulated. However, a lack of customer engagement is also recognised as an issue in retail electricity markets where prices are not regulated<sup>17</sup>.

If a lack of customer engagement is recognised as an issue, increasing headroom may just allow retailers to retain headroom in the form of higher profits, meaning that an alternative approach focusing on improving customer engagement in the competitive market may be more beneficial. Possible options may include:

- (a) an advertising campaign to encourage customers to shop around for the best deal<sup>18</sup>;
- (b) making it easier for customers to access and compare offers between retailers;
- (c) reviewing customer protection mechanisms to ensure they are adequate and provide customers with sufficient confidence to venture into the competitive market; and
- (d) removing barriers to customer switching, including termination fees where the contract price increases.

**The Authority seeks stakeholders' views on the following:**

- (a) **What matters should the Authority take into account to assess the effectiveness of competition in SEQ? What information could assist the Authority in this task?**
- (b) **What impact has the level of headroom had on competition in SEQ?**
- (c) **Are there other factors impacting on competition in SEQ? How could these be addressed?**
- (d) **What else should the Authority take into account in determining the appropriate level of headroom?**

## 5.2 Accounting for Unforeseen or Uncertain Events

In its 2012-13 Determination, the Authority considered that it would be appropriate to include some form of mechanism to account for the material impacts of unforeseen or uncertain events on retailers' costs.

However, the Authority considered that it did not have the capacity to include a within-year cost pass-through mechanism in its determination because it was only delegated the task of

<sup>17</sup> See, for instance, Consumer Utilities Advocacy Centre, *Improving energy market competition through consumer participation*, December 2011, available from: [www.cuac.org.au](http://www.cuac.org.au); Ofgem, *What can behavioural economics say about GB energy consumers?* 21 March 2011, available from: [www.ofgem.gov.uk](http://www.ofgem.gov.uk); Electricity Authority, *What's My Number – A changing landscape for New Zealand electricity consumers*, April 2012, available from: [www.ea.govt.nz](http://www.ea.govt.nz).

<sup>18</sup> In 2011, a marketing campaign was launched in New Zealand (where retail prices are not regulated) which aimed to increase competition by creating more informed and active electricity customers and increase their propensity to switch retailers. An early review of the campaign suggested that it had improved customer awareness, increased switching rates and incentivised retailers to offer bigger discounts. See Electricity Authority, *What's My Number – A changing landscape for New Zealand electricity consumers*, April 2012, available from: [www.ea.govt.nz](http://www.ea.govt.nz).



determining prices for one year and had no ongoing role in administering the determination. It also considered that it would not be possible for it to commit to some form of catch-up mechanism which would allow for unforeseen cost impacts from one year to be accounted for in setting prices for the following tariff year, because the Authority had only been delegated the function of setting notified prices for the 2012-13 tariff year and the Minister could have decided not to delegate the function to the Authority in the following year, making any commitment potentially worthless.

The Authority notes that other regulators commonly include cost pass-through mechanisms in their multi-year price determinations. While the Authority has now been delegated the task of determining prices for a three-year period, it is still required to make annual price determinations. While this suggests that a within-year cost pass-through mechanism is still not possible (as the Authority is required to set prices once each year, for the year in prospect), the Authority will seek to clarify whether it can include a catch-up mechanism (allowing for unforeseen cost impacts from one year to be accounted for in setting prices for the following tariff year).

**The Authority seeks stakeholders' views on whether the Authority should include a catch-up mechanism if it is able to do so and what events this should be applied to?**

### 5.3 Terms and Conditions for Notified Prices

#### Access to Obsolete Tariffs

In response to the Interim Consultation Paper, the Queensland Government and Ergon Energy raised the issue that, from 1 July 2012, no new customers would be able to access several 2011-12 regulated retail tariffs (referred to as obsolete tariffs). Ergon Energy suggested that this was producing inequitable outcomes for large business customers and suggested allowing all large customers to have access to transitional tariffs.

Some participants in the regional workshops the Authority conducted during November also queried the limited access to obsolete tariffs. For example, some customers shifted from now obsolete farming or irrigation-specific tariffs to Tariff 22 shortly before 1 July 2012 without knowing that the difference between the peak and off-peak charges in Tariff 22 would fall so much from 1 July, causing significant increases in their bills. These customers indicated that, had they been aware of the coming change in retail pricing set to occur from 1 July, they would not have shifted to Tariff 22, and therefore would have been able to enjoy the benefit of whatever transitional arrangements are to be put in place for obsolete tariffs from 2013-14.

The Authority notes that fundamental market reforms, such as the new approach to determining notified prices for 2012-13, can involve detriment to some customers. Such impacts may be an unavoidable element of achieving broader community benefits that flow from significant reforms.

As noted in the Consultation Paper on Transitional Issues, the Authority would be reluctant to make obsolete tariffs available to new customers because this will simply exacerbate the inefficiencies that pricing reform was intended to eliminate. However, the Authority is concerned that some customers may be facing very large price impacts which they could have avoided had they been aware of the impending changes to notified prices. As a result, the Authority will consider whether to allow some additional customers to access certain obsolete tariffs for a limited period of time.

For example, one option would be to allow customers that shifted from an obsolete tariff within a certain period prior to 1 July 2012 to shift back to that obsolete tariff if they wish

and then follow the transitional path that applies to the obsolete tariff. However, the application of this approach could be limited by the requirement for the Authority to consider the impact of its price determination on competition. This is because retailers supplying customers who now switch back to obsolete tariffs would very likely incur losses from continuing to supply those customers. While this is unlikely to affect the already limited level of competition in Ergon Energy's network area, it may have an impact on some retailers competing in Energex's network area.

### Service Fees

In response to the Interim Consultation Paper, Ergon Energy also raised the issue of the term "Service Fee" to describe electricity installation and maintenance costs, causing customer confusion. However, this has been a standard term in the gazette notice for many years, and changing it now would likely cause greater customer confusion, rather than reducing it.

**The Authority seeks stakeholders' views on the following:**

- (a) **Should new customers be allowed to access obsolete tariffs during the transitional period?**
- (b) **Should some customers who were already being supplied prior to 1 July 2012 on what were to become obsolete tariffs be granted access to the corresponding obsolete tariffs. If so, which customers, which tariffs and why?**
- (c) **Are stakeholders aware of any other issues with the current notified price terms and conditions?**

## 5.4 Other Issues

The Authority notes that a number of issues were raised in submissions that, while relevant to electricity customers, are outside the scope of the Delegation.

### Electricity On-Selling

Section 20J of the Electricity Act prevents electricity on-sellers from charging customers a higher rate than the applicable notified price the customer could otherwise access directly.

In response to the Interim Consultation Paper, the Shopping Centre Council of Australia and Energy Options raised two issues regarding the effect of 2012-13 notified prices on on-selling of electricity. First, given that notified prices are no longer available to large customers in Energex's area, and that notified prices for large customers in Ergon Energy's area are based on costs in that area, there is no longer an appropriate reference price for on-selling to large customers in south-east Queensland. Second, on-sellers in the Ergon Energy network area who are large customers and therefore face notified prices based on costs in Ergon Energy's area are unable to recoup their costs on-selling to small customers because notified prices for these customers are based on lower costs in Energex's network area.

The Department of Energy and Water Supply (DEWS) is responsible for administering on-selling arrangements. The Authority understands that DEWS is currently examining issues to do with on-selling. DEWS has been made aware of the issues raised in submissions and will consider these comments as part of that process.

### **Large Customer Threshold**

In response to the Interim Consultation Paper, CANEGROWERS and the Queensland Farmer's Federation raised the issue of customers experiencing sizeable price increases when they shift from tariffs for small customers to tariffs for large customers.

This is a direct result of the Queensland Government's UTP, which requires that small customers in Ergon Energy's network area pay the same notified prices available in Energex's network area, where costs are lower.

The threshold between small and large customers and the Government's UTP are both matters for Government.

### **Community Service Obligation Payments**

The ESAA and ERAA suggested that consideration be given to how CSO payments could be applied to facilitate a competitive market in the Ergon Energy distribution area. The lack of competition outside southeast Queensland was consistently identified by stakeholders as a serious issue in the regional workshops the Authority conducted during November.

While the Authority acknowledges, as it has done previously, that competition in regional Queensland could be significantly improved if the CSO payment to subsidise electricity costs in regional Queensland was made at the network level rather than the retail level, the issue is outside the scope of the Delegation and not a matter the Authority is able to address.

**APPENDIX A: MINISTERIAL DELEGATION AND COVERING LETTER**

## Office of the Minister for Energy and Water Supply

Ref: EWS/001799  
MBN6648

4 September 2012

Level 13 Mineral House  
41 George Street Brisbane 4000  
PO Box 15456 City East  
Queensland 4002 Australia  
**Telephone +61 7 3896 3691**  
**Facsimile +61 7 3012 9115**

Mr Brian Parmenter  
Chairman  
Queensland Competition Authority  
GPO Box 2257  
Brisbane Qld 4001

Dear Mr Parmenter

I attach a Delegation and Terms of Reference (ToR) to the Queensland Competition Authority (QCA) to determine regulated retail electricity prices for the next three years (with annual determinations published each year), as authorised under Section 90AA(1) of the *Electricity Act 1994* (the Act).

The Queensland Government has taken action to address cost of living pressures. In relation to regulated retail electricity prices in 2012-13, the Government froze the standard residential tariff (Tariff 11) (plus the cost of carbon) as a short-term cost of living relief measure.

The Delegation and ToR contains a number of important measures designed to assist Queenslanders in dealing with changes to electricity prices. More information on these measures is provided below.

**1. Three year Delegation and ToR**

This is the first Delegation on regulated retail electricity prices from this Government, and in order to provide a degree of certainty to consumers and industry, a move from an annual price determination to a three year delegation period will apply. For consumers, the Government is committed to an approach that will assist in managing short-term price shocks, and for industry an approach that may assist in the longer term investment in the sector.

The Government is seeking from the QCA a strong consultation process with a clear focus on key issues, with regard to the objectives of the Act as set out in this Delegation and ToR.

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## **2. Consideration of customer impacts and 'transitional arrangements'**

The Government is committed to tariff reform and addressing the cost drivers of electricity prices. However, this reform needs to be carefully managed and it is important that the QCA take into account the impacts of price increases on struggling Queensland households and businesses. To assist with this, the QCA is directed to consider transitional pricing arrangements over a number of years for a range of customers accessing the following tariffs:

- Tariff 11 (the standard residential tariff);
- Transitional and obsolete tariffs, including farming and irrigation tariffs; and
- Large business tariffs in Ergon Energy's distribution area.

Whilst the Government's freeze to Tariff 11 in 2012-13 provided households with immediate relief from cost of living increases, this was a short-term measure only. However, the Government expects the QCA to ensure that Queensland households experience a smooth transition from the freeze and to fully utilise the three-year delegation period to order to achieve this.

The other tariffs noted above have been chosen for transitional measures based on the unacceptable impacts for some customers accessing these tariffs, as identified by the QCA in their Draft and Final Determinations for 2012-13. Transitional arrangements over the three-year delegation period should be designed to assist in mitigating these potential impacts.

## **3. Extensive Consultation with Stakeholders and the Community**

The QCA is required to undertake a rigorous consultation process with all relevant parties and consider all submissions received. The QCA is not limited by the consultation schedule outlined in the Delegation and ToR and, should undertake additional consultation on key issues, and as appropriate, publish the results of this consultation.

An important aspect of the consultation process will be the publication of a consultation timetable within two weeks after submissions on the interim consultation paper are due, detailing any proposed additional public papers (other than those required by the Delegation and ToR). It is critical that all stakeholders, including retailers, customers and consumer advocacy groups understand the intent and timing of this crucial process.

Furthermore, given the three-year period of this delegation (compared to one-year delegations issued in the past) it is important that continuity in decision making is maintained in regard to key cost components. Therefore, the QCA must conduct a public workshop prior to the release of the 2013-14 Draft Determination on how the energy and retail cost components of regulated retail tariffs should be determined.

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#### 4. Public Communication of QCA Decisions/Determinations

Every Queenslanders is impacted by electricity price increases, so there will be significant public interest in the QCA's determination of regulated tariffs. Because of this, the Queensland Government expects the QCA to fully explain its decisions and encourages the QCA to, at a minimum, publish and communicate the outcomes of its reports in a clear and concise fashion using consumer oriented fact sheets and media releases. Access to this additional material should be easily accessible on the QCA website and be obvious to any new visitor to the QCA site.

#### 5. Other matters in the Delegation and ToR

##### *Time-of-Use Tariffs*

Queensland customers should be rewarded for shifting their consumption of electricity from peak periods to off-peak periods, which has material benefits for network and generation infrastructure. The QCA should determine whether its approach to determining the rates for time-of-use tariffs can strengthen or enhance the underlying network price signals and encourage customers to switch to time-of-use tariffs and reduce their energy consumption during peak times.

Finally, I would like to point out the Queensland Government has established longer-term reform processes to address unsustainable electricity price increases. This includes establishing an Inter-departmental Committee (IDC) on Electricity Sector Reform. In recognising the key role that the cost of poles and wires (transmission and distribution networks) has on electricity prices, an Independent Review Panel (IRP) is examining the cost of these networks. These reform processes are currently underway and scheduled to report back to Government in late January 2013.

I look forward to following the QCA process for determining regulated retail electricity prices and will be encouraging stakeholders to actively participate in the consultation process, and to assist the QCA at every turn in understanding the potential impacts arising from the determination of regulated retail electricity prices.

Yours sincerely



Mark McArdle MP  
Minister for Energy and Water Supply

Att

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**DELEGATION TO QCA**

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**ELECTRICITY ACT 1994****Section 90AA(1)****DELEGATION**

I, Mark McArdle, the Minister for Energy and Water Supply, in accordance with the power of delegation in section 90AA(1) of the *Electricity Act 1994* (the Act), delegate to the Queensland Competition Authority (QCA) the function under section 90(1) of the Act of deciding the prices that a retail entity may charge its non-market customers for customer retail services for the tariff years from 1 July 2013 to 30 June 2016.

The following are the Terms of Reference of the price determination:

**Terms of Reference**

1. These Terms of Reference apply for each of the tariff years in the delegation period.
2. In each tariff year of the delegation period, QCA is to calculate the notified prices and publish an annual price determination, in the form of a tariff schedule, in accordance with these Terms of Reference.
3. In accordance with section 90(5)(a) of the Act, in making a price determination for each tariff year QCA must have regard to all of the following:
  - (a) the actual costs of making, producing or supplying the goods or services;
  - (b) the effect of the price determination on competition in the Queensland retail electricity market; and
  - (c) the matters set out in paragraph 5 of these Terms of Reference.
4. In accordance with section 90(5)(b) of the Act, QCA may have regard to any other matter that QCA considers relevant.
5. The matters that QCA is required by this delegation to consider are:
  - (a) Uniform Tariff Policy - QCA must consider the Government's Uniform Tariff Policy, which provides that, wherever possible, non-market customers of the same class should have access to uniform retail tariffs and pay the same notified price for their electricity supply, regardless of their geographic location;
  - (b) Time of Use Pricing – QCA must consider whether its approach to calculating time-of-use tariffs can strengthen or enhance the underlying network price

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**DELEGATION TO QCA**


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signals and encourage customers to switch to time-of-use tariffs and reduce their energy consumption during peak times;

- (c) Framework - QCA must use the Network (N) plus Retail (R) cost build-up methodology when working out the notified prices and making the price determination, where N (network cost) is treated as a pass-through and R (energy and retail cost) is determined by QCA;
- (d) When determining the N components for each regulated retail tariff for each tariff year, QCA must consider the following:
  - (i) for residential and small business customers, that is, those who consume less than 100 megawatt hours (MWh) per annum - basing the network cost component on the network charges to be levied by Energen;
  - (ii) for large business customers in the Ergon Energy distribution region who consume 100MWh or more per annum - basing the network cost component on the network charges to be levied by Ergon Energy given that, from 1 July 2012, large business customers in the Energen distribution region no longer have access to notified prices;
- (e) Transitional Arrangements - QCA must consider:
  - (i) for the standard regulated residential tariff (Tariff 11), implementing a three-year transitional arrangement to rebalance the fixed and variable components of Tariff 11, so that each component (fixed and variable) of Tariff 11 is cost-reflective by 1 July 2015;
  - (ii) for the existing obsolete tariffs (i.e. farming, irrigation, declining block, non-domestic heating and large business customer tariffs), implementing an appropriate transitional arrangement should QCA consider there would be significant price impacts for customers on these tariffs if required to move to the alternative cost-reflective tariffs; and
  - (iii) for the large business customer tariffs introduced in 2012-13 (i.e. Tariffs 44, 45, 46, 47 and 48), whether customers on these tariffs should be able to access the transitional arrangements for the obsolete large business customer tariffs should QCA consider that a transitional arrangement for the obsolete tariffs is necessary.

*Interim Consultation Paper*

- 6. As part of each annual price determination, QCA must publish an interim consultation paper identifying key issues to be considered when calculating the N



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**DELEGATION TO QCA**

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and R components of each regulated retail electricity tariff and transitioning relevant retail tariffs over the three-year delegation period.

7. QCA must publish a written notice inviting submissions about the interim consultation paper. The notice must state a period during which anyone can make written submissions to QCA about issues relevant to the price determination.
8. QCA must consider any submissions received within the consultation period and make them available to the public, subject to normal confidentiality considerations.

*Consultation Timetable*

9. As part of each annual price determination, QCA must publish an annual consultation timetable within two weeks after submissions on the interim consultation paper are due, which can be revised at the discretion of QCA, detailing any proposed additional public papers and workshops that QCA considers would assist the consultation process.

*Workshops and additional consultation*

10. As part of the Interim Consultation Paper and in consideration of submissions in response to the Interim Consultation Paper the QCA must consider the merits of additional public consultation (workshops and papers) on identified key issues.
11. Specifically, given the three-year period of the delegation the QCA must conduct a public workshop on the energy and retail cost components used to determine regulated retail tariffs prior to the release of the 2013-14 Draft Determination.

*Draft Price Determination*

10. As part of each annual price determination, QCA must investigate and publish an annual report of its draft price determination on regulated retail electricity tariffs, with each tariff to be presented as a bundled price, for the relevant tariff year. The draft price determination must also specify the carbon cost allowances for the relevant tariff year.
11. QCA must publish a written notice inviting submissions about the draft price determination. The notice must state a period during which anyone can make written submissions to QCA about issues relevant to the draft price determination.
12. QCA must consider any submissions received within the consultation period and make them available to the public, subject to normal confidentiality considerations.

**DELEGATION TO QCA***Final Price Determination*

13. As part of each annual price determination, QCA must investigate and publish an annual report of its final price determination on regulated retail electricity tariffs, with each tariff to be presented as a bundled price, for the relevant tariff year, and gazette the bundled retail tariffs. The final price determination must also specify the carbon cost allowances for the relevant tariff year.

*Timing*

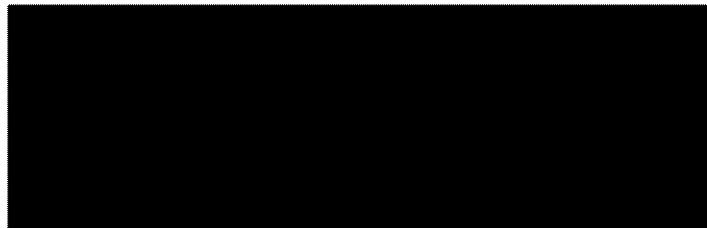
14. QCA must make its reports available to the public and, at a minimum, publicly release for each tariff year the papers and price determinations listed in paragraphs 6 to 13.
15. QCA must publish the interim consultation paper for the 2013-14 tariff year no later than one month after the date of this Delegation and no later than 30 August before the commencement of the subsequent tariff years.
16. QCA must publish the draft price determination on regulated retail electricity tariffs no later than 15 February 2013 for the 2013-14 tariff year and no later than 13 December before the commencement of the subsequent tariff years.
17. QCA must publish the final price determination on regulated retail electricity tariffs for each relevant tariff year, and have the bundled retail tariffs gazetted, no later than 31 May each year.

DATED this

5<sup>th</sup>

day of September 2012.

SIGNED by the Honourable  
Mark McArdle,  
Minister for Energy and Water Supply



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**APPENDIX B: SUBMISSIONS****Table B.1: Submissions in Response to the Interim Consultation Paper**

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<i>Organisation/Individual</i>
1. AGL
2. P.G. Atherton (Individual)
3. Australian Sugar Milling Council
4. Bundaberg Walkers Engineering Ltd
5. Canegrowers
6. CQMS Razer
7. Dobinson Spring & Suspension
8. Energex
9. EnergyAustralia
10. Energy Options
11. Energy Supply Association of Australia and Energy Retailers Association of Australia (Joint Submission)
12. Ergon Energy
13. Growcom
14. Mareeba Dimbulah Irrigation Area Council
15. Meridian Energy Australia
16. Origin Energy
17. Pioneer Valley Water Co-operative Ltd
18. Queensland Council of Social Service
19. Queensland Farmers' Federation
20. Queensland Government
21. Shopping Centre Council of Australia
22. Toowoomba Regional Council
23. Confidential Submission

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