

# Queensland Competition Authority

Interim Consultation Paper

**Regulated Retail Electricity Prices for 2014-15**

July 2013

The Authority wishes to acknowledge the contribution of the following staff to this report:

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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 Interim Consultation Paper as the first step in its determination of regulated retail electricity prices in Queensland for 2014-15. The Authority invites interested parties to lodge submissions on the matters covered within this consultation paper. 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 **6 September 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 is satisfied that the person's belief is justified 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.

## GLOSSARY OF ACRONYMS, TERMS AND CONDITIONS

### A

AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
AFMA	Australian Financial Markets Association
Authority	Queensland Competition Authority

### B

BRCI	Benchmark Retail Cost Index
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### C

CARC	Customer Acquisition and Retention Costs
CER	Clean Energy Regulator (formerly the Office of the Renewable Energy Regulator (ORER))
CSO	Community Service Obligation

### D

Delegation	The Delegation from the Minister for Energy and Water Utilities, pursuant to section 90AA(1) of the <i>Electricity Act 1994</i> , directing the Authority to determine regulated retail electricity tariffs (notified prices) to apply from 1 July 2013 to 30 June 2016
DEWS	Department of Energy and Water Supply

### E

Electricity Act	Electricity Act 1994
Electricity Regulation	Electricity Regulation 2006
ERET	Enhanced Renewable Energy Target Scheme
ESCOSA	Essential Services Commission of South Australia

### F

FRC	Full Retail Competition
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### G

GWh	Gigawatt hours
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### H

### I

IDC	Interdepartmental Committee on Electricity Reform
IPART	Independent Pricing and Regulatory Tribunal

## J

## K

kW	Kilowatt
KWh	Kilowatt hour

## L

Large customer	A customer that consumes more than 100 MWh of electricity per year
LGC	Large-scale Generation Certificate
LRET	Large-scale Renewable Energy Target
LPMC	Long Run Marginal Cost

## M

Minister	Minister for Energy and Water Supply
MW	Megawatt
MWh	Megawatt hour

## N

N + R	Network + Retail costs build-up approach
NECF	National Energy Customer Framework
NEM	National Electricity Market
NER	National Electricity Rules
Notified/regulated retail prices	The electricity prices that a retailer may charge its non-market customers, as defined under section 90 of the <i>Electricity Act 1994</i>
NSLP	Net System Load Profile

## O

## P

PPA	Power Purchase Agreement
Price Distribution Approach	A statistical model that estimates the price a retailer might be willing to pay to enter hedging contracts

## Q

## R

ROC	Retail operating costs
RPP	Renewable Power Percentage

**S**

Small customer	A customer that consumes 100 MWh of electricity per year or less
SRES	Small-scale Renewable Energy Scheme
STC	Small-scale Technology Certificate
STP	Small-scale Technology Percentage

**T**

TOU	Time-of-Use
ToR	Terms of Reference
TUOS	Transmission of Use System

**U**

UTP	The Queensland Government's Uniform Tariff Policy
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**V**

Very large customer	A customer that consumes over 4 GWh per year
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## 1 BACKGROUND

Since the introduction of full retail competition (FRC) on 1 July 2007, most electricity consumers in Queensland have been able to enter into a competitive market contract with the retailer of their choice. In South East Queensland (SEQ), most customers (around 70%) are supplied under a competitive market contract. In contrast, the vast majority of customers in regional Queensland (around 99%) are supplied under a standard contract and pay notified prices, which are determined by the Queensland Competition Authority (the Authority).

The low take-up of competitive market contracts in regional Queensland is largely because the Queensland Government provides a subsidy to Ergon Energy to offset the higher costs of supplying electricity to customers in regional and remote areas. As a result, other retailers are unable to offer an equivalent or better deal to customers because their costs are not subsidised.

The Authority has determined notified prices under delegation from the relevant Minister (currently the Minister for Energy and Water Supply) since the start of FRC. However, 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 2012-13, 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).

For the 2012-13 Determination, following the amendments to the Electricity Act and Regulation, the Authority 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 resulted in the introduction of a new set of retail tariffs which are aligned with the prevailing network tariff structure and retail prices which better reflect the cost of each customer's consumption. The Authority also implemented a number of transitional measures for certain customer groups for 2012-13. As a result, some customers continued to access tariffs that were below cost-reflective levels.

Following the change of Government in the first half of 2012, the incoming Government froze notified prices for the standard residential tariff (Tariff 11) for 2012-13, subject to inclusion of costs associated with the carbon tax. As a result, notified prices for Tariff 11 for 2012-13 were determined by the Minister, rather than the Authority.

On 5 September 2012, the Minister provided the Authority with a Delegation, requiring it to determine notified prices (including for Tariff 11) for a three-year period from 1 July 2013 to 30 June 2016. On 12 February 2013, the Authority received a revised Delegation, which changed the release date of the 2013-14 Draft Determination by one week. All other content remained the same as for the 5 September 2012 Delegation (see Appendix A). While the Delegation is for three years, the Authority is still required to set notified prices on an annual basis.

This consultation paper initiates the Authority's review of notified prices for 2014-15, which is the second year in the three-year delegation period.

### 1.1 Matters to Consider

In accordance with section 90(5)(a) of the Electricity Act, the Delegation of 12 February 2013 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.

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 an 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 Tariff 11 and tariffs that were classed as obsolete for 2012-13.

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

## 1.2 Proposed Approach to this Review

The legislation under which the Authority must make its 2014-15 Determination has remained unchanged since it made the 2013-14 Determination. For the purposes of consistency and regulatory certainty, the Authority's preliminary view is that the broad approaches adopted in making the 2013-14 Determination should be maintained. However, the Authority will consider changing approaches if there are good reasons to do so, and is also open to further refinement of approaches if necessary.

In conducting this review, the Authority will provide for as much public consultation with stakeholders as possible given the timeframes specified in the Delegation. While an initial timetable for the review is provided below, the Authority will consider conducting additional public consultation (workshops and papers) on key issues identified by stakeholders in their submissions.

Submissions are invited in response to this Interim Consultation Paper and are due no later than 6 September 2013. Interested parties should take this opportunity to inform the Authority of matters they believe are relevant to the Authority's task under the Delegation and Terms of Reference and provide detailed arguments and evidence to support their views.

The Authority is required to publish its Draft Determination for 2014-15 no later than 13 December 2013 and its Final Determination (including gazetting the notified prices) no later than 31 May 2014.

**Table 1.1: Initial Timetable**

<i>Task</i>	<i>Indicative Dates</i>
Release of Interim Consultation Paper	31 July 2013
Submissions in response to Interim Consultation Paper due	6 September 2013
Release of public consultation timetable	by 20 September 2013
Release of Draft Determination	13 December 2013
Workshops on Draft Determination	early February 2014
Submissions on Draft Determination due	28 February 2014
Release of Final Determination	31 May 2014

## 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 direct cost pass-through to customers. The Delegation also requires the Authority to consider:

- (a) basing notified prices for small customers (those consuming up to 100 MWh per year) on Energex network tariffs, and;
- (b) basing notified prices for large customers (those consuming more than 100 MWh per year) on Ergon Energy network tariffs (as only large customers in the Ergon Energy distribution area are able to access notified prices).

### 2.1 Network tariffs for small customers

#### Residential tariffs

For the 2013-14 Final Determination, the Authority considered that Energex's network tariffs provided the best available basis for setting flat, time-of-use and controlled load regulated tariffs for residential customers. This view was broadly supported during consultation and is consistent with the Delegation.

The Energex network tariffs that formed the basis for flat, time-of-use and controlled load regulated tariffs for residential customers in 2013-14 notified prices are shown in Table 2.1. The Authority is not aware of any proposed changes to the range or structure of Energex's residential network tariffs for 2014-15.

Any refinement of, or addition to, these tariffs for 2014-15 is a matter for Energex and the AER to determine within the requirements of the National Electricity Rules (NER).

The Authority notes that the Queensland Government has accepted a number of recommendations regarding reforms to network tariffs, made by the Interdepartmental Committee on Electricity Sector Reform (IDC). Specifically, the IDC recommended more flexible pricing with stronger time-of-use signals and demand and capacity-based charging approaches. The Queensland Government has indicated it is considering long-term network tariff reform as part of its 30-year electricity strategy<sup>1</sup>.

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<sup>1</sup> Queensland Government, *Response to the Interdepartmental Committee on Electricity Sector Reform*. June 2013. p. 8

**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 13 – Residential PeakSmart (time-of-use)	7600
Tariff 31 – Night rate (super economy) 1	9000
Tariff 33 – Controlled supply (economy) 1	9100

*1 These tariffs also apply to residential customers using card-operated meters*

### Small business tariffs

Energex network tariffs also provided a basis for the Authority's 2013-14 flat, time-of-use and demand-based regulated tariffs for business customers, as shown in Table 2.2. As is the case for network tariffs for residential customers, the Authority has no role in approving network tariffs for business customers. The Authority is not aware of any proposed changes to the range or structure of Energex's small business network tariffs for 2014-15. The implementation of the IDC recommendations will likely have some bearing on the network tariffs for small businesses, however, it is unclear whether any changes will take effect in the 2014-15 pricing year.

**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 Network tariffs for large customers

From 1 July 2012, large customers (those consuming more than 100MWh per year) in the Energex network area ceased to have access to notified prices. As a result, the current Delegation requires that the Authority determine notified prices for large customers in the Ergon Energy network area only.

Ergon Energy has network tariffs that may be used as the 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 2013-14, 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 2013-14 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 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 community service obligation (CSO) payment from the Queensland Government.

### Ergon Energy's Network Tariff Strategy Review

In July 2013, Ergon Energy commenced consultation on a new network tariff strategy which it intends to begin implementing from 2014-15. Ergon Energy has proposed a range of options to improve cost reflectivity through rebalancing of fixed and variable components, as well as introducing time-of-use pricing, greater demand and capacity-based charging, and (kVA) charges to its network tariffs. The proposed changes would be progressively phased in over a number of years, according to customer classes. Ergon Energy's large customers are not expected to begin transitioning to new tariff structures until between 2015 and 2017<sup>2</sup>.

As part of its future network tariff strategy, Ergon Energy also proposes to introduce three-part time-of-use pricing for small residential customers, and two-part time-of-use pricing for small non-residential customers in 2014-15<sup>3</sup>.

Ergon Energy's future network tariff strategy is an encouraging step toward more efficient network pricing. However, the full extent of the benefits it could provide to regional customers will not be fully realised until more fundamental reforms are implemented, including changes to how the uniform tariff policy and community service obligation are applied.

### Network tariffs for very large customers

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 (site-specific) network charges that reflect the unique circumstances of each customer in this diverse group. In setting 2013-14 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.

On 4 September 2012, the Minister issued a Direction to the Authority under section 253AA of the Electricity Act requiring it 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

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<sup>2</sup> Ergon Energy, Network tariff strategy review - Consultation paper. July 2013

<sup>3</sup> The introduction of Ergon Energy specific TOU charges for small customers is unlikely to have an immediate impact of Ergon Energy small customers in 2014-15, most of whom are on notified prices. Unless the uniform tariff policy is revisited (which requires that notified prices for small customers outside of south-east Queensland be based on Energex network tariffs), Ergon Energy small customers opting for TOU tariffs will not be exposed to the actual underlying network charges set by Ergon Energy.

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 if they were to move 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 would be possible to determine notified prices based on site-specific network charges, it is unclear whether this would be consistent with the Queensland Government's uniform tariff policy; 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.

The IDC considered the Authority's advice and, in June 2013, recommended development of a strategy to transition very large customers onto cost-reflective prices. The IDC recommended the Queensland Government consider removing notified prices for very large customers in tranches, commencing with the largest customers first. In its June 2013 response to the IDC report, the Queensland Government flagged this recommendation for further consideration, noting that the Queensland Commission of Audit Taskforce is examining how the CSO can be targeted to those customers most in need<sup>4</sup>.

It is unclear how and when these recommendations will be implemented. However, the Authority will work with the relevant parties to ensure that regulated retail tariffs reflect any changes to underlying network tariffs resulting from these reforms.

The current Ergon Energy network tariffs and the Authority's corresponding retail tariffs are presented in Table 2.3.

**Table 2.3: Network tariffs for large customers on the Ergon Energy network**

<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

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4 Queensland Government, *Response to the Interdepartmental Committee on Electricity Sector Reform*. June 2013. p. 7

- **The Authority seeks stakeholders' views on the following**
  - (a) the suitability of Energex's network tariffs as the basis of retail tariffs for residential and small business customers;**
  - (b) the suitability of Ergon Energy's network tariffs as the basis of retail tariffs for large customers and, in particular;**
    - (i) 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?**
    - (ii) 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?**

### 2.3 Unmetered supplies and street lighting

Unmetered supplies apply to those loads which have a predictable and consistent consumption profile, and can be reasonably charged based on a calculated estimate of energy consumption rather than a direct meter reading. Unmetered supply tariffs generally apply to loads such as traffic signals, public barbeques, public telephones, rail crossing boom gates and bus shelters.

A notified price is available to certain customers with unmetered loads in both the Energex and Ergon Energy network areas (Tariff 91). In 2013-14, the Authority based this notified price on Energex's network charge for unmetered supplies (network tariff 9600). This tariff is currently a flat energy-only tariff (applied based on estimated consumption), and does not include a fixed daily component.

Unlike unmetered supplies, notified prices for street lighting (Tariff 71) are not available in Energex's distribution area. As a result, the Authority used Ergon Energy's network tariff for street lighting as the basis for a street lighting tariff for 2013-14 for customers in the Ergon Energy network area.

Table 2.4 shows the retail tariffs and corresponding network tariffs for street lighting and other unmetered supplies.

**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

The IDC noted that street lighting services for many customers in the Ergon Energy region are currently provided at below cost-reflective levels. This is because regulated street lighting charges only recover the cost of supplying electricity and not the costs of constructing and maintaining the assets. The IDC recommended that, from 1 July 2014, street lighting customers

should begin paying non-energy street lighting charges where the assets are owned and maintained by Ergon Energy<sup>5</sup>.

The Queensland Government has accepted this recommendation and supported development of a price path to achieving cost-reflectivity for these customers.

It is not yet clear how this recommendation will be implemented, and whether it contemplates the introduction of a fixed component to existing street lighting tariffs, or some other form of customer capital contribution. The Authority will consult with the distributors on this issue and reflect any necessary changes through regulated retail tariffs if required.

## 2.4 Obsolete and transitional retail tariffs

The Authority is required to consider transitional arrangements for tariffs that were classified as obsolete during 2012-13. These are not determined based on the N+R approach that 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 the obsolete tariffs set out in Table 2.5.

**Table 2.5: Obsolete and transitional retail tariffs**

<b>Obsolete tariffs for small customers and Ergon Energy large customers</b>
Tariff 37
<b>Transitional tariffs for small customers and Ergon Energy large customers</b>
Tariffs 21, 22, 62, 65 and 66
<b>Transitional tariffs for large customers in Ergon Energy's network area</b>
Tariffs 20 (large)
<b>Obsolete tariffs for large customers in Ergon Energy's network area</b>
41 (large) & 43 (large)

## 2.5 Exporting energy to the network

During consultation on the 2013-14 determination, it was suggested that the Authority should consider special tariffs for large exporters of energy (such as sugar mills) 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 the 2014-15 pricing year.

## 2.6 Maintaining alignment of retail and network tariffs

Using an N+R approach to setting notified prices requires a 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 within each tariff class. Maintaining this alignment would also ensure that distributors are able to engage in effective demand management initiatives that rely on customers being exposed to appropriate price signals.

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5 Interdepartmental Committee on Electricity Sector Reform. *Report to Government*. May 2013. p.77-78



Under the 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 2014-15, the Authority must publish a draft report by 13 December. These deadlines require the Authority to rely on preliminary network prices provided by the distributors well ahead of the AER price approval process.

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 final 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.

For the 2013-14 Final Determination, the Authority based its notified retail prices on the distributors' network tariffs as submitted to the AER for approval in April 2013, with some subsequent amendments as advised by Ergon Energy prior to final approval by the AER. It noted that, in the event that the final network tariffs approved by the AER depart from those used in the Determination, the Authority would consider using the pass-through mechanism to adjust for any material difference when setting notified prices for 2014-15. This will not be necessary for the 2014-15 pricing year as the network tariffs used in the Authority's Final Determination are consistent with those approved by the AER for 2013-14.

In its September 2012 rule change 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 approved 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, it is not clear that this will occur before the Authority sets notified prices for 2014-15. As a result, the best option for setting 2014-15 prices will most likely be to 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 use these as the basis for notified prices to apply from 1 July 2014.

- **The Authority seeks stakeholders' views on how best to maintain or improve alignment between network and retail tariffs for the purposes of setting notified retail prices.**

### 3 ENERGY COSTS

Energy costs are those a retailer will incur, either directly or indirectly, in supplying energy to cover the load of its customers. In previous decisions, 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.

The Authority has engaged ACIL Allen (formerly ACIL Tasman) 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). Similar to applying the same approaches to estimating costs, as discussed in Chapter 1, 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.

#### Requirements of the Electricity Act and Delegation

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 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 under the Delegation; and
- (d) any other matter the Authority considers relevant.

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

#### 3.1 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 2013-14 Determination, the Authority considered two alternative approaches for determining wholesale energy costs, including a hedging-based model and long-run marginal cost (LRMC)<sup>6</sup>. The Authority also considered how it might take into account PPAs held by retailers. While each approach had its merits and drawbacks, the Authority decided that the hedging-based approach was the most appropriate because it was based on publicly-available data, it was intuitive and it was known and (largely) accepted as a reasonable approach by stakeholders.

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<sup>6</sup> In previous reviews, the Authority has also considered a statistical model that estimated the price a retailer might be willing to pay to enter hedging contracts (the Price Distribution approach).

## Potential approaches for 2014-15

For the 2014-15 Determination, the Authority will again have to determine the most appropriate approach for developing wholesale energy costs. As noted above, the Authority is of the view that retaining its earlier hedging-based approach would provide certainty to stakeholders. Throughout a number of previous reviews, the Authority has also made clear its preference for using a hedging-based approach because of its transparency and the fact that it reflects the actual value of the electricity purchased from the NEM in a given year.

As noted in the 2013-14 review, it appears as though other regulators and governments are starting to show a similar preference for a hedging-based approach. Prior to deregulation of retail pricing in South Australia in early 2013, the Essential Services Commission of South Australia (ESCOSA) was in the process of updating its wholesale energy cost modelling to account for market-based outcomes in the NEM<sup>7</sup>. Similarly, the NSW Government adjusted the Independent Pricing and Regulatory Tribunal's (IPART's) delegation for 2013-14 to 2016-17 to provide less weight to LRMC and more weight to market-based costs<sup>8</sup>. In implementing this method, IPART characterised the premium that LRMC added to its market-based energy cost estimates as headroom<sup>9</sup>.

The main alternative approach put forward by stakeholders in previous reviews is one based on LRMC. Some retailers retain the view that the Authority should base its wholesale energy cost estimates, at least in some part, on LRMC. Others have noted that LRMC might be a reasonable proxy for PPAs, which typically have a longer tenor than the quarterly contracts that are taken into account in a hedging-based approach.

As outlined in the ToR for its engagement, ACIL Allen has been asked to provide wholesale energy cost estimates for 2014-15. It will provide a draft report including preliminary 2014-15 energy cost estimates alongside the Authority's Draft Determination in December 2013.

The Authority will consider the merits of each approach for 2014-15. In addition to comments on how ACIL Allen's 2013-14 hedging-based approach might be improved for 2014-15, the Authority is interested in any new information stakeholders may be able to provide on why any alternative approach might be more appropriate for 2014-15.

## Dealing with carbon uncertainty under a market-based approach

There is potential for significant changes to carbon pricing in 2014-15 following the upcoming Federal election. The carbon tax could be left to operate in its current form, the planned move to an emissions trading scheme in 2015-16 could be brought forward a year, or carbon pricing could be removed altogether. Whatever the outcome, the Authority anticipates that uncertainty surrounding carbon pricing might lead to a shortage of d-cypha Trade futures trading data for 2014-15.

A similar data shortage was experienced preceding and during the Authority's 2012-13 review due to uncertainty surrounding the introduction of the carbon tax. To overcome the shortage

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<sup>7</sup> ESCOSA, *2011-14 Electricity Standing Contract Price Determination Wholesale Energy Cost Investigation – Draft Determination*, October 2012.

<sup>8</sup> Chris Hartcher MP, *Terms of Reference for IPART's 2013-14 to 2015-16 investigation into regulated retail electricity prices*, September 2012. IPART's wholesale energy costs were previously required to be set at no less than LRMC. The new delegation required wholesale energy costs of no less than 75% LRMC and 25% market-based.

<sup>9</sup> IPART, *Review of Regulated Retail Prices for Electricity 2013 to 2016 – Final Report*, June 2013.

of information, ACIL Allen (then ACIL Tasman) proposed adopting an alternative to the market-based approach, the price distribution approach, which did not rely on futures trading data (see Appendix B). Stakeholders criticised the price distribution approach because of its lack of transparency and its theoretical nature. As a result, the Authority asked ACIL Allen to consider other data sources, such as broker data, that might be used to bolster its market-based approach.

ACIL Allen undertook further analysis and identified that, for most contract types, there was sufficient liquidity to be reliable. Moreover, for those contracts that were lightly traded or for which there appeared to be particularly high levels of carbon-price uncertainty (base and peak contracts for the first half of 2013), ACIL Allen proposed to exclude trades prior to the passing of the carbon tax legislation in November 2012. The proposal to exclude earlier trades addressed retailers' suggestions that the majority of retailers would incur the full carbon price, whether it was reflected in the futures market or not, because they held PPA and other over-the-counter contracts that included carbon pass-through clauses.

For 2014-15, the situation is reversed. In the event that there is a significant change in the carbon price (either through a move to a floating price or the carbon tax being repealed), retailers with PPAs and other arrangements with carbon pass-through clauses would incur lower or no carbon costs. On that basis, there might be merit in trying to exclude the impact of carbon and carbon uncertainty on futures prices for 2014-15 if the carbon tax is repealed although this would mean a heavier reliance on broker trades not including allowance for carbon.

While the Authority will rely heavily on ACIL Allen's independent expert advice on this issue, it is looking for guidance from stakeholders on the most appropriate way to deal with carbon uncertainty and a possible lack of liquidity in the futures markets. While the Authority acknowledges stakeholders' earlier views of the price distribution approach, it considers this approach may still be a necessary fall-back option for 2014-15 as it could provide a viable alternative where there may be liquidity constraints in the futures markets.

### Enhancing time-of-use signals

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

In previous reviews, the Authority considered developing energy cost estimates that would include time-of-use signals to consumers. However, retailers pointed out that this did not reflect the way in which they are charged for electricity by the Australian Energy Market Operator (AEMO), which is based on the relevant distributor's net system load profile (NSLP).

Submissions to previous reviews were broadly supportive of the inclusion of time-of-use signals in wholesale energy costs, but only to the extent that they could be implemented on a cost-reflective basis. Stakeholders were against including artificial time-of-use signals in the wholesale energy costs without regard to the way in which AEMO charges retailers for electricity purchased from the NEM. However, stakeholders also noted that an amendment to AEMO's Metrology Procedures could allow customers who already have electronic meters (not accumulation meters) to be settled against their individual consumption and hence priced according to their time of use.

Amending the Metrology Procedures is a matter for the Queensland Government to decide and initiate with AEMO, not something over which the Authority has any control. This may be

something the Government could explore with AEMO in unison with the Authority's review. However, it is worth noting that even if time-of-use signals are included in energy cost estimates, the differentials seen in, for instance, Tariff 22 in 2011-12 (and prior years) cannot be recaptured without the bulk of the time-of-use signal coming through the underlying network tariff, as they make up, by far, the largest component of retail tariffs, as demonstrated in Table 3.1 below.

**Table 3.1: Time-of-use components in Tariff 22**

<i>Component</i>	<i>Off peak</i>		<i>Peak</i>		<i>Potential for time-of-use signals</i>
	<i>c/kWh</i>	<i>% of total</i>	<i>c/kWh</i>	<i>% of total</i>	
<b>2011-12 Tariff 22</b>	9.92	N/A	28.17	N/A	
<b>2013-14 Tariff 22</b>					
Network	9.014	48%	15.841	62%	Yes, but up to network businesses
Wholesale energy (ex carbon)	5.704	31%	5.704	22%	Yes, but requires amendment to AEMO metrology procedures
Carbon costs	2.590	14%	2.590	10%	Yes, but requires amendments to AEMO metrology procedure and would result in higher off-peak prices due to the higher carbon intensity of off-peak
RET and other costs	1.361	7%	1.361	5%	No basis for time-of-use signals
<b>TOTAL</b>	<b>18.668</b>	<b>100%</b>	<b>25.496</b>	<b>100%</b>	

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

*Sources: The Authority's workings and ACIL Tasman, Estimated wholesale energy costs for 2013-14 retail tariffs – final report, May 2013.*

- **The Authority seeks stakeholders' views on the following:**
  - (a) **What improvements might be made to ACIL Allen's hedging-based approach for 2014-15?**
  - (b) **Is there any new information available to suggest an alternative approach might be better than the hedging-based approach for 2014-15?**
  - (c) **What factors should ACIL Allen take into account when determining modelling inputs such as customer load forecasts, plant outage scenarios, hedging strategies and spot price forecasts?**
  - (d) **How best should the Authority account for carbon price uncertainty and the resultant potential lack of contract trading data?**

## 3.2 Other Energy Costs

In addition to wholesale energy costs there is a range of other energy costs including those related to:

- (a) the Small-scale Renewable Energy Scheme (SRES);
- (b) the Large-scale Renewable Energy Target (LRET) Scheme;
- (c) NEM participation fees and ancillary services charges; and
- (d) prudential capital costs.

### 3.2.1 Enhanced Renewable Energy target Scheme

From 1 January 2011, the RET scheme changed into the Enhanced Renewable Energy Target (ERET) scheme. The changes split the scheme into two categories; a Small-scale Renewable Energy Scheme (SRES) and a Large-scale Renewable Energy Target (LRET).

#### *The Small-scale Renewable Energy Scheme (SRES)*

The SRES covers small-scale technologies such as solar panels and solar hot water systems installed by households and small businesses, allowing these groups to create Small-scale Technology Certificates (STCs). Retailers have an obligation to surrender STCs according to Small-scale Technology Percentage (STP) targets set by the Clean Energy Regulator (CER) to fulfil their ERET obligations. If a retailer fails to meet its obligations, it will incur a penalty.

#### *Small-scale Technology Percentage Targets*

In response to previous pricing determinations, retailers have justifiably expressed concern at the inaccuracy of non-binding targets set by the CER. 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. Previous experience has shown that non-binding STP targets frequently underestimate the creation of STCs and as a result 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 was 7.94%<sup>10</sup> whereas the 2013 binding target is 19.7%<sup>11</sup> (or 35.7 million STCs). As a result using the non-binding STP target has historically underestimated future SRES compliance costs.

In response to previous determinations retailers suggested that the Authority adopt the latest binding calendar year target for the entire upcoming tariff year, as a way of avoiding estimation errors. However, this would be inconsistent with the requirement to estimate SRES costs a retailer would incur for the tariff year.

In the 2013-14 determination the Authority concluded that the non-binding STP target still seemed the most transparent and reasonable estimate available and as discussed in Chapter 5, the terms of the three-year delegation allow it to compensate for any differences between the non-binding and binding targets used to estimate SRES costs, via a catch-up mechanism.

#### *Small-scale Technology Certificate prices*

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.

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10 Clean Energy Regulator, 30 March 2012. Note that the STP was subsequently revised to 18.76% in October 2012, after the Authority's 2012-13 Final Determination was published.

11 Clean Energy Regulator, 15 March 2013.

However, the clearing house is currently significantly oversupplied, meaning that some certificate holders have been waiting for more than two years<sup>12</sup> to find a buyer.

A second selling option for certificate holders wishing to avoid such long waiting periods is to sell their STC certificates in the open market at a discount to the clearing house price. STCs sold on the open market have sold at a significant (up to 25%) discount on the clearing house price in the past. In response to previous determinations consumer groups suggested that estimating costs using the clearing house price overestimated SRES costs and recommended the Authority use market prices for its estimates.

For the 2013-14 Determination, the Authority estimated SRES compliance costs using the binding 2013 STP target for the first half of the pricing period and the non-binding 2014 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 Allen advised that at that time it would be difficult to estimate the proportion of STCs that were being traded in the open market. ACIL Allen also demonstrated that market prices had increased and were approaching the clearing house price. Recent survey data from AFMA<sup>13</sup> indicates that STCs are being traded at \$37.21, a 7% discount to the clearing house price.

#### *The Large-scale Renewable Energy Target (LRET) Scheme*

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) for surrender to the CER, the number of which is determined on the basis of achieving the annual target.

Retailers are required to surrender LGCs to fulfil their ERET obligations. If a retailer fails to meet its obligations, it will incur a penalty.

For the 2013-14 Determination, the Authority based its estimate of 2013 LRET costs on weekly market prices for LGCs, as published by AFMA, as well as the latest Renewable Power Percentage (RPP) and the latest annual LRET targets set by the CER. In addition to this actual data, ACIL Allen forecast its own estimate of total liable energy for 2014 and utilised the latest published LRET target to arrive at a forecast 2014 RPP.

In response to previous pricing determinations, some retailers suggested using the LRMC of renewable generation to estimate LRET costs, on the basis that they 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, are 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.

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12 At the time of writing certificates from April 2011 remain unsold.

13 AFMA Environmental Product Curve, 6 June 2013, \$37.21, mean of all bids for spot STC purchase.

- **The Authority seeks stakeholders' views on the following:**
  - (a) **What improvements might be made to ACIL Allen's approach to estimating SRES costs for 2014-15?**
  - (b) **What improvements might be made to ACIL Allen's approach to estimating LRET costs for 2014-15?**
  - (c) **Is there any new information available to suggest alternative approaches might be better at estimating SRES and LREST costs for 2014-15?**

### 3.2.2 NEM participation fees and ancillary services charges

Retailers are required to pay NEM participation fees and ancillary services charges to AEMO.

NEM participation fees<sup>14</sup> 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 weekly by AEMO on its website.

Given that changes in NEM participation fees and ancillary services charges are relatively stable from year to year, ACIL Allen uses historical data in forecasting these costs. In its previous decisions, ACIL Allen 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) **What improvements might be made to ACIL Allen's approach to estimating NEM fees for 2014-15?**
  - (b) **What improvements might be made to ACIL Allen's approach to estimating ancillary services charges for 2014-15?**
  - (c) **Is there any new information available to suggest alternative approaches might be better at estimating these costs for 2014-15?**

### 3.2.3 Prudential capital

Prudential capital costs relate to the financial guarantees a retailer must provide to AEMO and hedging providers. The Authority considered these costs as a separate allowance for the first time in its 2013-14 pricing determination following further consideration of the issue raised in submissions. Retailers argued that as the Authority had adopted a market-based approach based solely on futures contracts, then it should also account for the additional bank guarantees that a retailer would have to purchase if it hedged using futures.

The Authority concluded that it was appropriate to account for these prudential costs in the context of estimating the cost of energy and therefore included cost allowances for AEMO prudentials and hedge prudentials.

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14 NEM participation fees incorporate costs relating to FRC fees, the National Transmission Planner, National Smart Metering and the Electricity Consumer Advisory Panel.



- **The Authority seeks stakeholders' views on the following:**
  - (a) **What improvements might be made to ACIL Allen's approach to estimating prudential capital costs for 2014-15?**
  - (b) **Is there any new information available to suggest alternative approaches might be better at estimating these costs for 2014-15?**

### 3.3 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 2013-14 Review, ACIL Allen applied transmission and distribution losses published by AEMO<sup>15</sup> to all energy cost components, which was generally supported by stakeholders.

- **The Authority seeks stakeholder's views on the following:**
  - (a) **What improvements might be made to ACIL Allen's approach to estimating energy losses for 2014-15?**
  - (b) **Is there any new information available to suggest alternative approaches might be better at estimating losses for 2014-15?**

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15 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 more recent available at the time. Similarly, the Authority will be required to use 2012-13 losses in its 2013-14 Determination.

## 4 RETAIL COSTS

The Authority makes an allowance for retail costs, which comprise:

- (a) retail operating costs (ROC), which are the costs associated with services provided by a retailer to its customers; and
- (b) the retail margin, which represents the reward to investors for the retailer's exposure to systematic risks associated with providing customer retail services.

### 4.1 Retail Operating Costs

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

#### Approach taken to estimate ROC in 2013-14

For the 2013-14 Determination the Authority adopted a benchmarking approach for setting ROC, as in previous years, because it considered that undertaking a bottom-up approach may not necessarily have produced results that were any more robust or defensible.

When setting the ROC allowance, the Authority looked for recent determinations in other jurisdictions that may have been applicable for Queensland. The only regulator that had published recent work was IPART in New South Wales. The Authority considered that the ROC allowance for small customers in IPART's draft determination<sup>16</sup> was relevant and adopted IPART's ROC value, with a small adjustment to add back late payment fees.

The Authority's view on future ROC for small customers was that its allowance should be maintained for the remainder of the delegation period, subject to adjustments for inflation, but that it would consider any updated analysis that IPART undertook for its final determination.

The Authority was unaware of any updated work on an appropriate ROC allowance for large and very large customers, so it uplifted the 2012-13 allowances in line with inflation.

#### Setting ROC for 2014-15

One option to setting the ROC allowance for the 2014-15 Determination would be to continue with the benchmarking approach and using any new and relevant information that may come to light. Another option would be to pursue a bottom-up approach to setting ROC.

The Authority considers that there are sensible reasons to continue with its well-understood benchmarking approach that provides certainty to stakeholders, particularly as this is the second year of a three year delegation. In previous determinations and consultation papers the Authority has set out in detail its reasons for pursuing a benchmarking approach and considers that these reasons remain valid. In addition, the Queensland Government<sup>17</sup> recently proposed reforms to remove electricity price regulation by 1 July 2015. Given this, it is questionable whether changing to a bottom-up approach for a single year is warranted.

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16 IPART, Review of regulated retail prices for electricity, 2013 to 2016, Draft Report, April 2013.

17 <http://statements.qld.gov.au/Statement/2013/6/17/end-of-electricity-price-regulation-to-improve-competition>, accessed 20 June 2013.

The Authority is not aware of any upcoming determinations from regulators in other jurisdictions that may be applicable to its next Determination and so considers that IPART's final report, which is largely the same as its draft, will act as the Authority's benchmark.

There is also the question of whether to allocate ROC to the fixed or variable components of retail tariff. In its 2013-14 Determination, the Authority decided to allocate ROC to the fixed component of retail tariffs because it could not find any evidence to suggest that ROC vary with electricity consumption. No ROC was applied to the controlled load tariffs and unmetered tariffs 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 proposes to continue to adopt this approach for the 2014-15 Determination, but will consider any evidence provided by stakeholders that suggests an alternative approach would be more cost-reflective.

The Authority is keen for stakeholders' views on the approach to set ROC, the applicability of the 2013-14 ROC values for 2014-15 and how to allocate ROC.

- **The Authority seeks stakeholders' views on the following:**
  - (a) **Are there any compelling reasons why the benchmarking approach should not be used for 2014-15?**
  - (b) **Is there any evidence to suggest that retail operating costs have changed materially, making the 2013-14 values irrelevant?**
  - (c) **Is the Authority's 2013-14 approach to allocating the ROC allowance to retail tariffs cost-reflective?**
  - (d) **If not, what would be a more cost-reflective approach, and why?**

## 4.2 Retail Margin

As with ROC, when setting the retail margin for the 2013-14 Determination the Authority adopted a benchmarking approach in keeping with previous years. It did this as it considered that undertaking a bottom-up approach may not necessarily have produced results that were any more robust or defensible.

When setting the retail margin, the Authority looked for recent determinations in other jurisdictions that may have been applicable for Queensland, as it did for ROC. The only regulator that had published recent work was IPART in New South Wales. The Authority considered that the retail margin adopted by IPART was relevant to Queensland.

### Setting the Retail Margin for 2014-15

The Authority could set the retail margin for the 2014-15 Determination using a benchmarking approach, and updating the margin if any relevant work becomes available. It could also adopt a bottom-up approach.

As with ROC, the Authority considers that there are sensible reasons to continue with its well-understood benchmarking approach, which it has explained in detail in previous determinations and consultation papers, particularly as this is the second year of a three year delegation. There is also the possibility that the Authority will only perform this role for one more year, after the Queensland Government's recent announcement that it may remove retail price regulation by 1 July 2015.

Given this, it is questionable whether changing to a bottom-up approach for a single year is warranted. However, the Authority is keen for stakeholders' views on this, as well as for any evidence on whether the retail margin the Authority adopted for 2013-14 might not be appropriate for 2014-15.

- **The Authority seeks stakeholders' views on the following:**
  - (a) **Are there any compelling reasons why the benchmarking approach should not be used for 2014-15?**
  - (b) **Is there any evidence to suggest that the retail margin the Authority adopted for 2013-14 is not applicable for 2014-15?**

### Applying the Retail Margin to Retail Tariffs

For the 2013-14 Determination, the Authority applied the retail margin equally (on a percentage basis) to each component (fixed, variable and demand) of each retail tariff. This means 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.

The Authority proposes to continue to adopt this approach for the 2014-15 Determination. However, it will consider alternative approaches proposed by stakeholders provided there is sufficient justification and explanation as to why the alternative approach is superior and how it would apply in practice.

- **The Authority seeks stakeholders' views on the following:**
  - (a) **Is the Authority's 2013-14 approach to applying the retail margin to retail tariffs appropriate to use for 2014-15?**
  - (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 and Headroom

Under the Delegation and section 90(5)(a) of the Electricity Act, the Authority is required to have regard to the effect of its price determination on competition in the Queensland retail electricity market. In its submission to the 2013-14 price review, the Queensland Government considered that this requirement was consistent with its policy objective that customers, wherever possible, should have the opportunity to benefit from competition and efficiency in the marketplace.

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 six years ago, although it is largely limited to SEQ as a result of the UTP. In SEQ, most customers (around 70%) are supplied under a competitive market contract. In contrast, the vast majority of customers in regional Queensland (around 99%) are supplied under a standard contract and pay notified prices.

Where competition is effective, it generally provides the best means of delivering the goods and services that consumers demand at prices that reflect efficient costs. Regulation will almost always be an imperfect substitute for competition because:

- (a) it can distort incentives for businesses to compete and innovate;
- (b) regulators have imperfect information upon which to determine efficient costs and prices; and
- (c) regulated prices are not as responsive to changes in costs as competitively determined prices.

Following a recommendation from the Interdepartmental Committee (IDC) on Electricity Sector Reform, the Queensland Government recently announced that it is considering replacing retail price regulation with price monitoring in SEQ by 1 July 2015, if certain conditions relating to consumer protection and engagement are met. The Queensland Government expects that this will increase competition, resulting in better outcomes for customers in terms of choice, efficiency and customer service<sup>18</sup>. In regional Queensland, price regulation will be retained while the Government finalises a strategy for developing competition<sup>19</sup>.

Consistent with the 2013-14 Determination, the Authority considers that a key objective of notified prices is to facilitate the development of competition in the Queensland retail electricity market and to provide a transition to price deregulation, particularly in SEQ. In its previous two price determinations, the Authority has aimed to achieve this objective by:

- (a) estimating the efficient costs of supply and setting notified prices on a cost-reflective basis; and

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18 Queensland Government, *Response to the Interdepartmental Committee on Electricity Sector Reform*, June 2013; p. 9; and Minister for Energy and Water Supply, The Honourable Mark McArdle, *Media Release: End of electricity price regulation to improve competition*, 17 June 2013.

19 Ibid.

- (b) adding an explicit allowance for excess profit or 'headroom' in notified prices above the estimated efficient costs of supply.

### Approach in 2013-14

In its 2013-14 Determination, the Authority included an explicit allowance for headroom of 5% of the estimated efficient costs of supply in all retail tariffs. This was the same level of headroom included in the 2012-13 Determination.

The Authority decided that the headroom allowance should be maintained at 5% based on an assessment of the current state of competition in SEQ, the expected positive effects of other aspects of the price determination on competition and the impact on customers that do not have access to, or choose not to take up, competitive market offers.

The Authority's assessment of the current state of competition revealed that, on several measures, the level of competition appeared to have been maintained or improved. The Authority also acknowledged that declining switching rates and indications from some retailers that they are no longer actively marketing in Queensland may indicate that competition has slowed.

However, the Authority did not consider that there was sufficient evidence at that time to suggest that competition was declining in SEQ. The Authority also noted that, even if competition were declining, it would be difficult to determine whether (and to what extent) any decline was driven by the Authority's 2012-13 Determination or the Queensland Government's decision to freeze Tariff 11 in 2012-13.

### Approach for 2014-15

The Authority proposes to continue to include an explicit allowance for headroom in notified prices for all retail tariffs.

#### *Residential and Small Customer Retail Tariffs*

In deciding on the appropriate level of headroom to include in notified prices for residential and small customer retail tariffs, the Authority proposes to consider whether notified prices provide incentives for:

- (a) retailers to enter the SEQ retail market and to compete vigorously to acquire and retain customers; and
- (b) customers in SEQ to exercise market choice and seek out the best deal for them in the competitive market.

This will include an assessment of the state of competition in SEQ, including the impact of the Authority's 2013-14 Determination (to the extent possible). Consistent with the approach adopted for the 2013-14 Determination, the Authority proposes to consider the following factors: switching rates; the number of active retailers and degree of market concentration; available market offers; and customer participation and engagement. The Authority welcomes feedback from stakeholders on how it could improve its assessment of the state of competition.

It is also important to note that there are other factors that can impact on competition that are largely outside of the Authority's control. It can be difficult to isolate the impact of the Authority's determinations from these other factors, which may include:

- (a) *The relative attractiveness to retailers of the markets that have price regulation compared to markets that do not.* However, the Queensland Government's

announcement that it is considering deregulating retail electricity prices in SEQ by mid-2015 may improve the relative attractiveness to retailers of the SEQ market.

- (b) *Government intervention in the price-setting process, which may increase the perceived risk of retailing in Queensland.* Retailers have argued that the Queensland Government's decision to freeze Tariff 11 in 2012-13 increased uncertainty and the risk of retailing in Queensland<sup>20</sup>. The Queensland Government also intervened in the price-setting process in 2013-14 by capping the increasing in the 'obsolete' and 'transitional' tariffs at 10%, which is lower than the increases decided by the Authority.
- (c) *Metering technology limitations.* As pointed out by the IDC on Electricity Sector Reform, limited metering functionality can negatively impact on competition by inhibiting product innovation and limiting the choice of products retailers can offer consumers<sup>21</sup>.
- (d) *Barriers to customer engagement and participation in the competitive market.* The Authority has previously argued that greater customer engagement would provide incentives for retailers to compete vigorously to make the best offers to attract and retain customers. Following a recommendation from the IDC on Electricity Sector Reform, the Queensland Government will consult on options to increase customer engagement so that they obtain the benefits of discounts and improved products in the competitive market<sup>22</sup>.

Under the UTP and current community service obligation arrangements, any reasonable level of headroom would be insufficient to encourage retailers to offer market contracts to the majority of residential and small customers outside of SEQ. However, the Authority notes that the Queensland Government is considering options for developing competition outside of SEQ.

The Authority considers that including a reasonable level of headroom in small customer retail tariffs strikes an appropriate balance between promoting competition in SEQ, while recognising that customers outside of SEQ currently have limited or no access to competition.

#### *Large Non-Residential Customer Retail Tariffs*

As discussed in Chapter 2, notified prices for large non-residential customers are based on Ergon Energy's network charges (because large non-residential customers in Energex's network area no longer have access to notified prices) and are, therefore, more cost-reflective than they have been in the past. While there is limited information on the impact of more cost-reflective notified prices on competition for large customers in regional Queensland, in a submission to the 2013-14 price review, AGL indicated that it has been active in providing competitive market offers to these customers since the creation of cost-reflective tariffs.

The Authority is interested in receiving evidence or relevant sources of information that would assist it in understanding the impact of its 2013-14 Determination on competition for large customers in regional areas and whether headroom is set at an appropriate level. However, the Authority recognises that, even if headroom is set at an appropriate level, there are likely to be other barriers to competition. For instance:

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20 Sapere Research Group, *Review of Competition in the Retail Electricity and Natural Gas Markets in New South Wales – Report of Interviews with Energy Retailers, Prepared for the Australian Energy Market Commission*, February 2013, p. 36.

21 Interdepartmental Committee on Electricity Sector Reform, Report to Government, May 2013, p 60.

22 Queensland Government, *Response to the Interdepartmental Committee on Electricity Sector Reform*, June 2013, p. 10.

- (a) as discussed in Chapter 2, notified prices are currently based on:
  - (i) network charges for Ergon Energy's East pricing zone (transmission zone 1), meaning that customers in other pricing zones are not paying cost-reflective retail tariffs; and
  - (ii) for very large customers, the network charge for high voltage demand customers rather than each customer's site-specific network charge;
- (b) as discussed in Chapter 6, many customers are still accessing 'obsolete' and 'transitional' tariffs which are set below cost-reflective levels; and
- (c) once large non-residential customers accept a market contract they cannot revert to a standard contract (paying notified prices), which may discourage them from accepting a market offer<sup>23</sup>.

- **The Authority seeks stakeholders' views on the following:**
  - (a) **What is the impact of the Authority's 2013-14 Determination on competition in:**
    - (i) **SEQ in relation to residential and small customers; and**
    - (ii) **regional Queensland, particularly in relation to large customers.**
  - (b) **How could the Authority improve its assessment of the state of competition in SEQ?**
  - (c) **What information could assist the Authority in assessing the level of competition in regional Queensland for large customers?**
  - (d) **What impact are factors other than the Authority's price determinations having on competition in SEQ and regional Queensland?**

## 5.2 Accounting for Unforeseen or Uncertain Events

In the 2013-14 Final Determination, the Authority noted that it will consider using a cost pass-through mechanism during the current delegation period, potentially taking effect from the 2014-15 tariff year. This mechanism would allow retailers to recover the efficient costs or savings arising from certain, unavoidable and unforeseen events, at the Authority's discretion.

The schedule of notified prices in Queensland applies consistently to all retailers. Consequently, the types of costs which can be considered for cost pass through will necessarily be limited to uncontrollable and unavoidable costs which have equal incidence to all Queensland retailers, to the extent that they supply non-market customers. Events that may trigger a pass through could include significant, broad-reaching changes such as regulatory and policy changes imposed by State or Federal Government agencies, and changes in taxation.

The Authority considers that the following events may be eligible cost pass-throughs for setting 2014-15 notified prices, subject to the Authority's approval:

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<sup>23</sup> This restriction also applies to any future occupants of that premises (for example, if the premises is sold or occupied by a new tenant).



- (a) differences in small-scale renewable energy scheme (SRES) costs where the amounts provided in the determination are found to be materially understated or overstated; and<sup>24</sup>
- (b) differences in network charges (in the event that the final AER approved charges differ from those used by the Authority in its annual price determinations), would be eligible pass-through events.

Limiting the availability of the pass-through mechanism to these two situations at this stage strikes a reasonable balance between the concerns about the potential for regulatory gaming (as raised by customers and consumer groups), with the expectation that retailers should have the opportunity to recover the efficient costs of uncontrollable events.

With regard to a materiality threshold for pass-through, the Authority considers it is not necessary to prescribe a firm threshold, preferring to consider each proposed cost pass through on its merits, in conjunction with other relevant factors.

Matters of detail such as modelling of cost pass-through amounts, expenditure timing assumptions and compensation for the time value of money, will be addressed by the Authority when it is presented with a reasonable proposal for cost pass-through during the course of the Delegation period.

- **The Authority seeks stakeholders' views on how the Authority should apply a cost pass-through mechanism, and whether there is a need to apply such a mechanism when setting notified prices for 2014-15?**

### 5.3 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 previous determinations, stakeholders such as the Shopping Centre Council of Australia have raised issues relating to on-selling of electricity to customers in both the Energex and Ergon Energy distribution areas.

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 previous determinations stakeholders have raised the issue that a relatively small increase in customer consumption from less than 100MWh per year to a level above this can cause sizeable price increases in the Ergon Energy distribution area.

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<sup>24</sup> The Clean Energy Regulatory is required to publish the binding small-scale technology percentage (STP) prior to 31 March of the year in which it is to apply

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

In response to previous determinations, stakeholders have suggested that consideration be given to how community service obligation payments could be applied to facilitate a competitive market in the Ergon Energy distribution area. The lack of competition outside SEQ has been consistently identified by stakeholders as a serious issue in regional consultation conducted by the Authority.

The Authority acknowledges, as it has done previously, that competition in regional Queensland could be significantly improved if the community service obligation 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. However, on 16 June 2013, the Queensland Government released its response to the Interdepartmental Committee on Electricity Sector Reform report. As part of its response, the government will examine options for improving competition outside of SEQ.

## 6 TRANSITIONAL ARRANGEMENTS FOR OBSOLETE TARIFFS

The Delegation requires that the Authority consider implementing appropriate transitional arrangements for Tariff 11, and the tariffs classed as obsolete in 2012-13, should it consider that customers on these tariffs would face significant price impacts if they were required to move to the alternative cost-reflective tariffs immediately.

### 6.1 Transitional arrangements for Tariff 11

For the standard residential tariff (Tariff 11), the Delegation requires the Authority to consider implementing transitional arrangements when rebalancing the fixed and variable price components to cost-reflective levels by 1 July 2015.

For 2014-15, the Authority will take the second of three transitional steps toward achieving cost-reflective Tariff 11 charges.

#### Tariff 11 charges relative to cost-reflective charges

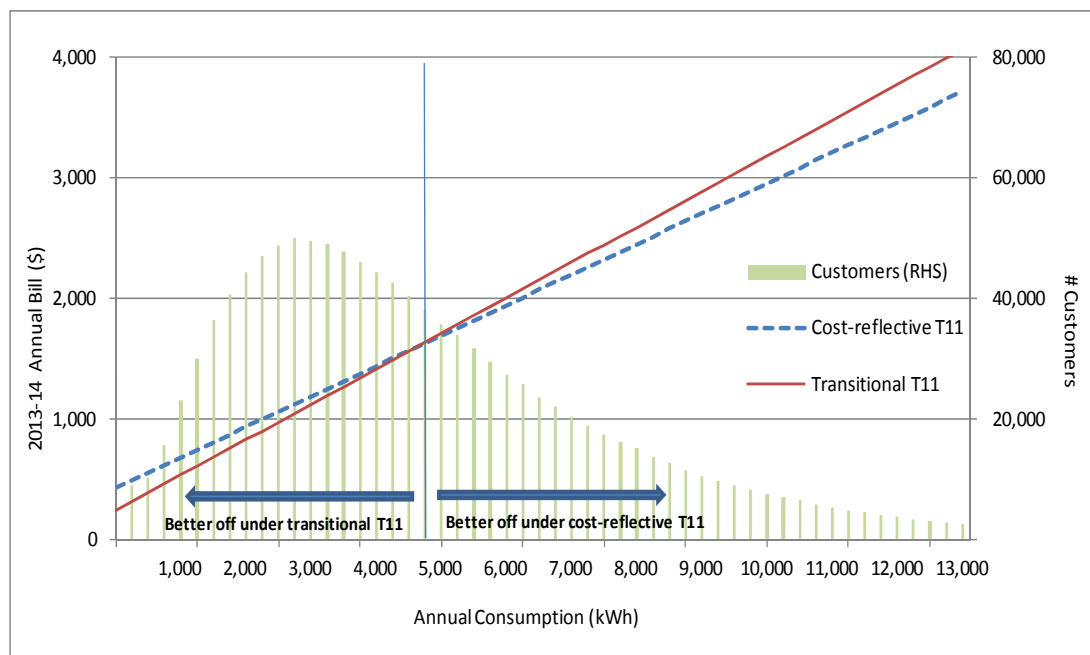
The fixed charge under Tariff 11 is 50.219c/day, which is significantly lower than the cost reflective level of 98.316c/day. In contrast, the variable charge under Tariff 11 is 26.730c/kWh, which is higher than the cost reflective level of 22.969c/kWh<sup>25</sup>.

The mismatch between Tariff 11 charges and their cost-reflective levels means that customers who consume less than around 4,625 kWh per year are better off on the existing Tariff 11 than they would be on a cost-reflective Tariff 11. The amount they save on the fixed charge outweighs the cost of the higher variable charge at their level of consumption. The extent of this saving increases the lower the customer's level of consumption (see Figure 6.1).

In contrast, customers who consume more than around 4,625 kWh per year are worse off on the existing Tariff 11 than they would be on a cost-reflective Tariff 11. The amount they save on the fixed charge is outweighed by the higher cost of the variable charge at their level of consumption. The extent of this detriment increases the higher the customer's level of consumption.

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<sup>25</sup> 2013-14 Tariff 11 charges in the *Queensland Government Gazette*, Vol. 363, No. 20, 31 May 2013, available at: <http://publications.qld.gov.au/dataset/gazettes-may-2013>; cost-reflective Tariff 11 charges as per the Authority's advice to the Minister for Energy and Water Supply, 31 May 2013, available at <http://www.qca.org.au/files/ER-QCA-FinalDeterm-RREP201314-0513.pdf>.

**Figure 6.1: 2013-14 Annual Electricity Bills - Cost-reflective and Transitional T11**

Note: A typical customer on Tariff 11 consumes around 4,250 kWh per year.

### Options for transitioning to cost reflective charges

Given the cross-subsidies inherent in Tariff 11 charges and the potential this has to distort the retail market for electricity in Queensland, in its 2013-14 price review the Authority determined a three-step transition to cost-reflective tariffs. This was consistent with the requirement in the Delegation for transitioning to be completed by 1 July 2015.

Given that the fixed charge is below cost, and the variable charge is above cost, the Authority determined that any transitional arrangement must involve gradual increases to the fixed cost component and off-setting reductions to the variable cost component. This approach ensures revenue adequacy for retailers as charges move closer to cost reflectivity – or, in other words, retailer revenues stay the same, but the amount individual customers pay changes, according to their usage.

The staged approach to rebalancing the fixed and variable charges of Tariff 11 that the Authority implemented in 2013-14 means that customers with higher annual consumption will continue to cover the shortfall in revenue retailers incur from supplying customers with lower annual consumption. This cross-subsidy will continue until Tariff 11 charges are fully rebalanced to cost-reflective levels.

The Authority considers that a continuation of the 2013-14 approach for the 2014-15 price determination is appropriate. Under this approach, as there are now only two steps left in the transition, the Authority would set the transitional 2014-15 fixed charge at halfway between the transitional 2013-14 fixed charge and the cost reflective 2014-15 fixed charge. The variable charge would then be determined at a level that ensures retailers are able to recoup their full revenue from all Tariff 11 customers.

- **The Authority seeks stakeholders' views on whether there are any compelling reasons not to continue with the approach to transitioning Tariff 11 that was established in the 2013-14 determination.**

## 6.2 Transitional Arrangements for Tariffs Made Obsolete in 2012-13

In 2012-13, the Authority introduced a range of new cost-reflective tariffs for use by small and large businesses, made 12 tariffs obsolete and removed three of the old regulated tariffs. In recognition of both the significant financial impact on many customers and the practical constraints of moving to different tariff structures (for example, because of the need to update or replace meters) a transitional period of one year was put in place to allow time for meter upgrades and affected customers to adjust business operations where possible to minimise the impact of moving to the new tariffs.

During consultation for the 2013-14 Determination it became clear that the impacts to customers would be so great in many cases that further transitional arrangements would be appropriate.

The Authority decided that there would be a seven-year transition for customers on tariffs 20 (large), 21, 22 (small and large), 37, 62, 65 and 66, a two year transition for customers on tariffs 41 (large) and 43 (large), and that three little used tariffs (63, 64 and 53 (large) should be removed. In addition, for equity reasons, the Authority opened access to tariffs 20 (large), 21, 22 (small and large), 62, 65 and 66 to all eligible customers over the seven year transition period. The tariffs with opened access were classified as transitional and tariffs 37, 41 and 43 were classified as obsolete either on the basis that they had been obsolete for some time (tariff 37) or because they will be removed in a shorter timeframe (tariffs 41 and 43).

The Authority set 2013-14 price increases for transitional and obsolete tariffs based on the percentage increases in the relevant cost-reflective tariffs that customers would otherwise be on, plus additional escalations to ensure the price differences between obsolete and cost-reflective tariffs did not blow out over the transition period. However, these prices were overruled by the Queensland Government, which set prices for all transitional and obsolete tariffs 10% above the 2012-13 prices.

Table 6.1 summarises the Authority's and Government's decisions.

**Table 6.1: Transitional Arrangements for Obsolete Tariffs 2013-14**

<i>Obsolete/Transitional Tariff</i>	<i>Retain or Remove in 2013-14</i>	<i>Period to be Retained</i>	<i>2013-14 QCA Increase<sup>a</sup></i>	<i>2013-14 Actual Increase</i>
Tariff 21 – transitional	Retain	7 years	24.0%	10.0%
Tariff 37 – obsolete	Retain	7 years	20.0%	10.0%
Tariff 62 – transitional	Retain	7 years	20.0%	10.0%
Tariff 63	Remove	N/A	N/A	N/A
Tariff 64	Remove	N/A	N/A	N/A
Tariff 65 – transitional	Retain	7 years	20.0%	10.0%
Tariff 66 – transitional	Retain	7 years	20.0%	10.0%
Tariff 20 (large) – transitional	Retain	7 years	14.3%	10.0%
Tariff 22 (small and large) – transitional	Retain	7 years	16.3%	10.0%
Tariff 41 (large) – obsolete	Retain	2 years	14.3%	10.0%
Tariff 43 (large) – obsolete	Retain	2 years	14.3%	10.0%
Tariff 53 (large)	Remove	N/A	N/A	N/A

*a. These increases were not applied in 2013-14.*

### Options for transitioning to cost-reflective tariffs

There are two key factors when assessing the transition to cost-reflective tariffs. The first is how long the transition should be, the second is how to adjust tariffs to move towards the cost-reflective levels.

The transitional periods the Authority set in its 2013-14 determination are presented in Table 6.1. Setting these periods was intended to provide certainty to businesses so that they could prepare for the new tariffs. As a result, the Authority does not think it is appropriate to create uncertainty by potentially changing the time period unless an analysis of customer impacts indicates that the tariff could be removed without significant customer detriment.

Increasing tariffs to reduce the gap to cost-reflectivity has been complicated by the Government's decision to cap price increases for 2013-14. One option is to increase prices to the level they would have been at had the Authority's decision not been over-ruled, and then calculate prices for 2014-15 using the same escalation method as used for 2013-14. Another option is not to undertake any 'catch-up' and simply apply the 2013-14 escalation method to the lower capped prices. Taking the second approach would mean customers' prices remain further below cost for longer compared to option one, but would avoid the larger price increases in 2014-15 that would result from undoing the effects of price capping in 2013-14.

As noted in Chapter 2, Ergon Energy has begun consultation on its network tariff strategy review, which may have an impact on the cost-reflective tariffs for large customers in the Ergon Energy distribution area. This in turn may affect the difference between the transitional tariffs

and cost-reflective tariffs customers should be on. However, changes to large customer tariff structures are not expected to be implemented in the 2014-15 pricing year and therefore will not impact the transitional arrangements for this price determination.

The Authority also notes that the Queensland Government has accepted a recommendation by the Interdepartmental Committee on Electricity Sector Reform (IDC) regarding removal of price controls in south-east Queensland, and improving competition in the Ergon Energy distribution area. The implications of these developments will need to be taken into account when setting the prices for 2014-15.

- **The Authority seeks stakeholders' views on the following:**
  - (a) **How should obsolete and transitional tariffs be increased towards cost-reflectivity, given the 10% increase applied in 2013-14?**
  - (b) **Any other suggestions on how customers might be transitioned to cost-reflective prices over the remaining six years of the transition period.**

### Allowing new large customers access to transitional tariffs

In its 2013-14 Price Determination, the Authority decided that all business customers should have access to transitional tariffs, subject to individual tariff terms and conditions throughout the seven year transitional period. This decision was made to ensure equity for all businesses, although it was recognised that there could be an adverse impact to retailers who would face a higher exposure to financial loss due to potentially supplying more customers below cost.

It is possible that the Government's decision to cap price increases for transitional tariffs at 10% might incentivise more customers to access a transitional tariff than otherwise would have. While this might apply to only a small number of customers, continued capping of prices in future years may expand the pool of customers accessing subsidised prices, in which case the Authority may be more inclined not to leave transitional tariffs open to all eligible customers.

- **The Authority seeks stakeholders' views on whether access to transitional arrangements should remain open to all eligible customers.**

## APPENDIX A: MINISTERIAL DELEGATION AND COVER LETTER



## Office of the Minister for Energy and Water Supply

Ref: EWS/002748  
CTS 02289/13

12 February 2013

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

Dr Malcolm Roberts  
Chairman  
Queensland Competition Authority  
GPO Box 2257  
BRISBANE QLD 4001

Dear Dr Roberts

I refer to the current Delegation and Terms of Reference (ToR), issued to the Queensland Competition Authority (QCA) on 5 September 2012, for determining regulated retail electricity prices for the three year delegation period 2013–14 to 2015–16 (with annual price determinations published each year), as authorised under section 90AA(1) of the *Electricity Act 1994* (the Act). Under the current Delegation, the Draft Determination on regulated prices for 2013–14 is required to be released no later than 15 February 2013.


In acknowledging your recent appointment as Chairman of the QCA Board on 29 January 2013, I have amended the current Delegation and ToR to extend the date for the release of the Draft Determination to 22 February 2013. I trust that this will provide the Board with additional time to comprehensively consider the QCA's Draft Determination for 2013–14 regulated retail prices, in advance of its public release.

Accordingly, I have attached a new Certificate of Delegation and ToR directing the QCA to publish the Draft Determination on regulated retail electricity prices for 2013–14 on 22 February 2013.

I thank the QCA for its work to date on the 2013–14 regulated pricing process, and will continue to encourage stakeholders to actively participate in the QCA's ongoing consultation process.

Should you require anything further, please contact Mr Benn Barr, A/Deputy Director-General, Energy Sector Reform, on 323 90039, or email [benn.barr@dews.qld.gov.au](mailto:benn.barr@dews.qld.gov.au).

Yours sincerely



Mark McArdle MP  
Minister for Energy and Water Supply

Att: Electricity Act 1994 Delegation

Page 1 of 1



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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 Energex;
  - (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 Energex 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*

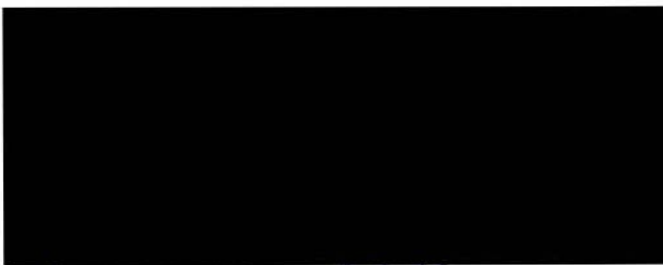
- 13. As part of each annual price determination, QCA must investigate and publish an annual report of its final price determination on regulated retail electricity tariffs, with each tariff to be presented as a bundled price, for the relevant tariff year, and gazette the bundled retail tariffs. The 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 on 22 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.
- 18. This Delegation revokes my previous Delegation issued on 5 September 2012.

DATED this *12th* day of February 2013.

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

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 ) .....  
 ) *(signature)*

## APPENDIX B: PRICE DISTRIBUTION APPROACH

In general terms, the price distribution approach involves estimating the price that a retailer would be willing to pay in purchasing energy to meet the load of customers while mitigating a range of risks, principally those flowing from the impacts on the spot price of weather and plant outages.

To implement this approach, ACIL Allen would largely follow the same steps as under its hedging based approach. First it would construct weather and outage-based load data for the tariff year for each NEM region and settlement class. These settlement classes include each distributor's NSLP, the two Energex controlled load profiles and Energex's unmetered load profile. ACIL Allen would then use its Powermark proprietary model to develop hourly NEM spot price forecasts for the tariff year which it would combine with the forecast load profiles for the tariff year to establish a distribution of over 400 load-weighted annual prices for each regulated retail tariff.

Under the hedging-based approach, ACIL Allen would then combine these load and spot price forecasts with prices for traded futures contracts to estimate a range of different hedged outcomes for the tariff year.

However, in the absence of sufficient futures data, ACIL Allen would base its energy cost estimates on the distribution of load-weighted annual prices based on its view that the mean of these price distributions represents the price that a retailer would be willing to pay for energy, over time, to cover the load of each settlement class. ACIL Allen also suggested that it would be appropriate to escalate this mean to account for energy losses and the time value of money associated with forward purchasing hedging contracts.

The price distribution approach recognises that a prudent retailer would hedge risks through energy purchase contracts and that this would incur extra costs, or a premium, over the expected spot market price and that an efficient retailer would contract to a level where the exposure to high spot prices was kept to a level acceptable to the retailer, based on its appetite for risk and financial capability to ride out periods of high spot prices. However, in 2012-13 ACIL Allen had difficulty estimating the extent to which the difference in risk aversion between retailers would affect the premium over the spot price that retailers would be willing to incur in purchasing forward energy contracts.

Further information on the price distribution approach can be found in ACIL Allen's Draft Report to the Authority's 2012-13 review, which can be accessed on the Authority's website.