

**Pricing for the retail supply
of electricity to franchise
customers**

December 1999

**INDEPENDENT PRICING AND REGULATORY TRIBUNAL
OF NEW SOUTH WALES**

**Pricing for the Retail Supply
of Electricity to Franchise
Customers**

December 1999

The Tribunal members for this review are:

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Mr James Cox, Full time member

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FOREWORD

The Tribunal has issued this determination under the *Independent Pricing and Regulatory Tribunal Act 1992* (IPART Act). This determination regulates retail prices for those electricity consumers, predominantly residential and small business customers, unable to select a retailer of choice. This determination is for an 11-month period, 1 February 2000 to 31 December 2000. From 1 January 2001 the state government plans to introduce full competition for the retail supply of electricity to all customers.

To protect the interests of customers, while providing some scope to franchise retailers to restructure tariffs, the Tribunal has also set limits on price movements. The limits will ensure that residential consumers (including rural residential consumers) receive no price increases in real terms for the same pattern and level of electricity consumption. However, after 1 July 2000, electricity prices will adjust by the net impact of the GST package.

The Tribunal has no power to regulate franchise retailers after 31 December 2000. Consequently, the Tribunal is not able to specify any default protection for consumers after contestability is introduced for all consumers. However the Tribunal **strongly believes** that some regulation for a period after the introduction of contestability is essential.

Thomas G Parry
Chairman
30 December 1999

EXECUTIVE SUMMARY

Legislative basis for this determination

The Tribunal issues this determination under the *Independent Pricing and Regulatory Tribunal Act 1992* (IPART Act). This determination sets a price cap on retail margins (retail costs and a profit margin) for the franchise retail supply of electricity for the period 1 February 2000 to 31 December 2000. It also sets charges levied by franchise retailers for miscellaneous services by approving an exhaustive list of charges for miscellaneous services.

This determination is largely consistent with the analysis presented in the Tribunal's June 1999 report addressing the reference issued by the Premier under section 12A of the IPART Act.

The section 12A report raises concerns about the lack of regulatory protection for franchise customers after 31 December 2000. The government has yet to extend the Tribunal's legislative power in relation to franchise retail customers. In the absence of legal powers, this determination gives no direction on retail regulation beyond 2000.

Retail supply

The NSW Government is introducing competition into electricity retail supply. Under the current timetable, the introduction of deregulation of domestic customers will commence from 1 January 2001 and proceed according to a transitional timetable yet to be announced. Eventually, all customers will be free to choose an electricity retailer. To date customers consuming more than 160MWh per annum¹ are free to select a retailer.² Franchise customers are those consumers of electricity who are not eligible to choose a retailer.

Retail supply businesses purchase electricity in the wholesale market, with appropriate hedging contracts to manage price risk. They on-sell electricity to end-use customers. Retailers incur transportation costs for delivering electricity through the network, energy losses, and market fees, and pass these on to customers through a bundled price.

The 'bundled' retail price paid by a franchise customer comprises energy costs, transmission and distribution costs and a retail margin. In this determination the Tribunal regulates the retail margin component only of the tariffs. Concurrent with this retail determination, the Tribunal is releasing a distribution determination under the National Electricity Code which will also be effective from 1 February 2000.

The Tribunal has determined that the retail margin for each franchise retailer is to be no more than 6.6 per cent on turnover of sales to franchise customers for this period. The retail margin consists of retail costs and a profit margin.

¹ Customers free to choose a retailer now include fast food restaurants and other businesses where their annual electricity bill is approximately \$10,000 or greater.

² These customers are referred to as contestable customers.

Pricing outcomes

Each franchise retailer's price outcomes will be different. The outcomes of this determination results in retail prices for franchise customers reducing on average over the 11 months to 31 December 2000 by 2.8% per cent³ in nominal terms. This reduction does not include the net effects of the GST which will operate from 1 July 2000. Nor does it take account of any adjustments for under or over collection of past years revenues.

However, four of the six distributors (combined franchise retail and distribution) have under collected allowable revenues⁴ for the past two years. Retailers will be able to recoup some of this under-collected revenue in the next 11 months but prices must comply with limits on price movements. Customers of these retailers who have under collected revenues are likely to see no price change in real terms before the impact of the GST.

Average retail prices for customers of EnergyAustralia are likely to reduce by 2 per cent in nominal terms over the 11 months to 31 December 2000 prior to the net effects of the GST and any adjustments retailers may make to reduce balances in their unders and overs accounts. However, Integral Energy's past network pricing strategies resulted with their franchise retailer under recovering their retail margin. As consequence of this determination and the distribution network determination, Integral's franchise retail customers are likely to see no price reductions, prior to the net effects of the GST.

Average retail prices for franchise customers of Great Southern Energy are likely to reduce by up to 6 per cent in nominal terms before the net effects of the GST and any adjustments retailers may make to reduce balances in their unders and overs accounts. NorthPower's average retail prices are likely to reduce by 3% in nominal terms before the net effects of the GST and any adjustments retailers may make to reduce balances in their unders and overs accounts. However, as a result of past under collections of allowable revenues, franchise customers of Advance Energy and Australian Inland Energy are likely to see no price reductions, prior to the net effects of the GST.

Limits on price movements

To protect the interests of customers, while providing scope for franchise retailers to restructure tariffs, the Tribunal has set the following price limits:

- the bill of any individual residential customer is not to exceed the bill for the corresponding period of the preceding year⁵ by more than \$30 pa or the preceding bill times CPI⁶ pa, whichever is greater
- the increase in revenue recovered from the residential class as a whole is not to exceed the CPI.

The price limits apply to the residential franchise retail prices, including rural residential, and apply to prices exclusive of the impact of GST.

³ Final price outcomes will depend upon the wholesale pass through price for type 2 vesting contracts and residual load.

⁴ retail revenues, network revenues or both.

⁵ For the same pattern and volume of electricity consumption.

⁶ The CPI means the December 99 on December 98 All Capital CPI.

These price limits are to apply to all retailers, except where the retailer can demonstrate to the Tribunal that meeting the price limits would not allow the retailer to recover its legitimate and efficient costs.

Charges for miscellaneous services

The Tribunal has approved an exhaustive list of charges for miscellaneous services. The Tribunal has also produced a narrative to accompany the list of charges for miscellaneous services. The narrative outlines the circumstances in which the charges may be levied. The Tribunal has also approved a regime for charging refundable deposits to electricity customers. The regime outlines the circumstances in which a franchise retailer is permitted to require a refundable security deposit from a customer.

Post contestability

The Tribunal will have no power to regulate franchise retailers after 31 December 2000. Consequently, the Tribunal is not able to specify any default protection for consumers after contestability is introduced for all consumers. The Tribunal strongly believes that some form of regulation or ability to set maximum tariffs for a period after the introduction of contestability is essential.



INDEPENDENT PRICING AND REGULATORY TRIBUNAL
OF NEW SOUTH WALES

**DETERMINATION UNDER SECTION 11(1) OF THE INDEPENDENT
PRICING AND REGULATORY TRIBUNAL ACT, 1992**

Reference no:	99/193
Determination no:	No 5, 1999
Government agencies:	EnergyAustralia, Integral Energy, NorthPower, Great Southern Energy, Advance Energy, and Australian Inland Energy, referred to collectively as franchise retailers
Government monopoly service	Retail supply of electricity to franchise customers, and charges for miscellaneous services and security deposits as defined in Attachments 1 & 2 Franchise customer is defined in the <i>Electricity Supply Act 1995</i> (ESA Act) to mean a person who has not been declared to be a non-franchise customer by virtue of an order under section 92 of the ESA Act.

1 Retail prices for franchise customers

The Tribunal will regulate the retail supply of electricity to franchise customers for the period from 1 February 2000 to 31 December 2000 through a price cap on the retail margin per kWh. Some specified additional costs can be recovered from franchise customers.

The retail margin for each franchise retailer will not be more than 6.6 per cent on turnover of sales to franchise customers for this period. The retail margin consists of retail costs and a profit margin.

The only additional costs that can be recovered from franchise customers are:

- Actual network charges (including charges for network miscellaneous services) as determined by the Independent Pricing and Regulatory Tribunal and the Australian Competition and Consumer Commission.
- Actual fees (including charges for ancillary services), imposed by NEMMCO under the National Electricity Code.
- Actual energy losses calculated using loss factors set by distribution network service providers (DNSPs) and transmission network service providers (TNSPs) and approved by the Tribunal.
- The net impact of *A New Tax System (Goods and Services Tax) Act 1999* from 1 July 2000 to 31 December 2000. The Tribunal requires an audit of the changes in costs under the GST package, to be paid for by the franchise retailer. Audit requirements will be notified to the franchise retailers by the Tribunal in writing.
- Type 1 vesting contracts at actual vesting price.

- Type 2 vesting contracts and any other residual wholesale purchases for franchise retail customers at a price to be determined by the Tribunal.
- The balance in their unders and overs accounts if the Tribunal's limits on price movements on retail prices are complied with.

A franchise retailer must pass on only to its franchise customers, either through the retail tariffs or by way of a rebate, any payment that a DNSP makes to that franchise retailer that represents a repayment by the DNSP, from the unders and overs account, of an earlier overcollection.

The difference between revenue from optional green tariffs and revenues that would have been obtained for the same quantity of sales using standard tariffs does not form part of the regulated retail margin.

In addition, the Tribunal will separately regulate miscellaneous charges and security deposits levied by franchise retailers by approving an exhaustive list of charges for miscellaneous services (see section 5 below).

2 Limits on price movements

In accordance with the National Electricity (New South Wales) (Savings and Transitional) Amendment Regulation 1999, retail prices from 1 July 1999 to 31 January 2000 are to be regulated under the Tribunal's determination 5.3 of 1997.

Movements in retail franchise prices over the period 1 February 2000 to 30 June 2000 are constrained by the following limits:

Any increase in the bill of any individual residential customer may not exceed the greater of:

- the change in the CPI (March on March) or
- for customers on non off-peak tariffs, \$5.00 per quarter, or
- for customers on off-peak tariffs, \$7.00 per quarter.

Any increase in the average residential tariff for the total residential group may not exceed 80 per cent of the change in the applicable CPI.

Franchise retailers can alter retail tariffs once during the period from 1 February 2000 to 30 June 2000. If retailers choose to increase tariffs between 1 February 2000 and 30 June 2000, they may only do so if the increase in residential tariffs over the twelve month period to 30 June 2000 does not exceed the price limits contained in the Tribunal's determination 5.3 of 1997.

For prices over the period 1 July 2000 to 31 December 2000, the Tribunal has determined the following price limits:

- the bill of any individual residential customer is not to exceed the bill for the corresponding period of the preceding year⁷ by more than \$30 per annum or the preceding bill times the change in the CPI per annum, whichever is the greater

⁷ For the same pattern and volume of electricity consumption.

- the increase in revenue recovered from the residential class as a whole is not to exceed the change in the CPI.

The limits on price movements apply to residential franchise retail prices, including rural residential. In addition to the above limits the net impact of the *A New Tax System (Goods and Services Tax) Act 1999* may be recovered from customers. For retail price changes in the period 1 July 2000 to 31 December 2000, the CPI means the percentage change between December 1999 and December 1998 All Capital CPI.

These price limits are to apply to all franchise retailers, except where the retailer can demonstrate to the Tribunal that meeting the price limits would not allow the retailer to recover its legitimate and efficient costs.

3 Price changes and notification requirements

Franchise retailers must alter retail tariffs on 1 July 2000, or as near as possible to that date. In addition franchise retailers may alter retail tariffs once during the period from 1 February 2000 to 30 June 2000 (see section 2 above for conditions).

Franchise retailers must agree with the Tribunal the date on which price changes will take effect.

Franchise retailers must provide the Tribunal with 20 days notice of proposed changes in retail prices.

When notifying price changes to the Tribunal, franchise retailers must provide supporting material that:

- indicates the percentage and absolute change in charges or average bills for each customer class
- demonstrates that proposed retail tariffs are projected to recover no more than the sum of the retail margin (including any adjustment of the unders and overs account within the limits set), plus additional costs as specified in this determination
- demonstrates the basis of the proposed prices, including information on cost allocations and cost assumptions, and supporting documentation
- demonstrates compliance with constraints on maximum increases in tariffs.

Franchise retailers must provide a statement signed by the retailers Chairman and CEO undertaking that the above requirements have been met when notifying price changes to the Tribunal.

4 Unders and overs account

An unders and overs account is not required as from 1 February 2000.

The Tribunal requires that franchise retailers reduce or eliminate the balances in their unders and overs accounts over the period to 31 December 2000. They should do so within the limits on price movements imposed by the Tribunal.

Great Southern Energy and Australian Inland Energy must return to customers all their over collection by 31 December 2000.

Any under collected balance recorded at 31 December 2000 will be foregone. Any over collected balance as at 31 December 2000 must immediately be repaid to franchise customers.

Balances approved by the Tribunal as at 30 June 1999 are:

Table 1 Allowed balance of the franchise retailer's unders and overs account as at 30 June 1999

	Opening Balance Over/(under) recovery (\$m)	Adjustment (\$m)	Balance to be carried forward (\$m)	Over/(under) Recovery, % of 1998/99 revenue
EnergyAustralia	(3.6)	-	(3.6)	(0.3)
Integral Energy	(131.6)	33.2	(98.4)	(14.8)
NorthPower	(14.1)	-	(14.1)	(4.8)
Great Southern Energy	3.9	-	3.9	1.9
Advance Energy	(4.8)	-	(4.8)	(8.2)
Australian Inland Energy	0.04	-	0.04	0.2

Franchise retailers must submit to the Tribunal by 10 March 2000 the balance of their unders and overs account as at 31 January 2000. A record of transactions which reconciles the movement between 30 June 1999 and 31 January 2000 must also be provided by 10 March 2000.

5 Charges for miscellaneous services

The Tribunal has approved an exhaustive list of charges for miscellaneous services. These charges are the maximum amount to be charged for each of these services. No new charges are to be introduced over the term of this determination.

The Tribunal has also introduced a narrative to accompany the exhaustive list of charges for miscellaneous services. This narrative outlines the circumstances under which these charges may be levied. The narrative is included in this determination as attachment 1 of this report. The list of approved maximum charges for miscellaneous services is:

Miscellaneous Charge	Maximum allowable charge (\$)
Dishonoured bank transaction charge	Twice bank fee
Late payment charge	5.00
Security deposit	See attachment 2 of this report

The Tribunal has also approved a regime for charging refundable deposits to electricity customers. This regime outlines the circumstances under which a franchise retailer is permitted to require a refundable security deposit from a customer. The Tribunal's approved protocol for charging security deposits is included in this determination as attachment 2.

6 Compliance

The Tribunal requires franchise retailers to report to the Tribunal in writing by 14 February 2001. The compliance report must demonstrate that prices over the period 1 February 2000 to 31 December 2000 comply with this determination.

Franchise retailers must not charge franchise customers other than in accordance with this determination.

This determination should be read in conjunction with the report.

Thomas G Parry
Chairman

1 INTRODUCTION

In accordance with the *Independent Pricing and Regulatory Tribunal Act 1992* (IPART Act), this determination sets a price cap on retail margins (retail costs and a profit margin) for the franchise retail supply of electricity for the period 1 February 2000 to 31 December 2000. In June 1999 the Tribunal released a report to the Premier under section 12A of the IPART Act (the section 12A report). The section 12A report dealt with, amongst other issues, the regulation of retail supply of electricity to franchise customers. The Tribunal considers the section 12A report relevant to the current determination and accordingly, has considered that report as well as submissions made to the Tribunal in relation to this determination.

The section 12A report raised concerns about the lack of regulatory protection for franchise customers after 31 December 2000. The government has not yet extended the Tribunal's legislative power in relation to franchise retail customers. In the absence of legal powers, this determination gives no direction on retail regulation beyond 2000.

1.1 The review process

On 21 August 1999 the Independent Pricing and Regulatory Tribunal (the Tribunal) advertised in the *Sydney Morning Herald* for submissions to this review, which is being conducted concurrently with the Tribunal's review of distributors' distribution network charges under the National Electricity Code. Fifty-three submissions were received from various stakeholders and considered by the Tribunal in its deliberations.

The Tribunal held public hearings on 14 and 15 October 1999 in IPART's meeting rooms on Level 2, 44 Market Street, Sydney. Twelve organisations presented information to the Tribunal.

Copies of all public submissions and a transcript of the hearings are available for inspection at the Tribunal's offices, or from the Tribunal's website.

In 1998 the Tribunal established an electricity industry consultation group (EICG), comprising representatives of the Distribution Network Service Providers (DNSPs), the retailers, large customers, and consumer and community groups. The EICG continued to meet throughout this review. Working groups were established to consider specific issues including charges for miscellaneous services provided by franchise retailers.

The Tribunal members who conducted this inquiry are:

Dr Thomas Parry, Chairman

Mr James Cox, Full-time Member.

1.2 Retail supply to franchise customers

Retail supply businesses purchase electricity in the wholesale market, with appropriate hedging contracts to manage price risk. They on-sell electricity to end-use customers. The retailer incurs transportation costs for delivering electricity through the network, energy losses, and market fees, and passes these on to customers through a bundled price.

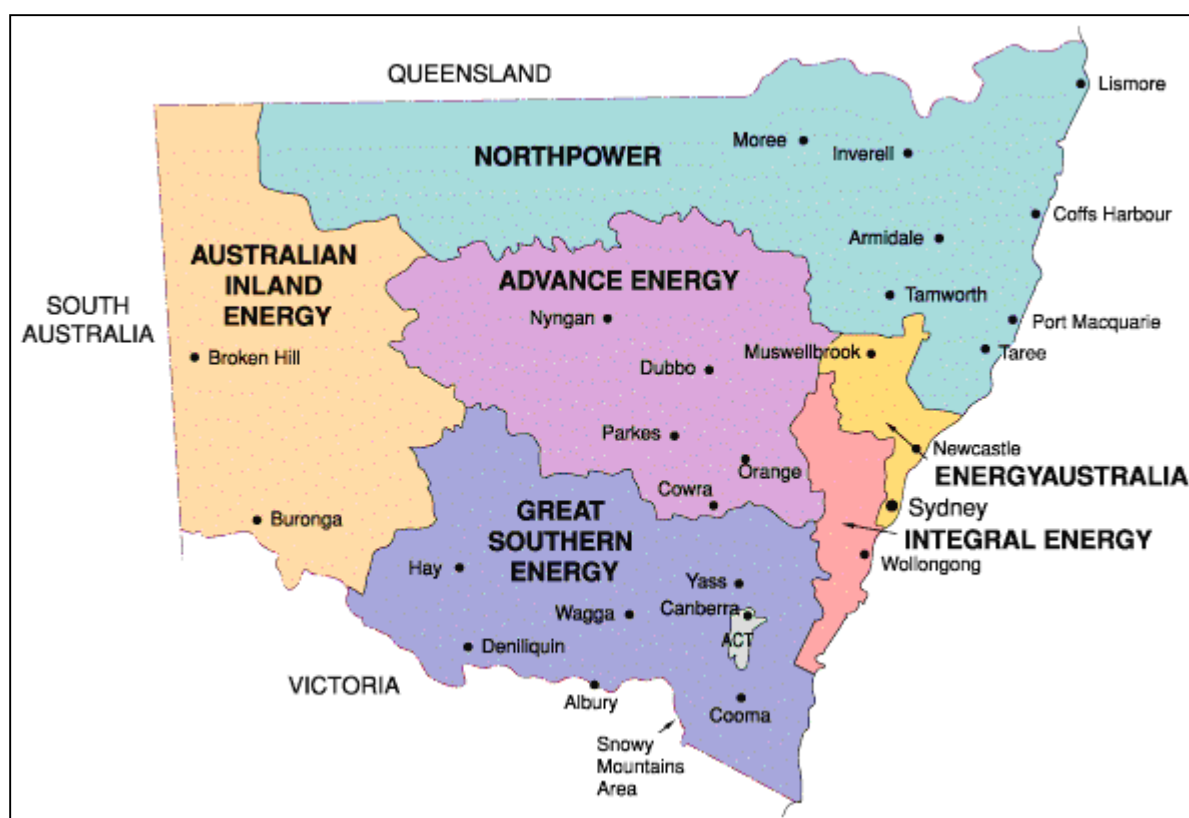
The NSW Government is introducing competition into electricity retail supply. Under the current timetable, the introduction of deregulation of domestic customers will commence from 1 January 2001 and proceed according to a transitional timetable yet to be announced. Eventually, all customers will be free to choose an electricity retailer. To date customers consuming more than 160MWh per annum⁸ are free to select a retailer.⁹ Retailers are required to be licensed. Licences are granted by the Minister for Energy and Utilities. Currently 24 licenced retailers¹⁰ supply electricity to contestable customers.

Franchise customers are those consumers of electricity who are not eligible to choose a retailer.

1.3 Franchise retailers

There are six franchise retailers in NSW. Each retailer provides electricity to small business and residential customers within its franchise area. Figure 1.1 is a map of these areas.

Figure 1.1 Franchise retailers' boundaries



Source: Ministry for Energy & Utilities.

Each of the six franchise retailers operates its own distribution network business. The network businesses operate under the same trading names as the retailers. The distribution businesses transport electricity to customers' premises. The distribution businesses are also

⁸ Customers free to choose a retailer now include fast food restaurants and other businesses where their annual electricity bill is approximately \$10,000 or greater.

⁹ These customers are referred to as contestable customers.

¹⁰ There are 24 licenced retailers as at 19 November 1999. This includes the 6 government owned retailers who are also responsible for supply to franchise customers. For further information refer to the Ministry of Energy and Utilities website www.doe.nsw.gov.au

regulated by the Tribunal. Concurrent with this retail determination, the Tribunal is releasing a distribution determination under the National Electricity Code which will also be effective from 1 February 2000.

The six franchise retailers also compete for customers in the competitive retail sector.

The NSW government recently convened the Market Implementation Group (MIG) to oversee and direct electricity reform in NSW. MIG's responsibilities will include guiding the transition to full retail competition.

1.4 The IPART Act

The National Electricity Code does not provide for retail pricing to be regulated. Until December 2000, the Tribunal will continue to regulate retail prices for franchise customers under the IPART Act.¹¹ Beyond 2000, the Tribunal does not have any legislative powers to regulate retail prices.

1.4.1 Requirements of the Act

The Tribunal must consider the issues listed in section 15(1) of the IPART Act when making determinations and recommendations. These matters include:

- the cost of providing the services concerned
- protection of consumers from abuses of monopoly power
- an appropriate rate of return on public sector assets
- the need to achieve greater efficiency in the supply of services
- the need to maintain ecologically sustainable development
- the need to promote competition of supply of the services concerned
- the social impact of the determinations and recommendations
- standards of quality, reliability and safety of the services concerned.

The Tribunal may also consider other matters it considers relevant.

Attachment 3 provides a summary of how the Tribunal's determination complies with section 15(1) of the IPART Act.

1.5 Current regulation

Retail prices from 1 March 1996 until 30 June 1999 were regulated under the Tribunal's determinations 2.2 of 1996 and 5.3 of 1997. The National Electricity (New South Wales) (Savings and Transitional) Amendment Regulation 1999 provides for determination 5.3 to continue until 31 January 2000.

¹¹ A binding determination in relation to entities listed in Schedule 1 of the IPART Act may be made under s11 of the IPART Act. Although the NSW distributors have been removed from Schedule 1 of the IPART Act, the National Electricity Law provides that until 31 December 2000 the Tribunal may continue to exercise its functions in relation to franchise retail supply provided by the distributors' associated retail arms.

1.6 An average electricity bill

An electricity bill comprises transmission and distribution costs and the energy cost plus a retail margin. Table 1.1 provides a summary of average franchise retail and network prices for each distributor.

Table 1.1 Electricity prices 1998/99

Distributor	Average retail price¹ c/kWh	Average network price (DUOS + TUOS) c/kWh¹²
EnergyAustralia		3.56
Residential	9.8	
Business	10.33	
Integral Energy		3.33
Residential	9.4	
Business	9.8	
NorthPower		4.9
Residential	10.4	
Business	11.4	
Great Southern Energy		4.33
Residential	9.6	
Business	8.4	
Advance Energy		3.21
Residential	10.6	
Business	10.4	
Australian Inland Energy		3.36
Residential	9.5	
Business	6.4	

1 : residential includes rural domestic customers

Source: 1998/99 regulatory accounts.

¹² Actual average network price, ie, revenue divided by load.

2 FORM OF REGULATION FOR FRANCHISE RETAILERS

Under the IPART Act, the Tribunal may regulate retail prices for franchise customers for the period until 31 December 2000. Beyond 2000 the Tribunal has no power to regulate retail prices. This section sets out the Tribunal's analysis and determination covering:

- the length of the determination
- the form of regulation
- operation of the unders and overs account.

2.1 Requirements of the IPART Act

Sections 14 and 14A of the IPART Act deal with the form of regulation that the Tribunal may implement. The Tribunal may either:

- (i) determine the maximum price for a government monopoly service (s14); or
- (ii) determine the methodology for fixing the price for a government monopoly service (s14A).

Section 14 provides the Tribunal with wide discretion when fixing the maximum price for a government monopoly service:

- (1) A determination of the Tribunal of the maximum price for a government monopoly service may fix that price in any manner the Tribunal considers appropriate, including the following:
 - (a) by fixing an average price for a number of categories of the service,
 - (b) by fixing a percentage increase or decrease in existing prices,
 - (c) by fixing an average percentage increase or decrease in existing prices for a number of categories of the service,
 - (d) by fixing a specified price for each category of the service (if any other manner is not considered appropriate).
- (2) The Tribunal may fix such a price by reference to:
 - (a) a general price index (such as the Consumer Price Index), or
 - (b) the government agency's economic cost of production, or
 - (c) a rate of return on the assets of the government agency.

Section 14A provides that the Tribunal may determine the methodology for fixing the price for a government monopoly service in any manner it considers appropriate. Section 14A sets out a number of matters that the Tribunal may have regard to when determining the methodology for fixing the price of a government monopoly service.

2.2 Length of regulatory period

2.2.1 Determination

As the Tribunal has no power to regulate retail supply to franchise customers after 31 December 2000 this determination must be an 11 month determination, ie 1 February 2000 to 31 December 2000.

However, it is highly likely that franchise customers will exist after December 2000. The Tribunal has raised the issue of regulation of franchise retail customers after 31 December 2000 with the NSW government. In its report to the Premier, the Tribunal states:

The Tribunal strongly recommends that the Government develop appropriate policy measures to deal with contestability and customer protection. This will require IPART to have appropriate powers to regulate prices and other terms and conditions for customers which are not able to participate in a genuinely competitive market for electricity services.

2.3 Form of regulation

2.3.1 Determination

The Tribunal will regulate franchise retailers through a price cap on the retail margin per kWh for the period from 1 February 2000 to 31 December 2000 with only certain specified additional costs to be passed through to franchise customers.

The Tribunal will separately regulate charges for miscellaneous services levied by franchise retailers by approving an exhaustive list of charges for miscellaneous services (see chapter 6).

2.3.2 Proposal in the report to the Premier

The Tribunal currently regulates the franchise retail margin for each franchise retailer via a hybrid revenue cap which takes the form of the margin $=a + bN + cM$ ¹³.

The section 12A report to the Premier canvasses various forms of regulation (see chapter 13 of Volume 1). In that report, the Tribunal recommends that a price cap be set on the retail margin (where the retail margin consists of retailing costs and a profit margin) per kWh with retailers being allowed to pass through certain costs.

In coming to this recommendation the Tribunal notes:

This will reduce the administrative complexity of the cap. Whilst the Tribunal recommends the adoption of a price cap, it is a price cap on the retail margin. Accounting for less than 10 per cent of the final price, this price cap mitigates any fears the Tribunal had concerning the possibility of reintroducing biases against demand side management.

¹³ N= customer numbers, M= MWh sales, b & c are coefficients reflecting on average the margin costs of supply, 'a' is a fixed parameter.

2.3.3 Public consultation

The majority of franchise retailers and NSW Treasury support having a price cap on the retail margin per kWh. However, NorthPower considers it inappropriate to change the form of regulation in the lead up to full contestability¹⁴:

... we have advocated the continuation of the existing retail gross margin formula which captures customer numbers and kilowatt hour coefficients. We do not resile from this position and do not believe it would be efficient or appropriate to adopt a flat gross margin across all distributors or to apply during a transitional implementation of competition.

The Public Interest Advocacy Centre (PIAC) supports a price cap in preference to a hybrid revenue cap but its first choice is a cap on price movements to any customer¹⁵:

PIAC supports the Tribunal's proposal that there be a price cap on the retail margin allowed per kWh, adjusted over time by CPI-X, in preference to Option 3 proposed in the Report which was setting the maximum total retail margin with pass through costs. However, in PIAC's view that this option is not preferable to placing a cap on price movements from current tariffs and within this option, a cap on prices for any customer or tariff class. This has better outcomes for residential consumers, particularly people on low and fixed incomes.

2.3.4 The Tribunal's assessment

If the Tribunal is required to regulate prices in the transition to full contestability, there may be merit in making the new form of regulation compatible with possible price controls in the contestable market.

Options available for the form of regulation include:

1. continuing the current hybrid revenue cap on the retail margin with pass through of certain costs
2. setting a price cap on the retail margin (where the retail margin equals retail costs plus a profit margin) with pass through of certain costs
3. regulating the final average retail price, ie average retail price = (wholesale price + transmission charges + distribution charges + TLF + DLF + NEMMCO fees + retail margin)/kWh sold
4. constraining the movement of any tariff along the lines set in the draft tariff gas decision for Wagga and Albury.

The main argument for continuing the current form of regulation, option 1, is that it may not be worth changing the form for an 11 month period only. However, the current form is complex and monitoring compliance is difficult. The Tribunal believes the difficulties of the current system outweigh the issue of introducing a different form of regulation for just 11 months. In reality, the Tribunal's role may continue after December 2000.

¹⁴ NSW Electricity Distribution Pricing Determination – NorthPower's submission to IPART, October 1999, p 28.

¹⁵ PIAC, Submission to IPART pricing for electricity networks and retail supply, October 1999, section 6.

Option 2, setting a price cap on the retail margin was recommended in the s12A report and is generally supported in submissions. The Tribunal's only concern is whether the form should change for what could be only an 11-month period.

Option 3 regulates the bundled price. This may be attractive if the primary focus is on the lead up to full contestability. However:

- this form of regulation has not had any public debate
- this option requires the Tribunal to determine an appropriate allocation of network charges to franchise customers, non-residential, residential and rural. The Tribunal has not endorsed a cost of supply methodology for the allocation of transmission and distribution charges to franchise customers.

In considering option 4, the question which must be asked is "Is it feasible to rely on only side constraints for franchise electricity customers?" In the Tribunal's recently released draft decision on tariff regulation for the supply of gas in Wagga and Albury, the Tribunal's support for constraints on movements in retail prices was based on two main issues:

Two of the critical issues addressed in this review have been the reasonableness of current prices, and the likelihood of competition constraining these prices into the future. The Tribunal's analysis suggests that current average tariff prices are reasonable, and that competition will constrain these prices into the future. Competition can also bring additional benefits in the form of product innovation that may not otherwise occur in a regulated market. This suggests that heavy-handed regulation of prices via a gas pricing order can be avoided by relying primarily on competition and ongoing monitoring to constrain prices. The Tribunal considers that a gas pricing order may not be necessary provided that the Tribunal continues to be satisfied that:

- gas prices remain reasonable
- customers, or classes of customers are not being overcharged
- customers are not under 'pressure' to enter into contracts, particularly contracts for long terms, without adequate exit provisions.

At the time the Tribunal made the above decision, there was a firm commitment to full contestability by 1 July 2000 and prices for 1999/2000 had already been posted.

Option 4 may not be sufficient for electricity, where there may not be effective competition for all franchise customers in the near future. Franchise retailers are still in the process of restructuring retail tariffs. In addition, many different tariff classes of customer remain, and levels of cost recovery are inconsistent.

For example, NorthPower's franchise tariffs consist of¹⁶:

- 6 residential tariffs
- 8 rural tariffs
- 2 small business tariffs
- 12 off-peak tariffs; and
- 15 time of use tariffs

A constraint on the movement of any tariff sufficient to provide scope for restructuring may provide scope for overcharging other customers.

¹⁶ NorthPower, NSW electricity distribution pricing determination submission to IPART, October 1999, p 29.

The Tribunal is mindful that this determination is for an 11 month period only. Having weighed the options, the Tribunal believes there is merit in changing the form of regulation. The Tribunal has not taken this decision lightly. In the Tribunal's opinion, the benefits of reducing the administrative complexity of the existing form of regulation outweigh the disadvantages of introducing a change. The Tribunal has determined to adopt a price cap on the retail margin (consisting of a profit margin and retail costs) per kWh.

Whilst the Tribunal has determined a price cap, it is a price cap on the retail margin. Accounting for less than 10 per cent of the final price, this price cap mitigates any fears the Tribunal had concerning the possibility of reintroducing biases against demand side management.

2.4 Pass through items

2.4.1 Determination

The only additional costs that can be recovered from franchise customers are:

- *Actual network charges (including charges for miscellaneous services) as determined by the Independent Pricing and Regulatory Tribunal and the Australian Competition and Consumers Commission.*
- *Actual fees (including charges for ancillary services), imposed by NEMMCO under the National Electricity Code.*
- *Actual energy losses calculated using loss factors set by distribution network service providers (DNSPs) and transmission network service providers (TNSPs) and approved by the Tribunal.*
- *The net impact of the GST package from 1 July 2000 to 31 December 2000. The Tribunal requires an audit of the changes in costs under the A New Tax System (Goods and Services Tax) Act 1999 at the expense of the franchise retailers. Audit requirements will be notified to the franchise retailers by the Tribunal in writing.*
- *Type 1 vesting contracts at actual vesting price.*
- *Type 2 vesting contracts and any other residual wholesale purchases for franchise retail customers at a price to be determined by the Tribunal.*
- *The balance in the franchise retailer's unders and overs account, if the Tribunal's limits on retail price movements are complied with.*

A franchise retailer must pass on only to its franchise customers, either through the retail tariffs or by way of a rebate, any payment that a DNSP makes to that franchise retailer that represents a repayment by the DNSP, from the unders and overs account, of an earlier overcollection.

2.4.2 Proposal in the report to the Premier

The Tribunal's section 12A report to the Premier discusses in detail the costs which franchise retailers should be permitted to pass through.¹⁷ In summary, the Tribunal proposes that:

The retailer should be able to pass through only costs outside its control. To allow a retailer to pass through costs over which it has even some control removes any incentive for the retailer to minimise those costs.

... the Tribunal proposes that retailers be allowed to pass through the following costs:

- electricity purchased via vesting contracts
- network charges including allowed miscellaneous charges
- fees imposed by NEMMCO under the National Electricity Code.

The Tribunal will develop a portfolio of contracts (including a component for residual pool exposure) which franchise retailers will be deemed to have used when purchasing electricity from the wholesale market. The portfolio of contracts will reflect any greenhouse emission reduction targets imposed by the government. This will provide an incentive for retailers to minimise the cost of electricity purchased from the wholesale market.

2.4.3 The Tribunal's assessment

Issues associated with passing through wholesale costs are discussed in chapter 4.

In addition to the list of pass through items contained in the section 12A report, the Tribunal has determined that franchise retailers may also pass through transmission loss factors and distribution loss factors. As the franchise retailer has no control over these loss factors, it is appropriate that the loss factors be passed through.

A New Tax System (Goods and Services Tax) Act 1999

The report to the Premier proposes that the net impact of the GST and associated tax change be a pass through cost for network businesses, with the net impact to be subject to independent verification. The Tribunal has also determined that the net impact of the GST and associated reforms may also be passed through by franchise retailers.

2.4.4 CPI – X

As this determination is for a period of 11 months the Tribunal has not determined X factors.

2.5 Price changes and notification requirements

2.5.1 Determination

Franchise retailers must alter their retail tariffs on 1 July 2000, or as near as possible to that date. In addition franchise retailers may alter retail tariffs once during the period from 1 February 2000 to 30 June 2000. If retailers choose to increase tariffs between 1 February 2000 and 30 June 2000, they may only do so if the increase in residential tariffs over the twelve month period to 30 June 2000 does not exceed the price limits contained in the Tribunal's Determination 5.3 of 1997.

¹⁷ Cost pass through means passing the actual costs incurred through to final customers. The Tribunal reserves the right to review the pass through costs to ensure only relevant costs are passed through.

For the period to 30 June 2000 franchise retailers must agree with the Tribunal the proposed date to which the price changes will take effect.

Franchise retailers must give the Tribunal 20 days notice of the proposed changes in retail prices.

Notification of price changes to the Tribunal must be accompanied by supporting material which:

- *indicates the percentage and absolute change in the charges or average bills for each customer class*
- *demonstrates that proposed retail tariffs are projected to recover no more than the sum of the retail margin (including any adjustment of the unders and overs account within the limits set), plus additional costs as specified in this determination*
- *demonstrates the basis of the proposed prices, including information on cost allocations and cost assumptions, and supporting documentation*
- *demonstrates compliance with constraints on maximum increases in tariffs.*

Price notification must be accompanied by a statement signed by the Chairman and CEO undertaking that the above requirements have been met.

2.5.2 The Tribunal's assessment

Whilst the Tribunal considers franchise retailers should continue to have responsibility for setting their prices it wishes to:

- be adequately informed in advance of changes and potential impacts
- be assured that the proposals comply with the Tribunal's determinations
- have an opportunity to raise any concerns it may have about the proposals.

In order to meet these requirements, franchise retailers must notify the Tribunal of proposed price changes 20 days in advance of the changes taking effect. This notification must be supported by the information package set out in this determination.

The Tribunal has determined retail margins to be implemented from 1 February 2000. Chapter 3 provides the reasons for this decision. Franchise retailers will be required to alter their retail prices on 1 July 2000, or as near as possible to that date. Franchise retailers may also alter their retail tariffs once in the period 1 February 2000 to 30 June 2000, but only if they have not exercised the allowable constraint in movements in tariffs during the twelve month period to 30 June 2000.

During the period to 30 June 2000, franchise retailers must agree with the Tribunal the proposed date on which their price changes will take effect.

2.6 Unders and overs account

2.6.1 Determination

As from 1 February 2000, an unders and overs account is not required.

The Tribunal requires that franchise retailers reduce or eliminate the balances in their unders and overs accounts by 31 December 2000 while remaining within the constraints on price movements imposed by the Tribunal.

Great Southern Energy and Australian Inland Energy must return to customers all their over collection by 31 December 2000. Any under collected balance still recorded at 31 December 2000 will be foregone. Any over collected balance as at 31 December 2000 must be repaid to franchise customers immediately.

Balances approved by the Tribunal as at 30 June 1999 are:

Table 2.1 Allowed balance of the franchise retailers' unders and overs account as at 30 June 1999

	Over/(under) Recovery (\$m)	Adjustment (\$m)	Balance to be carried forward (\$m)	% of 1998/99 revenue
EnergyAustralia	(3.6)	-	(3.6)	(0.3)
Integral Energy	(131.6)	33.2	(98.4)	(14.8)
NorthPower	(14.1)	-	(14.1)	(4.8)
Great Southern Energy	3.9	-	3.9	1.9
Advance energy	(4.8)	-	(4.8)	(8.2)
Australian Inland Energy	0.04	-	0.04	0.2

By 10 March 2000 franchise retailers must submit to the Tribunal the cumulative balance of their unders and overs account as at 31 January 2000. A record of transactions which reconciles the movement between 30 June 1999 and 31 January 2000 must also be provided by 10 March 2000.

2.6.2 The Tribunal's assessment

In association with the current hybrid revenue cap, retailers maintain an unders and overs account. Table 2.2 provides the cumulative balance as at 30 June 1999. The 1997 determination placed requirements on franchise retailers to ensure the balance did not remain above 5 per cent of the current year's revenue. As shown in Table 2.2 both Integral Energy's and Advance Energy's accounts are under collected by more than 5 per cent, and in the case of Integral Energy by substantially more.

Table 2.2 Balances recorded by franchise retailers for their unders and overs accounts as at 30 June 1999

	Over/(under) Recovery (\$m)	% of 1998/99 revenue
EnergyAustralia	(3.6)	0.3
Integral Energy	(131.6)	19.9
NorthPower	(14.1)	4.8
Great Southern Energy	3.9	1.9
Advance Energy	(4.8)	8.2
Australian Inland Energy	0.04	0.2

Retailers are required to operate an unders and overs account when a revenue cap is in operation. As a result of this determination implementing a price cap, current unders and overs accounts will not be required from 1 February 2000.

2.6.3 Dealing with the balance in the unders and overs account

Several franchise retailers have requested 'one off' adjustments to their retail prices to facilitate recoupment of the under collection. Integral Energy has requested a one-off adjustment¹⁸:

Integral suggests that [retail] prices after rebalance [or one-off adjustment] should at least equate to those of other businesses of similar scale and customer profile. As a guide, Integral suggests that the rebalance should place Integral's average prices between those of EnergyAustralia and Great Southern Energy

This request equates to a price increase of approximately 8 per cent for Integral's residential consumers.

NorthPower requested a one-off adjustment for its residential customers of the CPI plus 10 per cent. The level of constraints in movement of retail prices is discussed in chapter 5.

The intended purpose of the unders and overs account was to account for differences between forecast demand/customer numbers and actual demand/customer numbers. Integral Energy has included in their unders and overs account revenue foregone by not increasing tariffs in line with allowable constraints in the movement in tariffs. This was never the intention of the unders and overs account. The Tribunal will adjust the balance to exclude this amount.

In practice, operating an unders and overs account where there is a declining customer base as the result of introducing contestability is difficult. In theory, the franchise retailers have only 11 months to 'clear' the accounts but must also comply with any constraints on movements of individual tariffs determined by the Tribunal. The transition to full retail contestability will possibly commence from 1 January 2001. Even if the Tribunal has a continuing role in the regulation of the retail supply of electricity after 1 January 2001, there will be a declining customer base available from which to recoup the under collected revenue or, in the case of Great Southern Energy and Australian Inland Energy, to refund money to.

¹⁸ Integral Energy retail's submission to IPART, October 1999, p 14.

Under collection is the result of each franchise retailer's own actions. Therefore, the Tribunal requires franchise retailers to attempt to reduce or eliminate the balances in their unders and overs accounts by 31 December 2000 but within the constraints in movement of tariffs as determined in chapter 5. Great Southern Energy and Australian Inland Energy must return all their over collection by 31 December 2000. Any under collected balance still recorded at 31 December 2000 will be foregone. Any over collected balance as at 31 December 2000 must be repaid to customers immediately. Table 2.3 indicates the balances approved by the Tribunal as at 30 June 1999.

Table 2.3 Allowed balance of the franchise retailers' unders and overs account as at 30 June 1999

	Over/(under) Recovery (\$m)	Adjustment (\$m)	Balance to be carried forward (\$m)	% of 1998/99 revenue
EnergyAustralia	(3.6)	-	(3.6)	(0.3)
Integral Energy	(131.6)	33.2	(98.4)	(14.8)
NorthPower	(14.1)	-	(14.1)	(4.8)
Great Southern Energy	3.9	-	3.9	1.9
Advance energy	(4.8)	-	(4.8)	(8.2)
Australian Inland Energy	0.04	-	0.04	0.2

Franchise retailers must submit to the Tribunal by 10 March 2000 the cumulative balance of their unders and overs account as at 31 January 2000. A record of transactions which reconciles the movement between 30 June 1999 and 31 January 2000 must also be provided by 10 March 2000.

2.7 Green tariffs

Any premium from optional green tariffs does not form part of the regulated retail margin.

2.8 Compliance

The Tribunal requires franchise retailers to report in writing on their compliance with this determination by 14 February 2001. The compliance report should provide details of the 11-month period, 1 February 2000 to 31 December 2000.

3 RETAIL MARGIN

As stated in chapter 2, the Tribunal has chosen to regulate franchise retail prices by allowing retailers to:

- pass through to customers, costs which are out of the franchise retailer's control, ie wholesale purchase costs, network prices, network losses, and NEMMCO fees
- recover remaining retail costs and a profit margin, in a retail margin.

This section details the Tribunal's analysis and determination on an appropriate level for the retail margin.

3.1 Determination

In determining an appropriate margin¹⁹ for franchise retail businesses for the period from 1 February 2000 to 31 December 2000, the Tribunal has considered:

- the analysis contained in the Tribunal's section 12A report
- matters raised by stakeholders in public submissions and at the public hearing
- retail costs reported by the retailers in their regulatory accounts
- retail margins and costs of retail businesses in other states and overseas.

The Tribunal has determined the retail margin for each franchise retailer is to be equivalent to 6.6 per cent on turnover of sales to franchise customers for the period 1 February 2000 to 31 December 2000.

The basis for the Tribunal's decision is outlined below.

3.2 Proposal in the report to the Premier

In July, the Tribunal proposed that the retail margin for franchise customers be set at 6.6 per cent of sales turnover. It was intended that the margin would cover retail supply costs plus any profit.

In coming to this proposal,²⁰ the Tribunal considered:

- current margins and the level of profitability of the franchise retail businesses
- the margins of other retail businesses
- proposals made by the retailers.

¹⁹ ie, profit plus retail costs.

²⁰ For a discussion of the Tribunal's proposal, refer to pages 173 to 176 of Volume 1 of the Tribunal's section 12A report.

3.3 Public consultation

The Tribunal's proposal of a 6.6 per cent retail margin received considerable attention in submissions and at the public hearing.

The main issues raised by the retailers in submissions are:

- the derivation of the retail margin is unclear, and is not rigorous²¹
- a margin of 6.6 per cent is insufficient²²
- a uniform margin applicable to all retailers is not appropriate as retail costs vary widely between retailers.²³

These issues are discussed below.

3.4 The Tribunal's assessment

The purpose of a retail margin is to allow the retailers to recover:

- a reasonable profit margin
- the legitimate costs of providing retail services to franchise customers.

3.4.1 What is an appropriate level for the profit margin?

A profit margin, essentially, is a reward to investors for risk taking. Hence the profit margin to be incorporated in franchise retail prices should reflect the risk that franchise retail businesses face compared to alternative business or investment opportunities.

Two methods are generally used by regulators to determine profit margins. Regulators either:

- adopt the margins being achieved by businesses with similar characteristics and operating in similar environments
- determine an appropriate rate of return for the retail franchise business to apply to the capital employed.

As set out in the Tribunal's section 12A report, there is little publicly available information on margins earned by businesses comparable to the franchise retail businesses.

The information available to the Tribunal suggests that:

- the average margin (after retail costs) being earned by the New Zealand electricity retailers in 1994/95 was about 1 per cent, which was equivalent to a 10 per cent return on assets²⁴
- AGL Sales and Marketing is likely to be able to earn profit margins (after retail costs) over the next few years in the order of 3.5 to 4.5 per cent for gas and electricity sales²⁵

²¹ NorthPower and Integral Energy.

²² Great Southern Energy Retail, Advance Energy.

²³ Integral and SEDA.

²⁴ London Economics, *Retail margins for the NSW distribution businesses, Final Report*, February 1996.

²⁵ Credit Suisse First Boston - The Australian Gas Light Company, May 1999.

- ACTEW Corporation proposed in March 1999 to its regulator, IPARC, that an appropriate profit margin (after retail costs) is in the order of \$2 million for 1999/00,²⁶ which is equivalent to 1.4 per cent of sales turnover
- the operating profit margins (ie after retail costs) of the UK electricity suppliers have averaged at about 1 per cent over the past few years (see table below).

The Tribunal recognises that these margins are not directly comparable to those of the NSW franchise retailers, as the majority of retailers operate in different markets with varying degrees of risk from competition. However the margins do provide an indication of margins being earned by energy retailers elsewhere, and thus provide a useful starting point.²⁷

Table 3.1 Operating profit margins in the UK²⁸

Company	1991/92 ¹	1992/93 ¹	1993/94 ¹	1994/95 ²	1997/98 ²
Eastern	0.2%	1.5%	1.8%	1.8%	-8.4%
East Midlands	0.8%	2.0%	1.2%	2.5%	-1.6%
London	-0.3%	0.4%	0.3%	1.2%	1.2%
Manweb	-0.1%	0.8%	3.6%	2.0%	4.4%
Midlands	-0.5%	1.7%	3.0%	2.5%	2.2%
Northern	0.6%	0.2%	0.7%	3.5%	2.3%
NORWEB	0.4%	1.2%	1.3%	2.5%	3.5%
SEEBOARD	0.0%	1.0%	1.2%	1.5%	4.7%
Southern	0.1%	0.8%	1.5%	1.0%	2.4%
SWALEC	0.5%	1.0%	1.3%	1.8%	3.9%
South Western	-0.7%	1.5%	3.1%	2.1%	3.8%
Yorkshire	1.0%	0.3%	1.2%	2.1%	1.6%
Scottish Power	0.9%	0.1%	-1.1%	1.0%	3.5%
Hydro Electric	0.1%	-0.1%	0.2%	1.6%	-0.7%
Weighted-average	0.2%	0.9%	1.4%	1.9%	1.1%

Sources:

1. The Centre for Regulated Industries, The UK Electricity Industry: Electricity Services and Costs 1993/94. (As quoted by London Economics, in their report to IPART entitled "Retail margins for the NSW distribution businesses", February 1996.)
2. OFFER and OFGAS Review of Domestic and Small Business Electricity Price Regulation - A Consultation Document, June 1999. Figures refer to margins of 'first tier' suppliers.

As well as the actual margins earned by energy retailers, the treatment of retail margins by other regulators is of interest. Various UK regulators have considered retail margins at length, for example:

- i. In 1993, the Office of the Electricity Regulator (OFFER) set electricity supply price controls which allowed the electricity companies in the UK (RECs) a 1 per cent profit margin on turnover. This was said to be equivalent to 10 per cent on assets employed.

²⁶ ACTEW Corporation, Response to IPARC Draft Price Direction, 1999/00 – 2003/04, March 1999.

²⁷ For example, in the UK, competition has been introduced progressively since 1990. From June 1990 electricity customers with a maximum demand of 1 MW or greater became contestable. In 1994, the franchise limit was reduced to 100 kW, and in 1998, full retail competition was introduced.

²⁸ 'Operating profit' is the retailer's net earnings before depreciation and other fixed asset adjustments, exceptional costs, working capital, and provisions.

When this margin was set, OFFER noted that the RECs supply business was one where “financial risk is relatively low”.²⁹

- ii. In 1995, the Monopolies and Merger Commission (MMC) allowed Scottish Hydro-Electric a 0.5 per cent margin on turnover as it considered the 1 per cent return allowed by OFFER to be “unnecessarily generous”. The 0.5 per cent return on turnover was said to be equivalent to a 7 per cent return on assets.³⁰
- iii. In 1997, the MMC allowed Northern Ireland Electricity a 0.5 per cent margin on turnover. This provided a return of 7.5 per cent on CCA net assets.³¹
- iv. In 1997, OFFER incorporated a 1.5 per cent margin on turnover in supply price controls. This was said to cover “volume risk, return on capital employed and efficient management”. The 1.5 per cent was determined by allowing a return of 0.5 per cent for a case where price and volume risk are minimal (citing the MMC rulings as examples of appropriate returns in relatively risk free environments), and adding an allowance of 1 per cent for the quantity risk the public electricity suppliers (PESs) will face in the competitive market.³²
- v. In October 1999, the Office of Gas and Electricity Markets (OFGEM) released its initial proposal for maximum price constraints on two basic domestic tariffs, to apply in 2000/01. OFGEM proposed to continue to incorporate a 1.5 per cent profit margin within these constraints.³³ Subsequently, the majority of PESs have argued that a 1.5 per cent margin is too low. However half the Electricity Consumers’ Committees that commented on the OFGEM proposals supported the 1.5 per cent, and the remainder argued that the appropriate level of the margin should be seen in the context of encouraging competitive entry.³⁴
- vi. In December 1999, OFGEM released its final proposals for maximum price constraints. Its decision states that “OFGEM takes the view that the prescribed margin of 1.5 per cent is the appropriate level to apply to prices which reflect areas of the market in which PESs face relatively few competitive pressures”.³⁵

The Office of the Tasmanian Electricity Regulator (OTTER) recently established a net retail margin (ie, profit margin) of 1.5 per cent for Aurora, “taking into account the low risk faced by the retail activity”³⁶

This information suggests that the risks for franchise retail businesses are low, and appropriate profit margins could be as low as 0.5 per cent of sales turnover. This is consistent with observations made by various parties in their considerations of risks facing retailers. For example, in February 1996 London Economics undertook a study of retail margins for the NSW Government Pricing Tribunal. The study concluded that:

²⁹ OFFER, *The Supply Price Control: Proposals*, July 1993.

³⁰ Monopolies and Mergers Commission, *Scottish Hydro-Electric plc*, May 1995.

³¹ Monopolies and Mergers Commission: *Northern Ireland Electricity plc*, March 1997.

³² In addition, OFFER incorporated a margin, equivalent to 3 per cent on turnover, to cover the cost of hedging pool price risk on electricity purchases in the competitive market. Source: OFFER, *The competitive electricity market from 1998: price constraints proposals*, October 1997, p 30.

³³ OFGEM, *Review of Public Electricity Suppliers 1998 to 2000 and Supply Price Review - Initial Proposals*, October 1999.

³⁴ OFGEM, *Supply Price Control Review - Final Proposals*, December 1999.

³⁵ OFGEM, *Supply Price Control Review - Final Proposals*, December 1999.

³⁶ Office of the Tasmanian Electricity Regulator, *Investigation into the Electricity Supply Industry Pricing Policies, Final Report*, November 1999.

Retail supply is a high-turnover activity involving the purchase and resale of power, bulk contract trading, and logistic service to the final customer. These logistical services (essentially meter reading, billing, customer service activity) are essentially low risk.

The main justification for a high rate of return for retail supply services would then have to derive from the riskiness of the power trading activity. However, in practice we observe that retail suppliers are hedged against pool price variations that constitute the overwhelming source of profit risk.³⁷

The UK regulators in the past have used return on capital employed as an indicator of the reasonableness of margin estimates. Using information from the regulatory accounts for 1997/98, as a percentage of sales turnover, a margin can be translated to an equivalent return on capital employed for the NSW retailers.³⁸ Implied returns, assuming margins from 0.5 per cent to 2 per cent of sales turnover, are provided in the table below.

Table 3.2 Margin on turnover expressed as a return on assets

	Return on franchise retail total assets			
	2 per cent margin	1.5 per cent margin	1 per cent margin	0.5 per cent margin
EnergyAustralia	11.3%	8.5%	5.6%	2.8%
Integral	11.0%	8.2%	5.5%	2.7%
NorthPower	5.0%	3.7%	2.5%	1.2%
Advance	18.4%	13.8%	9.2%	4.6%
GSE	8.1%	6.1%	4.1%	2.0%
AIE	11.2%	8.4%	5.6%	2.8%
Overall	9.5%	7.1%	4.8%	2.4%

Source: Franchise retail sales and total assets as per retailers'/distributors' regulatory accounts, 1997/98.

The Tribunal considers that an appropriate rate of return for a franchise retail business is unlikely to differ significantly from the rate of return applicable to the distribution businesses.³⁹ For the purposes of determining network revenues, the Tribunal has decided that a return on capital of 5.0 to 8.5 per cent (real, pre-tax) is appropriate. On the basis of the information above, such a return applied to the franchise retailers would be consistent with a margin of between 1 and 2 per cent of sales turnover.

The Tribunal is mindful that retail competition for small customers will be introduced at some stage after 1 January 2001, and sufficient incentive, ie a sufficient profit margin, will be required to encourage new entry. Given the relatively small turnover of the NSW franchise retailers, and on the basis of the information outlined above, the Tribunal is of the view that, on balance, an appropriate profit margin for the franchise retail business is around 1.6 to 1.8 per cent.

³⁷ London Economics, *Retail margins for the NSW distribution businesses, Final Report*, February 1996.

³⁸ It should be noted that results would be sensitive to the allocation of assets between the contestable retail and franchise retail businesses. The Tribunal recognises that, inevitably, this allocation will be arbitrary; and on this basis results should be treated as indicative only.

³⁹ In this context, it should be noted that purchase cost passthrough accounts for risk associated with retailers' matching purchase contracts with sales.

3.4.2 Legitimate retail costs

The retail margin should allow retailers to recover efficient costs incurred to provide a retail service to franchise customers.

The Tribunal has determined that the retailers can pass through costs beyond their control, ie wholesale purchase costs, network prices, network losses, payments to NEMMCO (including for ancillary services), and the net cost of GST package.

The Tribunal has determined that distribution businesses can recover contestability costs incurred by the DNSPs in the AARR. However, due to competitive neutrality issues, the Tribunal considers that it is not appropriate for the retailers to recover contestability costs from franchise retail customers. Contestability costs are therefore not relevant for the purposes of calculating the retail margin.

In NSW, the costs of metering for franchise customers are incorporated in network revenues.

The remaining retail costs, to be recovered in the retail margin, include the costs of billing, customer advisory services, marketing, the negotiation of wholesale energy contracts, regulatory compliance, and other general corporate expenses.

In regulatory accounts supplied to the Tribunal, the NSW franchise retailers report the retail costs incurred to provide services to franchise customers. In arriving at these estimates, the retailers must make assumptions about the allocation of costs between contestable and franchise electricity retail activities (and indeed, potentially, between electricity and their other retailing activities such as gas). Fluctuations in retailers' reported costs from year to year raises the issue of the arbitrariness of these cost allocations (see table below). Bearing this in mind, it appears that most of the franchise retailers in NSW incur costs of an amount equivalent to 3 to 6 per cent of sale turnover.

Table 3.3 NSW electricity franchise retail costs

	1996/97		1997/98		1998/99	
	Retail costs per customer	Retail costs/ Turnover ⁴⁰ (%)	Retail costs per customer	Retail costs/ Turnover (%)	Retail costs per customer	Retail costs/ Turnover (%)
EnergyAustralia	43	3.0	29	3.0	37	4.4
Integral Energy	50	4.0	55	6.1	64	7.4
NorthPower	57	5.4	14	1.5	52	6.3
Advance Energy	55	3.9	43	4.0	46	9.3
Great Southern Energy	40	4.8	58	5.8	33	5.6
Australian Inland Energy	81	4.9	96	6.3	114	8.0
NSW average	47	3.7	37	3.9	52	5.7

Source: Regulatory accounts for 1998/99, 1997/98, and 1996/97.

⁴⁰ Turnover = franchise sales revenue, ie includes costs of generation, transmission, distribution, market fees and retail costs.

These costs tend to be a little higher than the retail costs of other, similar retailers. For example:

- The average retailing cost for AGL is forecast to be just over 3 per cent of sales turnover in the next few years (see table below).
- Similarly ACTEW Corporation has proposed to IPARC that its electricity retail costs will be in the order of \$8 million in 1999/00. This is equivalent to \$65 per customer or 5.8 per cent of sales turnover (including metering costs).⁴¹ Assuming \$20 per customer for metering costs,⁴² ACTEW's proposal is equivalent to \$45 per customer or 4 per cent of sales turnover.

Table 3.4 AGL sales and marketing - operating costs/sales turnover (%)

	1998	1999	2000	2001
Gas & Electricity	3.1	3.3	3.4	3.2
Gas	3.1	3.7	3.8	3.6
Electricity	3.0	2.7	2.7	2.4

Source: Credit Suisse First Boston - The Australian Gas Light Company, May 1999.

The table below provides the retail costs incurred by the PESs in 1997/98 in serving customers with a demand less than 100 kW. These costs include the cost of metering. However, the size of these costs is not published by OFGEM.

Table 3.5 PES supply business operating costs for customers under 100kW (1997/98)

	Pounds per customer	\$A per customer ⁴³	% of sales turnover
Eastern	16.94	43	3.6
East Midlands	15.87	40	3.6
London	25.34	65	5.1
Manweb	13.46	34	2.9
Midlands	21.65	55	4.6
Northern	26.39	67	6.1
NORWEB	14.37	37	3.2
SEEBOARD	18.82	48	4.4
Southern	18.01	46	3.7
SWALEC	18.06	46	3.8
South Western	14.37	37	3.0
Yorkshire	21.73	55	4.7
Scottish Power	20.68	53	3.3
Hydro Electric	45.32	116	6.5
Average	19.56	50	4.2

Sources: OFGEM, Supply Price Review Initial Proposals, October 1999.
OFFER and OFGAS Review of Domestic and Small Business Electricity Price Regulation – A Consultation Document, June 1999.

⁴¹ ACTEW Corporation, Response to IPARC Draft Price Direction, 1999/00 – 2003/04, March 1999. Note that this estimate includes meter and meter reading costs.

⁴² The Secretariat does not have access to information about ACTEW's metering costs. However, SRC's report on retail contestability estimates the cost of metering to be between \$33 and \$330 per customer. The Secretariat therefore considers \$20 to be a reasonable estimate, given age, level of sophistication, and technology considerations.

⁴³ Assumes 2.55 Australian dollars to the pound, as quoted in Australian Financial Review, 10 November 1999.

Several interested parties have argued that it is not appropriate to allow an industry-wide benchmark because retail costs vary widely between the NSW retailers due to economies of scale. In the UK, OFGEM recently set an industry benchmark cost to be incorporated in supply price controls on domestic tariffs. In its 'initial proposals' report, OFGEM concludes:

In a competitive market, and assuming all other things equal, companies that had costs significantly above the average would tend to earn lower profits, or charge higher prices that might lead to loss of market share. It would be expected that these companies would tend to achieve efficiency savings that moved them closer toward the average, or exit the market. On this basis it is appropriate to set an allowance for business costs based on average costs for all PESs.⁴⁴

The Tribunal concurs with this view.

The Tribunal recognises that the NSW retailers' average turnover is relatively small compared with the UK retailers. Furthermore, NSW retailers are restricted from aggregation⁴⁵. These two facets may limit the NSW retailers' ability to achieve optimal economies of scale in retailing, leading to higher costs per customer in comparison to retailers such as those in the UK. Nevertheless, the Tribunal is of the view that, in principle, it is appropriate to set an industry benchmark level of cost rather than a retailer specific cost.

On the basis of the retailer's reported costs, including the smaller retailers, an allowance of 4 per cent of turnover appears a reasonable amount to allow the retailers to recover the costs of retailing.

3.4.3 Conclusions

The information and analysis set out above suggests that a retail margin in the order of 4.5 to 7 percent of sales turnover is likely to be appropriate.

However, in light of the retailers' current margins, the Tribunal is of the view that for this 11-month determination, a retail margin of 6.6 per cent of sales turnover, as determined in the section 12A review, is appropriate.

⁴⁴ OFGEM, *Review of Public Electricity Suppliers 1998 to 2000 and Supply Price Review - Initial Proposals*, October 1999, p 71.

⁴⁵ As franchise retail boundaries are under NSW Government control.

4 WHOLESALE PURCHASE COSTS

Franchise retailers have some capacity to manage the costs of purchases under Type 2 vesting contracts and other residual purchases. In its report to the Premier, the Tribunal proposed to develop, with the assistance of an industry expert, a portfolio of electricity contracts (including a component for residue pool exposure). This portfolio would set a benchmark for the pass through of these costs. The objective of this approach would be to provide incentives for the retailers to minimise the cost of the electricity they purchase from the wholesale market.

This section determines the price at which wholesale costs should be passed through to franchise customers.

4.1 Determination

In determining the appropriate price at which wholesale purchase costs are to be passed through by franchise retailers, the Tribunal has considered:

- the analysis contained in the Tribunal's section 12A report
- matters raised by stakeholders in public submissions and at the public hearing
- a consultancy undertaken by Intelligent Energy Systems Pty Ltd (IES) to develop a benchmark price.

The Tribunal has determined that for the period 1 February 2000 to 31 December 2000:

- ***Type 1 vesting contracts are to be passed through at actual vesting price***
- ***Type 2 vesting contracts and any other residual wholesale purchases are to be passed through to franchise retail customers at a price to be determined by the Tribunal.***

The basis of the Tribunal's decision is outlined below.

4.2 Proposal in the report to the Premier

In its report to the Premier, the Tribunal proposes that the costs associated with purchasing wholesale electricity for franchise customers be passed through by franchise retailers at:

- the cost of energy purchased via vesting contracts.
- Given that not all energy will be purchased via vesting contracts, the Tribunal will develop a portfolio of contracts (including a component for residual pool exposure) which franchise retailers will be deemed to have used when purchasing electricity from the wholesale market. The portfolio of contracts will reflect any greenhouse emission reduction targets imposed by the government. This will provide an incentive for retailers to minimise the cost of electricity purchased from the wholesale market.

4.3 Public consultation

In submissions and at the public hearings franchise retailers were not supportive of the proposal to develop a portfolio of contracts. For example, Integral Energy states⁴⁶:

The wholesale electricity market is developing rapidly, and Integral fails to see how IPART will be able to develop any meaningful portfolio for a retailer when the nature of any optimal portfolio will vary over time. This would require a level of knowledge of the operation of the market that only an active energy trader itself could have. Integral is also concerned that IPART holds unrealistic views of the capacity of retailers to hedge against price spikes. This ignores both the relative immaturity of the electricity market in Australia, and the fact that extended hedging would be in direct contravention of a retail businesses operating risk guidelines.

This latter issue is of particular concern to Integral, as our high residential customer base creates a very unpredictable summer demand pattern (as demonstrated earlier in this submission and in the Integral retail submission of March 1999). It is not feasible for Integral to hedge against all possible spikes, as the cost of doing so would be extreme. It is also likely that to do so would breach the company's own internal risk management guidelines for energy traders.

It is also apparent to Integral that each retailer has a very different energy demand profile. As a result, IPART will have to develop a separate portfolio for each retailer if it is to have any chance of achieving an accurate portfolio.

Several franchise retailers cautioned the Tribunal that the development of an appropriate portfolio will be a difficult task:⁴⁷

NorthPower supports in principle, IPART's proposal to identify a contract portfolio mix to provide a benchmark wholesale contract price for pass through to franchise customers. However, it will be difficult to establish the appropriate profile and duration given that:

- full contestability will emerge on 1 January 2001
- there may be a requirement to regulate customers who remain franchise post 2000
- there is no way of knowing which customers and consequently what aggregate
- load profile will remain franchise post 2000

The proposal for the portfolio of contracts to reflect any greenhouse emission reduction targets imposed by the government received general support. EnergyAustralia has estimated their cost for implementing greenhouse gas emission strategies is \$4.18/MWh⁴⁸.

4.4 The Tribunal's assessment

Vesting contracts are contracts arranged by state jurisdictions between their local generators and retailers. They cover that portion of the electricity load still governed by regulated (rather than competitive) tariffs. They aim to provide a range of outcomes, including progressive exposure to competition, hedging protection for retailers against volatile spot prices, and revenue stability for generators and retailers.

⁴⁶ Integral Energy Retail Submission to IPART, October 1999, p 25.

⁴⁷ NorthPower's submission to IPART, October 1999, p 33.

⁴⁸ EnergyAustralia submission to IPART, October 1999, p 51.

In September 1999, the Australian Competition and Consumer Commission (ACCC) authorised the third tranche of NSW vesting contracts, subject to the following conditions:

- the Type 1 contract strike prices must be adjusted to a weighted average outcome no higher than \$40MWh
- the Type 2 contracts must be amended by removing the binary floor, adjusting the price caps to levels consistent with the Type 1 price structure, and setting a market-based option fee for the retailers
- the term of the vesting contracts must cease by 31 December 2000.

Given that the ACCC has approved a maximum price for type 1 vesting contracts, the Tribunal considers it is appropriate that these vesting contracts be passed through by franchise retailers at the actual vesting price authorised by the ACCC.

Nothing in the evidence presented to the Tribunal since the report to the Premier suggests that the pass through of type 2 vesting contracts and any other residual purchases should not be based on an arm's length market-based estimate of costs reflecting each franchise retailer's load characteristics. An arm's length benchmark for the pass through of controllable purchase costs provides franchise retailers with incentives for efficiency in purchasing. This benchmark should provide an acceptable proxy for the costs which may be achieved by franchise retailers. Establishing a benchmark is difficult, due to the scarcity of publicly available data on wholesale costs.

Franchise retailers may enter into contracts with generators and other parties in order to hedge against pool price risks. The cost of hedging is an appropriate cost to be included in the benchmark.⁴⁹

Under the licensing regime established by the Electricity Supply Act, the NSW Government has set targets for retailers in relation to the proportion of electricity purchased from renewable sources. The costs of complying with Government requirements in relation to greenhouse emission strategies will be included in the benchmark.

4.4.1 Developing the portfolio of contracts

In October 1999 the Tribunal engaged IES to make recommendations on the options of:

- setting an initial benchmark price which might be based on current market prices and would remain constant over the period to 31 December 2000
- developing a portfolio of electricity purchase contracts to simulate the efficient cost of non-vesting energy, taking into account the energy demand profile of the individual

⁴⁹ OFGEM has proposed that the cost of hedging UK retailers' supply to residential consumers be in the order of 7 to 11 per cent of the wholesale costs:

It seems reasonable to set any allowance for a contract premium on the basis of a single portfolio measure. Furthermore, it would seem reasonable to set a single premium across all PESs. Setting a single premium on the basis of an average, for example, would tend to encourage PESs with relatively expensive contract portfolios to achieve savings. The upper end of any such premium would recognise the average cost of IPP and long term contracts. Such a premium would be in the order of 11 percent. A lower end of the range for any such premium would recognise that in a competitive market, terms are available that exclude the costs of IPPs. This would tend to give a premium of the order of 7 percent.

retailers, the residual pool exposure, and the impact of greenhouse emission targets on electricity purchase costs. Under this approach the pass through price would be adjusted periodically in line with market changes.

In developing its proposals, IES was asked to:

- analyse the recent trend of electricity market prices
- analyse the franchise load characteristics of the individual retailers
- analyse electricity purchase costs paid by retailers for franchise customers since the inception of the NSW vesting contracts
- comment on the assumptions and methodologies used in the construction of the deemed portfolio of electricity contracts for establishing the benchmark pass through cost for the franchise load
- comment on the impact of greenhouse gas emission targets on electricity purchases for the franchise load and if possible, quantify the effect of such impacts
- comment on and analyse the potential financial risks faced by retailers/franchise customers.

Given the short period of this determination, IES was asked to advise the Tribunal only on the setting of a benchmark price to 31 December 2000.

4.4.2 Consultancy progress

The consultant encountered delays in obtaining the necessary data on residual loads and vesting contracts from NSW Treasury. At time of writing this report, the consultant was still awaiting sufficient data to calculate the benchmark.

The Tribunal does not want to delay the release of this determination. Accordingly, the Tribunal has determined that type 2 vesting contracts and all other residual load will be passed through at a benchmark price reflecting each distributor's load characteristics. The Tribunal will determine the dollar amount after considering:

- the outcomes of the consultancy
- matters raised by stakeholders in public submissions and at the public hearing.

The Tribunal will write to the franchise retailers, notifying them of the determined prices. The determined prices will also be published on the Tribunal's website. The benchmark price for each franchise retailer should be available by 31 January 2000.

5 PRICE LIMITS

5.1 Determination

In accordance with the National Electricity (New South Wales) (Savings and Transitional) Amendment Regulation 1999, retail prices from 1 July 1999 to 31 January 2000 are to be regulated under the Tribunal's determination 5.3 of 1997.

Movements in retail franchise prices over the period 1 February 2000 to 30 June 2000 are constrained by the following limits:

Any increase in the bill of any individual residential customer may not exceed the greater of:

- CPI (March on March) or*
- for customers on non off-peak tariffs, \$5.00 per quarter, or*
- for customers on off-peak tariffs, \$7.00 per quarter.*

Any increase in the average residential tariff for the total residential group may not exceed 80 per cent of the applicable CPI.

For prices over the period 1 July 2000 to 31 December 2000, the Tribunal has decided to set limits on price movements as follows:

- the bill of any individual residential customer is not to exceed the bill for the corresponding period of the preceding year⁵⁰ by more than \$30 per annum or the preceding bill times CPI, whichever is the greater*
- the increase in revenue recovered from the residential class as a whole is not to exceed CPI.*

The limits on price movements apply to residential franchise retail prices, including rural residential. In addition to the above limits the net impact of A New Tax System (Goods and Services Tax) Act 1999 may be recovered from customers. For retail price changes in the period 1 July 2000 to 31 December 2000, the CPI means the percentage change between December 1999 and December 1998 All Capital CPI.

These price limits are to apply to all retailers, except where the retailer can demonstrate to the Tribunal that meeting the price limits would not allow the retailer to recover its legitimate and efficient costs.

In putting a case to the Tribunal for price changes outside these price limits, the Tribunal would require the retailer to put forward a proposal that covers the following:

- a brief statement of reasons addressing why there is a need for the price change outside the price limits*
- a proposed, complete franchise retail price schedule*
- a proposed price implementation date*
- the basis of deriving the proposed prices, including information on cost components and allocations, and supporting analysis and documentation.*

⁵⁰ For the same pattern and volume of electricity consumption.

- *price impact analysis for a range of 'typical' customer profiles*
- *the revenue outcome for each franchise retail customer class.*

Proposals would need to be put to the Tribunal for consideration at least 3 months prior to the proposed implementation date. Given that the proposal meets the above requirements, the Tribunal would approve or disapprove the retailer's price proposal within six weeks of receiving the application.

5.2 Proposal in the report to the Premier

The Tribunal stated in its section 12A report that:

While prepared to facilitate some restructuring of prices, the Tribunal is mindful of its role in protecting the interests of electricity users.⁵¹

The Tribunal proposed that the price limits on retail prices for franchise customers should apply only to residential tariffs, including rural residential tariffs. It was proposed that increases in the bill of any individual residential customer, for the same pattern and volume of electricity consumption, was not to exceed the bill for the corresponding period of the preceding year by more than \$20 or CPI whichever is the greater. Increases to the residential class as a whole was not to exceed CPI March on March All Capital CPI.

The price limits currently in place, in accordance with the Tribunal's determination 5.3 of 1997 are:

Any increase in the bill of any individual residential customer may not exceed the greater of:

- CPI (December on December) or
- for customers on non off-peak tariffs, \$5.00 per quarter, or
- for customers on off-peak tariffs, \$7.00 per quarter.

Any increase in the average residential tariff for the total residential group may not exceed 80 per cent of the applicable CPI.

5.3 Public consultation

The majority of retailers have argued strongly that the imposition of the price limits, as proposed in the section 12A report, would hinder:

- tariff restructuring
- recovery of allowable revenue.

Advance Energy states that while it is conscious of the impact of price shocks on its customer base, there is a need for more pricing flexibility to allow necessary price restructuring. Advance argues that this is necessary in order to recover legitimate costs of retailing and for tariff rationalisation required with the introduction of full retail contestability. Advance argues that it has "demonstrated necessary pricing discipline to

⁵¹ Pricing for Electricity Networks and Retail Supply, Vol II, p 72.

both the Tribunal and its customers and there is no need for the Tribunal to impose additional retail tariff price limits and therefore advocate their removal.”⁵²

NorthPower raises similar arguments. NorthPower argues that it is necessary to further “rationalise” its retail tariff schedule (inherited from 8 former distributors) prior to the introduction of retail competition. NorthPower still has 8 residential tariffs, 8 rural tariffs, 12 off-peak tariffs, and 15 time of use tariffs. NorthPower states in its submission to the Tribunal that it “would like to negotiate with IPART a revenue neutral once-off tariff rationalisation set of price limits to apply in 2000.”⁵³ NorthPower also highlights that continuing to impose tight price limits is incompatible with the likely sizeable fluctuations in the cost of retail inputs, such as transmission losses.

Great Southern Energy retail argues that price limits “restrict the ability of the DNSP to respond to the needs of contestable customers”, and prevent the rebalancing of cross subsidies in network tariffs.⁵⁴

Integral’s main concern relates to its ability to recover franchise retail regulated revenue. Integral argues that the price limits on the movement of retail tariffs have limited Integral’s ability to recover allowable revenue over the past few years, and the proposed price limits will further compound the problem over the next year. Integral has raised particular concerns regarding the lack of profitability of its off-peak tariffs, and the consequent need to restructure these tariffs.

Integral and Great Southern Energy both argue that CSOs are a preferable mechanism to protect customers as opposed to price limits.

These issues are discussed below.

5.4 Tribunal’s assessment

5.4.1 Purpose of price limits on the movement of retail prices

As noted above, the purpose of price limits is to protect the interests of customers, which the Tribunal is required to do under the IPART Act. Another ‘protective’ mechanism that could be used, as some of the retailers have argued, is the use of CSOs. However, the imposition of a CSO is beyond the power of the Tribunal, and is a matter for resolution between the businesses and their shareholder.

On this basis, the Tribunal is of the view that price limits should remain in place to protect customers from price shocks. At issue is the size and coverage of price limits. This is discussed below.

⁵² Advance Energy, Submission to the Independent Pricing and Regulatory Tribunal – Pricing of Electricity Networks and Franchise Retail Supply, September 1999.

⁵³ NorthPower, NSW Electricity Distribution Pricing Determination – NorthPower’s Submission to IPART, October 1999, p 30.

⁵⁴ Great Southern Energy Submission, September 1999.

5.4.2 Retail price components and likely changes over time

Very broadly, current retail prices comprise (depending on the retailer):

- wholesale purchase costs (35 to 50 per cent of the total price)⁵⁵
- distribution service charges (35 to 50 per cent of the total price)
- transmission service charges (8 to 10 per cent of the total price)
- market fees, including ancillary services (0.5 to 2 per cent of the total price)
- transmission network losses (0.5 to 2 per cent of the total price)
- other retail costs and a margin (6 to 7 per cent of the total price).

From 1 February 2000, retailers will also need to address their unders/overs balance (as discussed in chapter 2), creating another potential ‘component’ of the retail price.

The Tribunal has undertaken preliminary analysis to estimate how these components, and therefore the retail price, might change over the few years. This has been done by drawing on submissions from retailers, market information, and regulatory decisions and derogations (including its own distribution price determination).

The Tribunal’s analysis shows that the most significant components of the retail price may change as follows (depending on the retailer):

- the average wholesale pass through price to franchise customers may decrease by more than 10 per cent
- average distribution prices to franchise customers may rise by up to 2.5 percent, and the average charges to some retailers could fall
- average transmission costs recovered from franchise customers may increase by up to 2 per cent for some retailers, and the average charges to some retailers could fall.

This suggests that average retail prices will fall, providing retailers with some scope to address “tariff rationalisation” requirements in the lead up to contestability. The Tribunal recognises that the scope of this depends somewhat on the cost reflectivity of current tariffs. The Tribunal also recognises, that for some retailers, movements in other retail cost components such as the transmission losses may have a considerable impact on the final retail price outcomes. Indicative modelling by the Tribunal has confirmed this.

5.4.3 Conclusions

Clearly, cost changes and thus price outcomes will differ by retailer. The tariff restructuring arguments put forward by the retailers, as detailed briefly in section 5.3, are also very different. The Tribunal is mindful then, that there are sound arguments for the need to treat each retailer individually.

However, to do this rigorously the Tribunal would need to model each retailer’s prices on a case by case basis, making appropriate cost and cost allocation assumptions. The Tribunal does not have access to sufficient data to be able to conduct such analysis. In addition, the

⁵⁵ Including distribution losses.

Tribunal maintains its view that while it seeks to protect the interests of electricity customers, price setting should be the responsibility of the electricity retail businesses.

The Tribunal acknowledges that several retailers have submitted the results of similar analysis to the Tribunal in their submissions to the section 12A review. The Tribunal has examined this information. The analysis however, is sensitive to cost assumptions and therefore needs updating in light of the ACCC's forthcoming determination on transmission revenues, the Tribunal's determination on distribution revenues and this determination on franchise retail prices.

On this basis the Tribunal is of the view that the price limits proposed in the section 12A report with the exception of one change, should be put in place to protect the interests of customers. To assist improved cost recovery for off-peak retail tariffs the maximum increase for residential customers is either \$30pa or the preceding bill times CPI pa, whichever is greater⁵⁶.

However, the Tribunal is also mindful of its need to consider the financial viability of the franchise retail businesses. Thus for the purposes of this determination, the Tribunal has decided that price limits will apply to all retailers unless a retailer can demonstrate to the Tribunal that it has a legitimate need to set prices which would exceed the price limits. The Tribunal will therefore consider detailed proposals by retailers for price changes outside the price limits.

Proposals to the Tribunal should contain:

- a statement of reasons addressing why there is a need for a price change outside the price limits
- a proposed, complete franchise retail price schedule
- a proposed price implementation date
- the basis of deriving the proposed prices, including information on cost components and allocations, and supporting analysis and documentation
- price impact analysis for a range of 'typical' customer profiles
- the revenue outcome for each franchise retail customer class.

Proposals would need to be put to the Tribunal for consideration at least 3 months prior to the proposed implementation date.

Given that the proposal meets the above requirements, the Tribunal would approve or disapprove the retailer's price proposal within 1 month of receiving the application.

⁵⁶ For the same pattern and level of consumption.

6 CHARGES FOR MISCELLANEOUS SERVICES AND SECURITY DEPOSITS

Charges for miscellaneous services are applied in various forms. Those most frequently applied by franchise retailers include: application fees, fees for late payments and reminders, disconnection fees, and dishonoured bank transaction charges. Five of the six franchise retailers also require security deposits for certain customers.

The Tribunal published a list of permissible miscellaneous charges in its Determination 5.3 of 1997. However, a wide disparity remains in the type and application of these charges across the franchise retailers. The Tribunal's concern about charges for miscellaneous services is highlighted by the complaints experience of the Energy Industry Ombudsman, NSW (EION). Although charges for miscellaneous services do not collectively account for a material proportion of total retail income, they can be individually significant, particularly for low income consumers.

6.1 Determination

6.1.1 Miscellaneous charges

The Tribunal has approved an exhaustive list of charges for miscellaneous services⁵⁷. These charges are the maximum amount to be charged for each of these services. No new charges are to be introduced over the term of this determination. The Tribunal has also introduced a narrative to accompany the exhaustive list of miscellaneous services. The narrative outlines the circumstances under which charges may be levied. The list of approved maximum miscellaneous charges and the narrative are included in this determination as Attachment 1.

Franchise retailers must ensure that they engage in an adequate customer information program, as outlined in section 6.3.

6.1.2 Security Deposits

The Tribunal has approved a regime for charging refundable deposits to electricity customers. This regime outlines the circumstances under which a franchise retailer is permitted to require a refundable security deposit from a customer. The Tribunal's approved protocols for charging security deposits is included in this determination as Attachment 2

6.2 Public consultation

To assist this review, the Electricity Industry Consultation Group (EICG) established a Miscellaneous Charges Working Group (MCWG) to investigate, discuss, and make recommendations on aspects of charges for miscellaneous services which members believe to be pertinent to their respective constituents. The group comprises representatives of: EnergyAustralia, Integral Energy, Advance Energy, the Energy Industry Ombudsman NSW, the NSW Department of Community Services, the NSW Council of Social Services (NCOSS), and the Public Interest Advocacy Centre (PIAC).

⁵⁷ The Tribunal is regulating miscellaneous charges separately to the supply of electricity to franchise customers.

The MCWG reported back to the Tribunal on 30 September 1999. The report was distributed to the EICG, made available to interested parties, and placed on the IPART website.

Submissions from the franchise retailers tend to concentrate on two proposals discussed in the section 12A report: the exhaustive list of charges for miscellaneous services, and the inclusion of miscellaneous charge revenues in the DNSP revenue cap.⁵⁸ Some submissions recommend refinements to the regime proposed in the section 12A report.⁵⁹

6.2.1 Exhaustive list of charges for miscellaneous services

The electricity retailer and network business submissions indicate a clear preference for flexibility in determining the suite of charges for miscellaneous services to be levied.⁶⁰ The retailers argue that this flexibility is required to address the changes coming with full contestability. The Tribunal is sympathetic to the retailers' desire to maintain flexibility in the face of changes to the industry. However, as discussed in the Tribunal's s12A report, the IPART Act does not allow the Tribunal to alter a list of prices without conducting a public consultation process and issuing a new determination. For this reason, it is not possible for the Tribunal to grant the retailers the flexibility they desire.

In light of the complaint activity in this area, the Tribunal has approved an exhaustive list of miscellaneous charges. For clarity, the list of miscellaneous charges and its accompanying narrative are to be interpreted strictly. The franchise retailers are not authorised to levy any charges not shown on the list, and they are authorised to levy the approved charges only in the circumstances outlined in the narrative. This is also important in the collection of security deposits.

6.2.2 Separation of network and retail charges

The working group was asked to separate the recommended list of charges for miscellaneous services into network and retail charges. Given the diverse internal structures among the distributors, the working group was unable to arrive at an agreed view. The Tribunal has considered the recommendations of the MCWG in approving the suite of miscellaneous charges in this determination. Whilst the suite of retail charges will not fit each retailer's business objectives exactly, the Tribunal considers that some charges are more clearly retail charges than network charges. In reaching this distinction, the Tribunal has considered that the retailer will be the entity with the ongoing customer service relationship. Accordingly, charges relating to bill payment and collection are assigned to the franchise retailer.

The Tribunal considers that the network business generally will not have a direct relationship with the franchise customers. Therefore, approved charges for miscellaneous services levied by the network business and relating to a particular customer, such as disconnection charges, may be passed through the franchise retailer to the end use customer, without adding any margin or administrative fees. It should be noted that these miscellaneous charges are maximum charges, and the franchise retailers are at liberty to reduce or waive these charges as may be appropriate in the circumstances.

⁵⁸ See Great Southern Energy retail submission p 28, Integral Energy retail submission p 27.

⁵⁹ See Advance Energy submission pp 71-73, EnergyAustralia submission pp 54-56.

⁶⁰ See, for example, EnergyAustralia submission p 54.

6.3 Informing customers

Customers must be informed about the charges for miscellaneous services that may be charged by their retailer. Furthermore, they must be informed of the miscellaneous charges that may be passed through the retailer by the network business. The Tribunal considers that this information will help reduce the amount of complaint activity about fees.

The following principles should be applied to the provision of this information to customers. Information should be provided to customers:

- in advance of any fees being charged
- in plain language
- in a physical form on bills and notices so that it is accessible to customers
- in a way which makes clear when the fees are to be applied.

Retailers should also make clear to customers:

- the internal and external dispute resolution mechanisms available if they query or dispute any of the charges
- the times during which normal hours fees apply and after which, after hours fees may apply
- the normal business hours for the retailer and related network business.

This information should be provided by retailers:

- to new customers at the time of connection
- to existing customers in advance of fees being charged for the first time
- to all customers from time to time as part of general customer information.

7 POST CONTESTABILITY

In NSW the electricity retail market is being deregulated in stages. Under the current timetable, the introduction of deregulation for domestic customers will commence from 1 January 2001 and proceed according to a transitional timetable yet to be announced. Eventually, all customers will be free to choose an electricity retailer.

The Tribunal's section 12A report to the Premier⁶¹:

... strongly recommends that the Government develop appropriate policy measures to deal with contestability and customer protection. This will require IPART to have appropriate powers to regulate prices and other terms and conditions for customers which are not able to participate in a genuinely competitive market for electricity services.

Franchise retailers and others have questioned the Tribunal's role after the introduction of full contestability.

The Tribunal has no power to regulate franchise retailers after 31 December 2000. Consequently, the Tribunal is not able to specify any default protection for consumers after contestability is introduced for all consumers. However the Tribunal strongly believes some regulation or ability to set maximum tariffs for a period after the introduction of contestability is essential.

⁶¹ IPART, Report to the Premier, *Pricing for Electricity Networks and Retail Supply, Volume 1* px, June 1999.

ATTACHMENT 1 RETAIL CHARGES FOR MISCELLANEOUS SERVICES

Charge for miscellaneous service	Maximum allowable charge (\$)
Dishonoured bank transaction charge	Twice bank fee
Late payment charge	5.00
Security deposit	See narrative

Dishonoured bank transaction charge

Where a customer pays a franchise retailer's bill by cheque, by a direct debit from an account with a bank (or other financial institution) or by credit card, and the payment is dishonoured or reversed by the customer's bank resulting in the franchise retailer incurring a bank fee, the franchise retailer may recover the bank fee from the customer, plus an equivalent amount to cover the franchise retailers' consequent administrative costs.

Late payment charge

The purpose of the late payment charge is to encourage customers to pay electricity accounts by the due date, or to make alternative payment arrangements with the franchise retailer. The Tribunal recognises that there are customers who genuinely have difficulty in meeting some payments by the due date. The imposition of this fee should not adversely impact on these customers.

Accordingly, the fee is not to be applied:

- during the period of an extension, where the customer and distributor have agreed to an extension of time to pay the account
- where a customer has made a billing related complaint to the Energy Industry Ombudsman or another external dispute resolution body and the complaint remains unresolved
- during the period of an instalment arrangement, where the customer has entered into an instalment arrangement to pay the account.

Additionally, the fee is to be waived:

- where the customer has contacted a welfare agency/support service for assistance; or
- payment or part payment is by EAPA voucher; or
- on a case by case basis as appropriate.

The late payment charge may only be levied:

- on or after the date which is at least 5 business days after the due date shown on the account; and
- provided the customer has been notified in advance that the late payment fee will be charged if the account is not paid, or alternative payment arrangements entered into, by the due date.

ATTACHMENT 2 SECURITY DEPOSITS

General

The amount of the security deposit required by each franchise retailer must be no greater than either:

For domestic and business customers:

- 1.5 times the average quarterly account⁶²
- 1.75 times the average two-monthly account
- 2.5 times the average monthly account.

based on the average consumption for that type of customer over the past 12 months.

Types of Security Deposit

The acceptable types of security deposits include:

- cash/cheque or credit card
- guarantees, including Department of Housing Guarantees for domestic customers and bankers guarantees for business customers
- annual security levy (ASL) – business customers only.

Residential Customers

Security deposits may not be required from residential customers prior to connection unless one or more of the following applies:

- the customer has left a previous supply address without settling an outstanding electricity usage debt, the debt remains outstanding and the customer refuses to make an arrangement to pay it; or
- within the previous two years, the customer has been responsible for the illegal use of electricity; or
- the customer does not have a satisfactory credit history with the franchise retailer or cannot demonstrate satisfactory credit history with another electricity retailer and the franchise retailer has offered the customer an instalment plan or other payment option (eg direct debit) and the customer has refused, or failed to agree to the offer.

Business Customers

Security deposits must not be required from business customers prior to the connection of supply unless one or more of the following applies:

- the business does not have a satisfactory credit history with the franchise retailer or cannot demonstrate satisfactory credit history with another electricity retailer
- the customer is a new business

⁶² The amount of the average account will vary between the franchise retailers, depending on average tariff levels and average consumption. The amount of the average retail account should be calculated as part of the tariff setting process, and the amount of required security deposits posted on the retailer's franchise tariff schedule.

- within the previous two years, the customer has been responsible for the illegal use of electricity.

Interest on security deposits

Franchise retailers will not be required to pay the customers interest on their security deposits.

Return of security deposits

When a customer has been required by a franchise retailer to pay a security deposit, the franchise retailer must, within 10 business days of either:

- a residential customer's completing one years payment of the billing cycle by the due dates listed on the initial bills
- a business customer's completing two years payment of the billing cycle by the due dates listed on the initial bills and still has a satisfactory credit rating.

inform the customer of the amount of the security deposit refundable in the customer's next bill and credit the amount to the customer's account.

Cessation of supply

When a customer, which has been required by a franchise retailer to pay a security deposit, requests that the franchise retailer cease supplying electricity to the customer's supply address, the franchise retailer must, within 10 business of the customer ceasing to take supply, inform the customer in writing of the amount (if any) of the security deposit and pay the amount (if any) to either:

- the customer's account; or
- the customer.

ATTACHMENT 3 SECTION 15 COMPLIANCE

Section	Reference
s15(1)(a) the cost of providing the services concerned	<p>The costs of providing electricity to franchise customers are discussed in chapters 3 and 4. Retail costs are compared with other energy retailers both in Australia and overseas.</p> <p>Profit margins are also benchmarked in chapter 3.</p>
s15(1)(b) the protection of consumers from the abuses of monopoly power in terms of prices, pricing policies and standard of services	<p>Chapter 2 discusses forms of regulation. The Tribunal has determined a price cap on the retail margin per kWh.</p> <p>Chapter 2 also addresses price change and notification requirements. While franchise retailers have freedom to determine price structures, they are required to provide the Tribunal with 20 days notice of any proposed change in retail prices. The notification must also be accompanied by supporting material including a statement signed by the Chairman and CEO undertaking that the proposed retail prices comply with the Tribunal's determination.</p> <p>Chapter 6 determines maximum prices for miscellaneous services and security deposits</p> <p>Chapter 7 highlights the Tribunal's lack of regulatory powers after 31 December 2000.</p>
s15(1)(c) the appropriate rate of return on public sector assets, including appropriate payment of dividends to the Government for the benefit of the people of New South Wales	<p>Chapter 3 discusses appropriate profit margins and rates of return for franchise retailers.</p>
s15(1)(d) the effect on general price inflation over the medium term	<p>Constraints on the movement of individual tariffs for franchise customers is detailed in chapter 5, will ensure that the impact of the Tribunal's determination will have a negligible impact on general price inflation over the medium term.</p>
s15(1)(e) the need for greater efficiency in the supply of service so as to reduce the cost for the benefit of consumers and tax payers	<p>Efficient retail costs are discussed in chapter 3.</p> <p>The main purpose of developing a portfolio of electricity wholesale contracts is to provide an incentive to franchise retailers to purchase wholesale electricity efficiently. This is discussed in chapter 4.</p>
s15(1)f the need to maintain ecologically sustainable development (within the meaning of section 6 of the Protection of the Environment Administration Act 1991) by appropriate pricing policies that take account of all the feasible options available to protect the environment	<p>Chapter 2 provides that any premium from optional green tariffs is not regulated and is therefore not part of the regulated retail margin.</p>
S15(1)(g) the impact on pricing policies of borrowing, capital and dividend requirements of the government agency concerned and, in particular, the impact of any need to renew or increase relevant assets	<p>Chapter 3 discusses appropriate profit margins for the franchise retailers. In determining these profit margins the Tribunal has considered dividend requirements.</p>

Section	Reference
s15(1)(h) the impact on pricing policies of any arrangements that the government agency concerned has entered into for the exercise of its functions by some other person or body	Not applicable
s15(1)(l) the need to promote competition in the supply of the services concerned	The Government is introducing competition into retail supply. Chapter 2 and 7 discuss issues associated with this.
s15(1)(j) consideration of demand management (including levels of demand) and least cost planning	<p>Chapter 2 addresses the form of regulation and its impact on demand management practices. While the Tribunal has determined a price cap, it is a price cap on the retail margin. Accounting for less than 10% of the final price, this price cap mitigates any fears the Tribunal had concerning the possibility of reintroducing biases against demand management.</p> <p>In addition the Tribunal's has determined that distribution network services are to be regulated by a revenue cap.</p>
s15(1)(k) the social impact of the determinations and recommendations	<p>Chapter 5 determines the constraints in movements of individual tariffs. These price limits are designed to minimise price increases, particularly for domestic users.</p> <p>Chapter 6 determines the maximum price franchise retailers can charges for a limited number of miscellaneous services.</p>
s15(1)(l) standards of quality, reliability and safety of the services concerned (whether those standards are specified by legislation, agreement or otherwise).	<p>In chapter 3 the Tribunal determines the retail margin which covers both retail costs and profit margin. In determining this margin the Tribunal was mindful that the allowed retails costs provide for an adequate level of service.</p> <p>Reliability is primarily a network function.</p>

ATTACHMENT 4 SUBMISSION LIST

Organisation	Name
	G. McDonell
Advance Energy	M. Coble
Australian Baldor Motors and Drivers	K. Limly
Australian Business	P. Orton
Australian Cogeneration Association	R. Brazzale
Australian Conservation Foundation	S. van Rood
Australian Inland Energy	E. Norris
Bathurst City Council	P. Perram
BB Water Saver Systems	B. Hibberd
BCA Energy Task Force	P. Weickhardt
Canterbury City Council	R. Davidson
Centron ToughGuard	J. Brady
Cessnock City Council	M. Alexander
Copmanhurst Shire Council	G. Cowan
Dynamic Synergies International Pty Ltd	D. Willis
Ecopower	B. Ellul
Energy Engineering of Australia Pty Ltd	J. Wyer
Energy Industry Ombudsman NSW	C. Petre
Energy Markets Reform Forum	W. Martin
EnergyAustralia	P. Broad
EnergyAustralia	M. Davies
Environmental Law & Policy Consultants	M. Mobbs
Gloucester Shire Council	N. McLeod
Great Southern Energy	L. Elder
Great Southern Energy	P. Hoogland
Harris Energy Solutions Pty Ltd	G. Harris
Illum-a-Lite Pty Ltd	J. Rutherford
Institute for Sustainable Futures	G. Milne
Integral Energy Australia	J. Allen (2 Submissions)
Integral Energy Australia	R. O'Donoghue
Integral Energy Australia	R. Thorn
Lane Cove Council	R. Selleck
Manly Council	J. Thompson
National Farmers Federation	
NCON Coporation Pty Limited	D. Barnes
NorthPower	P. Topfer
NSW Treasury	B. Hartnell
Port Stephens Council	R. Bowen
Power Visions	I. Lawrence
Public Interest Advocacy Centre	T. Benson

Organisation	Name
PV Solar Energy Pty Ltd	P. Erling
Quantum energy syste Pty Ltd	S. Harmon
Riverina Wool Combing Pty Ltd	B. Hamilton (2 Submissions)
Robert Turner Consulting Pty Ltd	R. Turner
SEDA	B. Precious
Singleton Shire Council	B. Carter
Sustainable Technologies Australia Limited	S. Tulloch
Sutherland Shire Council	G. Smith
Sydney Airports Corportation	N. Westnedge
TD International Pty Ltd	L. Taylor
Total Environment Centre	S. Crawford
Track Electrics	W. Allwood
Wagga Wagga City Council	C. Earnshaw
Waverley Council	M. McMahon
Wingecarribee Shire Council	D. McGowan

ATTACHMENT 5 GLOSSARY OF ACRONYMS AND TERMS

AARR	Annual aggregate revenue requirements: the calculated total annual revenue to be earned by an entity for a defined class of service
ABC	Activity based costing
ABC	Aerial bundled conductors
ACCC	Australian Competition and Consumer Commission
ACTEW	ACT Electricity and Water
AGL	The Australian Gaslight Company
AGSM	Australian Graduate School of Management
AIE	Australian Inland Energy
APT	Arbitrage pricing theory
ASX	Australian Stock Exchange
BCA	Business Council of Australia
CAIDI	Customer average interruption duration index
CAIFI	Customer average interruption frequency index
Capex	Capital expenditure
CAPM	Capital asset pricing model
CCA	Current cost accounting
CEGB	Central Electricity Generating Board (UK)
CIPSE	Community Information Project on Sustainable Energy
Code	National Electricity Code
COAG	Council of Australian Governments
CPI	Consumer price index
CPI-X	CPI minus a distributor efficiency factor
CRI	Centre for the Study of Regulated Industries, London
CRNP	Cost reflective network pricing: a cost allocation method which reflects the value of assets used to provide transmission or distribution services to network users.
CSO	Community service obligation: a government subsidy for activities undertaken by a government enterprise which would not be undertaken as a commercial activity or would require higher prices to be commercial
CWWG	Contestable Works Working Group
DAC	Depreciated actual cost
DB	Distribution business
DEA	Data envelopment analysis
Deprival value	A value ascribed to assets which is the lower of economic value or optimised depreciated replacement value.
Derogation	Modification, variation or exemption to one or more provisions of the National Electricity Code in relation to a Code Participant according to clause 8.4.1(a).
DGM	Dividend growth model
DLF	Distribution loss factor
DNO	Distribution network operator

DNSP	Distribution network service provider
DORC/ODRC	Depreciated optimised replacement cost (see definition under ODRC)
DSM	Demand side management
DUOS	Distribution use of system
DUOSC	Distribution use of system charge
EAPA	Energy Accounts Payments Assistance (Scheme)
EBIT	Earning before interest and tax
EGWG	Embedded Generation Working Group
EICG	Electricity Industry Consultation Group
EION	Energy Industry Ombudsman, NSW
EIOV	Energy Industry Ombudsman, Victoria
EPD	Energy Project Division, Victoria
ESI	Electricity Supply Industry
ETR	Effective tax rate
EUG	Energy Users Group
FDC	Fully distributed costs
γ	Franking credit gamma
Gaming	Any intentional structuring of a transaction so as to pervert the intention of the regulator's Determination
Gas Code	National Third Party Access Code for Natural Gas Pipeline Systems
GSN	Great Southern Energy Gas Networks Pty Ltd
GTE	Government trading enterprise
GWh	Gigawatt hour (one GWh=1000 megawatt hours or one million kilowatt hours)
IPART	Independent Pricing and Regulatory Tribunal
IRR	Internal rate of return
kWh	Kilowatt hour (the standard unit of energy which represents the consumption of electrical energy at the rate of one kilowatt over a period of one hour)
LCAB	Licence Compliance Advisory Board
LRAC	Long run average cost
LRMC	Long run marginal cost
MAR	Maximum allowable revenue
MCWG	Miscellaneous Charges Working Group
MFP	Multifactor productivity
MMC	Monopolies and Mergers Commission (UK)
MoEU	Ministry of Energy and Utilities
MRP	Market risk premium for equity
MWh	Megawatt hour (one MWh=1000 kilowatt hours)
NCOSS	NSW Council of Social Services
NECA	National Electricity Code Administrator
NEL	National Electricity Law

NEM	National Electricity Market
NEMMCO	National Electricity Market Management Company Ltd
NPV	Net present value
NRV	Net realisable value
NSP	Network service provider
NUOS	Network use of system
ODRC	Optimised depreciated replacement cost: the ODRC calculation is based on the gross replacement cost of modern equivalent network assets, adjusted for overdesign, overcapacity and redundant assets, less an appropriate allowance for depreciation. It measures the minimum cost of replicating the system in the most efficient way possible, given its service requirements and the age of the existing assets.
ODV	Optimised deprival value
OECD	Organisation for Economic Cooperation and Development
OFFER	Office of the Electricity Regulator (UK)
OF GAS	Office of the Gas Regulator (UK)
OFWAT	Office of Water Regulator (UK)
Opex	Operating expenditure
ORC	Optimised replacement cost
ORG	Office of the Regulator General, Victoria
P/E	Price/earnings ratio
PIAC	Public Interest Advocacy Centre
PJM	Pennsylvania/New Jersey/Maryland
QCA	Queensland Competition Authority
RAB	Regulatory asset base
RAPAS	Remote area power assistance scheme
RAPS	Remote area power system
RECs	Regional Electricity Companies(UK)
Ring fencing	The clear separation of subsidiaries or divisions of a company that may have competitive advantages in dealing with each other.
RPI	Retail price index
SAIDI	System average interruption duration index
SAIFI	System average interruption frequency index
SEDA	Sustainable Energy Development Authority
SLUOS	Streetlighting use of system
SOC	State Owned Corporations Act, 1989 (NSW)
SOCs	State owned corporations
SRMC	Short run marginal cost
TFP	Total factor productivity
TNSP	Transmission network service provider
TPA	Trade Practices Act
TPC	Trade Practices Commission
TUOS	Transmission use of system

UPS	Uninterruptible power supply
v	Volt (the unit of electric potential or electromotive force)
w	Watt (a measure of the power present when a current of one ampere flows under a pressure of one volt)
WACC	Weighted average cost of capital: a “forward looking” weighted average cost of debt and equity for a commercial business entity. The network owner’s WACC will represent the shadow price or social opportunity cost of capital as measured by the rate of return required by investors in a privately-owned company with a risk profile similar to that of the network company.
WDV	Written down value

