
TERMS OF REFERENCE - 3/09/2015

Project: Regulated retail electricity prices for 2016–17

Project Background

Queensland Competition Authority

The Queensland Competition Authority (the QCA) is an independent statutory body responsible for assisting with implementing competition policy in Queensland.

Since 2007, the QCA has been delegated the task of setting regulated retail electricity prices (notified prices) for standard contract customers in Queensland.

While the QCA has not yet been delegated this task for the 2016–17 pricing year, it is anticipated this will occur, albeit in late 2015 or early 2016. Nonetheless, the QCA considers it necessary to commence work on some aspects of this review immediately if it is to meet expected deadlines and afford sufficient time for stakeholder consultation.

Review of retail operating costs and retail margin for Queensland electricity retailers in 2016–17

One of the key issues for the 2016–17 price determination will be establishing efficient allowances for retail operating costs (ROC) and the retail margin for electricity retailers in Queensland.

The *Electricity Act 1994* (Section 90) establishes a number of general criteria to be observed when setting notified prices. Most notably, the pricing entity must have regard to:

- the actual costs of making, producing or supplying the goods or services
- the effect of the price determination on competition in the Queensland retail electricity market
- any other matter the pricing entity is required by delegation to consider.

In previous years, the QCA has derived the ROC and margin allowances based on benchmark observations of other regulatory decisions, predominantly those of the Independent Pricing and Regulatory Tribunal (IPART). However, as IPART no longer sets regulated retail prices in New South Wales, we consider that continuing to rely on previous IPART estimates is no longer appropriate or robust. As a number of jurisdictions have now deregulated their retail markets, existing sources of benchmark data have aged and are less robust for the QCA's purposes. For these reasons, the QCA proposes to conduct a comprehensive review of these components for the 2016–17 price determination.

Purpose/outline of consultancy

Key elements of the consultancy are to:

- (1) Estimate an efficient ROC/s for a representative electricity retailer serving residential and business customers in Queensland. In doing so, the consultant is to:**
 - (a) Consider bottom-up, benchmarking and any other appropriate estimation methods.
 - (b) Provide advice on the appropriate composition of an efficient ROC allowance by cost components, including customer acquisition and retention (CARC) costs, ensuring that costs have not been double-counted through other cost components.

- (c) Identify any other retailer costs that are typically characterised as ROC but that may be more appropriately included in other cost allowances, (for example the costs associated with prudential capital costs of financial guarantees and initial margins to AEMO and hedge providers, which may be more appropriately characterised as a variable energy purchase cost).
- (d) Consider and report on any Queensland specific cost drivers, or changes in cost drivers that should be considered in the ROC estimation.
- (e) Consider and report on any differences in efficient ROC allowances for serving different customer classes (i.e., residential, small business, large business customers).
- (f) Consider whether there are any material differences in ROC for a representative retailer operating in south east Queensland (on the Energex distribution network), compared with a representative retailer operating in regional Queensland (i.e., on the Ergon Energy distribution network) and recommend different ROC allowances where appropriate.
- (g) Provide advice on appropriate methodologies for escalating/updating the ROC allowance from year to year.

(2) Estimate an efficient retail margin/s for a representative electricity retailer serving residential and business customers in Queensland. In doing so, the consultant is to:

- (a) Consider bottom-up, benchmarking, expected returns approaches, and any other appropriate estimation methods.
- (b) Provide advice on the composition of the efficient margin by identifying all relevant risk components, and assign an appropriate risk premium to those risks, ensuring that the risk allowance has not been included elsewhere (i.e., energy purchase costs, ROC or CARC).
- (c) Consider and report on any differences in risk and therefore efficient margins for serving different customer types (i.e., residential, small business, large business customers) and recommend different margins where appropriate.
- (d) Consider and report on any differences in efficient margins for a representative retailer operating in south east Queensland (on the Energex distribution network), compared with a representative retailer operating in regional Queensland (i.e., on the Ergon Energy distribution network).
- (e) Provide advice on appropriate methodologies for updating the efficient margin from year to year.

Both the ROC and margin estimations should employ methodologies with sufficient flexibility to allow for the inclusion or exclusion of various cost components and risks, based on stakeholder consultation and information received from retailers.

In estimating both the efficient levels of ROC and margin, the consultant should consider a 'representative retailer' to be a retailer that:

- 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
- retails electricity on a standalone basis
- is not vertically integrated with an electricity generator.

The QCA will consider separating the ROC and margin elements of this project into two individual consultancy contracts, if necessary.

Resources/data provided

The consultant will be required to source information from relevant sources as appropriate.

The QCA intends to initiate formal information requests from Queensland electricity retailers to inform this analysis. The exact nature of these data requests will be determined in consultation with the consultant.

The QCA will also make available to the consultant all submissions received through consultation.

Additional information relevant to this consultancy may be found in the QCA's publications, available from the QCA or for downloading from its website at www.qca.org.au

Reporting and deliverables

The consultant is to provide:

- (1) A Methodology Paper, suitable for publication, addressing how the consultant proposes to estimate the ROC/s and margin/s, highlighting the key issues for consideration. At the same time the consultant is to provide the QCA with a proforma/spreadsheet setting out the information to be requested from retailers to undertake the analysis. The QCA will issue the information requests at an appropriate time.
- (2) A Preliminary Report with draft recommendations on the efficient ROC allowance/s and margin/s for 2016–17, addressing stakeholder feedback on the Methodology Paper. This report will inform the QCA's Draft Determination of retail prices for 2016–17. The consultant should provide a version suitable for publication and, if needed, a confidential version for the QCA.
- (3) A Final Report and recommendations, addressing stakeholder feedback on the QCA Draft Determination and consultant's Preliminary Report. The consultant should provide a version suitable for publication and, if needed, a confidential version for the QCA.
- (4) The consultant may also be required to present its findings at one or more QCA public forums. Details of participation in these forums will be negotiated with the consultant if needed.

Project time frame

The consultancy will commence in early October 2015, with completion by mid-May 2016.

As noted above, there is considerable uncertainty surrounding the timing of key milestones for the 2016–17 price determination. Nonetheless, the QCA's intention is to commence the consultancy work on ROC and margin as soon as possible, to ensure sufficient scope for stakeholder consultation. An indicative timeline is provided in the table below. The consultant should build-in sufficient time to allow QCA staff feedback on drafts prior to finalisation of each stage.

Dates for completion of each stage will be settled following appointment, and are subject to change based on external factors. Should this timeline change, the consultant's deliverable due dates may need to be re-negotiated.

The consultant should advise at earliest opportunity of any critical issues that may impede progress of the consultancy, particularly issues that impact on the successful delivery of the outputs described above and the consultant's capacity to meet the proposed deadlines.

Milestone	Date
Engage consultant	Late September 2015
Inception meeting - QCA and consultant	First week of October 2015
Consultant Methodology Paper - Draft to QCA	30 October 2015
QCA releases Interim Consultation Paper w/consultant Methodology Paper	23 November 2015
Consultation closes on Interim Consultation and Methodology papers	8 January 2016
Consultant Preliminary Report - Draft to QCA	12 February 2016
QCA releases Draft Determination and consultant Preliminary Report	16 March 2016
Consultation closes - Draft Determination and Preliminary Report	20 April 2016
Consultant Final Report - Draft to QCA	11 May 2016
QCA releases Final Determination and consultant Final Report	31 May 2016

Proposal specifications and fees

The consultant's proposal should:

- include the name, address and legal status of the tenderer
- discuss the proposed methods and analytical approaches to be applied, including identifying:
 - any matters that will require QCA input or decisions
 - data requirements and proposed sources of data
 - any matters that are likely to be contentious and how the consultant proposes to address these matters
 - how the consultant proposes to validate or cross-check its recommendations.
- provide a fixed price quote for the provision of the services detailed herein
- nominate the key personnel who will be engaged on the assignment together with the following information:
 - name
 - professional qualifications
 - general experience and experience which is directly relevant to this assignment
 - expected time each consultant will work on the project
 - standard fee rates for any contract variations.

The fee quoted is to be inclusive of all expenses and disbursements. A full breakdown of consultancy costs is required with staff costs reconciled to the proposed consultancy work plan/deliverables.

Total payment will be made within 28 days of receiving an invoice at the conclusion of the consultancy.

Contractual arrangements

This consultancy will be offered in accordance with the QCA's standard contractual agreement. This agreement can be viewed at <http://www.qca.org.au/About-us/Consultants-info>

Confidentiality

Under no circumstance is the selected consultant to divulge any information obtained from the QCA or a third party for the purposes of this consultancy to any party other than with the express permission of the QCA or the relevant third party.

Conflicts of interest

For the purpose of this consultancy, the consultant is required to affirm that there is no, and will not be any, conflict of interest as a result of this consultancy.

QCA assessment of proposal

The consultant's proposal will be assessed against the following criteria:

- understanding of the project
- skills and experience of the firm and team
- the proposed methods and approach
- capacity to fulfil the project's timing requirements
- value for money.

In making its assessment against the criteria, the QCA will place most weight on relevant experience of the team members involved and the proposed method for the completion of the task.

Insurance

The consultant must hold all necessary workcover and professional indemnity insurance.

Quality assurance

The consultant is required to include details of quality assurance procedures to be applied to all information and outputs provided to the QCA.

Grievances

If during the course of your engagement you wish to raise any grievances or make a complaint, please contact Mrs Robyn Farley-Sutton, Director Corporate Services, on (07) 3222 0505 or robyn.farley-sutton@qca.org.au.

Lodgement of proposals

Proposals are to be lodged with the QCA by 5:00 PM **Friday 18 September 2015**. Proposals should be submitted to:

The Chief Executive Officer
Queensland Competition Authority
GPO Box 2257
Brisbane Qld 4001

Phone: (07) 3222 0555

Fax: (07) 3222 0599

Email (via website): www.qca.org.au/Submissions

For further information concerning this consultancy, please contact the following staff members:

Dan Barclay

or

Sarah Duval

Senior Analyst

Project Manager

(07) 3222 0566

(07) 3222 0571

dan.barclay@qca.org.au

sarah.duval@qca.org.au