

# Queensland Competition Authority

Interim consultation paper

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## Regulated retail electricity prices for 2016–17

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December 2015

We wish to acknowledge the contribution of the following staff to this report:

Dan Barclay, Sarah Duval and Adam Liddy

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## SUBMISSIONS

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Closing date for submissions: 18 January 2016

Public involvement is an important element of the decision-making processes of the Queensland Competition Authority (QCA). Therefore submissions are invited from interested parties concerning its assessment of 2016–17 regulated retail electricity prices. The QCA will take account of all submissions received.

Submissions, comments or inquiries regarding this paper should be directed to:

Queensland Competition Authority  
GPO Box 2257  
Brisbane Q 4001

Tel (07) 3222 0555  
Fax (07) 3222 0599

[www.qca.org.au/submissions](http://www.qca.org.au/submissions)

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In the interests of transparency and to promote informed discussion, the QCA 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. 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.

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### Public access to submissions

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

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## THE ROLE OF THE QCA – TASK, TIMING AND CONTACTS

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The Queensland Competition Authority (QCA) is an independent statutory authority that aims to promote competition as the basis for enhancing efficiency and growth in the Queensland economy.

The QCA's primary role with respect to electricity pricing is to set regulated retail electricity prices in accordance with the requirements of the delegation from the Minister for Energy and Water Supply (Appendix A) and the *Electricity Act 1994* (the Act).

### Key dates

#### 2016–17 review of regulated retail electricity prices: indicative timetable

Release of interim consultation paper	By 14 December 2015
Submissions on interim consultation paper due	18 January 2016
Release of public consultation timetable	22 January 2016
Release of draft determination	By 25 March 2016
Workshops on draft determination	April 2016
Submissions on draft determination due	20 April 2016
Release of final determination	31 May 2016

### Registration of interest

[www.qca.org.au/Submissions](http://www.qca.org.au/Submissions)

### Contact

Enquiries regarding this project should be directed to:

ATTN: Sarah Duval or Adam Liddy

Tel (07) 3222 0555

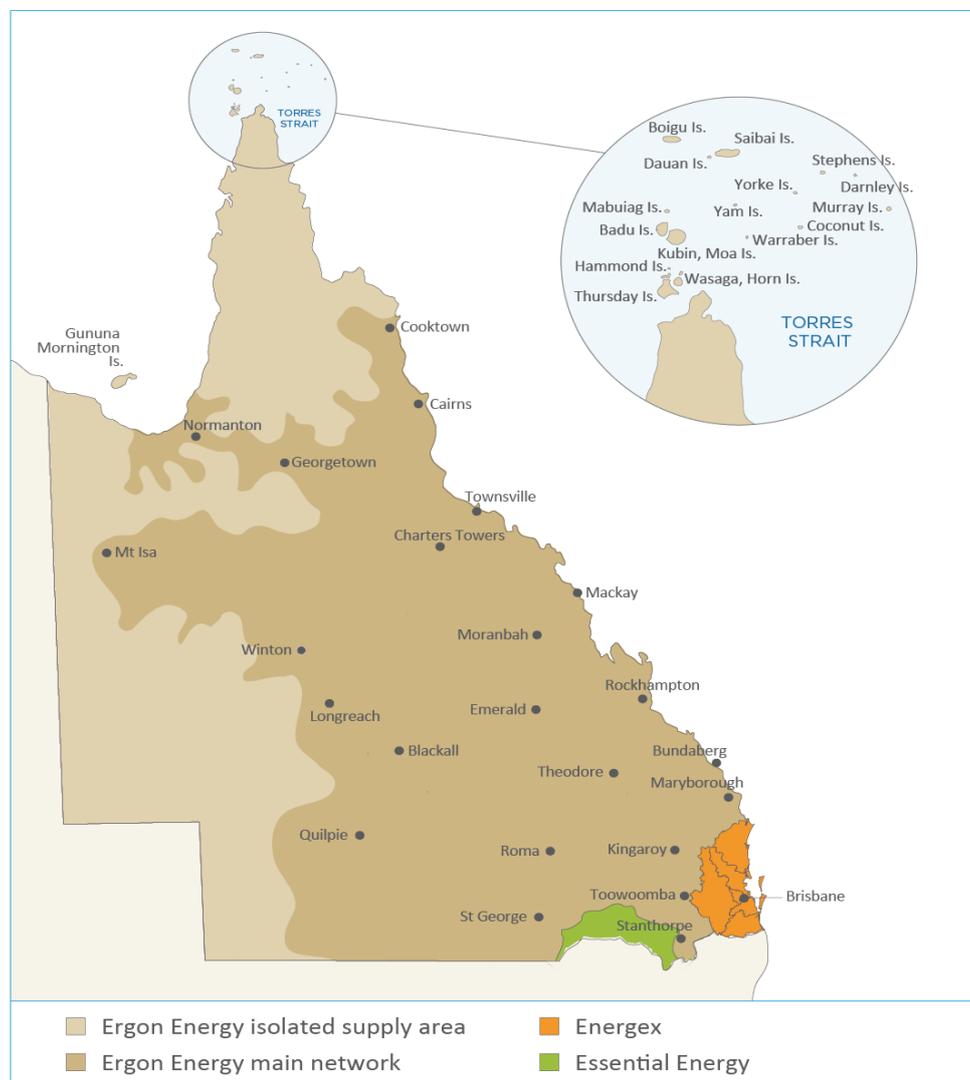
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# 1 INTRODUCTION

The Queensland Competition Authority (QCA) has received a delegation from the Minister for Energy and Water Supply (the Minister) to determine regulated retail electricity prices (notified prices) to apply to non-market customers from 1 July 2016 to 30 June 2017 (see Appendix A). We have prepared this interim consultation paper to commence our review.

The Queensland Government (the Government) has legislated to remove retail price regulation in the Energex distribution area (covering south east Queensland) from 1 July 2016. While this decision is subject to review by the Queensland Productivity Commission (QPC), the delegation notes that without further legislative change notified prices will only apply to customers in the Ergon Energy distribution area.<sup>1</sup>

**Figure 1 Queensland electricity distribution areas**



<sup>1</sup> Note that customers in the Essential Energy distribution area in southern Queensland do not have access to notified prices, although Origin Energy receives a subsidy to ensure that non-market customers pay no more than similar customers that have access to notified prices.

## 1.1 The uniform tariff policy and regional pricing

One of the central issues we must consider under the delegation is the Government's uniform tariff policy (UTP). The delegation defines the UTP as providing that, wherever possible, non-market customers of the same class should pay no more for their electricity, regardless of their geographic location.<sup>2</sup> The covering letter to the delegation<sup>3</sup> further specifies that, for the purposes of the delegation, prices in regional Queensland for small customers should broadly reflect the expected prices for customers on standing offers<sup>4</sup> in south east Queensland.

To date, applying the UTP has seen most notified prices being based on the costs of supply for standing offer customers in south east Queensland (i.e. the Energex distribution area). This benefits customers in regional Queensland who could otherwise face higher prices reflecting the higher costs of supplying electricity in regional areas. The cost difference between south east Queensland and regional Queensland is largely due to the higher network costs of supplying electricity over long distances to a low-density customer base. These additional costs are significant: the UTP's subsidy for regional electricity customers is expected to be \$432 million in 2015–16.<sup>5</sup>

## 1.2 Review process

This paper is the first stage of our public consultation process. An indicative timetable for the rest of the review, and details on how to make a submission, is provided on page v.

Submissions are invited in response to this paper and are due no later than 18 January 2016. While we have set out key issues on which we are seeking comments, stakeholders should take this opportunity to comment on any matters they consider are relevant to our review and provide detailed arguments and evidence to support their views, where possible.

We are required to publish a draft determination by 25 March 2016, and a final determination by 31 May 2016.

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<sup>2</sup> Clause 5(b) of the delegation (Appendix A).

<sup>3</sup> See the covering letter to the delegation (Appendix A).

<sup>4</sup> Standing offers are basic contracts with terms and conditions set according to the standard retail contract. In Queensland the prices charged under standing offers are the notified prices. As pointed out by the Australian Energy Market Commission, standing offer prices are generally the benchmark prices against which retailers make discounted market offers.

<sup>5</sup> Queensland Government, State Budget 2015–16—Concessions Statement, July 2015, p. 168.

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## 2 LEGISLATIVE REQUIREMENTS AND PRICING APPROACHES

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When we receive a delegation to determine notified prices, we must make that determination in accordance with our obligations under the Electricity Act. This chapter explains what these obligations are and the pricing approaches we could adopt.

### 2.1 Legislative requirements

The Electricity Act does not specify criteria or principles that we must apply when making a price determination. Rather, we are directed<sup>6</sup> to have regard to the following matters:

- (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
- (c) any matter required by delegation
- (d) any other matter we consider relevant.

When we make a determination, we must also have regard to the objectives of the Electricity Act, which are to:

- (a) set a framework for all electricity industry participants that promotes efficient, economical and environmentally sound electricity supply and use
- (b) regulate the electricity industry and electricity use
- (c) establish a competitive electricity market in line with the national electricity industry reform process
- (d) ensure that the interests of customers are protected
- (e) take into account national competition policy requirements.

#### Key matters we are required to consider by delegation

The delegation (Appendix A) sets out many matters we are required to consider. Consistent with the approach applied in previous price determinations, we are required to consider applying the network (N) plus retail (R) cost build-up methodology. As discussed in 1.1 above, we are also required to consider the Government's UTP.

When determining the N cost component, we must consider continuing with the same general approach we have applied in previous determinations. For residential and small business customer tariffs, this means using Energex's network charges and tariff structures for the flat rate tariffs (tariffs 11, 20, 31, 33, 41 and 91<sup>7</sup>). Adopting this approach would mean that network charges are below cost because they would be based on network costs in south east Queensland, not regional Queensland.

For the time-of-use and demand tariffs (tariffs 12A, 14, 22A and 24), we must consider using the price level of network charges to be levied by Energex, and Ergon Energy Distribution's (Ergon Distribution's) tariff structures. If this proposal is adopted, network prices would be at the same

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<sup>6</sup> Section 90(5) of the Electricity Act.

<sup>7</sup> Tariff 91 applies to unmetered supplies (except street lighting).

general level as Energex's network prices, but based on the structure of Ergon Distribution's network tariffs. Adopting this approach would mean that network charges are still below cost; using Ergon Distribution's tariff structures, however, would improve price signals and encourage customers to reduce consumption during peak periods in Ergon Distribution's area, as pointed out in the delegation.

For large business customer tariffs, we must consider using Ergon Distribution's network charges. This is the approach we have adopted in previous decisions.

We are also required to consider maintaining transitional arrangements for transitional and obsolete tariffs (e.g. farming and irrigation tariffs).

## 2.2 Possible pricing approaches

Taken together, the matters we are required to consider in the Electricity Act and objects of the Electricity Act suggest that cost-reflectivity and the promotion of retail competition are important guiding principles in making our determination. Accordingly, in previous determinations we considered cost-reflectivity to be important for efficiency and equity reasons and to support retail competition. However, as the 2016–17 determination applies to only the Ergon distribution area, the opportunities to promote retail competition are more limited than in previous determinations.

As noted above, the QCA must also have regard to the UTP.

Under the Electricity Act, we can also have regard to any other matter we consider relevant. We consider that the impact on customers is certainly a relevant factor, particularly given the significant price increases customers have faced in recent years.

Given that we are required to consider a number of potentially conflicting matters when making our price determination, we have considered a spectrum of possible pricing approaches, particularly for residential and small business customers.

### Residential and small business customers

While we are not considering this approach for 2016–17, a possible approach in setting retail prices at one end of the spectrum would be to move gradually from prices which reflect south east Queensland costs (under the UTP) to fully cost-reflective notified prices (i.e. reflecting the actual costs of supply to customers in each region). Cost-reflective pricing would avoid the need to subsidise electricity prices and would promote retail competition. However, it would be inconsistent with maintaining uniform tariffs (because it would result in different notified prices for customers based on their location) and would mean significant price increases, particularly for customers in western parts of the state and those supplied by isolated systems.

Another possibility would be to consider the approach applied for large business customers since 2012. When price regulation for large business customers in south east Queensland ended, we decided to base notified prices for large business customers outside south east Queensland on the lowest costs of supply for those customers still eligible for notified prices. This approach meant the new benchmark for pricing was Ergon Energy's east pricing zone, transmission region 1.<sup>8</sup> We have continued this approach for subsequent determinations. Adopting this approach for residential and small business customers would lower price impacts and maintain uniform tariffs compared to introducing fully cost-reflective prices. This would

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<sup>8</sup> Queensland Competition Authority, *Final Determination: Regulated Retail Electricity Prices 2012–13*, May 2012.

improve cost-reflectivity (relative to the current approach based on south east Queensland costs). It would also reduce the subsidy paid by taxpayers to subsidise electricity prices.

However, this approach would be inconsistent with the Government's interpretation of the UTP for residential and small business customers for 2016–17 and, in some cases, price increases would be too significant to introduce in a single year. With the costs of supplying residential customers in the east pricing zone about 30 per cent higher than in south east Queensland<sup>9</sup>, adopting this approach would result in significant price increases.

At the other end of the spectrum, we could maintain our current approach, which would involve setting notified prices based on the costs of supply in south east Queensland, rather than regional Queensland. As raised in the delegation, this approach could also allow use of Ergon Distribution's tariff structures for some or all retail tariffs (discussed in Chapter 3) while retaining prices at south east Queensland levels.

This approach would result in customers continuing to pay much less than the costs of supply, potentially leading to inefficient investment and decision-making and ongoing subsidisation of electricity prices by taxpayers (estimated at \$432 million for 2015–16, as noted above). However, it may be considered reasonable because it would avoid the high price increases associated with the other approaches and would be consistent with the uniform tariff policy for 2016–17.

On balance, the QCA regards the current approach of basing notified prices for residential and small business customers in regional Queensland on south east Queensland costs as the most appropriate approach for 2016–17.

### Large business customers

As noted above, in previous determinations we have set notified prices for large business customers based on the lowest costs of supplying customers in regional Queensland. This approach has the benefit of being more cost-reflective and less costly to subsidise than an approach based on south east Queensland costs. It is also consistent with the requirement in the delegation to consider basing the network cost component on Ergon Distribution's network charges. While moving to fully cost-reflective notified prices may be an option, we consider it would be inconsistent with the UTP.

#### Consultation questions

- For residential and small business customers, should we maintain the 2015–16 approach, which is to keep notified prices at south east Queensland levels, but use Ergon Distribution's tariff structures for time-of-use and demand tariffs? Why?
- For large business customers, should we maintain the 2015–16 approach, which is to base notified prices on regional Queensland costs? Why?

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<sup>9</sup> This is the estimated impact in 2014–15 on a typical tariff 11 customer in the Ergon Distribution east pricing zone (transmission region one) paying cost-reflective notified prices.

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## 3 NETWORK COSTS

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Network costs are the costs associated with transporting electricity through the transmission and distribution networks and account for around 50 per cent of the final cost of electricity for residential and small business customers.

As regulated monopoly businesses, Powerlink, Energex and Ergon Distribution all earn regulated revenues that are determined by the Australian Energy Regulator (AER). In addition to recovering their own distribution network costs, Energex and Ergon Distribution pass Powerlink's costs on to customers in network prices that are also approved by the AER.

The delegation requires that we consider:

- (a) for residential and small business<sup>10</sup> tariffs (with the exception of tariffs 12A, 14, 22A and 24), basing the network cost component on Energex network charges and tariff structures
- (b) for residential and small business tariffs 12A, 14, 22A and 24, basing the network cost component on the price level of Energex network charges, and the relevant Ergon Distribution tariff structures
- (c) for large customer<sup>11</sup> retail tariffs, basing the network cost component on Ergon Distribution network's charges.

### 3.1 Network tariffs for residential and small business customers and unmetered supplies

The 2016–17 delegation requires the QCA to consider basing non-time-of-use retail tariffs for residential, small business, and unmetered supply customers (with the exception of street lighting—see Section 3.2 below) on Energex's network charges and tariff structures. We must also consider basing all time-of-use, and seasonal time-of-use demand, tariffs for residential and small business customers in regional Queensland on Ergon Distribution's network tariff structures. The delegation also requires us to consider the Government's uniform tariff policy in setting notified prices.

#### Level of network charges

In order to maintain consistency with the uniform tariff policy we must decide on the appropriate level of network charges. Our preference, as discussed in Chapter 2, is to base notified prices for residential and small business customers in regional areas on south east Queensland costs. This would mean setting network charges at Energex price levels.

#### Structure of network tariffs

We must also consider whether to use the tariff structures of Energex or Ergon Distribution network tariffs. Energex and Ergon Distribution tariff structures differ across residential and small business tariffs in terms of their use of fixed charges, demand charges and consumption charges.

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<sup>10</sup> Business customers which consume 100 MWh per annum or less.

<sup>11</sup> Business customers which consume more than 100 MWh per annum.

In this section, we compare the proposed 2016–17 Energex and Ergon Distribution tariff structures for different customer classes and set out possible approaches the QCA may take to set 2016–17 notified prices. Table 2 compares the network tariff structures for time-of-use and demand tariffs, while Table 3 compares non-time-of-use tariffs.

### Residential and small business time-of-use tariffs

Ergon Distribution's residential time-of-use tariff structures comprise the same components as for Energex (i.e. a fixed charge, variable peak, shoulder and off-peak charges), but variable charges apply during different time periods. Ergon Distribution tariffs are seasonal, with peak and shoulder periods limited to the summer months, whereas Energex has no seasonal component in its tariffs. In practical terms, the off-peak period in Ergon Distribution's residential time-of-use tariff accounts for a much greater proportion of time.

Unlike the residential time-of-use tariff, there is a mismatch between the structure of the Energex and Ergon Distribution small business time-of-use tariffs. Energex has peak and off-peak variable charges, while Ergon Distribution has peak, shoulder and off-peak variable charges. Like the residential tariff, Ergon Distribution's peak and shoulder periods are seasonal, being limited to the summer months.

Ergon Distribution's tariffs are more heavily weighted toward the recovery of costs through fixed charges than Energex's tariffs. Therefore, using Ergon Distribution's tariffs would have a negative effect on customers with low consumption, but a positive effect on customers with high consumption.

**Table 2 Energex and Ergon Distribution residential and small business customer time-of-use and demand tariffs**

Distributor		Peak	Shoulder	Off-peak
Residential (time-of-use)				
Energex (retail tariff 12)	Consumption	4 pm–8 pm Mon–Fri 1,044 hours per year	7 am–4 pm, 8 pm–10 pm Mon–Fri 7 am–10 pm weekends 4,431 hours per year	10 pm–7 am every day 3,285 hours per year
Ergon Distribution (retail tariff 12A)	Consumption	3 pm–9:30 pm any day of the week, summer <sup>a</sup> only 585 hours per year		All other times 8,175 hours per year
Residential (time-of-use and demand)				
Energex (to be introduced on 1 July 2016)	Consumption	Flat consumption charge		
	Demand	4 pm–8 pm workdays 1,044 hours per year		
Ergon Distribution (retail tariff 14)	Consumption	Flat consumption charge		
	Demand	3pm–9:30 pm any day of the week summer <sup>a</sup> only 585 hours per year		All times—non-summer <sup>a</sup> months 8175 hours per year
Small business (time-of-use)				

Distributor		Peak	Shoulder	Off-peak
Energex (retail tariff 22)	Consumption	7 am–9 pm, week days 3,654 hours per year	n/a	All other times 5,106 hours per year
Ergon Distribution (retail tariff 22A)	Consumption	10 am–8 pm on summer <sup>a</sup> week days 540 hours per year		All other times 8,120 hours per year

<sup>a</sup> Summer months are December, January and February.

Note: Unlike Energex Ergon Distribution has a small business customer seasonal time-of-use and demand tariff (retail tariff 24). Energex currently has no equivalent distribution tariff.

### Residential and small business non-time-of-use tariffs

For non-time-of-use tariffs the key differences between the Energex and Ergon Distribution network tariff structures are:

- Energex has flat variable rates, while Ergon Distribution has three-part inclining block tariffs (IBTs).
- Ergon Distribution's tariffs are more heavily weighted toward the recovery of costs through fixed charges than Energex's tariffs.
- Ergon Distribution has a fixed charge for controlled load tariffs, whereas Energex does not.

**Table 3 Energex and Ergon Distribution residential and small business non time-of-use tariffs**

Type	Distributor	Fixed	Variable		
Residential (tariff 11)	Energex	c/day	Flat rate c/kWh		
	Ergon Distribution	c/day	c/kWh 1st 1,000 kWh/year	c/kWh next 5,000 kWh/year	c/kWh >6,000 kWh/year
Small business (tariff 20)	Energex	c/day	Flat rate c/kWh		
	Ergon Distribution	c/day	c/kWh 1st 1,000 kWh/year	c/kWh next 19,000 kWh/year	c/kWh >20,000 kWh/year
Small business demand (tariff 41)	Energex	c/day	Flat rate c/kWh		\$/kVa/month
	Ergon Distribution	No network tariff			
Night controlled load (tariff 31)	Energex	n/a	Flat rate c/kWh		
	Ergon Distribution	c/day	Flat rate c/kWh		
Controlled load (tariff 33)	Energex	n/a	Flat rate c/kWh		
	Ergon Distribution	c/day	Flat rate c/kWh		
Controlled load <sup>a</sup> (to be introduced on 1 July 2016)	Energex	n/a	Flat rate c/kWh		
	Ergon Distribution	c/day	Flat rate c/kWh		
Unmetered	Energex	n/a	Flat rate c/kWh		

Type	Distributor	Fixed	Variable
(tariff 91)	Ergon Distribution	c/day	Flat rate c/kWh

*a* Energex and Ergon intend to introduce a new controlled load tariff on 1 July 2016. While these tariffs are yet to be finalised we understand they will only be available in conjunction with a residential demand tariff.

### Possible approaches

For the 2015–16 determination, we used Energex’s network charges and tariff structures as the basis for setting non-time-of-use retail tariffs for residential customers, small business customers and unmetered supplies (excluding street lighting—see Section 3.2 below) because they reflected the costs of supplying customers in south east Queensland. For residential and small business customers in regional Queensland we based all time-of-use, and seasonal time-of-use demand, tariffs on Ergon Distribution’s network tariff structures adjusted to reflect south east Queensland network price levels to maintain consistency with the UTP.

We consider that there are three possible approaches we could adopt for 2016–17:

- (a) Use Energex’s tariff structures as the basis for all retail tariffs.
- (b) Use a mix of Energex’s and Ergon Distribution’s tariff structures (consistent with the proposal in the delegation).
- (c) Use Ergon Distribution’s tariff structures as the basis for all retail tariffs.

### Energex structures for all retail tariffs

Using Energex’s tariff structures as the basis for all residential and small business retail tariffs would be inconsistent with our 2015–16 determination, and would result in customers facing price signals that do not reflect the impact of their consumption on Ergon Distribution’s network, which may provide incentives for customers to make inefficient consumption and investment decisions.

### Mix of Energex and Ergon Distribution structures

Under this approach, Energex’s structures would be used for some tariffs and Ergon Distributions’ structures would be used for others. One example would be to use the approach followed in 2015–16 and proposed in the delegation, which is to use Energex’s structures for the flat and controlled load tariffs and Ergon Distribution’s structures for the demand and time-of-use tariffs (12A, 14, 22A and 24). This approach would result in tariffs which better reflect the structure of network tariffs and encourage customers to reduce consumption during peak periods on Ergon Distribution’s network.

As with our 2015–16 determination we would need to consider the incentives for customers to move between flat rate and time-of-use tariffs, if Energex tariffs are used as the basis for the former and Ergon Distribution tariffs are used as the basis for the latter.

### Ergon Distribution structures for all retail tariffs

The third approach is to base all residential and small business tariffs on Ergon Distribution’s structures. This would be a further step towards improving cost-reflectivity by adopting an inclining block tariff structure for non-time-of-use tariffs. The analysis we conducted for setting 2015–16 prices showed that this change in structure would affect the majority of customers in regional Queensland and result in larger customers being slightly better off, and negatively impact average and small users. We would need to consider these impacts carefully.

### 3.2 Network tariffs for large business customers and street lighting

For the 2015–16 determination, we based retail tariffs for large business customers and street lighting customers on the network charges of Ergon Energy's east pricing zone, transmission region one, on the basis that this area has the greatest proportion of large customers and the lowest costs for large customers in regional Queensland.

### 3.3 Obsolete and transitional retail tariffs

The delegation requires that we consider maintaining transitional arrangements for retail tariffs classed as transitional or obsolete. There is no need to determine network charges for these tariffs as they are not based on actual costs. Obsolete and transitional tariffs are discussed further in Chapter 5.

### 3.4 Approval of distributors' network tariffs for 2016–17

For the 2015–16 determination we based network costs on the prices which were approved by the AER in June 2015. For the 2016–17 final determination we expect to use network prices submitted to the AER for approval. As these prices will not be available when we are due to publish our draft determination we propose to follow the same approach as in previous years—that is, to base network costs for our draft determination on draft network charges provided by distributors.

#### Consultation questions

- Should we use Energex's tariff structures as the basis for retail tariffs for residential and small business customers?
- Alternatively, should we use Ergon Distribution's tariff structures for some or all retail tariffs for residential and small business customers? If so, how should Ergon Distribution tariffs be adjusted to reflect the uniform tariff policy?
- Should we use Ergon Distribution's tariff structures as the basis for retail tariffs for large business, and streetlighting, customers?
- Are there any other issues we should consider?

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## 4 ENERGY COSTS

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In setting the R component of regulated retail electricity prices we must include an allowance for energy costs. Retailers incur energy costs when purchasing electricity to supply their customers.

In our 2015–16 determination, our estimate of energy costs was based on advice from our consultant, ACIL Allen. For our 2016–17 determination we have again engaged ACIL Allen to provide advice.<sup>12</sup> We consider that engaging the same consultant for this review will provide continuity and certainty to stakeholders.

We have instructed ACIL Allen to provide cost estimates for both south east Queensland and regional Queensland. In previous determinations, we have used the south east Queensland estimates to set notified prices for residential and small business customers, and the regional Queensland estimates to set notified prices for large business, and street lighting customers.

### Energy cost components

Energy costs can be broken into five general categories:

- (a) wholesale energy costs
- (b) Renewable Energy Target (RET) costs
- (c) National Electricity Market (NEM) participation fees and ancillary services charges
- (d) prudential capital costs
- (e) energy losses.

A brief explanation of each of these components is provided below. A detailed explanation of how each cost component was estimated for 2015–16 is provided in our 2015–16 determination and ACIL Allen's reports, which are available on our [website](#).<sup>13</sup>

### Wholesale energy costs

Wholesale energy costs are the costs retailers incur when purchasing electricity from the NEM to meet the demand of its customers.

The NEM is a particularly volatile market where prices are determined every half hour and can range from –\$1000 per MWh to \$13,800 per MWh.<sup>14</sup> Retailers can, and do, take a range of measures to reduce their exposure to these volatile prices, including: pursuing a 'hedging strategy' by purchasing financial derivatives like swaps and options; entering long-term power purchase agreements (PPAs) with generators; or investing in their own electricity generators.

In the past, we considered two main alternative approaches for determining wholesale energy costs—a hedging-based approach and a long-run marginal cost (LRMC) approach which

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<sup>12</sup> The terms of reference for ACIL Allen's appointment are available on our website.

<sup>13</sup> <http://www.qca.org.au/Electricity/Regional-consumers/Reg-Electricity-Prices/Final-Report/Regulated-Electricity-Prices-2015-16#finalpos>.

<sup>14</sup> Minimum spot price is defined in clause 3.9.6(b) of the National Electricity Rules. The Market Price Cap is published by the AEMC every February (<http://www.aemc.gov.au/News-Center/What-s-New/Announcements/AEMC-publishes-the-Schedule-of-Reliability-Set-%283%29>).

attempts to estimate the long-run costs of generation.<sup>15</sup> In 2015–16 we used a hedging-based approach as we considered it to be transparent and best reflected the actual costs retailers incur when purchasing electricity from the NEM in a given year. Hedging-based approaches have also been adopted by other Australian regulators and have been endorsed by the Australian Energy Market Commission (AEMC) in its final report on best practice retail price regulation, produced for the Standing Council on Energy and Resources (SCER).<sup>16</sup>

### Renewable Energy Target costs

The RET scheme, comprised of the Large-scale Renewable Energy Target (LRET) and Small-scale Renewable Energy Scheme (SRES), provides incentives for the electricity sector to deliver 33,000 GWh of electricity from renewable sources by 2020, reducing greenhouse gas emissions from the electricity sector. The costs of these incentives are paid by retailers through the purchase of Large-scale Generation Certificates (LGCs) and Small-scale Technology Certificates (STCs).

### NEM participation fees and ancillary services charges

Retailers buying electricity from the NEM are required to pay NEM participation fees and ancillary services charges to the Australian Energy Market Operator (AEMO). NEM participation fees cover the costs of operating the electricity market. Ancillary services charges cover the costs of the services used by AEMO to manage power system safety, security and reliability.

### Prudential capital costs

Prudential capital costs are incurred by retailers when providing financial guarantees to AEMO and hedging providers. In the 2015–16 determination these costs were considered as part of the retail operating cost allowance. However, as discussed in Chapter 5, as prudential costs vary according to conditions in the electricity market, and the electricity load purchased, we are considering removing these costs from general retail operating costs and accounting for these costs separately in 2016–17.

### Energy losses

Some electricity is lost when it is transported over transmission and distribution networks to customers. Retailers must purchase additional electricity to allow for those losses when supplying customers.

#### Consultation questions

- Is there any new information available to suggest alternative approaches to those used in the 2015–16 determination might be more appropriate?
- What improvements could be made to the current approaches?
- Should prudential capital costs be removed from retail operating costs and accounted for as part of energy costs?
- Any there any other issues we should consider when estimating energy costs?

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<sup>15</sup> In previous reviews, we also considered a statistical model that estimated the price a retailer might be willing to pay to enter hedging contracts (the price distribution approach).

<sup>16</sup> AEMC, final report, *Advice on best practice retail price methodology*, 27 September 2013.

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## 5 RETAIL COSTS

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The second element of the R component is retail costs, which include retail operating costs (ROC) and a retail margin. In this chapter we examine the key issues relevant to estimating and applying ROC allowances and margins.

### Retail operating costs

ROC are the costs associated with services provided by a retailer to its customers and typically include the costs associated with customer administration, call centres, corporate overheads, billing and revenue collection, IT systems, and regulatory compliance.

We have previously considered that the level of ROC incurred by retailers differs based on whether the customer is a large or small user. In previous determinations, we have set three different ROC allowances to reflect the costs of supplying small, large and very large customers.

In past decisions, we have also included an allowance to reflect the costs that retailers incur in a competitive market to attract new customers and retain existing customers. These are known as customer acquisition and retention costs (CARC). While there is competition for large business customers in Ergon Distribution's east zone, transmission region one, we recognise that competition is extremely limited in some regional areas, particularly for residential and small business customers.

### Retail margin

The retail margin represents the return to investors for retailers' exposure to systematic risks associated with providing retail electricity services. A retail margin that is not sufficient to compensate investors for their investment and risk exposure can lead to under-investment by existing retailers, create a barrier to entry into the market, and hinder the development and maintenance of effective competition. For our 2014–15 and 2015–16 determinations, we applied a retail margin of 5.7 per cent of total costs for all cost-reflective tariffs. This was consistent with the retail margin adopted by IPART in its 2013 decision on regulated retail electricity prices in NSW.<sup>17</sup>

## 5.1 Establishing efficient ROC and margin allowances

In previous determinations, the QCA has derived the ROC and margin allowances based on publicly reported data and benchmark observations of other regulatory decisions, predominantly those of the Independent Pricing and Regulatory Tribunal (IPART).

In our 2015–16 determination we continued with this benchmarking approach as we considered that a more extensive analysis would not necessarily deliver significant benefits compared with the existing approach. Nonetheless, we indicated that we would consider undertaking a more thorough assessment of ROC and retail margins, should we be delegated the task of setting notified prices for 2016–17.

The QCA has engaged ACIL Allen to provide advice on the estimation of efficient ROC and margin allowances for 2016–17 notified prices. As a first step, ACIL Allen has prepared a Methodology Paper (Attachment A) outlining a proposed approach to estimating these

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<sup>17</sup> IPART, *Review of regulated retail prices and charges for electricity from 1 July 2013 to 30 June 2016*, June 2013, chapter 7.

allowances, which has been released along with this Interim Consultation Paper. ACIL Allen's Methodology Paper will be followed by further reports and analysis, which will also be released for comment. We will consider ACIL Allen's advice and stakeholder feedback when making our draft and final determinations.

The remainder of this chapter discusses the issues that we consider are key to this exercise and invites stakeholder feedback on our previous approaches and ACIL Allen's proposed methodology for estimating the ROC and margin allowances. Specifically, the key issues are:

- how to define a 'representative' retailer
- estimation methodologies
- applying ROC and margin to retail tariffs
- updating ROC allowances from year to year.

## 5.2 How to define a 'representative' retailer

Under the N+R approach, retail costs are estimated to reflect the costs that would be incurred by an efficient retailer supplying electricity to customers. Since our 2012–13 determination, we have considered that an efficient retailer is one that:

- (a) minimises the retail costs of supplying electricity to its customers
- (b) sets prices that are cost-reflective
- (c) earns a normal economic return that covers its cost of capital.

When determining the efficient level of ROC and margin, we must first define a benchmark representative electricity retail business, whose characteristics will be used to develop the level and structure of an efficient retail cost allowance and margin.

Defining the characteristics of the representative retailer is important, as these will affect the final levels of what can be considered 'efficient' ROC and margins. For instance, an incumbent retailer with some history in the Queensland market and a large customer base, could enjoy lower operating costs due to scale economies that a new entrant retailer may not have yet realised. Similarly, a vertically integrated retailer that owns upstream generation assets would likely face a different cost structure to a standalone retailer without generation interests. Other characteristics that will determine the efficient levels of ROC and margin for an individual retailer include the type of customers it serves, whether it is a horizontally integrated business operating in other product markets (for example gas supply), and whether the retailer operates in other jurisdictions.

In our 2012–13 determination—the first determination to apply the N+R approach—the Ministerial Delegation required the QCA to consider the retail costs that would reasonably be incurred by an 'efficient representative retailer, the characteristics of which should be determined by the Authority'. Since 2012–13, the QCA has considered that a representative retailer is one that:<sup>18</sup>

- is an incumbent retailer of sufficient size to have achieved economies of scale
- serves small and large retail customers in Queensland and other jurisdictions across the NEM
- has a mix of market and non-market customers

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<sup>18</sup> QCA, *Final Determination—Regulated retail electricity prices 2012–13*, May 2012, p. 48.

- retails electricity on a standalone basis (i.e.; it does not sell other products such as gas)
- is not vertically integrated with an electricity generator.

The representative retailer is not intended to reflect any actual retailer, nor is it meant to reflect an 'average' retailer. Rather, the representative retailer should have the characteristics necessary to deliver a ROC estimate which we consider reflects the cost of supply, in accordance with the requirements of the Electricity Act.<sup>19</sup> While the Electricity Act also requires us to consider the impact of our determination on competition, which can be influenced by the ROC and margin, we consider it is not the role of these components to encourage new entry and competition through higher than efficient allowances, which could result from setting costs to reflect those likely to be incurred by a new entrant. We consider that competition should be considered in a more transparent manner through the headroom component of notified prices (see Chapter 6).

#### Consultation questions

- Is the QCA's current definition of a representative retailer appropriate?
- Are there any alternative definitions the QCA should consider?

### 5.3 Estimating retail operating costs

Two main methods are generally used in estimating retail operating costs—benchmarking and bottom-up assessment.

Benchmarking involves examining other regulatory decisions and/or actual cost data from retailers to determine an efficient allowance. A bottom-up approach involves estimating the efficient level of each component of retail operating costs to build up a total allowance. A bottom-up approach, validated by a benchmarking exercise, was favoured by the AEMC in its advice on best practice retail price regulation. It stated:<sup>20</sup>

*The AEMC considers that the bottom-up approach is the preferred approach to calculate retail operating costs, since it will result in the most efficient retail operating cost component. In order to overcome information asymmetries that may exist, benchmarking should be undertaken in order to provide a sense check on the "efficiency" of the bottom-up costs. While undertaking two approaches increases the effort and time faced by the regulator, it does increase the likelihood of identifying the level of efficient costs.*

We do not see that the purpose of the ROC allowance is to compensate for the actual operating costs faced by retailers. Rather, we consider the allowance should be based on an estimate of the costs incurred by an efficient representative retailer. We consider that using a combination of bottom-up and benchmarking is likely to produce a more robust estimate for our purposes than using either method in isolation.

Consistent with the AEMC's best practice recommendations, ACIL Allen proposes to use a combination of bottom-up and benchmarking methods in estimating the ROC allowance, informed by analysis of publicly available data, observed retail market offers, and detailed information provided by retailers. ACIL Allen's proposed approach is explained in detail in its Methodology Paper (Attachment A).

<sup>19</sup> Section 90(5) of the Electricity Act.

<sup>20</sup> AEMC, final report, *Advice on best practice retail price methodology*, 27 September 2013, p. 61.

### Consultation questions

- Are ACIL Allen's proposed methods appropriate for estimating efficient ROC allowances?
- Are there any alternative estimation methods the QCA and ACIL Allen should consider?
- What costs should be considered as part of the ROC allowance? What costs should be excluded and why?

#### 5.3.1 Estimating ROC allowances for large business customers

The efficient level of ROC can differ according to the type of customers that the retailer serves. For example, retailers tend to incur higher operating costs to serve large customers than to serve small customers. This is due to higher costs of marketing, account management and costs associated with pricing larger loads.

We have previously found limited evidence to use in determining an appropriate ROC allowance for large customers, because regulators in most other jurisdictions have typically only determined regulated retail electricity prices for small customers, and publicly reported ROC data did not discriminate between customer classes. However, for our 2012–13 determination, we were able to draw on analysis conducted by Frontier Economics (Frontier) for the Western Australian Office of Energy in 2009 and Economic Regulation Authority (ERA) in 2012.<sup>21</sup> Frontier's analysis suggested that the cost of servicing larger customers was significantly higher than the cost of servicing smaller customers.

For our 2012–13 determination, we decided to set higher ROC allowances for large and very large business customers based on Frontier's analysis. No additional allowance was provided for CARC for large customer tariffs because it was implicitly included in Frontier's estimates. We have maintained these allowances in real terms for our 2013–14, 2014–15 and 2015–16 determinations.

We have instructed ACIL Allen to advise us on appropriate ROC allowances for large customers for determining 2016–17 notified prices.

### Consultation questions

- Are large and very large customers more costly to serve than small customers? If so, why?
- Should the QCA continue to apply a different ROC allowance for large and very large customers?
- Is ACIL Allen's approach to estimating large customer ROC allowances appropriate? Are there any other estimation methods that should be considered?

#### 5.4 Applying ROC to retail tariffs

Once estimated, the ROC allowances can be applied to the variable tariff components, fixed tariff components, or both. Generally, the principle of cost-reflectivity informs the decision on

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<sup>21</sup> Frontier Economics, *Retail Operating Costs—A Report Prepared for the Economic Regulation Authority of Western Australia*, February 2012.

where the ROC allowance should apply in each retail tariff. If retail operating costs are mostly fixed, they should generally be applied to the fixed tariff component and if they are mostly variable (they change with the level of consumption) they should generally apply to the variable tariff components. In previous determinations, we have allocated the ROC allowances to the fixed component of retail tariffs only as we considered there was no strong evidence indicating that these costs vary greatly with electricity consumption.

We have previously decided not to apply ROC allowances to the controlled load retail tariffs and unmetered retail tariffs because we assumed that customers accessing those tariffs would also access another general supply tariff and pay their fixed charges in that context. In 2015–16, we continued with this approach and applied the ROC allowances to the fixed component of each retail tariff, except:

- controlled load tariffs (tariffs 31 and 33), because customers accessing these retail tariffs will also be supplied under one of the general supply residential or small business tariffs (e.g. tariff 11 or 20)
- unmetered tariffs (tariffs 71 and 91), because customers accessing these tariffs are also likely to be supplied under another general supply business tariff.

#### Consultation questions

- Is the QCA's approach to applying ROC to retail tariffs appropriate? Are there any other approaches we should consider?
- Should the ROC allowance apply to the fixed or variable component of retail tariffs or some combination of the two?

## 5.5 Updating ROC from year to year

A thorough bottom-up and benchmark review of the efficient ROC allowance represents a time consuming and costly exercise, and places a significant reporting burden on electricity retailers. We consider that the cost of doing this exercise on a yearly basis would most likely outweigh any incremental benefit over the short term. Rather, we envisage that a thorough review of the ROC for the 2016–17 determination should produce robust estimates which can then be updated annually using a defined escalation method.

In recent determinations, we have escalated the ROC allowances from year to year by forecast inflation rates, using the Consumer Price Index (CPI). This is a simple approach which maintains the real value of the ROC allowance over time. Another possible approach is to derive a composite weighted-average index, designed to better reflect the change in costs actually faced by retailers. For example, as labour is a significant component of retailers' operating costs, we could consider escalating some proportion of the ROC allowance by the Wage Price Index (WPI).

In contrast, it might be argued that retailers should become more efficient over time. This would imply a real decrease in ROC over time, rather than an escalation, all other things constant. This could be captured by incorporating a productivity adjustment or 'X'-factor into the annual escalation formula.

Clearly, any form of annual escalation exercise could not be conducted indefinitely, and a further detailed review of the ROC would need to be conducted in due course. This would become particularly important if there are any material changes in cost drivers that flow through to retailers' operating costs.

### Consultation questions

- How should the QCA update the efficient ROC allowance from year to year?
- How often should the QCA conduct a comprehensive review/re-estimation of the ROC allowance?

## 5.6 Estimating the 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.

In our 2015–16 determination, we set the retail margin at 5.7 per cent of total efficient costs (including the margin). This is the retail margin we adopted in our 2013–14 and 2014–15 determinations and is consistent with the retail margin IPART adopted in its 2013 decision.

For our 2015–16 determination, we decided that it was appropriate to adopt the same retail margin as IPART, because it was the most recently estimated benchmark available and it was based on extensive analysis; we also considered that retailers face similar levels of risk in Queensland and NSW.

### 5.6.1 How to estimate the retail margin

To be cost reflective, the retail margin should be set so that it appropriately compensates for the risks incurred by a representative retailer. These risks can be quantified using a number of methods including:

- bottom-up methods, which estimate a retailer's asset base and its estimated cost of capital, then determining the revenues required to allow the retailer to earn an expected return equal to its cost of capital
- benchmarking techniques, which examine the reported margins of comparable firms by observing public data from stock exchanges or other data sources
- the 'expected returns' approach, which relies on an estimation of the expected cash flows that a retailer would earn from its customers. The retail margin is then estimated to compensate investors for the systematic risk associated with these cash flows.

The margin estimate we have previously adopted was derived by IPART and its consultants using a combination of these three approaches.

ACIL Allen proposes to use a combination of bottom-up and benchmarking methods in estimating efficient margins, informed by analysis of publicly available data, observed market offers, and detailed information provided by retailers. ACIL Allen's proposed approach is explained in detail in its Methodology Paper (Attachment A).

### Consultation questions

- Is ACIL Allen's proposed approach to estimating retail margins appropriate?
- Are there any other methods to consider for estimating retail margins?
- What risks should be compensated for through the margin, and what risks should not?

#### 5.6.2 Applying the retail margin to retail tariffs

Given that the margin has been estimated as a percentage of total costs, we have previously applied the retail margin equally (on a percentage basis) to all components (fixed, variable and demand charges) of each retail tariff. This has meant that all customers would pay the same margin as a percentage of their total bill but, in dollar terms, high-use customers would pay more than low-use customers.

### Consultation questions

- Is the way we have previously applied the margin to retail tariffs still appropriate?
- Are there any other approaches the QCA should consider?

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## 6 OTHER ISSUES

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This chapter discusses other issues relevant to our review, including:

- (a) competition and headroom
- (b) whether we should include a cost pass-through mechanism
- (c) the possible removal of tariff 41
- (d) transitional arrangements for tariffs classed as transitional or obsolete.

### Competition and headroom

Under section 90(5)(a) of the Electricity Act, we are required to have regard to the effect of our price determination on competition in the Queensland retail electricity market. We must also have regard to the objects of the Electricity Act<sup>22</sup>, which include:

- (a) establishing a competitive electricity market in line with the national electricity industry reform process
- (b) taking into account national competition policy requirements.

We consider effective competition provides the best means of delivering the goods and services that customers demand at prices that reflect efficient costs. In setting notified prices we must have regard to both the actual costs of supply and the impact of our determination on competition. As the two objectives are contradictory to an extent, a trade-off must be made between these two objectives.

In previous determinations we based notified prices for large business, and street lighting, customers on the lowest costs of supply in regional Queensland<sup>23</sup> and included a 5 per cent headroom allowance on top of efficient costs to support the development of competition. In this area (east zone, transmission region 1) retail tariffs for most large customers (excluding transitional tariffs) are now cost-reflective, and around 47 per cent<sup>24</sup> of large customers have moved to a market contract with a retailer other than Ergon Retail.

However, retail competition for large customers in other areas of regional Queensland, as well as for residential and small business customers in regional Queensland, is extremely limited, as under the UTP these customers pay notified prices which are based on prices in lower-cost areas of Queensland. The size of the deficit between the prices they pay and their actual costs of supply implies that it is unlikely the inclusion of any reasonable level of headroom would be sufficient to promote retail competition.

In previous determinations, headroom was calculated when determining price levels for these customers so that, as required by the UTP, notified prices reflect the prevailing price levels in cost-reflective areas of the state. However, some stakeholders have argued that headroom should not be included in small customer notified prices, because it would not promote retail competition in regional Queensland.

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<sup>22</sup> *Electricity Act 1994*, s. 3.

<sup>23</sup> The lowest costs of supply are in Ergon Distribution's east zone, transmission region 1.

<sup>24</sup> Based on data from Ergon Distribution.

In previous determinations, we considered that the inclusion of headroom, which is an allowance above efficient costs, was appropriate where notified prices are set on a cost-reflective basis to facilitate the development of competition and encourage retailers to compete for customers.

### Consultation questions

- Should headroom continue to be included in notified prices for residential and small business customers? Why?
- Should headroom continue to be included in notified prices for large business customers? If so, at what level? If not, why not?
- What other issues should we consider in relation to competition and headroom?

## 6.1 Cost pass-through mechanism

Cost pass-through mechanisms are used by regulators to account for the risk that the costs allowed for in regulated prices are higher or lower than actual costs. Cost pass-through mechanisms are usually included in multi-year price determinations and restricted to events that are outside the control of the regulated entity.

We applied a cost pass-through mechanism to adjust 2015–16 notified prices for the pass-through of an under-recovery of costs associated with the SRES incurred during 2014–15. We also decided that the pass-through mechanism could be used to account for material differences between final network charges approved by the AER and billed to retailers, and those used to set notified prices. However, no such adjustment was required in 2015–16, and as 2015–16 notified prices were based on final approved network charges, a network cost pass-through will not be necessary for 2016–17 notified prices.

The current delegation requires that we determine notified prices for one year. This means that, while we might consider a pass-through of any under-recovery of costs from 2015–16, we cannot guarantee the pass-through of any under- or over-recovery of costs in 2016–17, because we do not have a delegation to determine notified prices beyond 2015–16.

### Consultation question

- Should we allow for any pass-through of SRES under- or over-recoveries incurred during 2015–16 into 2016–17 notified prices?

## 6.2 Possible removal of tariff 41

Tariff 41 is a low-voltage demand tariff that is based on an Energex network tariff and is available to small business customers across Queensland. However, as Ergon Distribution does not have an equivalent network tariff with this structure, and Ergon Retail advised that it supplies fewer than 300 customers<sup>25</sup> on this tariff, it is questionable whether tariff 41 should be retained in 2016–17.

If tariff 41 is removed, customers would be moved to one of the other small business tariffs, either tariff 20 or 22A.

<sup>25</sup> Based on data from Ergon Retail.

We encourage customers and retailers to comment on the potential removal of tariff 41.

#### Consultation question

- Should tariff 41 be removed from the tariff schedule?

### 6.3 Transitional arrangements

Some business customers are supplied under transitional or obsolete tariffs, including farming and irrigation tariffs. Customers on these tariffs are often paying below the cost of supplying customers in the lowest cost area of the state (i.e. south east Queensland).

In previous determinations, we decided that most of these tariffs should continue to be available for several years because many customers would face significant financial impacts if they were moved to an alternative tariff.

Under the delegation, we are required to consider maintaining transitional arrangements for tariffs classed as transitional or obsolete, which includes farming and irrigation tariffs.

We propose to maintain the transitional arrangements for these tariffs.

#### Escalating transitional and obsolete tariffs

We propose to continue to set transitional and obsolete tariffs in accordance with the methodology established in the 2013–14 determination. We will consider whether it is appropriate to escalate the charges in each tariff based on the percentage increase in the charges in the alternative tariff that customers would otherwise pay, including an additional escalation to ensure that charges under the transitional and obsolete tariffs do not fall further below cost in dollar terms.

Consistent with previous decisions, if the underlying cost increase is low, or negative, we will consider what escalation factors, if any, are needed to prevent these tariffs falling further below cost.

#### Transition period

We established transitional time periods in our 2013–14 determination and decided to maintain these periods in subsequent determinations. Tariffs 21, 37, 62, 65, 66, 20 (large) and 22 (small and large) were made available until 2020.

We consider that maintaining these time periods will provide certainty to customers. Therefore, consistent with our approach in the 2015–16 determination, we do not propose to make any changes to transitional time periods, unless an analysis of customer impacts indicates that a tariff could be removed earlier without causing significant customer detriment.

#### Access to transitional tariffs

In our 2013–14 determination, we decided that all non-market customers should have access to transitional tariffs, subject to individual tariff terms and conditions.<sup>26</sup> We made this decision to ensure equitable access for all businesses. The delegation requires that we consider continuing to allow access for all regional customers.

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<sup>26</sup> New customers cannot access tariffs classified as obsolete. We made this decision on the basis that they had been obsolete for some time (tariff 37) or because they would be removed in a shorter timeframe (tariffs 41 (large) and 43 (large)).

In subsequent determinations, we noted that we would consider closing access to transitional tariffs to new customers if there was a significant increase in the number of customers accessing transitional tariffs, and thereby an increase in the subsidy paid by taxpayers. In 2015–16 we did not find that there had been a significant increase and decided to continue to allow open access. We propose to undertake a similar assessment as part of this price review.

#### Consultation questions

- Is there any new information that suggests the overall approach we propose to take for transitional and obsolete tariffs is no longer appropriate?
- What other issues should we should consider (please provide supporting evidence where possible)?

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## GLOSSARY

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### A

AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator

### C

CARC	Customer acquisition and retention costs
CSO	Community service obligation
c/day	cents per day
c/kWh	cents per kilowatt hour

### E

Ergon Distribution	Ergon Energy Corporation Limited (electricity distribution arm)
Ergon Retail	Ergon Energy Queensland (electricity retail arm)
Electricity Act	<i>Electricity Act 1994</i> (Qld)

### G

GWh	Gigawatt hour
Government	Queensland Government

### I

IBT	Inclining block tariff
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### K

kVa	kilovolt ampere
kWh	kilowatt hour

### L

LRET	Large-scale Renewable Energy Target
LRMC	Long-run marginal cost

### N

NEM	National Electricity Market
Notified prices	regulated retail electricity prices

### P

PPA	Power purchase agreement
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### Q

QCA	Queensland Competition Authority
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### R

RET	Renewable Energy Target
ROC	Retail operating costs

**S**

SCER Standing Committee on Energy and Resources

SRES Small-scale Renewable Energy Scheme

**T**

ToR Terms of Reference

**U**

UTP Uniform Tariff Policy

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## APPENDIX A: MINISTERIAL DELEGATION

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Minister for Main Roads, Road Safety and Ports  
Minister for Energy and Water Supply

Our Reference: CTS 27888/15

30 NOV 2015

Level 15 Capital Hill Building  
85 George Street Brisbane 4000  
GPO Box 2644 Brisbane  
Queensland 4001 Australia  
**Telephone** +61 7 3719 7300  
**Facsimile** +61 7 3224 2493  
**Email** [mainroads@ministerial.qld.gov.au](mailto:mainroads@ministerial.qld.gov.au)  
**Website** [www.tmr.qld.gov.au](http://www.tmr.qld.gov.au)

Professor Roy Green  
Chair  
Queensland Competition Authority  
Level 27, 145 Ann Street  
BRISBANE QLD 4000

Dear Professor Green

**Re: Regulated Retail Electricity Prices 2016-17**

I write to you to issue a Delegation and Terms of Reference to the Queensland Competition Authority (QCA) for the determination of regulated retail electricity prices for 2016-17 under Section 90AA(1) of the *Electricity Act 1994*.

As you will be aware, the Government made a decision to delay the introduction of price deregulation in South East Queensland (SEQ). While the Government has requested that the Queensland Productivity Commission (QPC) assess the costs and benefits of deregulation as part of its Electricity Pricing Inquiry, without further legislative changes, deregulation of retail electricity prices in SEQ will occur from 1 July 2016. As a result, this delegation applies to retail electricity prices for customers in regional Queensland only.

Given this delegation applies only to regional Queensland, considerations regarding the Uniform Tariff Policy (UTP) and competition in regional Queensland are important. I note that these issues are also under active investigation by the QPC. The Government is committed to maintaining the UTP and will not be considering any options to improve the current arrangements until we have addressed any recommendations from the QPC. The Terms of Reference, therefore, reflects a consistent approach to my delegation for 2015-16.

The removal of price regulation for small customers in SEQ removes a reference point for the determination of prices in regional Queensland. In order to maintain consistency with the regulation of prices in previous years, the Government considers that regulated prices in regional Queensland for small customers should broadly reflect the expected prices for customers on standing offers in SEQ.

Public consultation is a vital part of the QCA's process for determining retail electricity prices and I understand this delegation has been issued later than would normally be the case. As such, the Terms of Reference seeks for the Draft Determination to be issued by 25 March 2016. I trust this provides sufficient time to undertake the necessary consultation to support the Draft Determination and to allow for the Final Determination to be delivered by 31 May 2016.

Yours sincerely



Mark Bailey MP  
**Minister for Main Roads, Road Safety and Ports and  
Minister for Energy and Water Supply**

Att: Delegation and Terms of Reference – Determination of Regulated Retail Electricity Prices for  
2016-17

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

**DELEGATION**

I, Mark Bailey, 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 in the Ergon Energy Corporation Limited (EECL) distribution area for the tariff year 1 July 2016 to 30 June 2017.

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

**Terms of Reference**

1. These Terms of Reference apply for the tariff year 1 July 2016 to 30 June 2017.
2. The 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 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) Without further legislative change, from 1 July 2016, price regulation in the Energex distribution area will be removed for small customers. This will mean that notified prices will only apply to customers in the EECL distribution area;
  - (b) 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 pay no more for their electricity, regardless of their geographic location;
  - (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;

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**DELEGATION TO QCA**

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- (d) When determining the N components for each regulated retail tariff, QCA must consider the following:
  - (i) For residential and small business customer tariffs (with the exception of Tariffs 12A, 14, 22A and 24) - basing the network cost component on the network charges to be levied by Energex and the relevant Energex tariff structures;
  - (ii) For Tariff 12A (residential time-of-use), Tariff 14 (residential seasonal time-of-use), Tariff 22A (small business time-of-use tariff) and Tariff 24 (business seasonal time-of-use demand) - basing the network cost component on the price level of network charges to be levied by Energex, but utilising the relevant EECL tariff structures, in order to strengthen or enhance the underlying network price signals and encourage customers to switch to time-of-use and demand tariffs and reduce their energy consumption during peak times; and
  - (iii) For large business customers in who consume 100MWh or more per annum - basing the network cost component on the network charges to be levied by EECL.
- (e) Transitional Arrangements - QCA must consider:
  - (i) maintaining transitional arrangements for tariffs classed as transitional or obsolete (i.e. farming, irrigation, declining block, non-domestic heating and large business customer tariffs), and
  - (ii) continuing to allow all EECL customers access to tariffs designated as transitional in 2013-14.

*Interim Consultation Paper*

6. QCA must publish an interim consultation paper identifying key issues to be considered when calculating the N and R components of each regulated retail electricity tariff and transitioning relevant retail tariffs.
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.

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**DELEGATION TO QCA**

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*Consultation Timetable*

9. 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.

*Draft Price Determination*

11. QCA must investigate and publish its draft price determination on regulated retail electricity tariffs, with each tariff to be presented as a bundled price.
12. 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.
13. QCA must consider any submissions received within the consultation period and make them available to the public, subject to normal confidentiality considerations.

*Final Price Determination*

14. QCA must investigate and publish its final price determination on regulated retail electricity tariffs, with each tariff to be presented as a bundled price, and gazette the bundled retail tariffs.

*Timing*

15. QCA must make its reports available to the public and, at a minimum, publicly release the papers and price determinations listed in paragraphs 6 to 14.
16. QCA must publish the interim consultation paper for the 2016-17 tariff year no later than one month after the date of this Delegation.
17. QCA must publish the draft price determination on regulated retail electricity tariffs no later than 25 March 2016.
18. QCA must publish the final price determination on regulated retail electricity tariffs for the 2016-17 tariff year, and have the bundled retail tariffs gazetted, no later than 31 May 2016.

