



# **Promoting retail competition and investment in the NSW electricity industry**


Regulated electricity retail tariffs and charges for small customers 2007 to 2010

**Electricity - Final Report and Final Determination**  
June 2007



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Regulated electricity retail tariffs and charges for small  
customers 2007 to 2010



Electricity—Final Report and Determination Det07-01  
June 2007

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# 1 Introduction and overview

The Independent Pricing and Regulatory Tribunal of NSW (the Tribunal) is responsible for setting the regulated retail electricity tariffs charged by the Standard Retailers in NSW – Country Energy, EnergyAustralia and Integral Energy – to small retail customers on standard form customer contracts.<sup>1</sup>

Since 1 January 2002, all electricity customers in NSW have had the option to choose their retail electricity supplier and negotiate a retail supply contract, or to remain with their Standard Retailer on a regulated tariff.<sup>2</sup> Although customers are increasingly exercising choice and negotiating retail supply contracts, around 70 per cent of small retail customers are still on regulated tariffs.

At the Council of Australian Governments (COAG) meeting of 10 February 2006, the NSW Government (along with other Australian governments) agreed to the Ministerial Council on Energy's reform agenda. Part of this agenda is to phase out energy retail price regulation where it can be demonstrated that effective competition exists. Reviews of competition in each state are to commence on 1 January 2007, with the NSW review scheduled for 2009. Given this, the NSW Minister for Energy asked the Tribunal to set regulated retail tariffs and charges for small retail customers from 1 July 2007 to 30 June 2010, and to do so in a way that reduces customers' reliance on regulated prices and facilitates retail competition.

The Tribunal considers that higher retail electricity prices in NSW are justified, and indeed necessary, to ensure that the people in this state continue to have access to a safe and reliable supply of electricity. Over the next three years, the Electricity Tariff Equalisation Fund (ETEF) will be phased out and, as a consequence, NSW electricity arrangements will more closely resemble those in Victoria and South Australia. Wholesale energy prices need to be sufficient to attract efficient and economic investment in generation to NSW, and to enable retailers to meet their obligations in relation to greenhouse gas emissions and purchases of renewable energy. In addition, retail prices need to be sufficient to recover the costs incurred in selling electricity in a competitive market, and to compensate retailers for the risks that they face. Retail prices also need to be sufficient to recover investments in the distribution network associated with increased reliability standards and higher peak demand.

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<sup>1</sup> Customers consuming less than 160 MWh per annum of electricity can be supplied under a standard form customer contract and, therefore, be subject to a regulated tariff or can enter into a negotiated contract.

<sup>2</sup> Over the five years since full retail competition was introduced the Tribunal has continued to regulate electricity retail tariffs for small customers that have not entered into the competitive market.

The Tribunal supports the decision to phase out regulation where effective competition is demonstrated. In essence, the purpose of regulation is to simulate the effects of competition in a monopoly market, to protect consumers from the abuse of market power and put pressure on the incumbents to pursue efficiency gains. However, it is rarely, if ever, as effective as competition itself.

In addition, the Tribunal recognises that setting the ‘right’ regulated retail price for electricity is particularly important, and particularly difficult, in the current conditions. This retail price, which is the price end-consumers pay for electricity, needs to recover not only the costs incurred in selling the electricity, but also the costs of generating it and the costs of transporting it from the generators to the end consumer. It also needs to provide retailers with a profit margin that compensates them for the risks they face in supplying the retail market.

In general, the costs of generating electricity (wholesale energy costs) represent 40 per cent of the retail price, while the costs of transporting it (network costs) represent 47 per cent, retail costs represent 8 per cent, and the retailers’ margin represents 5 per cent. Wholesale electricity prices tend to be volatile, and sometimes spike sharply. The recent increases in reported spot and contract wholesale electricity prices have heightened both industry and public awareness of the level and volatility of electricity prices. They have also highlighted the relationship between critical inputs (such as water), plant availability and the market price of electricity. For example, the current drought has led to water restrictions that are directly affecting output from hydro-generation plants and also affecting output from coal-fired generation plants, which need water for cooling.

In undertaking its review and making its determination, the Tribunal was guided by the terms of reference provided by the Minister for Energy (see Appendix A). These terms of reference required the Tribunal to:

- ▼ Assess the costs of a hypothetical retailer, including the electricity purchase costs for the regulated load in each Standard Retailer’s supply district, and the retail costs and retail margin for a mass market new entrant.
- ▼ Recognise retailers’ hedging, risk management and transaction costs, particularly given that the ETEF will be phased out during determination period.

The terms of reference also direct the Tribunal to focus on ensuring that tariffs are cost reflective (from the perspective of the hypothetical retail business) by the end of the regulatory period, and facilitating retail competition.

This report explains the Tribunal’s review process and decisions, and accompanies the Tribunal’s determination on this matter.



## 1.1 Overview of determination

Under this determination, Standard Retailers will be able to set their own regulated retail electricity tariffs, subject to a weighted average price cap. The price cap allows EnergyAustralia to increase its total average regulated retail electricity price by 4.1 per cent in each year of the determination, while Integral Energy can increase its total average price by 4.9 per cent per year, and Country Energy by 3.7 per cent per year (real terms).

These increases in total average prices are due to:

- ▼ an increase in the electricity purchase cost allowance (except for Country Energy) compared to the 2004 determination
- ▼ an increase in the retail costs allowance (primarily due to the requirement for the Tribunal to consider the retail costs of a mass market new entrant, rather than those of the Standard Retailers)
- ▼ an increase in the retail margin
- ▼ increased network charges.

Although these price increases are similar to those under the Tribunal's draft determination, there are some differences between the draft and final determinations. The most significant difference is the inclusion of an annual review mechanism for the market-based electricity purchase cost allowance during the determination (in 2008 and 2009).

These reviews are intended to explicitly address the risk of significant changes in the wholesale price of electricity. If a review concludes that the market-based electricity purchase cost allowance for that year differs by 10 per cent or more from the allowance used in making the 2007 determination, the energy cost allowance will be adjusted accordingly. The tariff path may also be revised, to ensure that tariffs can still move to levels that recover the hypothetical retailer's costs by 2009/10. However, no other costs or cost allowances will be reviewed.

The Tribunal decided to include the review mechanism in response to stakeholder concerns about the significant increases in the spot and contract price of electricity since April 2007 (after the release of the draft determination). The Tribunal based its decision on expert analysis and advice from Frontier Economics.<sup>3</sup> Frontier Economics noted that the size of the increases, and the speed with which they have occurred, are unprecedented in the NEM. However, it advised the Tribunal to rely on the energy cost allowances assessed in making the draft determination because:

- ▼ it considered that it is very likely that contract prices will return to normal by 2009/10, which is the reference point the Tribunal has used to establish the price path from current levels

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<sup>3</sup> Frontier Economics, Analysis of recent changes in NEM wholesale electricity prices, May 2007.

- ▼ it considers that most mass market new entrant retailers are substantially hedged (and may even be over hedged) for 2007/08, and that the Standard Retailers are shielded from any cost increases in this year because of the ETEF
- ▼ it considered that it is more effective to review the energy purchase cost allowance during the determination period.

Other differences between the Tribunal's final and draft determinations are:

- ▼ The retail costs allowance (which is made up of retail operating costs and customer acquisition costs) is set at \$105 per customer.<sup>4</sup> This is \$5 less than the retail costs allowed for in making the draft determination, which reflects the Tribunal view that there is potential for costs to be double counted in calculating the retail operating costs and customer acquisition costs.
- ▼ The loss factors have been updated to reflect the most recent information available.
- ▼ the same retail price control (R value) is applied to both single rate and time of use (TOU) tariffs to remove any incentive to supply regulated customers on a single rate tariff in preference to TOU tariffs. The draft determination applied different R values to single rate and TOU tariffs.

Table 1.1 compares the final and draft determinations, highlighting the key differences.

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<sup>4</sup> With 75 per cent of retail operating costs and 100 per cent of customer acquisition costs being fixed costs per customer.

**Table 1.1 Comparison of draft and final determinations**

Description	2009/10	2009/10
	Draft report	Final report
<b>Country Energy</b>		
Electricity purchase cost (\$/MWh)	45	44
Green costs (\$/MWh)	6	6
NEM fees (\$/MWh)	1	1
Energy losses	12.6%	12.3%
Total energy purchase cost (\$/MWh)	58	57
Retail cost allowance (\$/customer)	110	105
Retail margin	5%	5%
<b>Cumulative average price increase</b>	<b>12.4%</b>	<b>11.7%</b>
<b>EnergyAustralia</b>		
Electricity purchase cost (\$/MWh)	51	51
Green costs (\$/MWh)	5	5
NEM fees (\$/MWh)	1	1
Energy losses	6.4%	6.8%
Total energy purchase cost (\$/MWh)	61	61
Total retail costs (\$/customer)	110	105
Retail margin	5%	5%
<b>Cumulative average price increase</b>	<b>14%</b>	<b>12.8%</b>
<b>Integral Energy</b>		
Electricity purchase cost (\$/MWh)	53	53
Green costs (\$/MWh)	6	6
NEM fees (\$/MWh)	1	1
Energy losses	9.0%	9.1%
Total energy purchase cost (\$/MWh)	65	65
Total retail costs (\$/customer)	110	105
Retail margin	5%	5%
<b>Cumulative average price increase</b>	<b>15.7%</b>	<b>15.3%</b>

The Tribunal is confident that its final determination will allow the Standard Retailers to set regulated retail tariffs that adequately reflect the costs of supplying regulated retail customers. As noted above, the terms of reference required the Tribunal to assess the costs of a hypothetical retailer, taking into account the retail operating costs and margin of a mass market new entrant, and the energy purchase costs, in the absence of the ETEF, for the regulated load in each Standard Retailer's supply district. The Tribunal considers that, with the inclusion of the market-based electricity purchase cost allowance review mechanism, the aggregated cost allowances for this hypothetical retailer are likely to be higher than the Standard Retailers' efficient costs in supplying regulated customers prior to 2010, for the following reasons:

- ▼ Due to the requirement to assess the retail operating costs of a mass market new entrant, these costs include customer acquisition costs even though the Standard Retailers do not incur customer acquisition costs in relation to regulated customers. However, these retailers will increasingly incur customer retention costs over the determination period, as the Tribunal expects the competitiveness of the NSW market to increase during this period.
- ▼ Due to the requirement to assess the retail margin of a mass market new entrant, the Tribunal has set a margin that is likely to be higher than the margin required by the Standard Retailers under current circumstances. However, this margin will become more appropriate for these retailers towards the end of the determination period, as the NSW market becomes more competitive.
- ▼ The Standard Retailers will still have access to the ETEF for a significant proportion of their regulated load until the end of the determination period.

The Tribunal also considers that its determination, through both the form of regulation and the level of tariffs (including the review of the market-based electricity purchase cost allowance), will reduce customers' reliance on regulated prices and facilitate increased retail competition, including the potential for new mass market retailers. In turn, increased competition should place pressure on all retailers, including the Standard Retailers, to pursue efficiency gains to increase their competitiveness. This is in the long-term interest of all customers. Finally, the determination should also encourage investment in new generation, where it is efficient and economic.

While the Tribunal was not required to directly consider the impact of its decisions on customers, it has had regard to the effect of its decisions on customers wherever possible. For example, the Tribunal considers that the phasing in of higher prices through its decision to transition to hypothetical retailer costs in 2010 gives customers time to adjust to the higher prices, including an opportunity to consider offers in the competitive market. In addition, as noted above, the Tribunal believes that ultimately, regulation is not as effective at establishing efficient costs as a competitive market. It considers that although the determination includes a higher retail margin in recognition of the increasing risks retailers will face during the determination period, over time, competition will result in a reduction in retailers' cost base (through efficiency gains) and a wider range of service and price offerings. Both these results will benefit customers.

A more detailed overview of the Tribunal's considerations and conclusions on the appropriate form of regulation, and the value of the regulated retail price controls that will apply to regulated retail tariffs is provided below.

### 1.1.1 Form of regulation

In general, as a market becomes more competitive, less regulation is required. The Tribunal reviewed the competitiveness of the NSW retail electricity market to inform its decision on the form of regulation. Consistent with its draft decision, it found that for the purposes of this review, there are currently two distinct markets within NSW: the metropolitan market, which includes EnergyAustralia's and Integral Energy's supply areas; and the non-metropolitan market, which includes Country Energy's supply area. These markets have different levels of competition. On balance, the Tribunal considers that:

- ▼ In the metropolitan market, there is sufficient competition to restrain increases in each individual tariff.
- ▼ In the non-metropolitan market, competition is developing but it is unclear whether there is currently sufficient competition to restrain increases in each individual tariff. There is the potential for the level of competition in this market to increase over the 2007 to 2010 determination period. However, there may also be persistent factors that will prevent it from developing to the same extent as the metropolitan market over the medium term.
- ▼ The competitiveness of both these markets will increase over the next three years, partly as a result of its determination.

Given this view on the current level of and potential for competition, the Tribunal considers that moving towards a more light-handed form of regulation in this determination is justified.<sup>5</sup> In particular, the Tribunal has made decisions to:

- ▼ Adopt a form of weighted average price cap as the form of regulation for regulated tariffs, which will allow the Standard Retailers to set their own prices subject to meeting an overall regulatory constraint. This overall constraint is expected to allow full cost reflectivity by 2010.
- ▼ Increase the discretion of the Standard Retailers to set their own prices by removing specific regulations related to price setting from the determination.
- ▼ Remove limits on price movements (except for Country Energy, which will need to seek Tribunal approval when it proposes individual tariff increases over a certain threshold).
- ▼ Maintain a prohibition on introducing new regulated tariffs (except with the agreement of the Tribunal).
- ▼ Allow the abolition of regulated tariffs (with some additional constraints for Country Energy).

The Tribunal considers that this form of regulation will allow the Standard Retailers to use pricing discretion to set tariffs at cost reflective levels by 2010, and will facilitate the development of competition in the market for small retail customers.

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<sup>5</sup> For example, this determination gives greater pricing discretion to the Standard Retailers compared to previous determinations and removes limits on individual prices.

The Tribunal considers that the Standard Retailers are best placed to determine individual cost-reflective tariffs throughout the determination period, although it would be concerned by very large movements in any particular individual tariff.

The Tribunal acknowledges the concerns that some stakeholders expressed about the Tribunal's review of the competitiveness of the market in their responses to the draft report. The Tribunal has provided additional information to support its analysis in Chapter 4 of this report. However, it stresses that the purpose of this analysis was to inform its deliberations on the appropriate form of regulation. This is very different to the purpose of the reviews the Australian Energy Market Commission (AEMC) will conduct to consider whether the market demonstrates sufficiently effective competition for retail price regulation to be removed. The Tribunal has not formed a view on whether competition is effective for the purpose of removing retail price regulation.

The Tribunal also acknowledges the concerns some stakeholders expressed about the potential for a weighted average price cap to result in above-average price increases for some customers, particularly those who are on low incomes or who are low consumers of electricity and are therefore less 'attractive' to competitors. The Tribunal has given this issue close consideration, and is satisfied that the weighted average price cap, together with the competitive pressures already present in the market, provides reasonable protection against prices that are significantly above costs.

In the metropolitan market, the vast majority of EnergyAustralia's and Integral Energy's regulated customers are on one or two regulated tariffs. Where customers are on the same tariff, they face the same price – whether or not they are 'attractive' to the competitive market. In other words, tariffs are kept in check because some customers on that tariff would otherwise seek a negotiated contract. And all customers on that tariff benefit from the limits that this competitive pressure places on tariff increases.

Further, the Tribunal considers that where there are only a limited number of tariffs, as is the case in the metropolitan area, side constraints for certain customers are not necessary as the changes in those tariffs will resemble the average price change determined by the Tribunal. Therefore a side constraint would make very little difference to price outcomes for the majority of customers.

In the non-metropolitan market, where Country Energy's regulated customer base is spread over a larger number of tariffs, the Tribunal has required that Country Energy seek its approval if it proposes individual tariff increases over a certain threshold. The Tribunal considers that this will provide additional protection against prices that are significantly above costs in this market.

### 1.1.2 Level of regulated price controls

The Tribunal has determined the values of the regulated retail price controls (R values), which are to be included in the weighted average price cap, together with actual network charges (N values). These values are higher than those provided in the 2004-2007 determination.

For 2010, the Tribunal has set R values (in \$2006/07) that reflect:

- ▼ market-based electricity purchase costs, based on the Frontier Economics' conservative point estimate for each business, consistent with the Tribunal's draft determination
- ▼ an allowance for volatility in these costs (based on the costs of retaining sufficient working capital to withstand this volatility) of \$0.7/MWh for Country Energy, \$0.9/MWh for EnergyAustralia and \$1.1/MWh for Integral Energy, consistent with the Tribunal's draft determination
- ▼ costs associated with greenhouse reduction and renewable energy requirements of \$4 to \$6 per MWh, consistent with the Tribunal's draft determination
- ▼ total retail operating costs and customer acquisition costs of \$105 per customer,<sup>6</sup> which is \$5 less than the retail costs allowed for in making the draft determination, to account for any double counting between retail operating costs and customer acquisition costs
- ▼ a retail margin of 5 per cent (on an EBITDA basis), consistent with the Tribunal's draft determination
- ▼ NEM fees of \$0.7 per MWh, consistent with the Tribunal's draft determination
- ▼ energy losses of 6.8 per cent for EnergyAustralia, 9.1 per cent for Integral Energy, and 12.3 per cent for Country Energy, which are slightly different to the losses included in the draft determination, reflecting updated information.

The Tribunal decided to set the R values for 2007/08 and 2008/09 to reflect a transition to the calculated hypothetical retailer costs in 2009/10. It considers that these R values are appropriate given the gradual increase in risks and costs as the ETEF unwinds and competition increases, and the impact on customers. Further, the Tribunal considers that, with the inclusion of the review of electricity purchase cost allowances, the hypothetical retailer costs more than recover the costs of a Standard Retailer for regulated customers while the ETEF remains and competition increases.

The total retail price of electricity includes network (distribution and transmission) charges, which are applicable irrespective of whether a customer remains on a regulated tariff or has entered into a negotiated tariff. Network prices are regulated by the Tribunal and the Australian Energy Regulator, and these prices will increase

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<sup>6</sup> With 75 per cent of retail operating costs and 100 per cent of customer acquisition costs being fixed costs per customer.



in real terms, on average, by around 3 to 4 per cent each year of the determination period.

Table 1.2 shows the cumulative real price increase in total retail tariffs over the period from 2007 to 2010 and the drivers of these increases.

**Table 1.2 Cumulative real increases in total retail tariffs and drivers of these increases (2006/07 to 2009/10)**

	EnergyAustralia %	Integral Energy %	Country Energy %
Electricity costs	3.3	5.7	-1.8
Retail costs	3.1	2.8	2.5
Retail margin	3.3	3.3	3.4
Network (including margin on network)	4.3	4.5	6.1
Under/over recovery	-0.3	0.0	3.2
Other	-0.7	-1.1	-1.7
<b>Cumulative average price increase</b>	<b>12.8</b>	<b>15.3</b>	<b>11.7</b>

**Notes:**

1. Under/over recovery refers to the difference between the costs established in the 2004 to 2007 determination and the costs recovered through tariffs.
2. Other includes losses, NEM fees and the effect of changes in the consumption of different types of tariffs since the 2004 determination.
3. Totals may not sum due to rounding.

The Tribunal also considered regulated retail charges (or non tariff charges) and has decided to continue the arrangements set out in the 2004 determination, with minor amendments. However, consistent with its draft decision, it has increased the late payment fee from \$5 to \$7.

## 1.2 Review process

In July 2006, the Tribunal released an issues paper and sought submissions from the three Standard Retailers and other stakeholders. The Tribunal also engaged Frontier Economics to provide expert advice on energy costs and mass market new entrant retail costs and margins for the review.

On 8 September 2006, the Tribunal held a public information session where the Standard Retailers presented their proposals, to inform other stakeholders and assist them in preparing their own submissions.

On 27 October 2006, the Tribunal released a paper drafted by Frontier Economics setting out its proposed methodologies for assessing energy costs and retail costs and margin. On 2 November, it held a workshop for interested parties to comment on the proposed approaches.



Frontier Economics' draft reports were released on 20 December 2006, and the Tribunal invited interested parties to attend a public meeting on 25 January 2007 to provide feedback on these reports. The Tribunal also sought submissions on these reports by 2 February 2007, which Frontier Economics took into account in making its final recommendations to the Tribunal at the end of February.

In April 2007 the Tribunal released its draft report and determination, together with Frontier Economics' final public report. The Tribunal held a public forum on its draft report and determination on 23 April and received submissions in May 2007.

The Tribunal engaged Frontier Economics to provide supplementary advice on:

- ▼ recent changes in NEM wholesale electricity prices, in response to increased energy prices since April 2007
- ▼ the association between unexpected changes in electricity volume and GDP growth for residential customers, and
- ▼ updated load data for Country Energy provided in March 2007.

Frontier Economics' reports on these issues are available on the IPART website.

In late 2006, the Tribunal conducted a survey of residential household water and energy customers in the greater Sydney region. The Tribunal relied on information from this survey in considering the competitiveness of the market. Since the final survey results are not yet available (as some information requires weightings) the Tribunal has decided to release the interim energy-related results to provide the maximum amount of information to stakeholders. The interim energy-related survey results are available on the IPART website.

The Tribunal considered the analysis supporting its draft report and determination, stakeholder comment and these additional reports in making its final report and determination.

The members of the Tribunal for this review are: Dr Michael Keating AC, Chairman, Mr James Cox, Full Time Member and Ms Sibylle Krieger, Part Time Member.

### 1.3 Structure of the report

This report explains the determination in detail, including the analysis that supports the Tribunal's decisions, and addresses the Minister's terms of reference.

- ▼ Chapter 2 sets out the Tribunal's approach to the review, including its objectives and assessment criteria
- ▼ Chapter 3 sets out the policy context for the review, including a number of recent Government decisions that the Tribunal has taken into account in making its determination
- ▼ Chapter 4 explains the Tribunal's findings and analysis on the current level of competition in the NSW retail electricity market
- ▼ Chapter 5 outlines the approach to tariff setting in the determination, including which tariffs are regulated, the form of regulation adopted and how this form will be applied, the requirement for Country Energy to obtain approval to increase tariffs by more than a specified level, and the inclusion of a pass-through mechanism for certain costs
- ▼ Chapter 6 provides the Tribunal's findings in relation to the allowance for energy purchase costs, including the reviews of market-based electricity purchase cost allowances
- ▼ Chapter 7 provides the Tribunal's findings in relation to the allowances for retail operating costs and retail margin
- ▼ Chapter 8 explains how the Tribunal calculated the hypothetical retailer costs from the allowances for energy costs (Chapter 6) and retail operating costs and margins (Chapter 7). It also explains how the Tribunal used these costs to inform its decision on the value of the regulated retail price controls (R values) in each year of the determination
- ▼ Chapter 9 illustrates the expected impact of the determination on customers
- ▼ Chapter 10 sets out the Tribunal's decisions on non tariff charges (including late payment fees, dishonoured bank cheque fees, and security deposits).

## 2 The Tribunal's approach to the review

Because this review is different to previous regulated retail electricity price reviews, the Tribunal needed to develop a new approach for its analysis and decision-making.

One important difference between this and previous reviews is that the terms of reference for this review direct the Tribunal to have regard to the costs of a 'hypothetical retailer', not those of the regulated businesses (the Standard Retailers). Another important difference is that the Tribunal is setting regulated retail tariffs and non tariff charges in the context of an increasingly competitive market.

The sections below explain the approach the Tribunal used to undertake its analysis and support its decisions, and discuss the Tribunal's objectives and the detailed assessment criteria it applied within this approach.

### 2.1 Overall approach

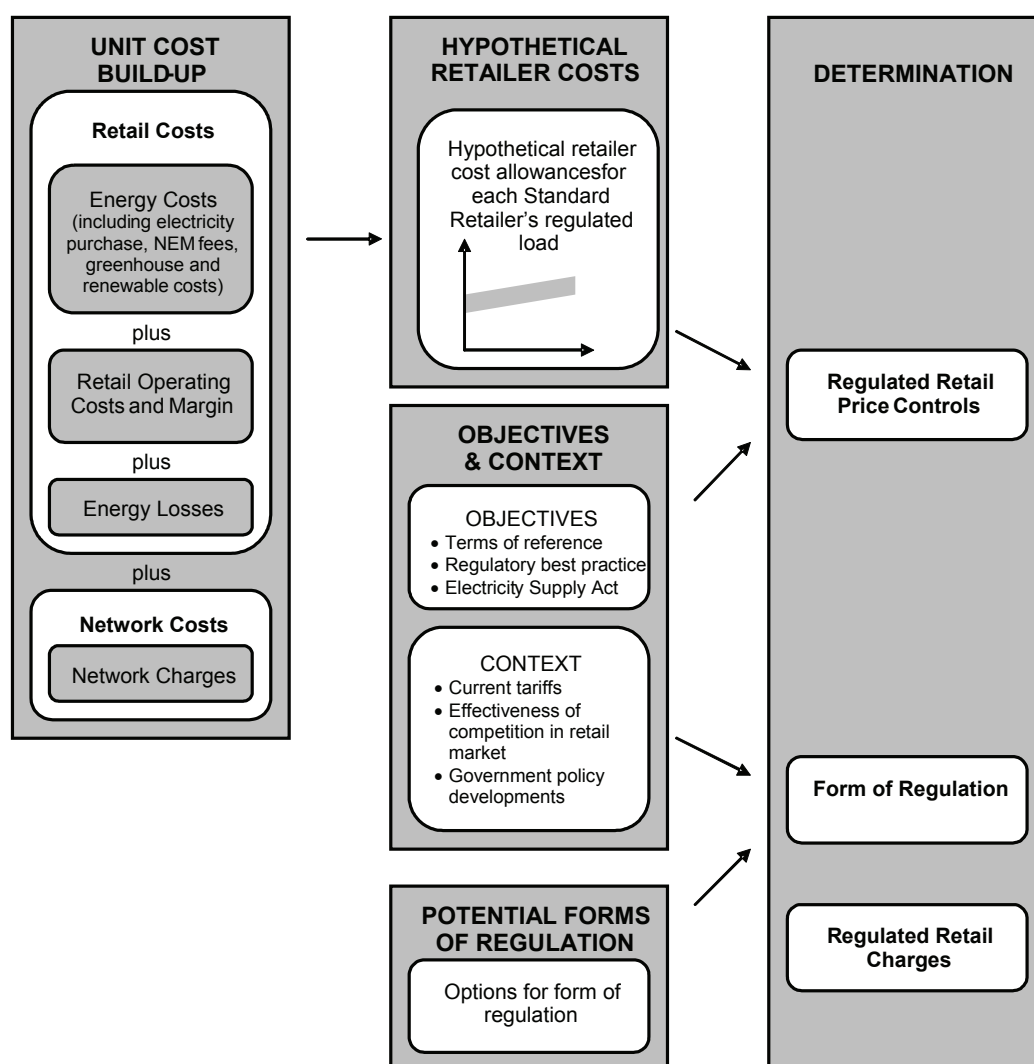
The Tribunal's approach to the review involved a number of explicit steps, which were designed to align with the terms of reference and to recognise the interim 'decision points' in the analysis process.

This approach, which is illustrated in Figure 2.1 below, involved the following steps:

- ▼ **Establishing objectives and assessment criteria.** At the outset of the review, the Tribunal established detailed objectives and assessment criteria to guide its analysis and support its decision-making.
- ▼ **Considering context.** The context for the review differs from previous reviews due to significant policy changes, such as the decision to phase out the Electricity Tariff Equalisation Fund (ETEF) arrangement over the course of the determination period, and also developments in retail competition. The Tribunal assessed these developments to inform its decisions.
- ▼ **Analysis of options for regulating retail tariffs.** The terms of reference asked the Tribunal to set regulated retail tariffs and charges, but did not prescribe the form of regulation it was to apply. Therefore, the Tribunal identified and analysed the options for regulating retail tariffs in the determination period, to inform its decision on the form of regulation.

- ▼ **Analysis of costs.** The terms of reference required the Tribunal to consider cost allowances for a hypothetical retailer and to recognise a number of risks. As a first step, the Tribunal assessed each cost component specified in the terms of reference. Second, the Tribunal aggregated these costs to obtain a cost allowance for a hypothetical retailer in each standard supply area. Third, it broke down these aggregated costs per unit (\$ per customer and \$ per MWh) for each year of the determination period. The output of this work informed the Tribunal's decisions, particularly those in setting the regulated retail price controls.
- ▼ **Deciding on the form of regulation and on the value of the regulated retail price controls.** As a last step, the Tribunal drew together the various streams of analysis, and made its decisions on the form of regulation to apply over the period, and on the value of the regulated retail price controls within this form of regulation.

Figure 2.1 Tribunal's approach to the review



## 2.2 Tribunal's objectives and assessment criteria

At the outset of the review, the Tribunal set objectives and assessment criteria to guide its decision-making. These objectives were largely determined by the *Electricity Supply Act 1995* and the terms of reference for this review. They were also influenced by the Tribunal's experience in other reviews and best-practice regulation.

The *Electricity Supply Act 1995* requires the Tribunal to have regard to the matters specified in the terms of reference and to the effect of its determination on competition in the retail electricity market.

The terms of reference provide detailed guidance on the matters to be considered by the Tribunal. However, there are inherent tensions between some of the objectives implied by the terms of reference and, as a result, there are trade-offs in how well any determination can meet these various objectives. For example, it is difficult to develop a form of regulation that would both allow for the further rationalisation of regulated retail tariffs and ensure that network charges are fully recovered, due to the large number of network tariffs.

There are also inconsistencies within the terms of reference. For example, the terms of reference require the Tribunal to consider costs of a mass market new entrant retailer while also requiring it to consider issues specific to the Standard Retailers (for example, recognising that the ETEF will cease operation within the determination period and the different load profiles of each Standard Retailer).

The Tribunal established the following criteria and objectives for this review:

1. To ensure that Standard Retailers charge prices that are at cost reflective levels by 2010 in order to provide regulatory protection to small retail customers.
2. To facilitate the development of effective retail competition for small retail customers.
3. To explicitly address each of the costs and factors listed in the terms of reference as "matters for consideration" under section 43EB (2)(a).
4. To take account of the "Government's policy aim to reduce customer's reliance on regulated prices".
5. To allow for the further rationalisation of regulated retail tariffs.
6. To enable, where possible, decisions to be made by the parties who are in the best position to make those decisions (avoid regulatory micro-management).
7. To ensure the determination is practical, pragmatic and feasible.
8. To ensure the determination is simple and understandable.
9. To ensure the determination is targeted – so that there is a clear match between the choice of mechanisms and the regulatory objectives.
10. To ensure that any 'solutions' within the determination are proportionate with the problem.

The first two objectives are the primary objectives of this review and were the Tribunal's main focus. These objectives are derived from the terms of reference and the Act. The third, fourth and fifth objectives are derived from the terms of reference, while the remaining objectives/criteria reflect regulatory best practice.

The Tribunal applied these objectives and assessment criteria during each of the steps in this review.

### 3 Context for the review

Since the Tribunal made its last electricity retail price determination in 2004, there have been a number of developments that affect the regulation of retail prices.

In particular, the Tribunal had to take into account six key issues in making its final determination. These were:

- ▼ The impact of the drought on electricity supplies and the operation of the NEM.
- ▼ The endorsement by the Council of Australian Governments (COAG) of the Ministerial Council on Energy's (MCE's) reform agenda, particularly the agreement to phase out retail price regulation where effective competition is demonstrated. At the MCE meeting of 25 May 2007, Ministers directed the Australian Energy Market Commission (AEMC) to commence its review on the effectiveness of retail competition.<sup>7</sup>
- ▼ COAG's agreement to the progressive national roll out of 'smart' electricity meters from 2007 to allow the introduction of time-of-day pricing.
- ▼ The NSW Government's decision to phase out the Electricity Tariff Equalisation Fund (ETEF) between September 2008 and June 2010.
- ▼ New policies related to green energy, including the requirement in the NSW Greenhouse Plan for retailers to offer a 10 per cent Green Power component to all new or moving residential customers, the proposed NSW Renewable Energy Target and the potential for a national emissions trading scheme.
- ▼ Significant existing customer assistance measures.

This chapter provides a summary of the Tribunal's considerations on each of these issues and a short overview of how they have influenced the final determination.

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<sup>7</sup> Ministerial Council of Energy, *Communiqué*, 25 May 2007, p 3.

### 3.1 Impact of the drought on electricity supplies and the operation of the NEM

Many regions in southern and eastern Australia have recently experienced the driest year on record.<sup>8</sup> The Bureau of Meteorology notes that for the 12 months from May 2006 to April 2007, there were serious to severe rainfall deficiencies across south-east South Australia, much of Victoria, much of south-east NSW, and a large part of south-east Queensland.<sup>9</sup>

These dry conditions have restricted the water available for electricity generation in the NEM. In particular, there has been a sustained decline in the water available to the three major hydro systems in south-east Australia (Snowy Hydro, Southern Hydro and Hydro Tasmania), which has restricted generation capacity. In March 2007, the Queensland Government decided to restrict the water available for electricity generation to its coal-fired power stations in south-east Queensland, which has further restricted electricity supply.

These reductions in generation capacity have put upward pressure on spot and forward market prices of electricity in the NEM. At the MCE meeting of 25 May 2007, Ministers noted this pressure, and considered the findings of the National Electricity Market Management Company's (NEMMCO's) analysis of its impacts, which was conducted in response to a request from the MCE Standing Committee of Officials in late 2006.

The increases in spot and forward market prices of electricity in the NEM have occurred largely since the Tribunal released its draft decision in early April 2007. Consequently, the Tribunal's draft decision did not take these price increases into account. In making its final decision, the Tribunal has given consideration to the impact of drought on spot and forward market prices of electricity in the NEM in the medium term. The Tribunal has considered public information on the effect of the drought on electricity prices as well as expert advice from its consultant Frontier Economics.

The Tribunal has decided to address the risk of a step change in wholesale electricity costs by annually reviewing the market-based electricity purchase cost allowance. The Tribunal's analysis on this issue is discussed in Chapter 6.

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<sup>8</sup> NEMMCO, *Potential Drought Impact on Electricity Supplies in the NEM – Final Report*, 30 April 2007.

<sup>9</sup> Bureau of Metrology (2007), *Drought Statement*, 30 April 2007.  
<http://www.bom.gov.au/climate/drought/drought.shtml>



### 3.2 COAG endorsement to phase out retail price regulation

At the COAG meeting of 10 February 2006, Australian governments agreed to the MCE's reform agenda. Part of this agenda is the phasing out of energy retail price regulation where effective competition can be demonstrated, with reviews to commence on 1 January 2007.<sup>10</sup> The Amended Australian Energy Market Agreement specifies that the AEMC will undertake regular assessments of the effectiveness of competition in retail energy markets and conduct a review every two years until all retail energy price controls are phased out. States and Territories retain the right to maintain reserve price regulation powers, obligation to supply arrangements, and price monitoring to protect consumer interests, provided these do not materially impede competition.<sup>11</sup>

At the MCE meeting of 25 May 2007, Ministers directed the AEMC to commence its review on the effectiveness of retail competition.<sup>12</sup> The AEMC will conduct sequential assessments commencing with Victoria in 2007, followed by South Australia in 2008, NSW in 2009 and ACT (if required) in 2010. Other jurisdictions are expected to be assessed once full retail competition is established.

Given the above, the Tribunal recognises that retail price regulation is a transitional measure. For this reason, it has selected a more light-handed approach to regulation, which it considers will facilitate the development of effective competition for small retail customers. The Tribunal's analysis in relation to this issue is discussed in Chapter 5.

### 3.3 COAG agreement to roll out time of use meters

In February 2006, COAG agreed to improve price signals for energy consumers and investors. COAG committed to:

... the progressive national roll out of 'smart' electricity meters from 2007 to allow the introduction of time of day pricing and to allow users to better manage their demand for peak power only where benefits outweigh costs for residential users and in accordance with an implementation plan that has regard to costs and benefits and takes account of different market circumstances in each State and Territory.<sup>13</sup>

At the MCE meeting of 25 May 2007, Ministers noted progress and a forward plan for implementation of a staged approach for the national roll out of smart electricity meters to areas where benefits outweigh costs.<sup>14</sup> The MCE noted that the full cost-benefit analysis of a smart meter roll-out will be completed by the end of 2007.

<sup>10</sup> Council of Australian Governments' Meeting, *Communiqué*, 10 February 2006, Appendix A to Attachment B, p 8.

<sup>11</sup> Ministerial Council of Energy, Energy Market Reform Bulletin No. 64, 7 June 2006.

<sup>12</sup> Ministerial Council of Energy, *Communiqué*, 25 May 2007, p 3.

<sup>13</sup> Council of Australian Governments' Meeting, *Communiqué*, 10 February 2006, p 5.

<sup>14</sup> Ministerial Council of Energy, *Communiqué*, 25 May 2007, p 3.

Electricity network service providers in NSW have already begun introducing time-of-use meters for small retail customers. For example, EnergyAustralia is currently rolling out smart meters that are able to record consumption in half-hour periods. It intends to implement time-of-use metering and pricing progressively over the next decade, as part of a long-term plan to help reduce the increasing peaks in electricity demand by spreading electricity consumption more evenly across the day.<sup>15</sup>

Under the current determination, retailers have experienced some practical difficulties in restructuring tariffs, including establishing time-of-use tariffs. Consistent with the COAG agreement to improve price signals for energy consumers the Tribunal considers that its final determination will provide the Standard Retailers with the flexibility to incorporate demand management initiatives, including time-of-use pricing. This issue is discussed in more detail in Chapter 5.

The final determination will also ensure that the Standard Retailers do not have a disincentive to supply regulated customers on time-of-use tariffs by applying one R-factor to both single rate and TOU tariffs. This issue is discussed in Chapter 8.

### 3.4 Decision to phase out the ETEF arrangement

The Electricity Tariff Equalisation Fund (ETEF) arrangement was put in place to allow the NSW Government to regulate retail prices without undermining competition or exposing retailers or the Government to unacceptable financial risk.<sup>16</sup> Retailers contribute to and/or withdraw from the fund based on differences between the actual price they pay for electricity and the cost of electricity assumed in setting regulated retail tariffs. Government-owned generators are also required to contribute to the fund when it falls below a certain level.

The Government has announced that the ETEF arrangement will be phased out gradually between September 2008 and June 2010.<sup>17</sup> The timetable for phasing out the ETEF is shown in Table 3.1.

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<sup>15</sup> EnergyAustralia website

<<http://www.energy.com.au/energy/ea.nsf/Content/NSW+TOU+Res+Home>>

<sup>16</sup> Office of Financial Management, *Electricity Tariff Equalisation Fund – Information Paper*, December 2000, p 1.

<sup>17</sup> Office of Financial Management, *Payment rules for the Electricity Tariff Equalisation Fund*, April 2006, p 3.

**Table 3.1 Timetable for phasing out the ETEF**

<b>Date</b>	<b>Percentage of NSW regulated retail load supported by the ETEF</b>
Until 27 September 2008	100
28 September 2008 to 28 March 2009	80
29 March 2009 to 26 September 2009	60
27 September 2009 to 27 March 2010	40
28 March 2010 to 26 June 2010	20
27 June 2010 onwards	0

**Source:** Office of Financial Management, Payment rules for the Electricity Tariff Equalisation Fund, April 2006, p 3.

The terms of reference for the review require the Tribunal to recognise that the ETEF arrangement will cease operation within the determination period and to consider the additional costs and risks that the Standard Retailers will face in its absence. The Tribunal accepts that the Standard Retailers will increasingly face costs and risks associated with hedging and risk management as the proportion of regulated load supported by the ETEF reduces, and has considered these costs and risks in making its final determination. The Tribunal's analysis in relation to this issue is discussed in Chapters 6 and 8.

### 3.5 New policies relating to green energy

Under the NSW Greenhouse Plan,<sup>18</sup> the NSW Government requires energy retailers to offer a minimum of 10 per cent Green Power to all new and moving customers. Since 15 January 2007, all retailers that offer electricity to new residential customers or residential customers that change address must offer a minimum of 10 per cent of electricity from accredited renewable energy sources. Customers have the option of taking electricity supply with or without 10 per cent Green Power.

Prior to this requirement being introduced, electricity retailers were able to offer customers the option of paying a premium to ensure that an agreed proportion of their electricity is sourced from renewable energy or 'green' sources. The 10 per cent Green Power requirement does not prevent a retailer from continuing to offer other green products.

In the past, the Tribunal has chosen not to regulate the price customers elect to pay to ensure that a certain percentage of their electricity is generated from renewable sources (the 'green premium'). The 2004 determination allows customers being supplied on a regulated retail tariff to elect to pay a green premium without the need to move from a standard form supply contract. The Tribunal considers that it is appropriate to continue not to regulate the premium. This includes the premium offered in relation to the 10 per cent Green Power program. This issue is discussed further in Chapter 5.

<sup>18</sup> NSW Greenhouse Office, The Cabinet Office of the Government of NSW, *NSW Greenhouse Plan*, 2005.

In addition, the Government proposes to introduce a NSW Renewable Emissions Target (NRET). The scheme will impose a target on electricity retailers and will include renewable energy certificate trading and an enforceable penalty for non-compliance where retailers fail to meet their targets.<sup>19</sup> Retailers will be required to meet their obligations under this scheme by surrendering renewable energy certificates. The Tribunal has included the likely prudent costs of securing adequate supply of renewable energy certificates to meet these statutory obligations in the green cost allowance. This issue is discussed further in Chapter 6.

There is also the potential for the Commonwealth to introduce a national emissions trading scheme, which may impose additional costs on electricity retailers. On 10 December 2006, the Prime Minister announced the establishment of a joint government-business Task Group on Emissions Trading. The Task Group's final report concludes that there are benefits, which outweigh the costs, in early adoption by Australia of an appropriate emissions constraint.<sup>20</sup> However, the report concludes that it would take about four years for Australia to begin full-scale emissions trading. The Tribunal has decided to introduce a pass-through mechanism that will allow the Standard Retailers to pass through to customers the incremental and efficient costs related to additional 'green' obligations. The Tribunal's analysis on this issue is discussed further in Chapter 5.

### 3.6 Customer assistance measures

The Tribunal notes that there are a number of NSW Government assistance measures to address the needs of customers in financial hardship, including:

- ▼ pensioner rebates (\$112 per year for pensioners with a Centrelink Pensioner Concession card, a Department of Veterans Affairs Pensioner Concession Card and pensioners in receipt of a Department of Veterans Affairs war widows/widowers or disability pension at the 'totally and permanently incapacitated' rate or 'extreme disablement adjustment rate' or 'Gold' Repatriation Health Card)
- ▼ life support rebates
- ▼ Energy Accounts Payment Assistance Vouchers, EAPA (\$30 vouchers to assist pay energy bills, issued by participating community welfare organisations).

<sup>19</sup> Department of Energy, Utilities and Sustainability, *NSW Renewable Energy Target Explanatory Paper*, November 2006, p 2.

<sup>20</sup> Prime Ministerial Task Group on Emissions Trading, *Report of the Task Group on Emissions Trading*, May 2007, p 6.

However EWON and the Council on the Ageing (NSW) have submitted that the pensioner energy rebate in NSW is lower than in other jurisdictions and has not been increased in many years.<sup>21</sup> EWON has also submitted that access to the rebate is more restricted in NSW than other jurisdictions, and that the EAPA budget has not increased for several years and may not be able to accommodate increased demand.

Customer hardship measures also form part of the obligations placed on holders of retail supplier licences. These include requirements for:

- ▼ disconnection and reconnection procedures
- ▼ Standard Retail Suppliers to operate payment plans with certain criteria
- ▼ all retailers to comply with directions of the Minister relating to implementation of any aspect of the Government's social programs for energy, which include Pensioner Energy Rebates, Life Support Rebates and EAPA programs administered by the NSW Department of Water and Energy.

The Tribunal also notes that if the draft regulations<sup>22</sup> circulated for comment in February 2007 are passed, it would be a licence condition for all retailers supplying residential small retail customers to:

- ▼ operate a payment plan that allows customers to make payments by instalments and for the instalments to be calculated having regard to the customers' consumption needs and capacity to pay
- ▼ before disconnecting a customer for failure to pay, ensure that they have advised the customer that he/she can apply for assistance under the payment plan and that the customer has either failed to apply for assistance or has been assessed as ineligible for assistance under the payment plan.

In its draft report, the Tribunal noted that retailers currently have or are developing assistance programs that include elements such as:

- ▼ payment plans tailored to the customer's circumstances
- ▼ referrals to assistance agencies and financial counselling services
- ▼ the provision of free energy audits for eligible customers to reduce the likelihood of accruing large debts
- ▼ guarantees of no disconnection for customers in assistance programs
- ▼ the use of internal indicators for early identification of customers in financial hardship so advice and assistance can be provided early
- ▼ incentive matching payments for eligible customers on instalment plans satisfying payment requirements.

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<sup>21</sup> EWON submission, May 2007, p 6, Council on the Ageing (NSW) submission, May 2007, p 2.

<sup>22</sup> Public Consultation Draft, *Electricity Supply (General) Amendment Regulation 2007*, circulated 5 February 2007.

In their submissions on the draft report the Standard Retailers submitted that they are in the process of expanding their hardship programs to include the above measures. However, EWON noted that while these measures would be considered attributes of best practice assistance programs, they are not common to all retailers' programs.<sup>23</sup>

The Public Interest Advocacy Centre (PIAC) and New South Wales Council of Social Services (NCOSS) argued that greater attention needs to be given to the impact of the determination on vulnerable and low-income customers.<sup>24</sup> Redfern Legal Centre argued that specific measures should be mandated to ease the impact of electricity price increases on low-income and vulnerable households.<sup>25</sup> However, it is not practical to establish specific tariffs for low-income and vulnerable households because it is difficult to identify these customers. Further, establishing a separate tariff for vulnerable customers would allow the Standard Retailers to segment the market. Rather, the Tribunal considers that targeted assistance programs (for example, pensioner rebates) are preferable where there is a concern about the affordability of an essential service.

The Tribunal is aware that it can be difficult to identify vulnerable customers from external criteria available to retailers. Retailers often rely on customers identifying themselves as having difficulty paying an electricity bill. Given that customers need to be encouraged to contact retailers if they are experiencing financial difficulty, central to the programs' effectiveness is increasing customers' awareness of the programs. The Standard Retailers have submitted that they are currently in the process of or intend to improve customer awareness of these programs.

In making its final determination, the Tribunal has considered these current and proposed customer assistance measures. From the retailers' point of view, many of the costs of administering these measures are unavoidable costs of doing business. In addition to meeting customer assistance obligations, efficient businesses will voluntarily incur costs associated with hardship programs as a business strategy to reduce costs associated with non-payment/bad debts. On this basis, the Tribunal has taken account of the costs associated with the measures currently in place as part of its consideration of efficient mass market new entrant retail costs, which is discussed in Chapter 7. The Tribunal has decided to introduce a pass-through mechanism that will allow retailers to pass through to customers the incremental and efficient costs related to additional obligations imposed by changes in Government hardship policies. The Tribunal's analysis on this issue is discussed further in Chapter 5.

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<sup>23</sup> EWON submission, May 2007, pp 6 – 8.

<sup>24</sup> PIAC submission, May 2007, p 5, NCOSS submission, May 2007.

<sup>25</sup> Redfern Legal Centre submission, May 2007, p 3.

## 4 Current level of retail competition

One of the main factors the Tribunal considered in making its decision on the most appropriate form of regulation for the period 2007 to 2010 is the effectiveness of competition in the NSW retail electricity market. If competition is effective, it will impede retailers' ability to keep tariffs significantly above cost-reflective levels. This means that regulation can be more light-handed, as competition will provide customer choices and limit prices to efficient levels.

In making its draft decision, the Tribunal examined the level of competition for small retail customers in the metropolitan market (which includes the EnergyAustralia and Integral Energy standard supply districts) and the non-metropolitan market (the Country Energy standard supply district) for the purpose of informing its approach to regulation. It also considered the likely effect of its determination on the level of competition in both these markets. This involved identifying the competitive constraints that currently exist, and the extent to which these competitive constraints will be addressed by the determination.

In making its final decision, the Tribunal reconsidered these issues, taking into account the views expressed by stakeholders in submissions in response to the draft report. In particular, the Tribunal closely examined some stakeholders' concern that certain customer groups within the metropolitan and non-metropolitan markets do not have access to the competitive market and as such may constitute sub-markets within these markets. It also examined stakeholders' concern about the availability of transparent and easily understood information about market offers, including information on the costs involved in switching retailers.

In addition, the Tribunal noted stakeholder comments that the Australia Energy Market Commission (AEMC) is responsible under the Australian Energy Market Agreement (AEMA) for reviewing and publicly reporting on the effectiveness of retail competition in jurisdictions participating in the NEM for the purpose of removing retail price regulation where competition is effective. The Tribunal's own review of competition in NSW was for the purpose of informing its decision on the appropriate form of regulation for the 2007 to 2010 period. While the matters the Tribunal took into account in assessing the competitiveness of the market are consistent with the criteria to be used by the AEMC, the Tribunal considers the purpose of its review to be different.



The Tribunal largely maintains the views on the effectiveness of competition for small retail customers in NSW it expressed in its draft report. The section below provides an overview of the Tribunal's final findings on this matter. The subsequent section sets out the analysis that underpins these findings, and addresses stakeholder responses to the draft report.

#### 4.1 Overview of final findings

In relation to the metropolitan market, the Tribunal finds that the balance of evidence suggests there is competition for small retail electricity customers in the metropolitan area. In the Tribunal's view, there is sufficient competition in this market to restrain increases in each individual tariff. The small number of regulated tariffs in the metropolitan area (one dominant tariff per retailer, which applies to the vast majority of its customers) combined with the Tribunal's decision to limit the creation of new regulated tariffs ensures that competition will restrain increases for customers in each individual tariff. Although there is still a high degree of market concentration, the fact that new entrants have acquired a significant number of small customers implies that there are no material barriers to entry in this market. On the information available to it, the Tribunal considers that there is rivalry between competitors in the form of increasing product diversity and/or price savings to entice customers to move off the regulated tariff.

In relation to the non-metropolitan market, the Tribunal finds that, on balance, the available evidence suggests that competition is developing; however, it is unclear whether there is currently sufficient competition to restrain increases in each individual tariff. The Tribunal notes that new entrants to this market have not acquired a significant number of small retail customers, and a high number of customers remain on the regulated tariff. The Tribunal considers that this implies that there are material barriers to entry in this market. However, the Tribunal also considers that there is potential for the level of competition to increase over the 2007 to 2010 determination period.

The Tribunal's final determination addresses some of the key impediments to retail competition in the non-metropolitan market by:

- ▼ accounting for the removal of the ETEF arrangement in the energy purchase cost allowances
- ▼ allowing regulated retail tariffs to increase to cost-reflective levels
- ▼ allowing Country Energy sufficient pricing discretion to rationalise tariffs (including reducing the number of obsolete tariffs).

Nevertheless, the Tribunal recognises that there may be persistent factors that will prevent the level of competition in this market reaching the same level as in the metropolitan market over the medium term.



## 4.2 Tribunal's analysis

In undertaking the analysis that underpins the above findings, the Tribunal had regard to the structural features of the retail electricity markets in NSW, the conduct of this market, and the outcomes for customers. Specifically, it considered the following matters:

- ▼ the definition of effective competition
- ▼ the definition of the market, including the existence of sub-markets
- ▼ market structure, including the number of retailers contesting the market, market concentration, and barriers to entry
- ▼ market conduct, including customer awareness, retailer marketing activity and market information, and retailer offers
- ▼ customer outcomes, including the exercise of customers' choice and customer switching behaviour.

An overview of its considerations in relation to each of these matters is set out below.

The Tribunal notes that the Ministerial Council on Energy has outlined a number of criteria to be used by the AEMC in determining whether competition is effective in retail energy markets.<sup>26</sup> The matters the Tribunal considered are consistent with these criteria, and with the approaches taken by regulators in other Australian jurisdictions.

### 4.2.1 Definition of effective competition

The Tribunal considers that in an effectively competitive market, the ability of participants to exercise market power (eg, by raising prices above the efficient cost level, restricting services, or reducing service quality to increase profits) is restricted by the actions of competitors in the market, or by the actions of potential competitors yet to enter the market. That is, competition from existing firms or the threat of entry from potential competitors has a disciplinary effect on the behaviour of the incumbents.

This view recognises that a definition of effective competition must consider both:

- ▼ actual competition (where new entrants have entered the market and actively compete with the incumbent suppliers, taking market share from them), and
- ▼ potential competition (whereby the threat of entry effectively disciplines the incumbents against abusing their market power but no entry actually occurs).

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<sup>26</sup> Ministerial Council on Energy, *Phase Out of Retail Price Regulation for Electricity and Natural Gas - Final Effective Competition Criteria*, p 1.

#### 4.2.2 Definition of the market

The Tribunal considers that there are two relevant markets for the retail supply of electricity. These are to customers consuming less than 160 MWh per annum in:

- ▼ the combined standard supply areas of Integral Energy and EnergyAustralia (the metropolitan market)
- ▼ Country Energy's standard supply area (the non-metropolitan market).

In reaching this view, the Tribunal noted that the relevant market needs to be defined with reference to the most important sources of competition for a retailer or set of retailers. Defining the market too broadly and including products or sellers that do not constrain the ability of retailers to exercise market power may overstate the competitiveness of the market. Defining the market too narrowly may understate the extent of competition, as some effective competition may be excluded from the analysis. The Tribunal also took into account the functional, product, geographic and time dimensions of the relevant market, and considered whether there are separate sub-markets defined along customer characteristics such as income, consumption, homeownership status or residential/business lines within NSW.

##### Functional dimension

The Tribunal considers that the functional market relevant to this review is the retail market. While there may be some efficiencies associated with a retailer holding generation or distribution assets, the electricity retail function is both economically separable and economically distinct.

##### Product dimension

The Tribunal considers that the product market relevant to this review is electricity only. It examined whether the product market should include the broader energy market, which includes the retail supply of gas. However, it concluded that gas and electricity are not reasonable substitutes for each other over the period of its determination. The sunk costs associated with switching from electricity to gas prevent these sources of energy being sufficiently interchangeable to be considered reasonable substitutes over the next three years. Further, customers may be able to use gas for a limited selection of activities such as cooking and heating, but they cannot switch to gas for all their power needs. Therefore, the Tribunal does not consider the retail supply of gas to form part of the relevant market.

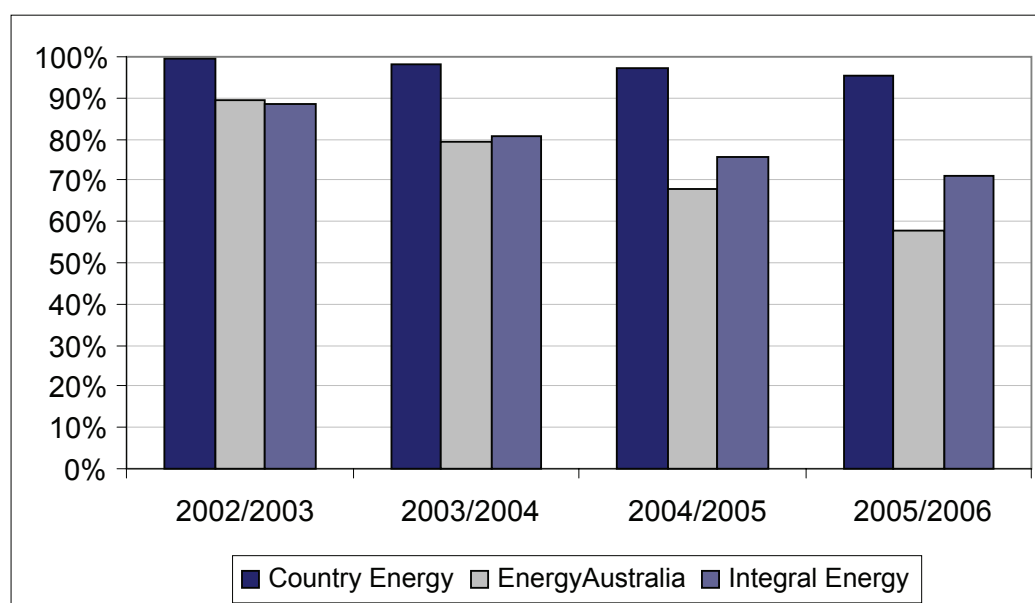
##### Geographic dimension

The Tribunal considered the geographic areas in which retailers currently operate (or could operate) and provide customers with practical offers for the retail supply of electricity. In its view, defining the market as the NEM would be too broad and would include products and sellers that do not constrain the ability of retailers licensed in NSW to exercise market power.

As outlined above, the Tribunal considers that there are two relevant markets for the retail supply of electricity in NSW – the metropolitan market and the non-metropolitan market. In forming this view, the Tribunal noted the differing trends in market concentration in these markets. In addition, a significant proportion of small retail customers in the metropolitan market have exercised choice in the competitive market by moving off the regulated tariff and signing a negotiated contract either with a second tier retailer or with the incumbent. However, very few customers in the non-metropolitan market have done so.

As Figure 4.1 shows, in 2005/06, 58 per cent and 71 per cent of customers in the EnergyAustralia and Integral Energy standard supply areas respectively remained on regulated tariffs, compared to around 95 per cent of customers in Country Energy's standard supply area. This implies there is a significant difference in the level of competitive activity in the metropolitan and non-metropolitan areas, and that the geographic dimension of the market definition should be narrower than NSW.

**Figure 4.1 Percentage of small retail customers on regulated tariffs in each standard supply area 2002/03 – 2005/06**



#### Time dimension

The Tribunal considers that the time period relevant to this review is the period of the determination (the three years from 2006/07 to 2009/10).

#### Sub-markets

In making its draft decision, the Tribunal considered whether there should be separate markets defined along consumption or residential/business lines for small retail customers.

The Tribunal noted that a number of licensed retailers in NSW do not supply small residential customers. The Tribunal also noted the Federal Court definition of the retail markets in Victoria as a market for supply to industrial and commercial users and a market for residential and small business users.<sup>27</sup>

The Tribunal considered that based on its examination of the available information – which includes information on the consumption characteristics of small residential and business customers on negotiated contracts with the Standard Retailers, and results from the Tribunal’s 2006 Household Survey of the greater Sydney region (which includes Sydney and the Blue Mountains and Illawarra areas) – there are not separate retail markets defined along consumption or residential/business lines for small retail customers.

In their submissions in response to the draft report, a number of stakeholders expressed concern that vulnerable or low-income customers have a reduced opportunity to access retailer offers and to benefit from the competitive process.<sup>28</sup> These stakeholders submitted that vulnerable customers tended to be those with lower incomes and lower levels of consumption, and were more likely to be in rental accommodation.<sup>29</sup> PIAC and NCOSS asked the Tribunal to specially consider the effectiveness of competition for vulnerable and low-income customers.<sup>30</sup> The findings of the Tribunal’s household survey and information provided by the Standard Retailers indicate that low income customers and those on hardship programs with the Standard Retailers are not necessarily low consumption customers.

In making its final decision, the Tribunal closely considered these concerns. As Chapter 5 will discuss in more detail, it is the nature of the tariff rather than the nature of the customer that is most relevant in assessing competition and its benefits. This is because tariffs apply to general customer classes (for example, residential customers) regardless of the characteristics of individual customers (for example, pensioners or low consumption customers). Given that retailers compete on a tariff basis, all customers on the same tariff face the same price regardless of whether they are “attractive” to the competitive market. While the number of regulated tariffs and the number of customers on each tariff affects the Standard Retailer’s ability to increase individual tariffs above cost reflective levels, given that the majority of customers in the metropolitan area are on one or two tariffs, the Tribunal considers that not all customers need to be actively switching suppliers to restrain increases in each tariff. In other words, where tariffs are kept in check because a significant number of customers on that tariff would otherwise seek a negotiated contract, then all customers on that tariff benefit from the competitive pressure that limits the increase in that tariff, regardless of the nature of the customer.

<sup>27</sup> *Australian Gas Light v Australian Competition and Consumer Commission* (No.3) [2003] FCA 1525, paragraph 380.

<sup>28</sup> PIAC submission, May 2007, p 7 and NCOSS submission, May 2007, p 3.

<sup>29</sup> NCOSS submission, May 2007, p 3 and EWON submission, May 2007, pp 10-12.

<sup>30</sup> NCOSS submission, May 2007, p 4 and PIAC submission, February 2007, p 4.

Further, the Tribunal considers that where there are only a limited number of tariffs, as is the case in the metropolitan area, side constraints for certain customers are not necessary as the changes in those tariffs will resemble the average price change determined by the Tribunal. Therefore a side constraint will make very little difference to price outcomes for **the majority of** customers.

In making its final decision, the Tribunal also examined whether there are certain customer groups within the metropolitan and non-metropolitan markets, such as low-income or vulnerable customers, that do not have the opportunity to access the competitive market and as such constitute sub-markets within these markets. The Tribunal relied on information provided by the Standard Retailers, and the results from the 2006 Household Survey.

Based on the information provided by the Standard Retailers, and the results from the 2006 Household Survey, the Tribunal considers that for the purposes of this review there are not separate sub-markets defined along consumption, income, residential/business and household ownership/tenant lines.

The Tribunal's analysis in relation to this issue is discussed in detail in Appendix C. However, in summary, this analysis indicates that:

- ▼ customers participating in the Standard Retailers' hardship programs have moved onto negotiated contracts to the same extent as the wider customer base (see Appendix C, section C.1)<sup>31</sup>
- ▼ low-income customers in the greater Sydney region are just as likely to have been approached by other retailers and to have switched retailers as higher income customers (Figures C.1 and C.2)
- ▼ customers from low-income suburbs in the EnergyAustralia standard supply area are just as likely to have signed a negotiated contract as customers from higher income suburbs (Figure C.3)
- ▼ customers from low-income suburbs in the Integral Energy standard supply area are more likely to have switched retailers than the overall Integral Energy residential customer base (Figure C.4)
- ▼ customers with poor credit ratings in Integral Energy's standard supply area are more likely to have switched retailers than the overall Integral Energy residential customer base (Figure C.5)
- ▼ customers with low consumption levels in the greater Sydney region are almost as likely to have been approached to switch suppliers as those with higher consumption (Figure C.6), and the proportion of low-consumption customers who have signed negotiated contracts with the Standard Retailers has increased significantly since 2003/04 (Tables C.1 and C.2)

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<sup>31</sup> The Tribunal also noted that customers on hardship programs are more likely to consume more energy than typical customers.

- ▼ Standard Retailers' residential customers and business customers are equally likely to have signed a negotiated contract with their retailer (Table C.3)
- ▼ different pensioner groups in Integral Energy's standard supply area have been switching retailers at different rates. While aged pensioners are less likely to have switched suppliers than the overall Integral Energy residential customer base, single-parent pensioners (those most likely to be suffering financial distress) are more likely to have switched retailers than the overall Integral Energy residential customer base (Figure C.7)
- ▼ customers in rental accommodation in the greater Sydney region are just as likely to have been approached by other retailers and to have switched retailers as customers who own their own home (Section C.7).

#### 4.2.3 Market structure

The structure of a market will affect the scope for effective competition within it. In assessing the implications of market structure for the effectiveness of retail competition, the Tribunal had regard to the number of electricity retailers operating in the two relevant markets in NSW, the concentration of these markets, and barriers to entering these markets.

##### The number of firms operating in the NSW markets

There are currently 25 electricity retail licence holders in NSW, an increase of one since the release of the draft determination. Fourteen of these licence holders currently supply or intend to supply the small retail market, which is also an increase of one since the release of the draft determination. While the total number of electricity retail licence holders has not significantly increased since 2004, the number of those that supply small retail customers, particularly small residential customers, has increased.

The retail licence holders participate in the NSW markets to differing degrees. These suppliers can be categorised as:

- ▼ The incumbent or Standard Retailers. These are the three retailers that inherited the standard supply areas that mirror the distribution network areas: EnergyAustralia, Integral Energy and Country Energy. In addition to being Standard Retailers, these firms also have the distribution function in their supply area.
- ▼ Mass market 2nd tier retailers. These are the non-incumbent retailers who aim over time to establish a customer base of sufficient size to achieve economies of scale.
- ▼ Niche 2nd tier retailers. These are the retailers that focus on specific customer classes or offer specific products and are likely to remain on a smaller scale.

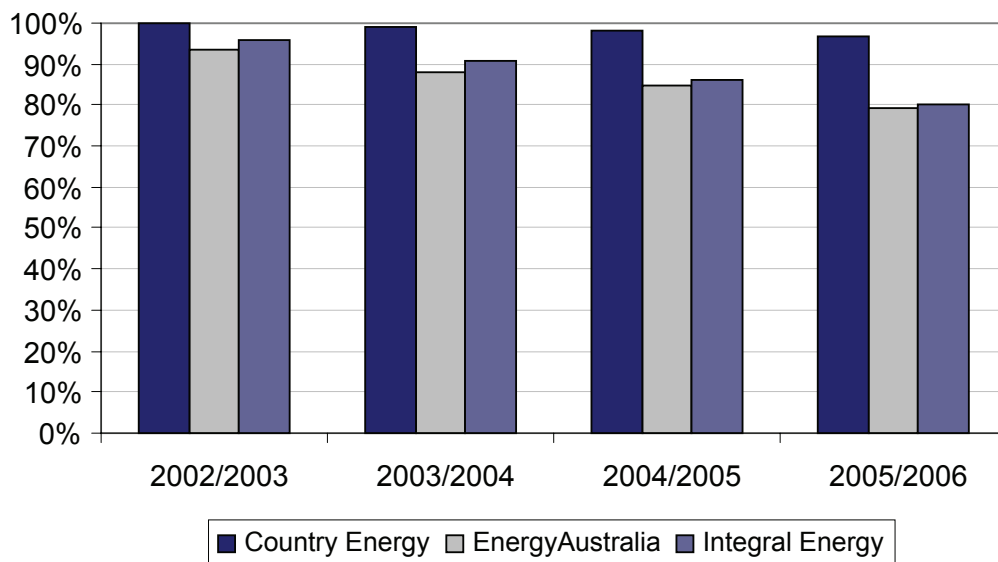
### Concentration of the market

The more concentrated a market, the greater the potential for firms to exercise market power. Therefore, a market with a considerable number of firms may still not exhibit effective competition if the market is concentrated in the hands of a small number of firms.<sup>32</sup>

The Tribunal notes that there are significant differences in market concentration in the two relevant markets in NSW. Since the introduction of full retail contestability in 2002, a considerable number of customers in the metropolitan market have entered into negotiated contracts, and new entrants have steadily reduced the market share of the incumbents (Figure 4.2). As at 1 July 2006, EnergyAustralia and Integral Energy had around 80 per cent of the small retail electricity customers in their standard supply areas, while other retailers including new entrants had around 20 per cent.

Although the metropolitan market would typically be considered highly concentrated, the Tribunal considers that this reflects the fact that the market is still in transition from the previous franchise monopoly market towards a competitive energy retail market.

**Figure 4.2 Market shares of incumbents in each standard supply area 2002/03 – 2005/06**



<sup>32</sup> Firms with considerable market share may be able to exercise market power.



In the non-metropolitan market, a significantly higher proportion of small customers have remained with the incumbent retailer, Country Energy. As at 1 July 2006, Country Energy had around 97 per cent of the small retail electricity customers in this market, while other retailers including new entrants had around 3 per cent. As noted earlier, significant proportion of customers also remain on the regulated tariff.

The level of market concentration and the low uptake of negotiated contracts in Country Energy's standard supply area most likely indicate that there are barriers to entry to this market.

### Barriers to entry

Barriers to entry are the key determinant of how easy it is for firms to enter or exit a market. Generally, a competitive market does not have significant barriers to entry, ensuring that the behaviour of market participants is disciplined by the entry of new firms or by the threat of entry. If barriers to entry exist in a market, there may be an opportunity for firms in the market to exercise market power, reducing the extent to which competitive pricing and product differentiation occurs. Barriers to entry do not include obstacles that are part of the normal process of entering any market.

The Tribunal has considered whether any of the following barriers to entry limit the potential for competition in the NSW retail electricity markets:

- ▼ sunk costs<sup>33</sup>
- ▼ legal or regulatory barriers
- ▼ advantages for incumbent firms
- ▼ under-recovering tariffs
- ▼ customer inertia.

The Tribunal considers that any sunk costs or legal/regulatory differences are unlikely to act as barriers to entry to the retail market. However, there are advantages for the incumbent firms, such as having access to information on the consumption levels and load profiles of customers that is not initially available to new entrants. There are also benefits to incumbents from customer inertia or possible customer loyalty. The Tribunal notes that the Standard Retailers' access to the ETEF, to the extent that the ETEF price is below market-based prices, could also provide a barrier to entry by other retailers.

However, the Tribunal considers that the fact that new entrants have acquired a significant number of small customers in the metropolitan market, and that a considerable number of customers have moved off the regulated tariff implies that there are no material barriers to entry for the metropolitan market.

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<sup>33</sup> Sunk costs are costs which cannot be recovered by firms when exiting a market. Sunk costs arise because some activities require specialised or firm-specific assets that cannot easily be diverted to other uses. As these assets cannot easily be sold, the existence of sunk costs creates risk for firms entering the market.



In the non-metropolitan market, the fact that there has been little reduction in market concentration since the introduction of full retail contestability, and that the majority of customers remain on regulated tariffs would seem to indicate that there are barriers to entry.

The Tribunal considers that the large number of tariffs – particularly the large number of significantly under-recovering obsolete tariffs – represents a barrier to entry in this market. Almost half of Country Energy’s regulated tariffs are more than 5 per cent below the cost reflective targets for 2006/07 set by the Tribunal in 2004.<sup>34</sup> Almost half of these tariffs are more than 20 per cent below the targets for 2006/07. Most of the significantly under-recovering tariffs are obsolete tariffs, in that customers are unable to move onto these tariffs.

There are more than 100 network tariffs in Country Energy’s standard supply area, including obsolete network tariffs, creating more than 300 regulated retail tariffs. To attract customers to move off the regulated tariff, a second tier retailer would need to identify the relevant network tariff to apply to the customers and the relevant regulated retail tariff (being a measure of the price to beat). The Tribunal notes AGL’s comments that new entrants find it difficult to compete in areas where there are numerous regulated tariffs.<sup>35</sup>

In its draft report, the Tribunal noted that the remoteness of some customers and the relatively low population density in some parts of Country Energy’s supply area are also likely to limit the extent of competition. The Tribunal notes Country Energy’s comments that although some customers are remote and therefore may not be approached by doorknockers, these customers may increasingly self-select competitive options that come to their notice through other forms of marketing.<sup>36</sup> The Tribunal recognises that other forms of marketing such as telemarketing and internet marketing are likely to reduce the extent to which relative remoteness and low population density act as barriers to entry. However, it still considers that these factors may prevent competitive activity from reaching the levels attained in the metropolitan market over the period of the determination.

#### 4.2.4 Market conduct

Even markets that exhibit high levels of concentration may achieve competitive market outcomes, provided there is ongoing competition between competing firms or potential competition from the threat of entry. In an effectively competitive market, retailers are motivated to compete for customers by making innovative price/service offers and providing supporting information about their offers to customers. In examining market conduct in the metropolitan and non-metropolitan

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<sup>34</sup> This refers to the percentage of Country Energy tariffs below cost, not the percentage of customers on under-recovering tariffs.

<sup>35</sup> AGL submission, October 2006, p 9.

<sup>36</sup> Country Energy submission, May 2007, p 6.

markets in NSW, the Tribunal considered the level of customer awareness and the extent of competitive rivalry between firms in terms of retailer marketing activity and the price/service packages being offered to customers.

### Customer awareness

To exercise choice, customers must be aware that a competitive market for electricity exists. Customer awareness of full retail contestability is influenced by the extent of retailer marketing and government awareness programs.

The Tribunal's 2003 Household Survey of the greater Sydney region found that 74 per cent of respondents were aware they could change their electricity supplier.<sup>37</sup> The Tribunal notes that the 2006 Household Survey indicate customer awareness of full retail contestability is now widespread in this region, with over 91 per cent of respondents answering that they were aware they could choose their electricity supplier. Further, the level of customer awareness of full retail contestability does not differ significantly across different customer income or consumption groups.

The level of customer awareness in the greater Sydney region is in line with other jurisdictions that have competitive energy markets. In Victoria (one of the most active retail markets), the Essential Service Commission's 2004 survey noted that 90 per cent of customers were aware that they were able to choose their electricity supplier.<sup>38</sup> In the United Kingdom (the most active retail market), Ofgem's 2004 review noted that surveys conducted between 2001 and 2003 found that 92 – 94 per cent of people were aware they could buy electricity from suppliers other than their local electricity supplier.<sup>39</sup>

As the Tribunal's household surveys are limited to the greater Sydney region, it has not been able to form a view on the extent of customer awareness of full retail contestability in the non-metropolitan market.

### Retailer marketing activity

To have effective competition, customers not only have to be aware of their ability to choose their retailer, they also need to be provided with sufficient information to allow them to make an informed choice.

The Tribunal considers there is market information available to customers in NSW to allow them to exercise choice. However, the Tribunal notes the view expressed by PIAC in its response to the draft report that there is a lack of transparent price

<sup>37</sup> IPART, *Residential energy use in Sydney, the Blue Mountains and Illawarra: Results from the 2003 household survey*, December 2004, p 35.

<sup>38</sup> Essential Services Commission, *Review of Effectiveness of Retail Competition in Gas and Electricity: Draft Report*, 30 March 2004, p 55.

<sup>39</sup> OFGEM, *Domestic Competitive Market Review 2004: A review document April 2004*, p 22.

information available for customers. PIAC submitted that firms have little incentive to offer price transparency, which results in significant search costs for customers.<sup>40</sup>

The Tribunal recognises that higher search costs (including transaction costs) involved with assessing market offers will tend to reduce competitive rivalry. It notes that when assessing market offers for retail electricity supply there are likely to be search costs involved with comparing available offers (as with other services such as telecommunications, private health insurance etc).<sup>41</sup> These search costs, together with other transaction costs such as termination fees, need to be balanced against the potential price and non-price benefits on offer.

However, for a significant number of retailer offers in NSW, the regulated price still forms the benchmark as discounts are offered as a percentage reduction on this price. Given this, the Tribunal considers that the costs involved with searching and comparing offers are likely to be less than in other industries. Results from the 2006 Household Survey indicate that less than 2 per cent of customers did not take up a negotiated contract with their original supplier or an alternative supplier because they were not given the price comparison information they wanted. This did not vary by customer group.

The Tribunal recognises that actual or perceived search costs are likely to vary with the level of education, similar experience in other markets, age and computer literacy (ie, ability to access and browse the internet). In addition, it considers that the provision of transparent information about the alternative retail offers available, as well as information about the core details of these offers, is likely to benefit consumers, particularly customers who have little experience or confidence in their ability to search for and compare available offers.

Such transparent market information can be provided by market players (such as new entrants, who have an incentive to provide supporting information about their price/service offers to customers to entice them onto their contracts) and by external players (such as government or consumer groups).<sup>42</sup> The Tribunal supports the view put by the Energy and Water Ombudsman of NSW (EWON) that there would be value in having a comparative information service available in NSW (as there is in Victoria and South Australia) which presents market offerings in a simple and easy-to-understand format.<sup>43</sup>

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<sup>40</sup> PIAC submission, May 2007, p 7.

<sup>41</sup> Comparing offers requires consumers to know their consumption and to give consideration to other issues such as methods of bill payment, termination fees etc.

<sup>42</sup> Comparable information services are common in other retail services such as telecommunications, CTP Green Slips, private health insurance etc.

<sup>43</sup> EWON submission, October 2006, p 12.

The Tribunal notes that similar comparative information is already available on health insurance offers. For example, the Australian Government has recently introduced an independent website that provides an overview of available private health insurance products.<sup>44</sup> The Australian Government has also made it compulsory for all health funds to describe the products they offer, including the price and other key product features, in a common format. The intention is to allow customers to easily see where products differ in terms of price and non-price features so that consumers can review their existing policy or compare private health insurance products.<sup>45</sup>

Given the potential benefits to customers of making more transparent information available about the core details presented in retail electricity offers, the Tribunal recommends that the NSW Government give consideration to the publication of core information presented in retail offers to enable retail customers to make a comparison of retail offers. The Tribunal considers that access to this information is central to increasing customers' confidence in their ability to comprehend and compare competing market contract offers, including the price and non-price benefits available and the ease and costs associated with switching retailers. The Tribunal notes that the Department of Water and Energy already provides some information to customers on choosing their energy supplier on its website.<sup>46</sup>

The Tribunal recommends that the NSW Government give consideration to the publication of core information presented in retail offers to enable customers to make a comparison of retail offers.

#### Retailer offers

The Tribunal's analysis indicates that discounts of up to 10 per cent are available in the metropolitan market.<sup>47</sup> On the whole, smaller discounts are on offer in the non-metropolitan market. The Tribunal notes that these results differ from the 2004 review of regulated retail electricity tariffs, which found that relatively small discounts of 2 – 5 per cent off the regulated tariff were being offered.<sup>48</sup>

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<sup>44</sup> The website is intended to allow customers to find and compare products. The website is to be operated by the Private Health Insurance Ombudsman.

<sup>45</sup> Health insurers are now required by law to provide Standard Information Statements (SIS) on all private health insurance products they offer. A Standard Information Statement gives a summary of the key product features to allow customers to see where products differ in both price and non-price features. The Department of Health and Ageing website notes that customers will need to contact the health insurer to get all the details about the product.

<http://www.health.gov.au/internet/phimprove/publishing.nsf/Content/improvements-lp-1#sis>

<sup>46</sup> See <<http://deus.nsw.gov.au>>

<sup>47</sup> Discounts are relative to the regulated tariff.

<sup>48</sup> IPART, *NSW Electricity Regulated Retail Tariffs 2004/05 to 2006/07 - Final Report and Determination*, June 2004, p 35.

In a competitive retail market, suppliers would also be expected to offer innovative price/service packages to entice customers onto their market contracts. Although stakeholders have offered contrasting views on the extent of product diversification in the NSW market, the Tribunal considers that there is increasing innovation in the price/service packages being offered to customers.

As part of its 2004 review of regulated retail electricity tariffs, the Tribunal found that although incumbent retailers were offering dual fuel products, there appeared to be limited product innovation in negotiated offers.<sup>49</sup> The Tribunal noted that in most cases, the regulated price formed the benchmark in negotiated offers and that most offers involved a fixed term contract of 2 – 3 years with fees for early termination.

Although the regulated price still often forms the benchmark in negotiated offers, with discounts offered as a percentage reduction on this price, there are an increasing number of price/service options being offered to customers. These include:

- ▼ time-of-use tariffs targeted to specific customer groups
- ▼ alternative methods of bill payment (including payment plans and discounts for direct debit)
- ▼ options to bundle services, such as electricity, gas and telecommunications services
- ▼ options for varying levels and sources of green energy supply
- ▼ differing levels of termination fees (including no termination fees)
- ▼ differing contract lengths (including no fixed contract).

Retailers are also offering a range of other rewards/savings to customers such as:

- ▼ petrol discounts
- ▼ shopping vouchers
- ▼ frequent flyer points
- ▼ magazine subscriptions
- ▼ free electricity for one month.

The Tribunal also considers that an increasing number of customers from a range of demographics are being offered and are accepting negotiated contracts. For example, several stakeholders expressed the view that retailers are targeting wide sections of the community for negotiated contracts.<sup>50</sup> EWON submits that there is considerable marketing activity occurring across NSW with its marketing complaint data indicating that much of this activity is occurring outside of the Sydney metropolitan

<sup>49</sup> IPART, *NSW Electricity Regulated Retail Tariffs 2004/05 to 2006/07 - Final Report and Determination*, June 2004, p 30.

<sup>50</sup> EWON submission, October 2006, p 9, Integral Energy submission, September 2006, p 12.

area.<sup>51</sup> In addition, the Tribunal's analysis of information provided by the Standard Retailers and obtained from its 2006 Household Survey indicates that all major customer groups are being offered the opportunity to take up negotiated contracts with their current supplier or switch supplier, including customers that have traditionally been considered unlikely to be offered competitive contracts (such as low-income customers, customers with low consumption, and customers with poor credit ratings). (See section 4.2.2 and Appendix C.)

The Tribunal notes EWON's comments that while customers may receive market offers, some groups' ability to enter the competitive market is reduced by a lack of product differentiation, notably in regard to term-based contracts.<sup>52</sup> For example, tenants are likely to find it more difficult than homeowners to enter into multi-year contracts, because they have less certainty about their future living arrangements. The Tribunal notes that some retailers are now offering contracts with differing contract lengths, including no fixed contracts and no termination fees. Results from the 2006 Household Survey indicate that homeowners and tenants are equally likely to change electricity supplier if they are approached, and homeowners and tenants are being approached by suppliers to the same extent. This is a change from the 2003 Household Survey, which found that customers who were homeowners were more likely to be offered contracts by other suppliers than renters.

The Tribunal also notes stakeholder concerns that while general market offers may be being made to all small energy customers, the offers being made to certain customer groups such as low-income or low-consumption customers may not be attractive relative to the regulated price, resulting in these customers remaining on the regulated tariff.<sup>53</sup> PIAC and NCOSS submitted that research from the UK indicates that the tariffs offered to low-income households often include a premium compared to those offered to higher income households.<sup>54</sup>

The Tribunal recognises that it is likely that the relative benefits that different customers receive, in terms of the price and non-price elements of negotiated contracts, will vary depending on a number of characteristics – such as their level of consumption, whether they are bundling electricity and gas, the length of the contract and their payment method. However, the Tribunal's analysis indicates that the nature of competitive offers in NSW is not influenced by household income.

In addition, while a large proportion of low-income customers are low consumers of energy, results from the 2006 Household Survey indicate that higher income households represent a significant proportion of households with low energy consumption. Information provided by the Standard Retailers also indicates that customers who are experiencing payment difficulties (and therefore most likely to be considered vulnerable) tend to consume more energy than a typical customer.

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<sup>51</sup> EWON submission, May 2007, p 4 and p 9.

<sup>52</sup> EWON submission, May 2007, p 10.

<sup>53</sup> NCOSS submission, May 2007, p 3 and EWON submission, May 2007, p 3.

<sup>54</sup> PIAC submission, May 2007, p 7 and NCOSS submission, May 2007, p 3.



Furthermore, the fact that there is evidence to show that an increasing number of customers including low-income and low-consumption customers are entering into negotiated contracts suggests that the offers being made to these customers are attractive relative to the regulated tariff.

#### 4.2.5 Customer outcomes

The Tribunal considered the extent to which customers are benefiting from the competitive rivalry between firms. In particular, it looked at the extent to which customers are exercising their option to choose their retailer and move off the regulated tariff, and customer switching behaviour.

The Tribunal notes PIAC's concern that in forming its draft view on the level of competition, the Tribunal has relied too heavily on information about customer switching. PIAC submits that customer switching information discloses little about the experiences of vulnerable customers in the competitive market.<sup>55</sup>

The Tribunal agrees that relying only on customer switching information to form a view on the competitiveness of the market is not appropriate. However, switching information was only one of the indicators the Tribunal considered in forming its view on the level of competition. In line with the approach outlined by the AEMC the Tribunal has had regard to the structural features of the retail electricity markets in NSW (including the number of electricity retailers operating in the two relevant markets in NSW, the concentration of these markets, and barriers to entering these markets), the conduct of these markets (including the extent of customer awareness, retail marketing activity and retailer offers), and the outcomes for customers.

It was not possible for the Tribunal to evaluate the actual contracts negotiated between customers and retailers. The Tribunal notes that results from the 2006 Household Survey indicate that the majority of customers who entered into a negotiated contract with their existing retailer or switched their electricity retailer did so because they felt the prices offered were lower. As noted above, it is likely that the relative benefits in terms of the discounts that different customers will receive will vary, as will the value that individual customers place on price and non-price incentives (eg, frequent flyer points). For example, customers who are more price sensitive are more likely to attach greater weight to the price benefits or discount elements of negotiated contracts.

The Tribunal acknowledges that some customers, particularly those more likely to be price sensitive, may underestimate some of the details of retail offers such as termination fees, and may not consider all the costs involved with signing a negotiated contract. As discussed above, the Tribunal has recommended to Government that it gives consideration to the publication of core information in retailer offers. The Tribunal considers that making more transparent price

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<sup>55</sup> PIAC submission, May 2007, p 5.

information available is likely to benefit consumers, particularly those with little experience or confidence in their ability to search for and compare available offers.

The Tribunal also acknowledges that some customers such as aged pensioners (refer section 4.2.2) have been less likely to negotiate a contract with their current supplier or to switch suppliers than the overall customer base. However as noted earlier, pensioners and other vulnerable customer groups are usually on general residential tariffs that apply regardless of the income and consumption characteristics of individual customers. Where customers are on the same tariff, they face the same price, whether or not they are 'attractive' to the competitive market. In other words, tariffs are kept in check because some customers on that tariff would otherwise seek a negotiated contract, and all the customers on that tariff benefit from this competitive pressure.

#### Exercise of customer choice

An increasing number of customers in NSW are moving onto negotiated contracts with either their existing retailer or with another retailer. As at 30 June 2006, around 922,000 customers, or 29 per cent of the small customer base in NSW, were on negotiated contracts.

However, there is a significant difference in competitive activity across the two relevant markets in NSW. Table 4.1 below shows that as at 30 June 2006, 42 per cent and 29 per cent of customers in the EnergyAustralia and Integral Energy standard supply areas respectively were on a negotiated contract (including with their existing supplier) compared with fewer than 5 per cent in the Country Energy standard supply area.

**Table 4.1 Total small customers on negotiated contracts in NSW by standard supply area, 2003/04 – 2005/06**

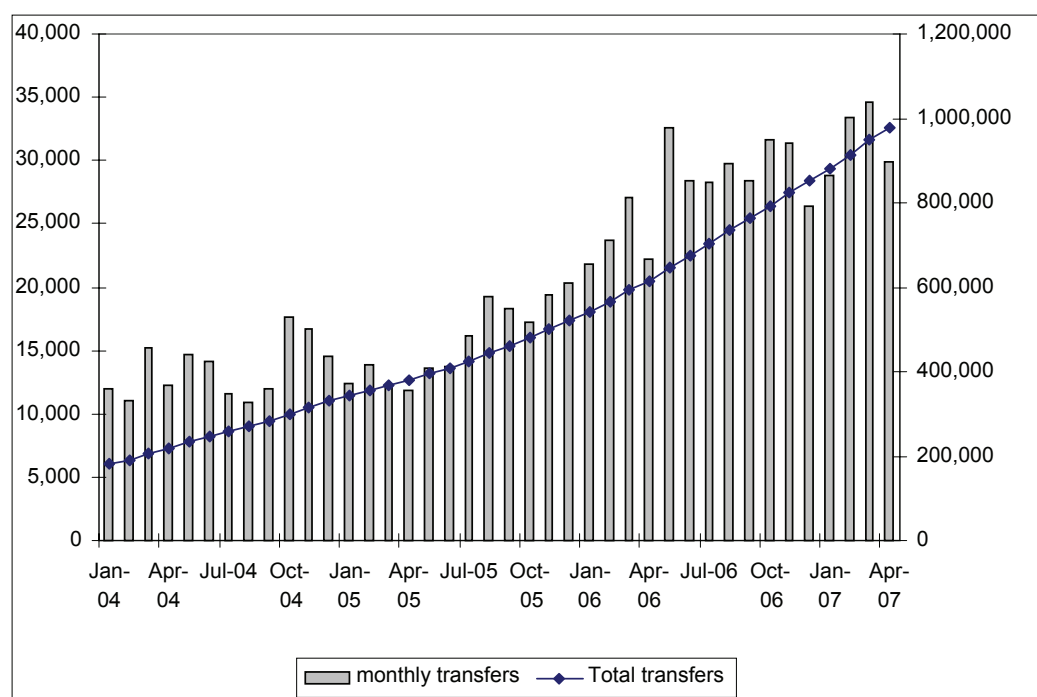
	2003/04	2004/05	2005/06
<b>Country Energy standard supply area</b>			
Total small customers on negotiated contracts tariffs	12,359	20,041	34,464
Total small customers	741,894	753,720	757,179
% of total customers	1.7	2.7	4.6
<b>EnergyAustralia standard supply area</b>			
Total small customers on negotiated contracts tariffs	311,039	489,365	648,310
Total small customers	1,499,653	1,526,143	1,544,271
% of total customers	20.7	32.1	42.0
<b>Integral Energy standard supply area</b>			
Total small customers on negotiated contracts tariffs	157,564	199,887	239,081
Total small customers	809,514	816,752	829,196
% of total customers	19.5	24.5	28.8



### Customer switching behaviour

The Tribunal's analysis indicates that customers are also increasingly switching retailers. NEMMCO switching data (shown in Figure 4.3) indicates that the cumulative number of small customer transfers in NSW at the end of April 2007 was 977,948, up from around 180,000 in January 2004.<sup>56</sup> Since June 2006, switching between electricity retailers has increased to levels in excess of 25,000 per month.

**Figure 4.3 Completed small retail customers transfers (gross switching) in NSW**



Data source: NEMMCO, MSATS transfer data.

During 2006, there were 331,706 small customer transfers in NSW, which represents an annualised switching rate of almost 11 per cent.<sup>57</sup> Based on this level of switching, NSW is more active than the ACT market but less active than the Victorian and South Australia markets.

<sup>56</sup> [http://www.nemmco.com.au/data/ret\\_transfer\\_data.htm](http://www.nemmco.com.au/data/ret_transfer_data.htm). NEMMCO transfer data records gross customer switching between suppliers. It does not record customers moving from the regulated tariff to a negotiated contract with the same supplier. NEMMCO completed small customer transfers at 31 April 2007.

<sup>57</sup> This represents the total number of transfers between suppliers in 2006, not the total number of customers switching suppliers. It may include customers that have switched supplier multiple times.

The Tribunal recognises that customer switching information does not reflect customers who are satisfied with their existing retailer and have chosen to remain on either a market or regulated contract with them. The Tribunal also recognises that, unlike the information on customers taking up negotiated contracts, the switching information presented above is not broken down between the metropolitan and non-metropolitan markets. Therefore, the above information is of more limited use in examining the effectiveness of competition in the two relevant markets. However, given the barriers to entry and the market share of the incumbent in the non-metropolitan market, the Tribunal is of the view that customer switching is likely to be less in this market.

## 5 How tariffs will be regulated

As part of its review, the Tribunal considered which retail electricity tariffs should be regulated, what form this regulation should take, and whether any additional regulatory instruments are required. The section below provides an overview of the Tribunal's final decisions on each of these issues. The subsequent sections discuss the Tribunal's decisions and considerations in relation to each issue in more detail.

### 5.1 Overview of Tribunal's final decisions

In line with the Government's request, the Tribunal will continue regulating retail tariffs and retail charges for small customers who have not chosen to enter a negotiated electricity supply contract, or who have returned from a negotiated contract to a regulated retail tariff.<sup>58</sup> Retailers will be able to rationalise their existing regulated retail tariffs and remove those that are obsolete. However, retailers will only be able to introduce new regulated tariffs in exceptional circumstances, with the approval of the Tribunal. This will avoid a proliferation of regulated tariffs, which could prolong customers' reliance on regulated tariffs, and have an adverse impact on the development of retail competition.

In relation to the form of regulation, the Tribunal has decided to introduce a weighted average price cap (WAPC), which constrains the change in the average level of regulated tariffs (weighted by customer numbers and consumption). This form of regulation gives retailers the flexibility to restructure and simplify their tariffs, while protecting customers by ensuring that average prices do not exceed the average cost allowance determined by the Tribunal. It represents a stepping stone from the 2004 determination, which regulated individual tariffs, towards the potential removal of price regulation in the future. The Tribunal's analysis of the competitiveness of the NSW electricity market (discussed in Chapter 4) was a key consideration in its decision to adopt this form of regulation.

The Tribunal has also made the following decisions in relation to additional regulatory instruments:

- ▼ The Tribunal recommends that the NSW Government consider amending the *Electricity Supply (General) Regulation 2001* to require the Standard Retailers to publish their regulated prices on their websites within 5 calendar days of the Tribunal approving them.

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<sup>58</sup> A small customer is defined as one who uses less than 160MWh of electricity per year, which is equivalent to an annual bill of around \$20,000.

- ▼ No additional price constraints will apply to either the retail component of prices, or individual customer bills. This reflects the focus in the terms of reference on ensuring that regulated tariffs are cost reflective by 2010 and on reducing customers' reliance on regulated prices, and the Tribunal's view on the competitiveness of the market.
- ▼ Three additional regulatory mechanisms will be introduced:
  1. A 'threshold price increase test' for Country Energy, which requires this retailer to seek Tribunal approval if it proposes to increase individual tariffs above a threshold level. This threshold is set as the annual change in the WAPC allowed by the Tribunal, plus an additional 5 per cent. To complement this test, Country Energy will have an additional requirement that it must seek Tribunal approval to abolish regulated tariffs if it moves customers from that tariff onto another regulated tariff, unless the price of the two tariffs (including level and structure) is the same.
  2. A cost pass-through mechanism that allows retailers to pass through to customers material increases or decreases in costs associated with regulatory or taxation change events, which were unanticipated at the time of the determination. Approved cost pass-through amounts are included in the formula for the WAPC.
  3. An annual review of the market-based electricity purchase cost allowance, which is discussed in Chapter 6.

The form of regulation adopted by the Tribunal is designed to complement the further evolution of the competitive retail electricity market and protect customers in a number of ways:

- ▼ The WAPC limits the maximum increase in average regulated tariffs.
- ▼ The small number of existing regulated tariffs (in all areas except Country Energy's), combined with the Tribunal's decision to limit the creation of new regulated tariffs constrains retailers' ability to segment different types of regulated customers in order to increase prices to particular groups (such as those perceived to be less attractive to the competitive market).
- ▼ The additional constraint on Country Energy – the threshold price increase test – will ensure that increases in individual tariffs significantly above the average increase allowed by the WAPC must be justified. Again, this will constrain the retailers' ability to segment the market for reasons other than differences in underlying costs.
- ▼ The cost pass-through mechanism ensures unanticipated changes in specific costs (either increases or decreases) are passed on to customers.

## 5.2 Which tariffs will be regulated

The Tribunal considered whether to regulate the ‘green premium’ component of regulated tariffs, whether retailers can introduce new regulated tariffs during the determination period, and whether they can remove regulated tariffs during this period.

### 5.2.1 Tribunal's final decision

The Tribunal has decided that:

- ▼ It will not regulate the green premium paid by customers who choose to have an agreed proportion of their electricity sourced from renewable energy or ‘green’ sources.
- ▼ Standard Retailers will not be able to establish new regulated retail tariffs unless there are exceptional circumstances and they obtain Tribunal approval.
- ▼ Standard Retailers will have the flexibility to rationalise their regulated retail tariffs, and to remove obsolete tariffs, as long as they continue to offer a regulated tariff to small retail customers.
- ▼ Country Energy will be subject to an additional condition such that if it seeks to remove regulated tariffs and transfer customers from that tariff to another tariff, it must seek Tribunal approval if the price applying to the two tariffs (including level and structure) is not the same.

### 5.2.2 Tribunal's considerations

#### Green premiums

The Tribunal has decided not to regulate the premium customers voluntarily pay to ensure that a certain percentage of the electricity they use is generated from renewable sources. This continues the approach taken in the 2004 determination to allow an unregulated green premium incurred voluntarily by the customer to sit on top of a regulated base tariff. The Tribunal considers this approach will promote retail competition and cost reflectivity of green premiums.

#### Introducing new regulated retail tariffs

The Tribunal has decided to limit the circumstances under which retailers can introduce new regulated retail tariffs to exceptional circumstances, and only with the approval of the Tribunal. This is consistent with the terms of reference for the review, which direct the Tribunal to consider the Government’s aim of reducing customers’ reliance on regulated prices. However, the Standard Retailers are free to make business decisions about new unregulated tariffs, and to consider tariff innovations in the competitive market.

In addition, the Tribunal is concerned to ensure that competition is not inhibited by the proliferation of regulated tariffs. Such proliferation can make it harder for second-tier retailers to compete for regulated customers, by making it more difficult for them to understand what tariff a customer is currently on, and therefore what price they need to 'beat'. Furthermore, the Tribunal wants to ensure that retailers are not able to use new regulated tariffs as a means of segmenting customers (for example, by offering more competitive tariffs to some regulated customers, while raising prices above cost-reflective levels to customers they consider they are less likely to lose to the competitive market). Requiring retailers to provide justification and obtain Tribunal approval for new regulated tariffs provides scope for new regulated tariffs where these are desirable, while facilitating the development of competition.

During the course of the review, Country Energy wrote to the Tribunal proposing to create special regulated 'hardship' tariffs that would mirror a customer's regulated tariff but remove the fixed charge. Country Energy noted that it would have eligibility criteria for customers seeking access to the proposed tariffs, and that these tariffs would only be available to the customer for a limited period of time. The Tribunal's draft decision was that it would not approve the proposed hardship tariffs as new regulated tariffs. In its submission to the draft report, Country Energy noted its continued desire to introduce hardship tariffs that would involve forgoing the fixed component of regulated tariffs for customers identified to be in hardship.<sup>59</sup> Country Energy noted that it considered the WAPC could be designed to allow the recovery of any forgone revenue through total revenue allowances.

The Tribunal reaffirms its draft decision not to approve the proposed hardship tariffs as new regulated tariffs. As noted in its draft report, the Tribunal does not consider that specific regulated hardship tariffs should be introduced, for the following reasons:

- ▼ Allowing the introduction of regulated hardship tariffs would not be consistent with the terms of reference, which require regulated tariffs to reach cost-reflective levels by 2010, and which require the Tribunal to consider the Government's aim of reducing customers' reliance on regulated tariffs.
- ▼ Given the form of regulation (the weighted average price cap – discussed in section 5.3 below), the costs associated with a new regulated hardship tariff could be recovered through increases in other regulated tariffs. While Country Energy may make a commercial business decision to provide rebates to customers in financial hardship, the Tribunal does not consider it is appropriate to recover these costs from the rest of the regulated customer base.

The Tribunal notes that those with low incomes are provided with assistance through various Federal and State schemes. The Tribunal is also aware that Country Energy has a range of schemes in place to assist customers who may be having difficulty paying their electricity bills.

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<sup>59</sup> Country Energy submission, 2 May 2007, p 9.

### Removing regulated retail tariffs

The terms of reference for the review required the Tribunal to consider “the potential to simplify regulated tariff structures including the potential to remove obsolete tariffs”. This requirement is reflected in the Tribunal’s fifth objective for this review, which is to “allow for the further rationalisation of regulated retail tariffs” (see Chapter 2).

The Tribunal’s determination facilitates the rationalisation of tariffs in several ways:

- ▼ It allows retailers to abolish obsolete tariffs.
- ▼ The form of regulation – the weighted average price cap (discussed in section 5.3 below) – provides the Standard Retailers with significant flexibility to restructure their tariffs, including both the level and structure of tariffs. This will increase the opportunity particularly for Country Energy to consolidate their regulated tariffs.
- ▼ The removal of the constraint on the change in individual customers’ bills (discussed in section 5.4.3 below) gives retailers greater latitude to restructure and rationalise their tariffs.

The Tribunal’s analysis indicates that one of the reasons retail competition has not developed to the same extent in Country Energy’s standard supply area as it has in the rest of the state is the high number of retail tariffs in that area. This makes it more difficult for competing retailers to know the ‘price to beat’ for individual customers. By increasing retailers’ flexibility to rationalise tariffs and delete obsolete tariffs (albeit constrained by the number of network tariffs in Country Energy’s area), the Tribunal’s determination will enhance the potential for competition.

The Tribunal has also decided to impose an additional requirement on Country Energy to seek the Tribunal’s approval if it proposes to abolish a tariff, and transfer customers from that tariff to another tariff that has a different price structure and/or level. This requirement is designed to ensure that the threshold test (discussed in section 5.4.4 below) cannot be circumvented by transferring customers from one tariff onto another tariff that is significantly higher.

## 5.3 The form of regulation

### 5.3.1 Tribunal's final decision

The Tribunal has decided that regulated retail tariffs will be regulated using a weighted average price cap (WAPC). The WAPC will ensure that regulated tariffs do not recover more revenue than the total of network charges and the regulated retail price control set by the Tribunal. The WAPC will be calculated on the following basis:

1. The N values, which relate to network costs, are based on actual network charges imposed by the distribution network service providers.
2. The R values, which relate to retail costs, are established by the Tribunal in this determination (see Chapter 8).
3. The quantities used to weight prices are:
  - for fixed components, the actual customer numbers as at 31 December in the previous year
  - for variable components, the estimated consumption (in MWh) for the previous 12 months
  - for new tariff components, the estimated quantities based on the previous year's level and pattern of consumption, and approved by the Tribunal.

### 5.3.2 Tribunal's considerations

Under the WAPC approach, the Tribunal will regulate the average change in regulated tariffs (weighted by the relevant quantity), rather than the change in individual tariffs. This is a significant change from the 2004 determination, under which the Tribunal regulated individual tariffs by setting target tariffs and establishing a process for retailers to move towards those targets. The main difference between the two approaches is that, under a WAPC, retailers have more discretion in setting individual regulated tariffs. The WAPC gives the Standard Retailers the flexibility to determine the level and structure of these tariffs, as long as they meet the constraint on the change in weighted average prices. It also protects customers by limiting the maximum increase in average prices the Standard Retailers can charge for regulated tariffs.

The Tribunal's issues paper for this review<sup>60</sup> outlined four broad options for regulating retail electricity tariffs:

1. setting target or maximum tariffs based on a build up of the network and retail (N + R) cost components (the approach used in the current determination)
2. applying a WAPC

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<sup>60</sup> IPART, *Review of Regulated Retail Tariffs and Charges for Electricity 2007 to 2010, Issues Paper*, July 2006, p 9.



3. establishing a new 'safety net' or 'opt-in' tariff that customers will need to choose to be on
4. monitoring prices for some types of tariffs or classes of customer.

In their submissions to the review, there was broad support from retailers (both Standard and second-tier) for moving away from individual tariff control and introducing a WAPC. In contrast, several submissions from consumer groups expressed concern about the potential for a WAPC to result in above-average price increases for some customers. Both PIAC and EWON argued that a WAPC should be accompanied by constraints on the movement in individual bills or individual tariffs, and PIAC suggested the constraint could be placed on the R component rather than the total bill.<sup>61</sup>

Stakeholders' different views on the appropriateness of the WAPC are associated with differing views on the current and future level of competition for small retail customers in NSW. Retailers generally consider that competition in the market is maturing and able to protect customers against prices that vary substantially from costs. However, consumer groups consider that competitive forces, particularly for some segments of the market, are not sufficiently developed to restrain the market power of the incumbents.<sup>62</sup>

As recognised in submissions, the appropriate form of regulation depends largely on the level of competition (and potential competition) in the market. In considering how tariffs should be regulated, the Tribunal took account of its analysis of the level of competition (and potential competition) in the NSW retail electricity market, discussed in Chapter 4. The need for price regulation stems from a concern that competitive forces are not sufficiently developed to ensure that customers are offered services with the mix of characteristics they demand (including quality and price), at prices that reflect efficient costs.

However, regulation also imposes costs, including the direct costs incurred by the regulator and the regulated business, as well as the risk of 'regulatory error' (costs resulting from the regulator making imperfect decisions). More intrusive forms of regulation may be justified where there is little competition (that is, where the potential costs resulting from market power are likely to be high), while a more light-handed approach can be adopted where there is greater competition.

Given the role the competitive market can play in restraining prices, and the development of retail competition since the 2004 review, the Tribunal considers that moving to a more light-handed form of regulation than the current target tariff approach is appropriate. By giving retailers discretion over individual prices, the WAPC approach is less intrusive, while still protecting customers by ensuring that average prices reflect the average costs allowed by the Tribunal. The WAPC acts as a

<sup>61</sup> PIAC submission, May 2007, pp 8 -9; EWON submission, 2 May 2007, p 11.

<sup>62</sup> For example, see PIAC submission, May 2007, p 8.

stepping stone from the current regulatory framework towards the possible removal of retail price regulation in the future.

The current target tariff approach was designed to ensure that retailers moved their tariffs towards cost-reflective levels. However, the price constraints on changes in individual customer bills constrained retailers' ability to restructure tariffs and reach cost-reflective levels.

Even without these price constraints (discussed further in section 5.4.3), individual tariff setting has shortcomings. The costs used to set target tariffs are estimates made by the Tribunal, and involve averaging. Therefore, they can diverge from the actual cost of serving different customers. They can also diverge from actual costs during the determination period, as circumstances change. Without the flexibility to adjust tariffs to reflect actual costs, this imposes costs on retailers (who may be unable to charge the full cost of supply for some tariffs). It also imposes efficiency costs, because customers may not face prices that reflect actual (rather than estimated) costs.

For example, the target tariff approach used in the 2004 determination created difficulties when network businesses began introducing time-of-use metering. Retailers argued that the structure of target tariffs was not conducive to time-of-use billing, and that they were restricted in their ability to restructure tariffs to reflect the changes in their underlying cost base. The WAPC will facilitate the introduction of time-of-use metering by giving retailers flexibility to restructure their tariffs. This is consistent with the COAG agreement to introduce 'smart' meters to facilitate time-of-use metering (discussed in Chapter 3), and with the requirement in the terms of reference to consider the impact of the determination on demand management.

PIAC proposed that a constraint could be placed on the allowance for retail costs (the R component), rather than the total allowance, which includes network costs.<sup>63</sup> While this would allow the recovery of network charges, it would not ensure that the Standard Retailers could recover their total costs through cost-reflective prices. Furthermore, it undermines the argument that the main objective of individual bill constraints is to ensure customers are not subject to large price increases, since putting a constraint on the R component does not by itself limit the overall price impact on customers.

The WAPC allows retailers to minimise the impact of any regulatory error involved in the Tribunal's cost estimation, and to respond to changes in their cost base by restructuring individual tariffs to reflect the underlying costs. Nevertheless, while a WAPC ensures that, on average, prices reflect the costs assessed by the Tribunal, it does not ensure that all individual tariffs are cost reflective.

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<sup>63</sup> PIAC submission, May 2007, p 9.

The concerns voiced by consumer groups in relation to the WAPC, combined with the removal of individual bill constraints, relate to two distinct issues:

1. the difficulties faced by vulnerable customers in absorbing increases in electricity prices,<sup>64</sup> and
2. the possibility that vulnerable customers could face higher than average price increases (implying that retailers could segment specific customer groups and charge vulnerable customers higher prices than other customers).<sup>65</sup>

The Tribunal notes that the first issue exists even if price increases directly reflect increases in the underlying cost of supplying electricity. The Tribunal also notes that its terms of reference for this review require that regulated retail tariffs and charges be at cost-reflective levels by 30 June 2010, and that any price constraint set should allow tariffs to move to these levels over the determination period. The Tribunal considers that the WAPC approach it has adopted is consistent with these terms of reference, and also provides protection to customers by limiting the increase in the average price charged for regulated tariffs. In addition, the Tribunal considers there are sound reasons not to impose price constraints on individual bills, and to introduce targeted assistance measures where there are concerns about the impact of price increases on specific customer groups (discussed in more detail in section 5.4.3).

The second issue implies that retailers have the ability to do the following:

1. segment the market by separating different types of customers into different regulated tariffs, and
2. charge prices to some customers that exceed costs, while offering other customers more attractive prices.

In the metropolitan market, the Tribunal considers that the Standard Retailers have limited capacity to segment regulated customers. Both EnergyAustralia and Integral Energy have a limited number of regulated tariffs, and most of their customers are on one or two of those tariffs. Approximately 91 per cent of Integral Energy's regulated customers are on the Domestic tariff, while 8.4 per cent are on the General supply tariff (which is typically for non-residential customers). Similarly, around 86 per cent of EnergyAustralia's regulated customers are on the Domestic all time tariff.

Where customers are on the same tariff, they face the same price – whether or not they are 'attractive' to the competitive market. In other words, tariffs are kept in check because some customers on that tariff would otherwise seek a negotiated contract. And all customers on that tariff benefit from the limits that this competitive pressure places on tariff increases.

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<sup>64</sup> NCOSS submission, 3 May 2007, section 8.

<sup>65</sup> NCOSS submission, 3 May 2007, section 8.

Furthermore, the Tribunal's determination prevents the creation of new regulated tariffs, except in exceptional circumstances and with the Tribunal's approval. This prevents retailers from creating new tariffs aimed at more attractive customers, while leaving less desirable customers on more costly tariffs.

The potential for individual prices to exceed costs will depend on the level of competition. In their submissions to the issues paper, a number of retailers (both Standard and second tier) stated that any over-pricing by Standard Retailers under a WAPC would be corrected by competition.<sup>66</sup> In contrast, the Total Environment Centre submitted that a WAPC "allows too much room for retailers to manipulate tariffs and charges".<sup>67</sup>

As discussed in Chapter 4, the Tribunal's assessment is that there is sufficient competition in the metropolitan market to restrain increases in individual tariffs. For this reason, the Tribunal considers that a WAPC, together with the competitive pressures already present in the metropolitan market, provides reasonable protection against prices that are significantly above costs.

In the non-metropolitan market, the regulated customer base is spread over a larger number of tariffs than in the metropolitan market. Nonetheless, a significant proportion of Country Energy's regulated residential customers (46 per cent) is on the main domestic tariff, and many of the other regulated tariffs are obsolete (which means that customers cannot move onto these tariffs).

The Tribunal considers that the current level of competition in the non-metropolitan market may not be sufficient to restrain increases in each individual tariff, and that the greater number of regulated tariffs in this market may provide more potential for customers to be segmented than is the case in the metropolitan market. Therefore it considers that a WAPC, by itself, may not ensure cost reflectivity for each of Country Energy's regulated tariffs. For this reason the Tribunal has introduced a supplementary mechanism for Country Energy, the 'threshold price increase test', which is discussed in section 5.4.4 below. The Tribunal considers that this mechanism will provide additional protection against prices that are significantly above costs in this market.

Finally, as discussed in Appendix C, information provided by the Standard Retailers suggests that customers on the Standard Retailers' hardship programs are just as likely to enter the competitive market as the broader customer base. EnergyAustralia indicated that 40 per cent of customers on its hardship program are on negotiated contracts, relative to 42 per cent of its overall customer base. Integral Energy indicated that 17 per cent of customers on its hardship program are on negotiated contracts, relative to 24 per cent of its overall customer base. Country Energy indicated that 15 per cent of customers on its hardship program are on negotiated contracts, relative to 2 per cent of its overall customer base.

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<sup>66</sup> EnergyAustralia submission, September 2006, p 27, Origin Energy submission, October 2006, p 11, Integral Energy submission, September 2006, p 21, TRUenergy submission, October 2006, p 3.

<sup>67</sup> Total Environment Centre submission, October 2006, p 2.

### 5.3.3 The weighted average price cap

Under the WAPC, the maximum average regulated tariff charged by the retailer (weighted by customer numbers and consumption) must be less than the average price calculated by the Tribunal on the basis of the N and R values. This is equivalent to saying that the tariff revenue earned by the retailer must be less than the revenue allowed by the Tribunal (given assumed customer numbers and electricity consumption). The formula for the WAPC adopted by the Tribunal is as follows:

$$\sum_{i=1}^n \sum_{j=1}^m P_{ij}^t \cdot q_{ij}^{t-1} \leq \sum_{i=1}^n \sum_{j=1}^m C_{ij}^t \cdot q_{ij}^{t-1} + PT^t$$

where:

$i=1, 2 \dots n$  and  $j=1, 2, \dots m$

that is, the retailer has  $n$  regulated tariffs which have up to  $m$  components (such as a fixed component and variable components).

$P_{ij}^t$  is the price proposed by the retailer for each component of tariff  $i$

$q_{ij}^{t-1}$  is the relevant quantity (eg, customer numbers or consumption in MWh)

$C_{ij}^t = N_{ij}^t + R_{ij}^t$ , that is, the regulated price control set by the Tribunal

$PT^t$  is the cost pass-through amount allowed or required by the Tribunal

More detailed definitions are provided in clause 7 of the determination. A worked example of the WAPC is provided in Box 5.1.

Each year of the determination, the WAPC will be calculated using:

1. the relevant R values determined by the Tribunal as part of this determination
2. the N values, which are equivalent to the actual network charges incurred by the retailer
3. the relevant quantities, including consumption figures and customer numbers for each tariff.

### The R values

The R values for each year of the determination period have been set by the Tribunal as part of this determination, and are discussed in Chapter 8.

### The N values

The 2004 determination allowed retailers to pass through network charges in the N component of target tariffs. Experience with the current approach shows it has been relatively simple to implement and ensure compliance, and has gained wide acceptance both by industry and customer groups. Stakeholders did not raise any reasons for changing this approach. Furthermore, the terms of reference require the Tribunal to ensure that network charges are fully recovered. Therefore, the Tribunal reaffirms its draft decision that actual network charges will be used to calculate the WAPC.

The N values will be determined on the basis of the network charges approved by the regulator. These charges are proposed each year by the distribution network service providers (DNSPs), and must meet the constraints set out in the Tribunal's electricity network determination.<sup>68</sup> Since these charges are determined on an annual basis, the WAPC for retail prices must also be determined on an annual basis.

While the Tribunal's decision is to allow retailers to recover the actual costs of network charges, the WAPC approach gives retailers flexibility regarding how these charges are recovered. The WAPC limits the tariff revenue that retailers can recover (for a given demand), but leaves retailers to determine the level and structure of individual tariffs.

### The quantities

The quantities required to calculate the WAPC include consumption figures (in MWh) and customer numbers for each regulated tariff. Potentially, these quantities may either be forecast for the entire determination period, or set on a year-by-year basis. For the retail sector, there is considerable uncertainty about the level of demand over the determination period, given that customers can choose to enter the competitive market (or to return to regulated tariffs). Furthermore, network charges are set on an annual basis. For these reasons, the Tribunal has decided that quantities will be estimated on an annual basis during the determination period.

In addition, the quantities may either be forecast for the coming year (as suggested in Integral Energy's submission to the issues paper<sup>69</sup>) or estimated based on the current year's data (which is used for compliance purposes under the current determination). Given the potential for forecasting errors, the Tribunal has decided to calculate the

<sup>68</sup> The Tribunal's determination applies until 30 June 2009. The Australian Energy Regulator is expected to make a new price determination commencing 1 July 2009.

<sup>69</sup> Integral Energy submission, September 2006, p 22.

WAPC using estimates of the current year's consumption to weight the variable components, and actual customer numbers on December 31 of the previous year to weight the fixed components.

#### Adding and deleting tariff components

The determination prevents the Standard Retailers from introducing new regulated retail tariffs without the Tribunal's approval, but does not prevent new components being introduced into an existing tariff, or existing components being removed. For example, new components could include a fixed charge where one didn't previously exist; different prices (per MWh) for different volumes of consumption (ie, an inclining or declining block tariff); or different prices for consumption at different times of the day (a time-of-use tariff).

Where a tariff component is introduced or removed, there is a question about what quantity should be assumed for the various tariff components, given that the components have changed since the previous year. The Tribunal has decided that the Standard Retailer should provide the following information when proposing to introduce or remove tariff components, in order for the Tribunal to approve the quantities used in calculating the WAPC:

- ▼ details of any proposed new tariff component
- ▼ details of any removed tariff component
- ▼ reasonable estimates of the relevant quantity for each tariff component (for example, the number of customers or the quantity of electricity) that would have been supplied in the previous year had that tariff component existed. These estimates should be made on the basis of the number of customers subject to the tariff in the previous year, and assuming these customers had the same consumption and load profile as the previous year
- ▼ details of the basis for the above estimates.

## 5.4 Additional regulatory instruments

### 5.4.1 Tribunal's final decisions

The Tribunal has made the following decisions:

- ▼ **To recommend that the NSW Government consider amending the *Electricity Supply (General) Regulation 2001* to require Standard Retailers to publish their regulated prices and miscellaneous charges on their website within 5 calendar days of the Tribunal approving them.**
- ▼ **No additional price constraints will apply to either the retail component of prices, or on individual customer bills. This reflects the focus in the terms of reference on ensuring that regulated tariffs are cost reflective by 2010, and on reducing customers' reliance on regulated prices.**



▼ **Three additional regulatory mechanisms will be introduced:**

1. A ‘threshold price increase test’ for Country Energy, which imposes additional conditions on this retailer if it proposes to increase individual regulated tariffs above a threshold level. This threshold is set as the annual change in the costs allowed by the Tribunal, plus an additional 5 per cent.
2. A cost pass-through mechanism, which allows retailers to pass through to customers material increases or decreases in costs associated with regulatory or taxation change events, which were unanticipated at the time of the determination.
3. An annual review of the market-based electricity purchase cost allowance.

Each of these decisions is discussed below, except the decision to introduce an annual review of the market-based electricity purchase cost allowance which is discussed in Chapter 6.

#### 5.4.2 Publication of price increases

The availability of adequate information about the characteristics of different products being offered in the market – such as price and quality – plays an important role in the development of competition. Information about different products assists customers in making purchasing decisions, and assists competing retailers in developing alternative products for the market.

In the NSW retail electricity market, information about regulated tariffs is important for second-tier retailers developing competing products. To date, second-tier retailers have tended to offer prices that are pegged in some way to the regulated price. They need to know about any changes to regulated prices so they can inform their customers about their own prospective price increases, and to assist them to develop products to attract new customers.

Currently, the *Electricity Supply (General) Regulation 2001* requires Standard Retailers to inform their customers of any changes to prices before they are implemented, either:

- ▼ by publishing it in a newspaper or newspapers circulated throughout NSW or the area in which the variation is to take effect, and on the Standard Retail Supplier’s website, or
- ▼ in relation to a particular customer or group of customers, by notifying the customer or group of customers.

TRUenergy’s submission noted that Victoria and South Australia require significantly longer notification periods before new regulated tariffs are introduced, and that new regulated tariffs must be published in the government gazette.<sup>70</sup>

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<sup>70</sup> TRUenergy submission, 1 May 2007, p 3.



TRUenergy proposed that Standard Retailers be required to publish, on their website and/or in the government gazette, their proposed tariffs within one business day of application, and their final tariffs within one business day of the Tribunal's approval.

The Tribunal has some sympathy with the points raised by TRUenergy, and considers that a requirement to publish regulated tariffs and charges on the Standard Retailers' websites has merit. However, given that the *Electricity Supply (General) Regulation 2001* already addresses price notification requirements, it is a matter for the Government to make appropriate changes to that regulation. Therefore the Tribunal recommends that the Government amend the *Electricity Supply (General) Regulation 2001* to require Standard Retailers to publish their regulated retail tariffs and charges within 5 calendar days of the Tribunal's approval.

The timeframe proposed has regard to the compliance timetable set out in part 3 of the determination, and to the practicalities involved in the Standard Retailers putting the tariff information on their websites. This timeframe is consistent with that agreed by the Tribunal and standard gas suppliers as part of the NSW gas retail price review that has been run concurrently with the electricity retail review.

#### 5.4.3 No additional price limits will apply

Under the 2004 retail determination, the rate at which retailers could move tariffs towards the target tariff levels was constrained by two mechanisms:

1. limits on increases to each retailer's total retail revenue, and
2. limits on increases to individual customer bills.

The 2004 determination reflected the need for the Tribunal to balance two objectives: achieving cost reflectivity, and managing the impact on customers. However, the additional price limits constrained retailers' ability to move under-recovering tariffs towards cost-reflective levels. This particularly affected Country Energy, which has a large number of tariffs, many of which are significantly below cost-reflective levels.

In their submissions to the issues paper for this review, retailers consistently expressed concern about the impact of the price constraints in limiting the move to cost-reflective pricing and inhibiting tariff rationalisation.<sup>71</sup> In contrast, a number of consumer groups submitted that the price constraints have been integral to protecting customers, and should be maintained.<sup>72</sup>

<sup>71</sup> See, for example: EnergyAustralia submission, September 2006, p 24, Origin Energy submission, October 2006, p 11, Integral Energy submission, September 2006, p 17, Country Energy submission, September 2006, p 18.

<sup>72</sup> NCOSS submission, October 2006, p 3, PIAC submission, October 2006, p 10, EWON submission, October 2006, p 18.

In considering whether price constraints on customer bills should be incorporated in the 2007 determination, the terms of reference provide clear guidance for the Tribunal. These terms state that:

The determination should ensure that:

- regulated retail tariffs and regulated retail charges are at cost reflective levels (including all the costs listed above) for all small retail customers by 30 June 2010
- the setting of any price constraint should allow the further rationalisation of regulated retail tariffs and movement to full cost recovery over the determination period

Thus the terms of reference make it clear that if a price constraint is imposed, it should not prevent tariffs rising to cost-reflective levels.

In addition, the Tribunal considers that a range of factors form a compelling argument for not imposing additional price constraints in this determination. As discussed in section 5.3.2, a significant proportion of the Standard Retailers customers (and in the case of EnergyAustralia and Integral Energy, most customers) are on one or two of their tariffs. This means that most customers will face a price increase that is close to the average price increase imposed in the WAPC. In the case of Country Energy, further protection is provided by the threshold price increase test, discussed in section 5.4.4.

Furthermore, price constraints limit tariff rationalisation by constraining the retailers' ability to raise under-recovering or obsolete regulated tariffs to the level of current, cost-reflective tariffs, making it more difficult to move customers onto current tariffs and abolish obsolete tariffs. The continued existence of under-recovering regulated tariffs is likely to limit the development of competition, because it makes it difficult for second-tier retailers to offer prices that are competitive compared to these tariffs. Similarly, customers will have little incentive to seek a competitive contract, and will continue to rely on regulated prices (which is contrary to the terms of reference and the Tribunal's objectives for this review).

In addition, most of the significantly under-recovering tariffs are obsolete, so no new customers have access to those tariffs. This has equity implications, as two households could be on significantly different tariffs, even if their characteristics are identical apart from the fact that one household recently moved house and the other household has lived in the same house for a long time.

Further, price constraints affect the prices of all customers, whether they are vulnerable or not. The Tribunal's view is that concerns about the impact on specific customer groups could better be addressed through other, more targeted mechanisms.

Finally, retail price regulation may be removed in the future, at which time all customers will be on competitive contracts that are likely to be cost-reflective. If regulated prices have been kept below cost-reflective levels, customers could face significant price shocks at that time.

In submissions in response to the draft report, PIAC and EWON suggested that more targeted forms of price constraints could be introduced. PIAC proposed applying a constraint to the R component of tariffs.<sup>73</sup> It suggested side constraints on individual bills for EnergyAustralia and Integral Energy, and on Country Energy's non-obsolete tariffs, and a constraint at the tariff level for Country Energy's obsolete tariffs. As noted in section 5.2.2, the Tribunal considers that a constraint on the R component alone does not achieve the objective of price constraints, which is to limit the overall price impact faced by customers. At the same time, it imposes the drawbacks of price constraints in limiting the retailers' flexibility to respond to underlying costs when setting tariffs, and to ensure that tariffs reach cost reflective levels by 2010.

EWON submitted that individual price limits should be maintained for targeted customer groups.<sup>74</sup> It suggested either using the definition of 'hardship' that retailers use to identify customers who may benefit from their hardship programs, or targeting low-consumption customers. However, there are difficulties in both these measures. First, the hardship criteria used by retailers consider a range of factors (such as late payment) that may be open to interpretation and manipulation by either retailers or customers (who perceive they will be charged a lower price if they are classified as vulnerable).

Second, there is no evidence that electricity usage is a good proxy for vulnerability. For example, Integral Energy submitted that the average customer on its *INpower* hardship program uses approximately 10MWh per annum, which is well above the average use of a typical Integral residential customer.<sup>75</sup> Country Energy submitted that some customers on its Country Support program have high consumption (such as young families under financial stress) and others have low consumption (older single people).<sup>76</sup>

The Standard Retailers also submitted that competition will protect customers from the exercise of market power, and that targeted hardship programs are the best way to address the needs of low-income and vulnerable customers, rather than price limits based on consumption levels or some other customer characteristic. Their submissions noted the development and expansion of their customer hardship programs.<sup>77</sup>

Given the above, the Tribunal is not persuaded that price constraints targeted to specific customer groups should be introduced.

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<sup>73</sup> PIAC submission, May 2007, p 9.

<sup>74</sup> EWON submission, May 2007, pp 11-12.

<sup>75</sup> Integral Energy submission, May 2007, p 14.

<sup>76</sup> Country Energy submission, 2 May 2007, Attachment 1, p 2.

<sup>77</sup> Integral Energy submission, May 2007, pp 15-17; Country Energy submission, 2 May 2007, pp 4-5; EnergyAustralia submission, May 2007, p 6.

#### 5.4.4 Threshold price increase test for Country Energy

As discussed in Chapter 4, the Tribunal is not convinced that there is sufficient competition to restrain increases in each individual tariff in the non-metropolitan market – that is, Country Energy’s standard supply area. As a result, the WAPC alone may not ensure that Country Energy’s regulated tariffs will be cost reflective. For this reason, the Tribunal has decided to introduce an additional constraint on Country Energy, whereby Country Energy will be required to seek Tribunal approval if it proposes to increase any individual tariff by more than a ‘threshold’ level.

The formula for this threshold price increase test is as follows, for each individual tariff:

$$\frac{\sum_{j=1}^m P_{ij}^t \cdot q_{ij}^{t-1}}{\sum_{j=1}^m P_{ij}^{t-1} \cdot q_{ij}^{t-1}} \leq \frac{\sum_{i=1}^n \sum_{j=1}^m C_{ij}^t \cdot q_{ij}^{t-1} + PT^t}{\sum_{i=1}^n \sum_{j=1}^m C_{ij}^{t-1} \cdot q_{ij}^{t-1} + PT^{t-1}} + 0.05$$

The definitions for these variables are provided in section 5.3.3 above. A worked example is provided in Box 5.1.

The threshold price increase test compares the proposed increase in each individual tariff (weighted by the different components of the tariff) with the average increase in costs allowed by the Tribunal (the WAPC), plus an additional 5 per cent. Thus, for example, if the WAPC allows Country Energy to increase average prices by 4 per cent in one year, Country Energy will need to seek Tribunal approval if it proposes to increase an individual tariff by 9 per cent or more in that year. However, overall the WAPC must continue to be met.

Submissions in response to the draft determination made little comment about the threshold price increase test. Country Energy put the view that it may not be necessary, but did not oppose its introduction.<sup>78</sup> EWON suggested that, if the Tribunal's final decision was not to impose price constraints on individual customer bills, the threshold price increase test should be extended to EnergyAustralia and Integral Energy.<sup>79</sup>

In relation to EWON's suggestion, the Tribunal decided to introduce the threshold price increase test to Country Energy because its analysis indicates that competition in the non-metropolitan market served by this retailer is not sufficiently developed to restrain increases in individual tariffs. As the analysis suggested this is not the case in the metropolitan market, extending the test to EnergyAustralia and Integral Energy would be an unnecessary regulatory burden.

In applying the threshold price increase test, the Tribunal's focus will be on encouraging Country Energy to rationalise its tariffs and restructure them to better reflect underlying costs. Where Country Energy is able to demonstrate that a significant increase in an individual tariff reflects the underlying costs of that tariff, the Tribunal may approve the tariff change. The threshold price increase test is designed to deter a significant, unjustified increase in an individual tariff, while ensuring that increases based on underlying costs are allowed.

#### 5.4.5 Cost pass-through mechanism

The Tribunal reaffirms its draft decision to introduce a pass-through mechanism that will allow retailers to pass through to customers the incremental and efficient costs associated with certain regulatory or taxation change events, with the amount to be passed through to be determined by the Tribunal. The pass-through mechanism will allow retailers to pass through costs associated with:

- ▼ regulatory events, including:
  - meeting additional obligations related to green energy schemes (existing and future)
  - a retailer of last resort (ROLR) event
  - meeting additional obligations related to Government-imposed energy hardship policies
  - one-off NEMMCO charges (such as reserve trader or direction events)
- ▼ certain new taxation events.

The WAPC formula incorporates the pass-through amount (identified as PT). The pass-through amount is incremental to the original revenue allowed under the determination.

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<sup>78</sup> Country Energy submission, 2 May 2007, p 10.

<sup>79</sup> EWON submission, 2 May 2007, p 12.

In their submissions on the draft report, stakeholders broadly supported the Tribunal's draft decision to include a mechanism to pass through the incremental and efficient costs associated with a regulatory or taxation change event. However, stakeholders offered several comments on the scope of the mechanism. Retailers submitted that the definition of a pass-through event should be expanded to include material changes in their electricity purchase costs, noting the recent movements in the cost of purchasing energy in the NEM. However, the Tribunal has decided to address the risk of a step-change in electricity purchase costs by conducting an annual review of the market-based electricity purchase cost allowance used in making this determination (see Chapter 6).

NCOSS submitted that it does not support the pass through of costs related to hardship policies, as these costs should be treated as a cost of doing business.<sup>80</sup> The Tribunal notes that the operating cost ranges provided by Frontier Economics include an allowance for the costs associated with current customer hardship programs.<sup>81</sup> The intention of the pass-through mechanism is not to pass through general cost increases related to current hardship programs but to allow the pass through of the incremental and efficient costs related to additional obligations imposed by changes in Government mandated hardship policies.

Given that it is difficult to assess the probability of a regulatory or taxation change event occurring, and that these events are both beyond the control of retailers and may impose material costs on the retailers, the Tribunal considers that it is appropriate for retailers to share some of the risk associated with these events occurring with customers. The principal benefit of the cost pass-through mechanism is that it will reduce the financial risk associated with unforeseen changes in the retailers' regulatory and taxation obligations, by allowing them to pass through to customers the efficient incremental costs associated with these changes. The Tribunal considers that such a mechanism helps to ensure that regulated prices are set at cost-reflective levels, given that some of the costs that should be recovered are uncertain. The Tribunal also considers that such a mechanism is preferable to including an allowance for the risk that retailers will incur such costs in the retail margin.

The Tribunal considered EnergyAustralia's comment that the definition of regulatory change event in the draft determination is limited to regulatory changes that occur after 1 July 2007.<sup>82</sup> EnergyAustralia proposed that the definition should be amended to capture pass-through events that may occur on or after the Tribunal makes its final determination but before 1 July 2007. Although the likelihood of this occurring is small, the Tribunal considers that EnergyAustralia's proposal is appropriate, and has amended the definition to capture events that occur after the making of the

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<sup>80</sup> NCOS submission to IPART, May 2007, p 5.

<sup>81</sup> Frontier Economics, *Mass market new entrant retail costs and retail margin: Public report prepared for IPART*, March 2007, p 39.

<sup>82</sup> EnergyAustralia submission, May 2007, p 8.

determination and that result in retailers occurring material costs (or cost savings) in the period 1 July 2007 – 30 June 2010.

### Establishing a materiality threshold

The Tribunal reaffirms its draft decision to establish a materiality threshold per event to limit the pass through of costs to those that have a material impact on the retailers' financial position.

In their submissions on the draft report, stakeholders broadly supported the establishment of a materiality threshold to limit the pass through to material unforeseen changes in costs, and to minimise the administrative costs associated with the pass-through mechanism. However, Integral Energy and EnergyAustralia sought clarification about how the materiality threshold was defined. In particular, they asked whether 'revenue' referred to N+R or R revenue.<sup>83</sup>

The Tribunal has previously noted that there are several ways to define materiality (for instance, an absolute dollar amount or a percentage of revenue), and one way may be appropriate in some cases and not in others.<sup>84</sup> Given that the Standard Retailers are different sizes, the Tribunal considers that defining one materiality threshold that applies to all three retailers in terms of an absolute dollar amount is inappropriate.

While defining the threshold in terms of a percentage of R revenue is an option, the Tribunal considers that defining the threshold as a percentage of N+R revenue is more appropriate. This is because this definition is simpler, and because the WAPC applies to the N +R revenue.

Other stakeholders commented on the appropriate level of the threshold. TRUenergy submitted that a threshold of 0.25 per cent of revenue was overly restrictive, particularly when the aggregation of pass-through events was not allowed.<sup>85</sup> EWON submitted that the threshold should not be so low as to make the customer bear the larger portion of such risks.<sup>86</sup>

The Tribunal recognises that the appropriate size of the threshold represents a trade-off between not creating a cost-plus form of regulation (as small cost changes should be viewed as part of the ordinary operation of business) and not setting the threshold too high, so that events that have a serious impact on the businesses' financial position do not qualify for pass through.

<sup>83</sup> EnergyAustralia submission, May 2007, p 7 and Integral Energy submission, May 2007, p 17.

<sup>84</sup> IPART, *Revised Access Arrangement for AGL Gas Networks: Final Decision*, 2005, p 152.

<sup>85</sup> TRUenergy submission, May 2007, p 1.

<sup>86</sup> EWON submission, May 2007, p 13.



In making its final decision, the Tribunal considered the financial risk to the Standard Retailers associated with cost events that are below the threshold. Given the nature of an incentive-based regime, the Tribunal considers that a threshold of 0.25 per cent (of N+R revenue) to be an acceptable outcome in terms of balancing the interests of customers and retailers. A threshold at this level avoids the risk of the regulatory framework becoming a cost-plus regime by limiting the pass through of costs to those that have a material impact on the retailers' financial position. The inclusion of a materiality threshold at this level also helps to ensure that the pass-through amount is not outweighed by the administrative costs of assessing a pass-through event.

Given the above, the Tribunal reaffirms its draft decision to allow each Standard Retailer to pass through the costs associated with a pass-through event if the average annual cost impact as a result of that event is equivalent to or greater than 0.25 per cent of its previous year's allowed (N + R) revenue. The threshold is not cumulative across events.

The Tribunal considers that specifying the threshold on a per event basis rather than as a cumulative amount is consistent with its intention that the cost-pass through mechanism should address only large cost shocks rather than becoming a cost-plus regulatory regime. It also prevents retailers from passing through a number of small costs incurred as a result of a number of events.

#### Applying a symmetrical approach

The Tribunal reaffirms its draft decision to adopt a symmetrical pass-through mechanism. Under this mechanism, retailers are obliged to inform the Tribunal of a material cost-reducing regulatory or taxation change event. The Tribunal may also initiate the process of approving the pass through of cost savings following such an event.

The terms of reference required the Tribunal to ensure that tariffs are at cost-reflective levels by 2010. This means that cost increases **and** cost decreases associated with regulatory and taxation change events need to be passed through to customers. The Tribunal recognises that in a market with sufficient competition, customers would be able to benefit from any cost savings associated with a regulatory or taxation change event. Rivalry between competitors would encourage retailers to pass on cost savings regardless of whether the Tribunal required them to do so in regulated tariffs. However, the Tribunal does not consider there is sufficient competition in the non-metropolitan area to ensure that customers benefit from cost savings resulting from a regulatory or taxation change event. For simplicity, the Tribunal considers that one mechanism that passes through cost increases and decreases should apply to all regulated tariffs in NSW.



### The scope of the Tribunal's approval process

The Tribunal reaffirms its draft decision on the scope and timing of the approval process, with one amendment. Retailers seeking to pass through costs associated with a regulatory or taxation change event will need to apply for approval of these costs. The pass-through mechanism is intended to capture only those costs that are incremental, efficient and a direct result of the pass-through event.

In their submissions on the draft report, stakeholders broadly supported the scope and timing of the Tribunal's approval process. However, NCOSS submitted that any review mechanism that will potentially pass on costs to consumers should include an opportunity for input by stakeholders.<sup>87</sup> EnergyAustralia expressed concern over the discretion the Tribunal had to delay the decision on a pass-through amount for one or more years.<sup>88</sup> It submitted that the Tribunal should be required to make a decision within 90 business days, in line with National Electricity Rules and the IPART 2004 Electricity Network determination.

The Tribunal's approval process will:

- ▼ ensure that the event is consistent with the Tribunal's definitions of regulatory and/or taxation change event
- ▼ check that the costs incurred by the retailers are as a direct result of the event and are incremental (ensuring they are not already included in original cost build up)
- ▼ assess whether the costs represent an efficient or reasonable response to the event (including consideration of whether the retailers have failed to take any action that could have reduced the costs incurred)
- ▼ determine the total amount of costs associated with the regulatory and/or taxation event that can be passed through in each year.

In applying to pass through the costs, retailers will be required to provide evidence of the nature of the pass-through event and the actual and likely costs, and to demonstrate that the costs represent the efficient and incremental costs associated with the pass-through event. The Tribunal's approval process will involve it consulting with stakeholders on matters that it considers appropriate.

While all costs associated with regulatory or taxation events will be subject to approval by the Tribunal, the length and complexity of the review will depend on the costs being passed through. For example, where incremental costs (such as irregular NEMMCO charges) are readily observable and are already subject to some form of oversight or review, the Tribunal's review process will be minimal.

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<sup>87</sup> NCOSS submission, May 2007, p 6.

<sup>88</sup> EnergyAustralia submission, May 2007, p 8.

The Tribunal requires retailers to submit their application by 1 March (ie, no later than 4 months before the date of effect of the increase) to allow the Tribunal sufficient time to review the application, including consulting with stakeholders, with prices to be in place by 1 July.

The Tribunal considered EnergyAustralia's comments on the draft decision to allow the Tribunal to delay its decision on a pass-through amount for one or more years.<sup>89</sup> In making this decision, the Tribunal intended to give itself flexibility in setting the annual pass-through amount when there is uncertainty about the future costs to be incurred over the remainder of the determination (given that the mechanism allows for a one-time application). However, after considering comments on the draft report, it recognises that the uncertainty associated with forecasting costs two years into the future is unlikely to be large, and that delaying its decision on the costs to be passed through in future years will create some regulatory uncertainty. Therefore, the Tribunal's final decision is that it will make a one-time decision on the approved costs to be passed through over the remainder of the determination period (with no ability to delay this decision).

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<sup>89</sup> EnergyAustralia submission, May 2007, p 8.

### Box 5.1 Worked example of the weighted average price cap and the threshold price increase test

Consider a retailer that has two regulated tariffs. In year 1, the tariffs have the following customer numbers and total electricity consumption:

Customer Numbers	Year 1	Year 2
Tariff 1	3	
Tariff 2	5	
Electricity consumption (MWh)		
Tariff 1	5	
Tariff 2	10	

Each tariff has a fixed charge (per customer) and a variable charge (per MWh of electricity consumed).

The prices charged by the retailer in year 1, and the prices the retailer proposes in year 2, are as follows:

Price charged by the retailer	Year 1 (actual)	Year 2 (proposed)
Tariff 1		
- Fixed (\$/customer pa)	10	15
- Variable (\$/MWh)	2	4
Tariff 2		
- Fixed (\$/customer pa)	4	5
- Variable (\$/MWh)	2	2

Using this information, it is possible to calculate the retailer's estimated revenue, from each tariff and in total, using the customer and consumption figures for year 1. This information is an input into the checks that the Tribunal will undertake to ensure the retailer has complied with the WAPC and the threshold price increase test.

Estimated revenue using retailer's prices*	Year 1	Year 2
Tariff 1	$(10 \times 3) + (2 \times 5) = 40$	$(15 \times 3) + (4 \times 5) = 65$
Tariff 2	$(4 \times 5) + (2 \times 10) = 40$	$(5 \times 5) + (2 \times 10) = 45$
Total revenue using retailer prices	$40 + 40 = 80$	$65 + 45 = 110$

The regulated price controls set by the Tribunal have two components: the R values (relating to retail costs) and the N values (relating to network charges). The Tribunal has set the R values for each year in its determination, while the N values are based on the actual network charges of the distribution business. In this example, the R values and N values for each year are as follows:

Regulated price controls set by the Tribunal	Year 1	Year 2
<b>Tariff 1</b>		
<i>R Value</i>		
Fixed (\$/customer pa)	7	7
Variable (\$/MWh)	1	2
<i>N Value</i>		
Fixed (\$/customer pa)	8	8
Variable (\$/MWh)	1	1
<i>Total N+R</i>		
Fixed (\$/customer pa)	15	15
Variable (\$/MWh)	2	3
<b>Tariff 2</b>		
<i>R Value</i>		
Fixed (\$/customer pa)	3	4
Variable (\$/MWh)	1	1
<i>N Value</i>		
Fixed (\$/customer pa)	2	3
Variable (\$/MWh)	1	2
<i>Total N+R</i>		
Fixed (\$/customer pa)	5	7
Variable (\$/MWh)	2	3

Using this information, it is possible to calculate the retailer's revenue based on the N values and R values allowed by the Tribunal, using customer and consumption figures from year 1 (refer to the table at the top of the previous page). These figures are also inputs into the Tribunal's compliance checking.

Estimated revenue using regulated price controls *	Year 1	Year 2
Tariff 1	$(10 \times 3) + (2 \times 5) = 40$	$(15 \times 3) + (4 \times 5) = 65$
Tariff 2	$(4 \times 5) + (2 \times 10) = 40$	$(5 \times 5) + (2 \times 10) = 45$
<b>Total revenue using retailer prices</b>	<b>40 + 40 = 80</b>	<b>65 + 45 = 110</b>

Note: \* Estimate revenue = (fixed N+R \* customer numbers + (variable N+R \* consumption in MWh).

### 1. Compliance check: testing the WAPC in Year 2

The formula used in the determination for the WAPC is:

$$\sum_{i=1}^n \sum_{j=1}^m P_{ij}^t \cdot q_{ij}^{t-1} \leq \sum_{i=1}^n \sum_{j=1}^m C_{ij}^t \cdot q_{ij}^{t-1} + PT^t$$

That is:

$$\begin{array}{ccc} \text{total revenue (using the} & & \text{total revenue (using the} \\ \text{retailer's proposed prices)} & \leq & \text{regulated price controls plus} \\ & & \text{the approved pass-through} \\ & & \text{amount} \end{array}$$

This formula tests whether the retailer's estimated total revenue from all its tariffs (using proposed prices and the previous year's demand) is less than or equal to the Tribunal's allowed revenue (using the regulated price controls, actual network charges, and the previous year's demand, plus the pass-through amount).

In the above example (and assuming  $PT^t = 0$ , that is, a zero pass-through amount), this test is as follows for year 2:

$$\begin{array}{ccc} \text{Is} & 65+45 & \leq 60+65? \\ \text{ie, is} & \$110 & \leq \$125? \end{array}$$

Yes, therefore the WAPC test is met.

### 2. Compliance check: the threshold price increase test in Year 2

The Tribunal has decided to introduce a supplementary regulatory mechanism for Country Energy, in addition to the WAPC, known as the threshold price increase test.

The formula used in the determination for the threshold test is, for each individual tariff  $i$ :

$$\frac{\sum_{j=1}^m P_{ij}^t \cdot q_{ij}^{t-1}}{\sum_{j=1}^m P_{ij}^{t-1} \cdot q_{ij}^{t-1}} \leq \frac{\sum_{i=1}^n \sum_{j=1}^m C_{ij}^t \cdot q_{ij}^{t-1} + PT^t}{\sum_{i=1}^n \sum_{j=1}^m C_{ij}^{t-1} \cdot q_{ij}^{t-1} + PT^{t-1}} + 0.05$$

That is:

$$\begin{array}{ccc} \text{(the change in revenue} & & \text{(the change in total revenue using the} \\ \text{from one tariff using the} & \leq & \text{regulated price controls plus the allowed pass-} \\ \text{retailer's proposed prices)} & & \text{through amount) + 0.05} \end{array}$$

This formula tests whether the change in the estimated revenue from an individual tariff from one year to the next (using the retailer's prices) is less than or equal to the change in the Tribunal's estimated revenue for all tariffs (using regulated price controls plus the allowed cost pass-through), plus an additional 0.05 (5%). If this condition is not met for any individual tariff, the retailer must justify the proposed increase in the price of that tariff.

In the above example, (and assuming  $PT^t = 0$ , that is, a zero pass-through amount), this test is as follows:

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For tariff 1:

$$\begin{aligned}
 \text{Is } & \frac{\text{(revenue from tariff 2 in yr2 using proposed prices)}}{\text{(revenue from tariff 2 in yr1 using proposed prices)}} \leq \frac{\text{(tot. rev using reg. price controls plus pass-through amt in yr2)}}{\text{(tot. rev using reg. price controls plus pass-through amt in yr1)}} \quad ? \\
 \text{Is } & \frac{45}{40} \leq \frac{125 + 0.05?}{100} \\
 & 1.125 \leq 1.3?
 \end{aligned}$$

Yes, therefore the retailer does not need to justify the proposed price increase in tariff 1 to the Tribunal.

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## 6 Allowance for energy costs

One of the key inputs to the Tribunal's calculation of hypothetical retailer costs, which informed its decision on the value of the regulated retail price controls, was an allowance to cover the costs retailers will incur in participating in and buying energy from the NEM over the determination period. The terms of reference required the Tribunal to take into account a range of matters in determining this allowance, including:

- ▼ an allowance for electricity purchase costs, based on an assessment of the long-run marginal cost of electricity generation from a portfolio of new entrant generation to supply the load profile of customers remaining on regulated retail tariffs
- ▼ an allowance based on long-run marginal cost for retailer compliance with any Commonwealth mandatory renewable energy target (MRET) requirements and the licence requirements relating to the NSW Greenhouse Gas Benchmark Scheme, which takes in to account price and volume
- ▼ energy losses as published by the National Electricity Market Management Company (NEMMCO)
- ▼ fees (including charges for ancillary services) as imposed by NEMMCO under the National Electricity Code
- ▼ an allowance for expected movements in regulated components and NEMMCO fees
- ▼ recognition that the ETEF will cease operation within the determination period
- ▼ recognition of hedging, risk management and transaction costs faced by retailers in the absence of the ETEF
- ▼ recognition of the forecasting risks faced by retailers in the absence of the ETEF
- ▼ recognition of Net System Load Profiles (NSLPs) for each Standard Retailer, as well as projected future changes in those net system load profiles.

Together, these energy costs account for 70 to 75 per cent of retailers' controllable costs (excluding network charges), and about 40 per cent of a customer's electricity bill (which includes network charges). Therefore, the Tribunal's findings on the size of the allowance for energy costs could have a significant impact on the regulated retail price of electricity.

In addition, regulatory decisions on allowances for energy costs are often controversial. One reason is that the calculations required to estimate energy costs are complicated and are usually performed by expert consultants. Other reasons are

that the approach used to calculate these allowances differs between regulators, depends heavily on the terms of reference, and involves a number of assumptions and forecasts.

Further, the recent increases in reported spot and contract wholesale electricity prices have heightened both industry and public awareness of the volatility of electricity prices. They have also highlighted the relationship between critical inputs (such as water), plant availability and the market price of electricity. For example, the current drought has led to water restrictions that are directly affecting output from hydro-generation plants and also affecting output from coal-fired generation plants, which need water for cooling.

Given this context, the Tribunal undertook extensive consultation, sought independent expert advice and undertook its own analysis on the energy cost allowance. In making its draft determination, it engaged Frontier Economics to develop recommendations on the allowance for energy costs to be factored into regulated retail prices, and to specifically address the associated matters in the terms of reference. It released Frontier Economics' draft methodology document and held a public workshop on that methodology. It also released Frontier Economics' draft report, held a hearing on the calculated results, and sought submissions on that draft report. Finally, it considered Frontier Economics' final report<sup>90</sup> and all stakeholder submissions and comments.

In making its final determination, the Tribunal considered the submissions it received in response to its draft report and determination, held a public hearing on the draft determination, and considered the recent changes in national electricity market wholesale electricity prices. Most of the submissions that commented on the energy cost allowance addressed the electricity purchase cost allowance, and several stakeholders noted that wholesale prices had increased significantly since the release of the draft determination. To help inform its final decision, the Tribunal sought supplementary advice from Frontier Economics on the electricity purchase cost allowance in the context of the changes in the wholesale electricity prices. Frontier Economics' supplementary report on this issue is available on the IPART website.

The Tribunal's findings on the allowance for energy costs which have informed its decision on the regulatory retail price controls in this determination are set out in the section below. The subsequent sections discuss its findings and considerations on each of the components of this allowance, including electricity purchase costs, greenhouse and renewable energy costs, NEMMCO fees (including ancillary charges), and energy losses.

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<sup>90</sup> Frontier Economics, *Analysis of recent changes in NEM wholesale electricity prices*, May 2007.



## 6.1 Overview of final findings on the allowance for energy costs

The Tribunal's findings on the allowance for energy costs to be taken into account in setting the regulated retail tariff controls, and each of the components that make up this allowance, are shown on Table 6.1.

**Table 6.1 Summary of Tribunal's findings on the allowance for energy costs (2006/07 \$/MWh)**

Description	2007/08	2008/09	2009/10
<b>Country Energy</b>			
Market-based electricity purchase cost allowance	48.7	47.7	43.7
Volatility allowance	0.7	0.7	0.7
Greenhouse & renewable costs (MRET, NRET, GGAS)	4.7	5.0	5.7
<b>Subtotal</b>	<b>54.1</b>	<b>53.4</b>	<b>50.2</b>
NEM fees	0.7	0.7	0.7
Losses	6.8	6.7	6.3
<b>Total energy costs</b>	<b>61.6</b>	<b>60.7</b>	<b>57.1</b>
Peak	85.5	83.4	74.2
Shoulder	92.2	90.2	80.5
Off peak	38.4	38.6	39.6
<b>EnergyAustralia</b>			
Market-based electricity purchase cost	55.6	54.4	49.8
Volatility allowance	0.9	0.9	0.9
Greenhouse & renewable costs (MRET, NRET, GGAS)	4.3	4.7	5.4
<b>Subtotal</b>	<b>60.8</b>	<b>60.0</b>	<b>56.2</b>
NEM fees	0.7	0.7	0.7
Losses	4.2	4.1	3.8
<b>Total energy costs</b>	<b>65.7</b>	<b>64.8</b>	<b>60.7</b>
Peak	120.3	117.3	104.7
Shoulder	60.5	60.0	56.3
Off peak	37.9	38.4	39.6
<b>Integral Energy</b>			
Market-based electricity purchase cost	57.8	56.7	52.2
Volatility allowance	1.1	1.1	1.1
Greenhouse & renewable costs (MRET, NRET, GGAS)	4.5	4.9	5.5
<b>Subtotal</b>	<b>63.4</b>	<b>62.8</b>	<b>58.9</b>
NEM fees	0.7	0.7	0.7
Losses	5.9	5.8	5.4
<b>Total energy costs</b>	<b>70.0</b>	<b>69.2</b>	<b>65.0</b>
Peak	134.4	131.0	116.0
Shoulder	61.1	60.7	57.3
Off peak	41.2	41.7	42.8

**Note:** Columns may not add due to rounding

## 6.2 Electricity purchase cost allowance

The Tribunal's final findings on the electricity purchase cost allowance for each retailer (which includes a market-based electricity purchase cost allowance and a volatility allowance, but excludes greenhouse and renewable costs, NEM fees and losses) are shown in Table 6.2.

**Table 6.2 Summary of Tribunal's findings on the electricity purchase cost allowance (2006/07 \$/MWh)**

Retailer	2007/08	2008/09	2009/10
<b>Country Energy</b>			
Market-based electricity purchase cost	48.7	47.7	43.7
Volatility allowance	0.7	0.7	0.7
<b>Total</b>	<b>49.4</b>	<b>48.4</b>	<b>44.4</b>
<b>EnergyAustralia</b>			
Market-based electricity purchase cost	55.6	54.4	49.8
Volatility allowance	0.9	0.9	0.9
<b>Total</b>	<b>56.5</b>	<b>55.3</b>	<b>50.7</b>
<b>Integral Energy</b>			
Market-based electricity purchase cost	57.8	56.7	52.2
Volatility allowance	1.1	1.1	1.1
<b>Total</b>	<b>58.9</b>	<b>57.8</b>	<b>53.3</b>

**Note:** Columns may not add due to rounding

For EnergyAustralia and Integral Energy, these findings have not changed since the draft report. Country Energy's allowance has been adjusted since the draft report to reflect the correct load profile.<sup>91</sup>

In reaching these findings, the Tribunal considered Frontier Economics' assessment of the options for calculating the electricity purchase cost, and recommendations for addressing the various types of risk associated with electricity purchase arrangements. Specifically, it considered Frontier Economics' assessment of the long-run marginal cost of electricity generation, and stakeholder views on this assessment. It also considered Frontier Economics' assessments of the market-based cost of electricity purchase (including its supplementary assessment of the market-based cost of electricity purchase if the current drought conditions continue); Frontier Economics' assessment of the additional costs and risks retailers will face in the absence of the ETEF; and stakeholder views.

Consistent with the draft report, the Tribunal decided to base its findings on the market-based cost of electricity purchase rather than the long-run marginal cost of generation or a blend of these numbers. This decision supports the Tribunal's

<sup>91</sup> Country Energy submitted a corrected load profile to the Tribunal prior to the draft determination; however there was insufficient time for the costs to be recalculated then.

objective of ensuring that the prices charged by Standard Retailers are at cost-reflective levels by 2010. In general, stakeholder submissions in response to the draft report expressed support for this decision.

In relation to the various risks associated with electricity purchasing, the Tribunal considered the nature of the risks, the parties best able to manage these risks, and the need for regulatory certainty. It also sought advice from Frontier Economics and considered stakeholder views and submissions on risks.

Consistent with Frontier Economics' supplementary advice and analysis of the recent changes in the wholesale electricity prices, the Tribunal decided to address the risks associated with market-based electricity purchase costs through the following three approaches:

1. The risks inherent in the load profile and customer base and managed by retailers through a combination of contracting and spot price exposure have been taken into account in estimating the market-based costs, and in selecting the most conservative point on the efficient frontier (which reflects the high level of hedging a risk adverse retailer would prefer).
2. The risks associated with price variation caused by normal system volatility have been taken into account by making an allowance for the cost of retailers holding sufficient working capital to withstand the resulting cash flow variations.
3. The risks associated with a step-change in the future wholesale electricity market price will be addressed through a review of the market-based electricity purchase cost allowance to be conducted annually during the determination period. If this review concludes that there is a material step-change in the expected market-based electricity purchase cost allowance for future years, the value of the regulatory control parameter (R) will be adjusted.

The Tribunal adopted the first two of these approaches in making the draft determination. However, since the release of the draft determination, there have been significant changes in the NEM wholesale electricity prices. Stakeholder submissions that commented on the electricity purchase cost allowance highlighted the need for the Tribunal to explicitly address the risk of significant changes in the prevailing wholesale electricity costs within the determination period in a way that provides certainty, minimises perverse outcomes and is relatively simple. For these reasons, the Tribunal also adopted the third approach in making its final determination.

Sections 6.2.1 and 6.2.2 below summarise the Tribunal's considerations in relation to the assessment of the long-run marginal cost of electricity generation for each retailer's regulated load, and the assessment of the market-based cost of electricity purchase. Section 6.2.2 also:

- ▼ explains why the Tribunal decided to base its calculation of the electricity purchase cost allowance on the 'normal hydrology' market-based cost of electricity purchase (rather than the 'drought' cost), plus a volatility allowance to address the cost associated with normal system volatility
- ▼ outlines the need for an annual review of the market-based electricity purchase cost allowance for future years, and explains how this review will be undertaken.

### 6.2.1 Assessment of the long-run marginal cost of electricity generation

The Tribunal has considered the long-run marginal cost of electricity generation in past reviews of retail electricity prices. Analysts involved in forecasting electricity prices also consider this cost. However, assessments of this cost are usually based on existing generation plant, and focus on the cost to supply the market in general. In contrast, the terms of reference for this review specifically require the Tribunal to base its assessment on a portfolio of new entrant generation plant, and focus on the cost to supply the load profile of customers remaining on regulated retail tariffs.

The Tribunal engaged Frontier Economics to provide advice on the electricity purchase allowance, including assessing the long-run marginal cost of electricity generation consistent with the terms of reference. Frontier Economics assessed the long-run marginal cost using its proprietary total cost optimisation model of the NEM (WHIRLYGIG). In doing so, Frontier Economics relied on a range of input assumptions, including:

- ▼ a pre-tax weighted average cost of capital of 8.6 per cent (see Appendix D)
- ▼ cost estimates for generation plant set out in a report by ACIL Tasman for NEMMCO<sup>92</sup> adjusted for the WACC of 8.6 per cent.

In general, stakeholders who commented on the assessment of the long-run marginal cost of electricity generation supported Frontier Economics' final approach to calculating this cost.<sup>93</sup> The Tribunal considered the assessment of the long-run marginal cost that resulted from this approach in making its draft determination.

<sup>92</sup> Report on NEM generator costs, Prepared for Inter Regional Planning Committee (IRPC) and NEMMCO, February 2005.

<sup>93</sup> That is, the approach set out in its final report. The long-run marginal cost estimates in Frontier Economics' draft report were lower than those in its final report; stakeholder submissions did not support the lower estimates.

In making its final determination, the Tribunal noted the recent changes in wholesale electricity prices, and stakeholder comments about these changes. The Tribunal asked Frontier Economics to review its advice on the electricity purchase cost allowance in the context of the changes in wholesale market prices, and to advise the Tribunal of any changes to its assessments of the long-run marginal cost of electricity generation and the market-based cost of electricity purchase.

Frontier Economics assessed the impact on the long-run marginal generation cost and wholesale electricity market prices of a particular scenario where drought conditions continued. In particular, it examined the effects of continued water restrictions on the Snowy Hydro, Southern Hydro and Tarong power stations. It found that, under this scenario, the long-run marginal generation cost would increase by a relatively small amount of \$1 to \$2 per MWh.<sup>94</sup> Frontier Economics concluded that the underlying costs of generation had not changed and recommended that, at this time, the Tribunal should base its assessment of the long-run marginal cost of electricity generation on the normal hydrology estimates, as it did for the draft determination.

The Tribunal adopted Frontier Economics' recommendation, and considered Frontier Economics' estimates of the long-run marginal cost of electricity generation under normal hydrology conditions (Table 6.3) in making its final decision on the electricity cost allowance. In the Tribunal's view, this approach is consistent with its decision on the appropriate ways to address risk in this determination.

**Table 6.3 Frontier Economics' assessment of long-run marginal cost of electricity generation (excluding green costs) (2006/07 \$/MWh)**

Retailer	2007/08	2008/09	2009/10
Country Energy	42.4	42.5	42.6
EnergyAustralia	49.9	50.1	50.2
Integral Energy	52.0	51.9	52.0

As noted above, the estimates for EnergyAustralia and Integral Energy are the same as those used in the draft determination. For Country Energy, the estimates have been adjusted to reflect the revised load profile; this resulted a reduction of \$0.80 per MWh in 2009/10.

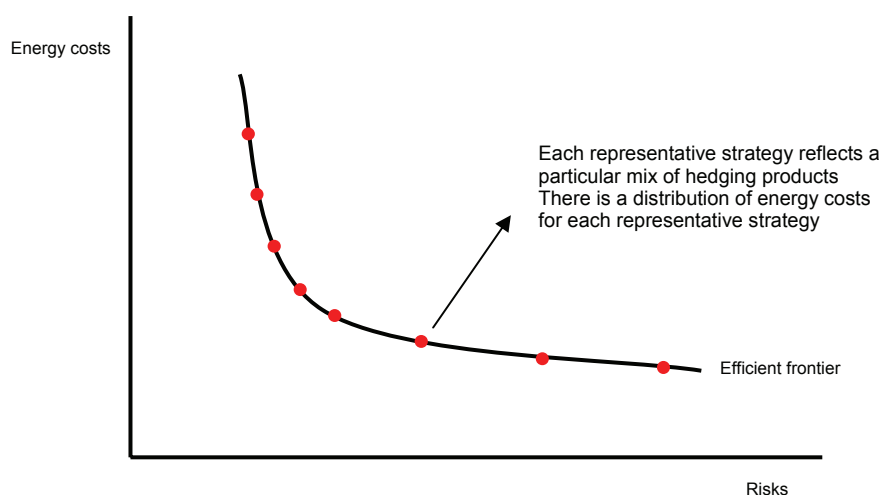
### 6.2.2 Assessment of market-based electricity purchase costs

The terms of reference require the Tribunal to consider the risks faced by retailers in the absence of the ETEF, taking into account the forecasting risks, hedging risks, transaction costs and the timetable for phasing out the ETEF. Frontier Economics proposed that these risks and costs should be considered within a consistent framework, and that the concepts of portfolio theory used in finance and investment optimisation could be applied for this purpose. Frontier Economics proposed to use

<sup>94</sup> Frontier Economics, *Analysis of recent changes in NEM wholesale electricity prices*, May 2007, p 8.

its portfolio optimisation model (STRIKE), to determine the efficient mix of electricity purchasing instruments (ie, spot market purchases and electricity contracts of various kinds) for each level of risk. As shown in Figure 6.1, the results of this analysis can be graphically represented as an 'efficient frontier' with the expected cost of the electricity portfolio on the vertical axis and the associated risk on the horizontal axis.

**Figure 6.1** *STRIKE* outputs – the "efficient frontier"



Frontier Economics argued that this approach would result in an assessment of the market-based electricity purchase cost that the Tribunal could consider alongside the assessment of the long-run marginal cost of electricity generation (discussed above).

Submissions on Frontier Economics' draft methodology, Frontier Economics' final report, and the Tribunal's draft report and determination generally supported the use of Frontier Economics' efficient frontier methodology to calculate a market-based estimate of electricity purchase costs, and strongly supported the use of a market-based approach rather than a long-run marginal cost approach to develop the electricity purchase cost allowance.

However, a number of submissions in response to both Frontier Economics' draft report and the Tribunal's draft report (including those from the Standard Retailers) put the view that the assessment of market-based electricity purchase costs that resulted from this methodology was too low and did not take account of all the risks and costs. Following the increases in wholesale electricity prices in April 2007, several stakeholders submitted that the Tribunal needed to take account of these increases in its final determination – for example by assessing the market-based electricity purchase cost allowance with reference to the increased contract prices.

In making its draft determination, the Tribunal considered Frontier Economics' methodology, stakeholder submissions and feedback on this methodology, and its own analysis of the options for recognising the various risks highlighted in the terms of reference. The Tribunal decided that it was appropriate to consider the risks and costs associated with the phasing out of the ETEF through an assessment of the market-based cost of electricity purchase based on Frontier Economics' methodology. It also considered the arguments raised by stakeholders, its own analysis and Frontier Economics' advice on the need for additional allowances and mechanisms to be incorporated in the determination.

In making its final determination, the Tribunal reviewed its draft findings, and considered stakeholder submissions. As discussed in section 6.2.1, the Tribunal also asked Frontier Economics to review its advice on the electricity purchase cost allowance in the context of the changes in the wholesale market prices, and to advise the Tribunal of any changes to its assessment of the market-based cost of electricity purchase. It then reviewed Frontier Economics' supplementary advice and other publicly available information in relation to wholesale electricity prices.

The following sections discuss the Tribunal's considerations of:

- ▼ Frontier Economics' assessment of normal-hydrology market-based electricity purchase costs, and its supplementary advice on drought market-based electricity purchase costs
- ▼ the volatility allowance required to address the risks associated with variations in the expected market-based electricity purchase costs
- ▼ the need for an annual review of the future market-based electricity purchase cost allowance, and for material step-changes in this allowance to be factored into future regulated retail prices by adjusting the R factor.

#### Considerations on Frontier Economics' assessments of market-based electricity purchase costs under normal hydrology and drought conditions

Frontier Economics' report on energy costs, released in conjunction with the draft determination, set out efficient frontiers for the three Standard Retailers calculated using its proposed methodology. The calculations were based on Frontier Economics' own spot and contract price forecasts, and on price forecasts submitted by the retailers. The calculations were also based on the relevant retailer's load forecasts. Frontier Economics supplementary advice<sup>95</sup> reviewed its earlier analysis and also considered the efficient frontiers for the Standard Retailers under the scenario where drought conditions continued.

In making its draft determination, the Tribunal based its assessment of the market-based cost of electricity purchase on the conservative point on the efficient frontier curve for each retailer calculated using Frontier Economics' price forecasts. The Tribunal adopted the conservative point, rather than an alternative point – for

<sup>95</sup> Frontier Economics, *Analysis of recent changes in NEM wholesale electricity prices*, May 2007.



example, the elbow point – because it considered that this was a realistic, prudent position and that it was preferable to err on the side of overestimating rather than underestimating the costs of electricity purchase. The Tribunal noted that the conservative point was at least \$2 per MWh higher than the elbow point.

In making its final determination, the Tribunal reaffirmed that it should base its analysis on Frontier Economics' own estimates of the conservative points on the efficient frontiers.

However, the Tribunal also considered whether to base its analysis on Frontier Economics' normal-hydrology market-based costs or drought market-based costs. Frontier Economics<sup>96</sup> recommended that the Tribunal maintain the position it took in the draft determination and base its analysis on the normal-hydrology market-based costs. It also recommended that the Tribunal address the risks associated with continued drought conditions by undertaking annual reviews of the energy purchase cost allowance during the determination period.

The Tribunal considered Frontier Economics' recommendation in the context of the objectives for the determination; the principles of good regulation; the principles of risk management; and public information on the effect of the drought on electricity prices, including NEMMCO's *Potential Drought Impact on Electricity Supplies in the NEM – Final Report*, which was prepared for the Ministerial Council on Energy Standing Committee of Officials.

The Tribunal acknowledges the recent significant changes in wholesale electricity market spot and contract prices, and that these changes and the possibility that the current drought will continue to impact electricity supplies in the NEM, raise questions about the medium-term outcomes for wholesale electricity prices. It also notes NEMMCO view:

The low rainfall scenario was recognised by the [Committee] as being very unlikely, given that many regions have experienced the driest year on record in the past twelve months. It is noted that even if certain areas of the NEM do continue to experience record low rainfall levels, the [Committee] considered it unlikely that this will be experienced simultaneously across all areas of the NEM.<sup>97</sup>

The Tribunal has assessed the impact of the current market prices on the risk faced by Standard Retailers in the context of the phasing out of ETEF. The Tribunal also considered Frontier Economics' view that new entrant retailers are likely to hold hedged positions for the next year that would protect them from current adverse market movements and its advice that:

- ▼ The Bureau of Meteorology's analysis suggests that, based on 107 years of records, there is a very strong likelihood that there will be above average rainfall over the 2007 winter. If this occurs, it will go some way to relieve the current shortages facing generators across the NEM.

<sup>96</sup> Frontier Economics, *Analysis of recent changes in NEM wholesale electricity prices*, May 2007, p 1.

<sup>97</sup> NEMMCO, *Potential Drought Impact on Electricity Supplies in the NEM – Final Report*, 30 April 2007.



- ▼ In its most recent consultation on its Annual Network Transmission Statement modelling<sup>98</sup>, NEMMCO assumed long-term average inflows, rather than a continuation of recent low hydrology inflows.
- ▼ Modelling shows that if the planned delivery of recycled water to the Tarong Power Station occurs as planned, and Kogan Creek power station is commissioned on time, this will relieve the shortage of capacity and raise competitive pressures for generators across the NEM.

The Tribunal decided to adopt Frontier Economics' recommendation to base its analysis on Frontier Economics' normal-hydrology market-based electricity purchase costs,<sup>99</sup> as set out in the draft report (see Table 6.4) and to account for the risk of a step-change in the future market-based electricity purchase costs through an annual review (discussed below).

**Table 6.4 Frontier Economics' assessment of the market-based cost of electricity purchase – Conservative point (2006/07 \$/MWh)<sup>a</sup>**

Retailer	2007/08	2008/09	2009/10
Country Energy	48.7	47.7	43.7
EnergyAustralia	55.6	54.4	49.8
Integral Energy	57.8	56.7	52.2

<sup>a</sup> See Frontier Economics, *Energy costs, Final Report*, March 2007, and Frontier Economics, *Updated Country Energy load profile*, May 2007 for Country Energy's revised costs.

Because the Tribunal's calculation of the regulatory price control parameter (the R value) takes account of the load in each of the time-of-use periods (Peak, Shoulder and Off-peak), it asked Frontier Economics to disaggregate the market-based costs shown on Table 6.4 by the time-of-use period. Frontier Economics determined the costs for these time-of-use periods by allocating the half-hourly spot load costs and contract difference payments to each respective period. It allocated cap contract premiums between the Peak, Shoulder and Off-peak periods on a pro-rata basis, according to the value of difference payments received in respect of the cap contract. The resulting costs for the Peak, Shoulder and Off-peak periods are shown in Table 6.5 below.

<sup>98</sup> NEMMCO, *2007 ANTS Consultation: Issues Paper*, Version 1, March 2007, p 16.

<sup>99</sup> It notes that, in the case of Country Energy, these costs need to be adjusted for the revised load profile.

**Table 6.5 Frontier Economics' assessment of the market-based cost of electricity purchase – Conservative point by time-of-use (2006/07 \$/MWh)**

Description	2007/08	2008/09	2009/10
<b>Country Energy</b>			
Peak	70.0	67.9	58.9
Shoulder	76.0	73.8	64.6
Off-peak	28.1	28.0	28.1
<b>All periods</b>	<b>48.7</b>	<b>47.7</b>	<b>43.7</b>
<b>EnergyAustralia</b>			
Peak	106.7	103.6	91.0
Shoulder	50.8	49.8	45.7
Off-peak	29.6	29.6	30.1
<b>All periods</b>	<b>55.6</b>	<b>54.4</b>	<b>49.8</b>
<b>Integral Energy</b>			
Peak	116.9	113.3	99.0
Shoulder	49.6	48.9	45.1
Off-peak	31.5	31.5	31.9
<b>All periods</b>	<b>57.8</b>	<b>56.7</b>	<b>52.2</b>

### Considerations on the volatility allowance

The Tribunal's draft report included an allowance for the cost of holding working capital to withstand normal electricity market system volatility around the expected wholesale electricity price. The allowance was calculated by estimating the cost incurred by the business to access sufficient additional working capital to withstand the resulting cash flow variation over time.

The Tribunal proposed this volatility allowance after considering stakeholder views on the residual volatility associated with the conservative point on the efficient frontier, and after considering the alternative ways in which retailers could manage such risks (such as purchasing additional hedging products to virtually eliminate this risk).<sup>100</sup>

The Tribunal considered that adopting a volatility allowance calculated as described above:

- ▼ represented an efficient and therefore reasonable means of addressing the residual risk
- ▼ was consistent with the approach adopted in other decisions where the costs of holding working capital are taken into account, and

<sup>100</sup> Frontier Economics estimated that the cost of virtually eliminating price volatility from the conservative point on the efficient frontier was around \$9/MWh (assuming normal hydrology) and that the cost associated with the business maintaining sufficient additional funds to withstand the volatility for 99.5 per cent of forward price outcomes was much lower, with an annual cost of holding sufficient working capital of around \$1/MWh.

- ▼ was objective and transparent.

Frontier Economics calculated the allowances for each Standard Retailer,<sup>101</sup> consistent with the relevant conservative points on the efficient frontier curves for each retailer.<sup>102</sup> The allowances represent the annual cost of the business having access to working capital sufficient to withstand adverse variation around the expected cost for over 99 per cent of the time.

Retailer submissions in response to the draft report expressed general support for the concept of a volatility allowance based on an assessment of the working capital required to fund extreme events. However, retailers questioned the assumptions underlying the calculation, arguing that the magnitude and frequency of the events that underlie Frontier Economics' calculated allowances are inconsistent with observed market behaviour, including the recent changes in the wholesale electricity market.

The Tribunal has reviewed its draft decision, taking account of stakeholder submissions, Frontier Economics' supplementary advice, and the types of risks to be compensated for in the volatility allowance as compared to the other mechanisms and allowances in the determination. The Tribunal's final finding is to adopt the volatility allowances shown on Table 6.6.

**Table 6.6 Volatility allowance (2006/07 \$/MWh)**

Retailer	2007/08	2008/09	2009/10
Country Energy	0.7	0.7	0.7
EnergyAustralia	0.9	0.9	0.9
Integral Energy	1.1	1.1	1.1

#### Considerations on the need for an annual review of the market-based electricity purchase cost allowance and R values

As discussed above, in their response to the draft determination, several stakeholders noted the recent changes in NEM wholesale electricity prices, and argued that the Tribunal's final determination should specifically address the risk of a step-change in the future wholesale electricity prices. Frontier Economics in its supplementary report, recommended that the Tribunal address this risk by reviewing the adequacy of the market-based electricity purchase cost allowance prior to the first stage of the

<sup>101</sup> The details of the calculation are set out in Frontier Economics' final report. In general, the calculation involves:

1. Calculating the annual dollar amount that is required to be 'held' each year to accommodate potential movements in the actual market costs relative to the expected or forecast costs. For the purposes of the calculation, Frontier Economics assumed that sufficient funds should be maintained to accommodate volatility for 99.5 per cent of the forward price outcomes.
2. Assessing the cost of holding these funds by applying the WACC of 8.6 per cent used in analysis of the retail operating costs and margin (discussed in Chapter 7).

<sup>102</sup> Frontier Economics, *Energy costs*, Final Report, March 2007, Section 5.3.5.

roll-off of ETEF, at which point the standard retailers will be more exposed to the prevailing market prices.<sup>103</sup>

The Tribunal's purpose in setting prices for three years, is to provide regulatory certainty, provide incentives for the businesses to pursue efficiency gains, and reduce the costs associated with regulation. On the other hand, given the current market environment, and the significant volatility in input prices coupled with a fixed selling price, retailers clearly face significant risk.

On balance, and in recognition of the difficulty in forecasting wholesale electricity prices, the Tribunal has decided to include in its final determination annual reviews of the market-based electricity purchase cost component of the energy cost allowance. The Tribunal has, however, limited these reviews to the market-based electricity purchase cost component to preserve as far as possible the regulatory certainty, simplicity, transparency and objectivity normally associated with a three year price path. It considers that this approach achieves an appropriate balance between the need for regulatory certainty and the need to address the risk of under or over estimating the volatile wholesale electricity prices.

The Tribunal also considered whether, in undertaking these annual reviews, it would assess significant movements in market-based electricity purchase costs using publicly available sources of price information or expert advice. One source of information is the AFMA Curve. However, the AFMA Curve is an industry price survey, and therefore represents each participant's view of where the future market lies (as opposed to actual trading prices). This means it is open to manipulation.

Another source of information is d-Cypha, which represents eight futures products based on both base-load and peak-period electricity bought and sold over a calendar quarter in the NEM in NSW, Victoria, South Australia and Queensland. However, while trade has increased significantly in recent months, in absolute terms d-Cypha trade is relatively small and, therefore, at this time does not adequately represent the contract market.

The Tribunal concluded that, for the purpose of setting the market-based electricity purchase cost allowance, the use of expert advice is superior to relying on the publicly available information. Therefore, for each annual review of this allowance, the Tribunal will engage an expert to advise it on the appropriate future market-based electricity purchase cost allowance.

These reviews will commence by 1 March 2008 and 1 March 2009. The Tribunal will release a draft report and consult prior to issuing its final decision by 20 May in each year.

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<sup>103</sup> Frontier Economics, *Analysis of recent changes in NEM wholesale electricity prices – Effect on energy cost allowance*, May 2007, p 2.

In undertaking the reviews, the Tribunal will adopt the same approach it used in making the 2007 Determination. That is, the Tribunal will:

- ▼ adopt a conservative approach to estimating the market-based electricity purchase cost, and focus on changes to the spot and contract prices for electricity
- ▼ use the same the load profiles as it used in the 2007 Determination – it will not update the load profiles.

The reviews will not reconsider the long-run marginal cost of electricity generation, the volatility allowance, green energy costs, NEM fees, energy losses, retail operating costs, customer acquisition costs or the retail margin.

The Tribunal has incorporated a threshold for change in the review, recognising the principle of materiality, and the objective of regulatory efficiency, including minimising administrative costs. It has set the threshold at 10 per cent on the basis that a higher threshold may result in retailers being exposed to costs significantly above the allowance on which the regulated retail tariff is based, and may have a significant impact on the level of competition in the market. It decided not to set a lower threshold, as this would imply a very high level of accuracy in the estimates and, at the extreme, would mean that the Tribunal would effectively have decided to set new R values each year.

The Tribunal considers that the 10 per cent threshold is consistent with its other decisions on the retail margin. For example, the 5 per cent retail margin in 2009/10 would be eliminated if energy wholesale prices increase by 13 per cent for EnergyAustralia and Integral Energy and 17 percent for Country Energy.

If the results of a review of the market-based electricity purchase cost allowance for a future year in the determination period show a change (positive or negative) of 10 per cent or more compared to the Tribunal's most recent allowance amount for the market-based electricity purchase cost, then the Tribunal will notify the Standard Retailers and publish the new electricity purchase cost allowance amount.

If the change in the market-based electricity purchase cost allowance meets or exceeds the 10 per cent threshold in the March 2008 and or the March 2009 review, the Tribunal will reconsider the transition path and recalculate the R values at that time. The Tribunal will not revisit the other cost allowances included in this determination (see section 8.4). If the threshold is not met, the existing electricity purchase cost allowance and R values will continue to apply.

### 6.3 Greenhouse and renewable energy cost allowance

The Tribunal's findings on the allowance for greenhouse and renewable energy costs to be taken into account in setting the regulated retail price controls are shown in Table 6.7.

**Table 6.7 Tribunal's findings on the allowance for greenhouse and renewable energy costs (2006/07 \$/MWh)<sup>a</sup>**

Scheme	2007/08	2008/09	2009/10
NSW Renewable Energy Target Scheme	0.2	0.4	0.6
Commonwealth Mandatory Renewable Energy Target	0.9	1.2	1.5
Greenhouse Gas Reduction Scheme			
Country Energy	3.6	3.5	3.6
EnergyAustralia	3.2	3.2	3.3
Integral Energy	3.4	3.4	3.4

<sup>a</sup> GGAS costs are presented as costs at the regional reference node and they will be adjusted by appropriate transmission and distribution loss factors to convert the costs to costs at the customer meter.

Frontier Economics was asked to provide specific advice on the allowance for the costs of complying with the Greenhouse Gas Reduction Scheme (GGAS)<sup>104</sup> and the Commonwealth Mandatory Renewable Energy Target (MRET).

In addition, during the course of the review, the NSW Government announced its intention to establish the NSW Renewable Energy Target Scheme (NRET). The Tribunal therefore asked Frontier Economics to provide advice on the costs of complying with NRET based on known elements of the scheme at the time. Frontier Economics made a number of assumptions<sup>105</sup> including the level of the NRET target, the renewable plant that would be eligible for NRET and the penalty for compliance shortfall. It noted that if the scheme changes as it develops, the cost associated with the scheme might need to be reconsidered.

The MRET and NRET schemes are designed to promote the generation of electricity from renewable energy sources and require retailers to annually surrender certificates that represent the generation of electricity from renewable energy sources. The costs of compliance per MWh are identical for serving regulated retail customers in each Standard Retailer's supply area.

The GGAS promotes the reduction of greenhouse gases associated with the production and use of electricity to a target level set for each year. Retailers must surrender certificates representing the abatement of greenhouse gases each year, based on their share of the target set for that year. Because compliance with GGAS is assessed at the customer meter, the number of certificates required by each retailer is influenced by the retailer's distribution loss factor. Therefore, Country Energy, with

<sup>104</sup> Formerly the Greenhouse Gas Abatement Scheme.

<sup>105</sup> Frontier Economics, *Energy costs*, Final Report, March 2007, p 39.

the highest distribution losses, is expected to face the highest costs per MWh of complying with GGAS, followed by Integral Energy then EnergyAustralia.

Frontier Economics recommended that the Tribunal adopt the estimates of long-run marginal cost of greenhouse and renewable energy schemes set out in Table 6.7.

For its draft report and determination, the Tribunal considered Frontier Economics' analysis, and the retailers' submissions, including views that the estimates were too low, and decided to adopt Frontier Economics' recommendation on the allowance for greenhouse and renewable costs.

In response to the draft report, Country Energy submitted that the allowance for the MRET and NRET schemes are lower than its predicted costs for the 2007-10 period.<sup>106</sup> Country Energy submitted that there is likely to be an increase in the future market price of Renewable Energy Certificates (RECs) as a result of water scarcity causing a significant reduction in the supply of RECs.<sup>107</sup> Country Energy also submitted that the allowance for the NSW GGAS is below its current and forecast costs of compliance.<sup>108</sup>

In its supplementary advice on recent changes in NEM wholesale electricity prices, Frontier Economics reaffirmed its recommendation on the greenhouse and renewable energy cost allowance and noted that:

REC prices have now risen to almost precisely the level set by IPART

...the NGAC prices have not changed materially since the Draft Determination.

The Tribunal is not aware of any information that would cause it to disagree with Frontier Economics' recommendations. The Tribunal considers the allowance for greenhouse and renewable energy costs as set out in Table 6.7 to be appropriate.

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<sup>106</sup> Country Energy submission, May 2007, p 18.

<sup>107</sup> Country Energy submission, May 2007, p 18.

<sup>108</sup> Country Energy submission, May 2007, p 18.



## 6.4 NEMMCO Fees

The Tribunal's findings on the allowance for retailer NEM fees and ancillary charges to be taken into account in setting the regulated retail tariff controls are shown in Table 6.8.

**Table 6.8 Tribunal's findings on the allowance for retailer NEM fees and ancillary fees (2006/07 \$/MWh)**

	2007/08	2008/09	2009/10
General participant fees (\$/MWh)	0.35	0.33	0.32
FRC fees (\$/MWh)	0.06	0.06	0.05
Ancillary service costs (\$/MWh)	0.30	0.29	0.29
Total (\$/MWh)	0.71	0.68	0.68

**Note:** Columns may not add due to rounding.

Frontier Economics was also asked to advise on an appropriate allowance for retailer NEM fees and ancillary charges during the determination period.

NEM fees are levied on retailers, generators and market participants to cover NEMMCO's costs. Ancillary charges cover the cost of the ancillary services purchased by NEMMCO to ensure the power system remains in a secure state. Both NEM fees and ancillary charges are levied on retailers on a per MWh basis according to their electricity purchases. NEM fees do not vary according to retailer.

NEM fees and ancillary charges are a relatively small component of retailers' total costs. NEM fees are relatively easy to predict as they are based on the operational expenditure of NEMMCO.<sup>109</sup> Ancillary service costs are somewhat more difficult to estimate as these costs are likely to vary over time.

Stakeholders were broadly in agreement that Frontier Economics' allowance for NEM fees and ancillary charges in its draft report was appropriate. However, TRUenergy submitted that Frontier Economics' estimation of ancillary service costs was too low.<sup>110</sup> Frontier Economics affirmed its draft recommendations on NEM fees and ancillary charges in its final report.

EnergyAustralia was the only stakeholder to comment on the allowance for NEM fees set out in the Tribunal's draft report. EnergyAustralia submitted that these fees may increase over the period, pointing to the release of NEMMCO's Draft Statement of Corporate Intent for 2007/08, which outlined a 4.6 per cent increase in budgeted fee revenue for 2007/08.

<sup>109</sup> NEMMCO outlines forecasts of operational expenditure relating to general participant fees and FRC fees for each year in its Statement of Corporate Intent.

<sup>110</sup> TRUenergy submission, February 2007, p 2.



In its supplementary advice on recent changes in NEM wholesale electricity prices, Frontier Economics noted that a 4.6 per cent change in the NEM fees allowance provided for by IPART in the draft determination represents around \$0.03/MWh.<sup>111</sup>

Frontier Economics noted that given the level of precision that can be achieved by the econometric modelling of the ancillary services costs, and the fact that its cost estimate for ancillary services already erred on the side of caution, there is insufficient reason to change the recommended NEM fee allowance from that set out in the draft determination.<sup>112</sup>

The Tribunal is not aware of any information that would cause it to disagree with Frontier Economics' recommendations. The Tribunal considers the allowance for NEM fees and ancillary charges as set out in Table 6.8 to be appropriate.

## 6.5 Energy losses

The Tribunal's findings on the loss factors to be taken into account in setting the regulated retail price controls are shown in Table 6.9.

**Table 6.9 Loss factors for 2007-10 included in final determination**

Loss factors (transmission plus distribution loss factors)	%
EnergyAustralia	6.8%
Integral Energy	9.1%
Country Energy	12.3%

'Energy losses' refers to the energy that is lost as energy flows through the transmission and distribution networks. As retailers record energy consumption at the customer's meter but are billed for the energy sent out from the generator, energy purchase costs need to be adjusted for these losses (the difference between total energy purchases and total sales).

The loss factors taken into account in the regulated retail price controls are total system losses. The system loss factors vary for each Standard Retailer and are calculated by multiplying transmission and distribution losses. Transmission losses are approved by NEMMCO and published on its website. Distribution losses are approved by the Tribunal and published on NEMMCO's website.

Stakeholders did not comment on the energy losses used by the Tribunal in the draft determination.

<sup>111</sup> Frontier Economics, *Analysis of recent changes in NEM wholesale electricity prices: Effect on energy cost allowance*, May 2007, p 15.

<sup>112</sup> Ibid.

Without any means of predicting variation in losses over time, the Tribunal believes that the losses incorporated into the retail determination should be based on the most recent information available and should remain the same throughout the regulatory period.

The loss factors included in Table 6.9 have been updated to reflect the most recent information available. They are slightly different from those included in the draft determination, as illustrated in Table 6.10, below.

**Table 6.10 Difference between loss factors used in draft and final decisions**

Loss factors (transmission and distribution loss factors)	Draft Report (%)	Final Report (%)
EnergyAustralia	6.4	6.8
Integral Energy	9.0	9.1
Country Energy	12.6	12.3

## 7 Allowances for retail costs and retail margin

Other key inputs to the Tribunal's calculation of hypothetical retailer costs were the allowances for retail costs and retail margin. The terms of reference specify that these allowances should reflect the retail operating costs and retail margin of a mass market new entrant, rather than those of the Standard Retailers who supply regulated customers. This represents a significant change from the approach the Tribunal has taken in previous determinations.

The terms of reference do not define a mass market new entrant. However, they do note that it should be a new market entrant that is of sufficient size to achieve economies of scale. The Tribunal accepts that mass market new entrant retail costs include both retail operating costs and costs to acquire new customers.

In considering the allowances for retail costs and retail margin, the Tribunal undertook extensive consultation and review, and sought independent expert advice. It engaged Frontier Economics to develop recommendations on these allowances, and consulted stakeholders on Frontier Economics' methodology and draft recommendations. It also asked Frontier Economics to provide supplementary advice in relation to its recommendations on the allowance for retail margin. The Tribunal considered Frontier Economics' final report and supplementary report, and the comments on retail costs and margin in stakeholder submissions in response to its own draft report and determination, in making its final determination.

The section below provides an overview of the Tribunal's final findings on the allowances for retail costs and retail margin. The subsequent sections explain these findings in more detail, including the input assumptions on retail operating costs and customer acquisition costs.

### 7.1 Overview of final findings of the allowances for retail costs and retail margin

The Tribunal's findings are that the allowances for retail costs and retail margin to be taken into account in setting the regulated retail tariff controls are those shown in Table 7.1.

**Table 7.1 Tribunal's final findings on allowances for retail costs and retail margin (\$2006/07 \$/customer, % sales)**

Description	2007/08	2008/09	2009/10
<b>All retailers</b>			
Retail operating costs (\$2006/07 \$/customer)	75	75	75
Customer acquisition costs (\$2006/07 \$/customer)	35	35	35
Adjustment for double counting (\$2006/07 \$/customer)	-5	-5	-5
<b>Retail cost allowance (\$2006/07 \$/customer)</b>	<b>105</b>	<b>105</b>	<b>105</b>
Retail margin (EBITDA, % of sales)	5%	5%	5%

These findings reflect the Tribunal's decision to accept Frontier Economics' interpretation of a mass market new entrant in calculating retail costs and margin. The Tribunal considers that its findings reflect the costs of a new market entrant that has achieved economies of scale but not all potential economies of scope, particularly those available through vertical integration.

The Tribunal's final finding on the retail cost allowance is slightly lower than its draft finding. After undertaking additional analysis on the components of retail operating costs and customer acquisition costs, the Tribunal considers that there is potential for double counting some of these costs. In recognition of this, the Tribunal has reduced the allowance for total retail costs (including retail operating costs and customer acquisition costs) by \$5 per customer per year compared to its draft findings.

## 7.2 Mass market new entrant retail costs

The Tribunal's final findings on mass market new entrant retail costs are shown in Table 7.2.

**Table 7.2 Tribunal's final findings on mass market new entrant retail costs (\$2006/07 \$/customer)**

Description	2007/08	2008/09	2009/10
<b>All retailers</b>			
Retail operating costs	75	75	75
Customer acquisition costs (residential customers)	34	34	34
Customer acquisition costs (business customers)	42	42	42
Customer acquisition costs (weighted average)	35	35	35
Adjustment for double counting	-5	-5	-5

### 7.2.1 Mass market new entrant retail operating costs

In making its findings on mass market new entrant retail operating costs, the Tribunal considered Frontier Economics' recommendations on these costs, stakeholder submissions on this issue, and Frontier Economics' response to these submissions. It also reviewed the potential for efficiency savings to be made over the next three years.

Frontier Economics recommended a range for retail operating costs of \$60 to \$80 per customer, per year (in 2006/07 dollars). Frontier Economics developed this range using a bottom-up approach based on cost information provided by the Standard Retailers as a proxy for mass market new entrant costs. Frontier Economics then benchmarked the results against regulatory decisions in other jurisdictions.<sup>113</sup>

The Tribunal notes that Frontier's benchmarking shows that allowances for retail operating costs (excluding customer acquisition costs) in other jurisdictions tend to be higher than \$75. The Tribunal also notes that the NSW Standard Retailers' actual reported retail operating costs are below recent regulatory decisions on these costs, and that there may be a number of reasons for this.

Several stakeholder submissions suggested that focusing on the costs of the Standard Retailers is likely to underestimate mass market new entrant costs because there is potential for significant cost sharing with the electricity distribution businesses carried out by these retailers (for example, refer to submissions from EnergyAustralia,<sup>114</sup> Country Energy,<sup>115</sup> AGL,<sup>116</sup> TRUenergy<sup>117</sup> and Origin Energy<sup>118</sup>).

Frontier Economics' final report provided some information on the categories of costs that are most likely to be shared between different business operations, and the contributions these categories make to the Standard Retailers' total reported retail operating costs.<sup>119</sup> Frontier Economics also noted that second tier retailers have been able to win customers away from the Standard Retailers, which suggests that the additional costs associated with being a mass market new entrant retailer with no electricity distribution functions are unlikely to be large.<sup>120</sup>

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<sup>113</sup> Frontier Economics, *Mass market new entrant retail costs and retail margin*, Final Report, March 2007, p 28.

<sup>114</sup> EnergyAustralia submission, February 2007, p 29.

<sup>115</sup> Country Energy submission, February 2007, p 17.

<sup>116</sup> AGL submission, February 2007, p 10.

<sup>117</sup> TRUenergy submission, February 2007, p 3.

<sup>118</sup> Origin Energy submission, February 2007, p 5.

<sup>119</sup> Frontier Economics, *Mass market new entrant retail costs and retail margin*, Final Report, March 2007, p 38.

<sup>120</sup> Frontier Economics, *Mass market new entrant retail costs and retail margin*, Final Report, March 2007, p 38.

After considering these issues, the Tribunal's draft findings were that the allowance for retail operating costs should be set at \$75 per customer per year. Submissions in response to the draft report suggested that second tier retailers consider that this is at the lower end of the cost range,<sup>121</sup> and is below allowances in other states.<sup>122</sup>

There is limited retail cost data in the public domain to allow the Standard Retailers' costs to be benchmarked against the actual costs of new entrant retailers competing in the NSW electricity retail market. However, since the release of its draft determination, the Tribunal has reconsidered its draft finding on the retail cost allowance in detail, and reviewed the cost information provided by the Standard Retailers and AGL.<sup>123</sup> The Tribunal has also considered recent regulatory findings on the retail cost allowance in other jurisdictions. For example, since the release of the draft determination, the ACT's Independent Competition and Regulatory Commission (ICRC) and the Queensland Competition Authority (QCA) have made draft decisions that included retail operating cost allowances of \$94 and \$75 respectively.

On balance, the Tribunal still considers that the retail operating costs of a mass market new entrant retailer without access to economies of scope from a shared distribution/retail business are likely to be towards the top of the range recommended by Frontier Economics of \$60 to \$80 per customer per year. For this reason, the Tribunal reaffirms its draft finding that a retail operating cost of \$75 per customer per year is appropriate, subject to the adjustment for double counting.

The Tribunal's considerations on how new entrant retail operating costs will change over time and what proportion of these costs should be recovered through fixed and variable charges are discussed below.

#### Considerations on how retail operating costs will change over the determination period

In the cost forecasts provided by the Standard Retailers, each retailer projected increases in retail operating costs (in real terms) over the period 2006/07 to 2009/10. These were due to increases in both fixed and variable costs coupled with declining customer numbers. Submissions from other retailers tended to support the view that there will be upward pressure on retail operating costs during the determination period. However, having considered the submissions and Frontier Economics' response, the Tribunal is not persuaded that there will be a net increase in the efficient level of mass market new entrant retail operating costs over the determination period.

<sup>121</sup> Origin Energy submission, May 2007, p 4.

<sup>122</sup> TRUenergy submission, May 2007, p 2.

<sup>123</sup> AGL response to IPART information request (commercial in confidence), November 2006.

Several retailers submitted that increasing real wages will be a significant driver of increasing retail operating costs over the determination period (for example, see submissions from EnergyAustralia,<sup>124</sup> Integral Energy<sup>125</sup> and AGL<sup>126</sup>). However, in its final report to the Tribunal, Frontier Economics argued that this view is not supported by the evidence, which shows that, historically, increasing input prices have not led to increasing retail operating costs. Frontier Economics noted that the expected increase in nominal wages is in line with past increases (4-5 per cent per year). It also noted that productivity in the utilities sector was also low in the current determination period, but is expected to increase in the future.<sup>127</sup> Overall, Frontier Economics expects downward pressure on retail operating costs due to improvements in productivity (especially related to IT, where costs are expected to fall over the 2007 to 2010 period).

Submissions also referred to findings by Ofgem that retail costs in the UK were higher than the earlier costs quoted by Frontier Economics, and are expected to increase over time.<sup>128</sup> However, in its final report Frontier Economics noted that most of the costs discussed by Ofgem relate to full retail contestability, and such costs would have already been recovered by NSW retailers or included in the actual retail operating costs reported by these retailers. Frontier Economics argued that there is nothing to suggest that there will be any further increase in retail operating costs in NSW as a result of contestability-related costs. It also noted that Ofgem did not expect costs to continue to rise but were more likely to reduce in the future.<sup>129</sup>

The Tribunal expects that any future costs resulting from full retail contestability would be mainly related to information technology (such as, software, middleware and customer billing systems). Frontier Economics put the view that fixed retail operating costs will fall over the period, as some investments that are currently part of fixed costs (for example, billing systems) become scaleable over time. This is due to retailers having the capacity to scale shorter term investments to better match their operations.

The Tribunal acknowledges that many of the submissions it received on Frontier Economics' draft report disagreed with Frontier Economics' comments on scalability. The Tribunal agrees that it is difficult to determine the extent to which retail investments will be scalable. However, it also considers that future costs resulting from full retail contestability are most likely to relate to items of information technology expenditure, and that the cost of these items is likely to fall. Based on

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<sup>124</sup> EnergyAustralia submission, February 2007, pp 29 and 31.

<sup>125</sup> Integral Energy submission, February 2007, p 41.

<sup>126</sup> AGL submission, February 2007, p 10.

<sup>127</sup> Frontier Economics, *Mass market new entrant retail costs and retail margin*, Final Report, March 2007, p 26.

<sup>128</sup> For example, Integral Energy submission, February 2007, p 39.

<sup>129</sup> Frontier Economics, *Mass market new entrant retail costs and retail margin*, Final Report, March 2007, p 26.

these issues, the Tribunal does not consider that additional full retail contestability costs are likely to drive higher costs over the determination period.

Stakeholders raised a number of other factors that they believe will drive increases in retail operating costs during the determination period, such as costs relating to the introduction of time-of-use pricing<sup>130</sup> and the costs of hardship programs.<sup>131</sup> The current costs associated with these activities are already accounted for in the Tribunal's finding on retail operating costs. If new regulatory requirements in relation to these costs arise during the determination period, they will be considered in accordance with the cost pass-through mechanism (see Chapter 5).

After considering the above information, the Tribunal made a draft finding that the retail operating cost allowance should not change in real terms over the determination period. However, the Tribunal noted that increased competition should place pressure on all retailers, including the Standard Retailers, to pursue efficiency gains to increase their competitiveness.

In making its final finding, the Tribunal gave further consideration to the possibility of efficiency gains. It also considered stakeholder comments on this issue in submissions in response to the draft report. These comments included the following:

- ▼ EnergyAustralia put the view that productivity gains are unlikely over the next three years, as most potential gains have been realised since the introduction of full retail contestability.<sup>132</sup> It also submitted that increasing wage pressure is evidenced by a BIS Shrapnel report that suggests the Wage Cost Index is expected to increase by 4.6–5.7 per cent per annum for the next three years.<sup>133</sup> In addition, it submitted that Frontier Economics' analysis of labour productivity in the utilities sector is incorrect, arguing that a report the consultant relied on related to an electricity transmission company in Queensland with different characteristics to a retail business.<sup>134</sup>
- ▼ Origin Energy cautioned against the inclusion of an efficiency factor on the basis that new retailers will enter progressively over the period, and that operating efficiencies are only achieved over the medium term (concurrent, for instance, with system upgrades).<sup>135</sup> It stated that in its experience, market entry is associated with high manual interventions and that efficiency factors will be at least partly offset by greater churn-related IT and labour costs.
- ▼ Australian Power and Gas submitted that the Tribunal had not adequately considered likely increases in cost drivers over the period.<sup>136</sup>

<sup>130</sup> EnergyAustralia submission, February 2007, p 31.

<sup>131</sup> AGL submission, February 2007, pp 2-3.

<sup>132</sup> EnergyAustralia submission, May 2007, pp 22-23.

<sup>133</sup> EnergyAustralia submission, May 2007, pp 22-23.

<sup>134</sup> EnergyAustralia submission, May 2007, pp 22-23.

<sup>135</sup> Origin Energy submission, May 2007, p 4.

<sup>136</sup> Australian Power and Gas submission, May 2007, p 4.



The Tribunal also considered the decision on retail costs by the Essential Services Commission of South Australia (ESCOSA) in 2005 and a recent draft decision by the Queensland Competition Authority (QCA), both of which incorporated real increases in the retail operating cost allowance during the regulatory period.

The real increase built into the ESCOSA decision was an adjustment for a declining regulated customer base,<sup>137</sup> which has limited relevance to the Tribunal's consideration of a mass market new entrant retailer. However, the QCA draft decision was based on advice from Charles River Associates (CRA) that the retail operating cost allowance should be increased above inflation due to nominal wage increases, which are expected to be around 4.5 per cent between 2006/07 and 2007/08.<sup>138</sup> CRA recommended to the QCA that 60 per cent of the retail operating cost allowance (the proportion thought to be labour related) be increased by the expected wage escalation, and the remaining 40 per cent be increased by the change in the consumer price index. The QCA accepted this as a reasonable estimate of the likely increase in ongoing retail costs in 2007/08, but indicated that it will revisit this issue for 2008/09.<sup>139</sup>

After considering all of the above, the Tribunal was not persuaded that any adjustment should be made to the retail operating cost allowance over the determination period. On balance, the Tribunal still considers that expected increases in labour productivity and technology are likely to result in productivity improvements over this period. These improvements should at least keep pace with the productivity improvements expected in the broader economy. The Tribunal considers that a mass market new entrant retailer would be able to take advantage of these improvements to some extent, although it accepts that the ability of existing retailers to do this may be somewhat limited (for example, due to existing investments in computer systems). Further, it considers that its view is supported by historical trends in the Standard Retailers' actual retail operating costs, where higher wages growth has not led to real increases in these costs.

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<sup>137</sup> Essential Services Commission of South Australia, *Inquiry into retail electricity price path Final Report*, March 2005, p 53.

<sup>138</sup> Charles River Associates, *Calculation of the benchmark retail cost index for 2006-07 and 2007-08* (prepared for the Queensland Competition Authority), 7 May 2007, p 48.

<sup>139</sup> Queensland Competition Authority, *Draft Decision on the Benchmark retail cost index for electricity: 2006-07 and 2007/08*, May 2007, p 22.

### Considerations on the proportion of retail operating costs that should be recovered through fixed and variable charges

Frontier Economics recommended that 75 per cent of mass market new entrant retail operating costs be considered fixed costs and 25 per cent be considered variable costs.<sup>140</sup> Frontier Economics also recommended calculating a variable (\$/MWh) allowance for retail operating costs using the average level of consumption across the three Standard Retailers.<sup>141</sup>

The Tribunal accepts the percentages recommended by Frontier Economics and that the variable element should be calculated with regard to average consumption not the consumption of each retailer. However, the Tribunal has used the average across the three Standard Retailers based on the most recent actual consumption information available to it, rather than forecast annual average consumption as recommended by Frontier Economics. The fixed and variable elements of mass market new entrant retail operating costs resulting from these decisions are shown in Table 7.3.

The Tribunal considered Country Energy's view that it is not appropriate to use average consumption for this calculation because consumption varies across retailers, and therefore the average consumption does not reflect the retailers' actual costs.<sup>142</sup> The Tribunal also considered AGL's comments on the importance of choosing an accurate conversion figure so that a retailer's costs can be fully recovered.<sup>143</sup>

While the Tribunal has considered the regulated load for each Standard Retailer in calculating energy purchase costs, the terms of reference require it to include an allowance for retail operating costs that is based on the costs of a mass market new entrant and not the costs of the Standard Retailers. In developing its recommended range for these costs, Frontier Economics applied a definition of mass market new entrant that required it to identify the relevant size and scope of a hypothetical mass market new entrant retailer. This recommended range was developed with regard to the costs of the Standard Retailers and a number of other benchmarks, but ultimately the terms of reference require a departure from the costs that the Standard Retailers will actually incur.

The Tribunal considers that the use of average consumption to calculate fixed and variable allowances is consistent with Frontier Economics' notion of a hypothetical mass market new entrant retailer. It also considers that incorporating different cost allowances for each Standard Retailer based on the level of consumption of their regulated retail customers would be a departure from the mass market new entrant

<sup>140</sup> Frontier Economics, *Mass market new entrant retail costs and retail margin*, Final Report, March 2007, p 41.

<sup>141</sup> Frontier Economics, *Mass market new entrant retail costs and retail margin*, Final Report, March 2007, p 39.

<sup>142</sup> Country Energy submission, February 2007, p 20.

<sup>143</sup> AGL submission, February 2007, p 11.

approach, and as such would introduce inconsistency into Frontier Economics' framework.

In addition, the Tribunal considers that using actual average consumption across the three retailers instead of forecast consumption will minimise the impact of forecasting errors. This approach is also consistent with Frontier Economics' decision to place greater emphasis on the Standard Retailers' actual costs than on their forecasts in determining mass market new entrant retail costs over the determination period.

The Tribunal's findings on these issues are consistent with its draft findings.

**Table 7.3 Fixed and variable elements of mass market new entrant retail operating costs (\$2006/07)**

Description	2007/08	2008/09	2009/10
<b>All retailers</b>			
Fixed retail operating costs (\$/customer)	56.25	56.25	56.25
Variable retail operating costs (\$/MWh)	2.13	2.13	2.13
<b>Total (expressed as \$/customer)</b>	<b>75</b>	<b>75</b>	<b>75</b>

### 7.2.2 Customer acquisition costs

Frontier Economics found that the overall cost of acquiring customers was approximately \$200 per customer. Given Frontier Economics' analysis and the absence of submission comments on this figure, the Tribunal's draft decision was to accept this view.

In its submission in response to the draft determination, the PIAC requested clarification of the costs included in the \$200 cost.<sup>144</sup> The customer acquisition costs reported by the Standard Retailers include costs relating to marketing to new customers (for example, the payment of commission on sales) and the costs associated with the process of transferring customers.<sup>145</sup> Specifically, the Standard Retailers provided estimates of their customer acquisition costs that included the following categories of costs:

- ▼ sales overheads
- ▼ credit checking
- ▼ communications/stationery/information booklets/confirmation packs
- ▼ data and processing/customer transfers/registration
- ▼ door to door/commission/agent cost - per sale

<sup>144</sup> PIAC submission, May 2007, p 9.

<sup>145</sup> Frontier Economics, *Mass market new entrant retail costs and retail margin*, Final Report, March 2007, p 14.

- ▼ postage
- ▼ telecommunications costs (1300 numbers, etc) per sale – inbound/outbound telesales.<sup>146</sup>

Approximately two-thirds of the reported customer acquisition costs relate to transfer processes, and the remaining third relates to direct acquisition costs. Where specific incentives are offered to customers in order to acquire them, the Tribunal anticipates that these costs would be covered by the customer acquisition cost allowance.

PIAC also submitted that the Tribunal should not include any allowance for customer acquisition costs in retail costs.<sup>147</sup> The Tribunal has not made allowance for these costs in past determinations, as the Standard Retailers do not incur these costs in relation to their regulated customers. However, the terms of reference for this review require the Tribunal to make allowance for the retail costs applicable to a mass market new entrant. By definition, a mass market new entrant has no existing customer base and therefore must incur acquisition costs in relation to all of its customers. For this reason, the Tribunal considers that the terms of reference unambiguously require it to make allowance for customer acquisition costs in the retail cost allowance.

Frontier Economics recommended that the overall cost of acquiring a customer be amortised over the expected number of years the customer will remain with a retailer. It recommended a range (\$/customer) for customer acquisition costs based on different expectations of this number of years. The Tribunal has formed its own view on the expected life of a customer and has selected a point in Frontier Economics' range that reflects its views. The customer acquisition costs recommended by Frontier Economics and the Tribunal's findings are set out in Table 7.4.

**Table 7.4 Customer acquisition costs (2006/07 \$/customer)**

Description	Assumption on the number of years customer is retained	Customer acquisition costs
<b>Frontier Economics recommendation</b>		
Costs per business customer	3-6 years	40-80
Costs per residential customer	6-10 years	25-40
<b>Tribunal's findings</b>		
Costs per business customer	6 years	42
Costs per residential customer	8 years	34

<sup>146</sup> Information provided by Standard Retailers in response to IPART information request (commercial in confidence), October 2006.

<sup>147</sup> PIAC submission, May 2007, p 10.

The Tribunal's considerations on the expected number of years customers can be expected to be retained and the fixed and variable elements of customer acquisition costs are set out below.

#### Considerations on the number of years customers can be expected to be retained

To derive a figure for customer acquisition costs, the estimate of the overall cost of acquiring one new customer was amortised over the number of years a new entrant is expected to retain its customers. The Tribunal's draft findings on this number of years – six for business customers and eight for residential customers – were based on Frontier Economics' recommendations, information provided in submissions, the Tribunal's own analysis and its view of the competitiveness of the market over the determination period.

Submissions in response to the Tribunal's issues paper suggest there is broad consensus among both Standard Retailers and second tier retailers that the period over which customers will be retained is:

- ▼ four to five years for residential customers
- ▼ three to four years for business customers.

Submissions argued that customers will be retained for fewer years than the level suggested by current rates of switching in NSW. Several submissions put the view that the Tribunal's determination is likely to increase these rates to a level similar to the one currently observed in Victoria and South Australia.<sup>148</sup> The period of customer retention submitted by retailers was at or below the low end of the ranges recommended in Frontier Economics' final report. Frontier Economics noted that at the low end of the range, the implied average churn rate, across both residential and business customers, is 17–18 per cent.<sup>149</sup>

In making its draft determination, the Tribunal acknowledged that the level of competition in NSW is likely to increase over the determination period. However, it also noted that there is uncertainty about the impact of increased levels of competition on customer switching. In the Tribunal's view, a market may deliver competitive outcomes (in terms of market conduct and performance) but still have relatively low levels of customer churn.

<sup>148</sup> For example, see Country Energy submission, February 2007, p 19, Origin Energy submission, February 2007, p 6 and TRUenergy submission, February 2007, p 2.

<sup>149</sup> Frontier Economics, *Mass market new entrant retail costs and retail margin*, Final Report, March 2007, p 18.

In addition, the Tribunal noted that while it is difficult to predict the extent of customer switching over the determination period, it considered that there are a number of reasons why the rate of churn in NSW is unlikely to approach the rates seen in Victoria and South Australia. These reasons include:

- ▼ there were high levels of dissatisfaction with the incumbent in South Australia<sup>150</sup>
- ▼ the South Australian Government offered a \$50 cash rebate for concession card holders to encourage them to seek out a competitive market offer rather than stay with the franchise tariff<sup>151</sup>
- ▼ Victoria and South Australia have comparative price information services for which there is currently no equivalent in NSW
- ▼ Victoria and South Australia are the 2nd and 3rd most active markets in the world.<sup>152</sup>

Further, the Tribunal considered that the experience of the European Union and New Zealand supported its view. During 2002, the average switching rate for small retail customers in the European Union was around 10 per cent.<sup>153</sup> Of the eight countries that had full retail contestability for small retail customers, only the United Kingdom and Norway (the 1st and 5th most active markets) had switching rates above 10 per cent (in both 2002<sup>154</sup> and 2003<sup>155</sup>). Similarly, in New Zealand, which has the longest history of full retail contestability, the switching rate was around 10 per cent in 2004. Although this rate has experienced high peaks – around 30 per cent per year in mid 2001 (due to a large price increase) – the Peace Vaasaemg report notes that switching in the range of 5 to 12.5 per cent per year is emerging as a stable active level.<sup>156</sup>

Frontier Economics' draft and final reports differentiated between residential and business customers, noting that business customers are likely to stay with a retailer for fewer years than residential customers, on average. In its draft report, the Tribunal noted that it had not found any detailed comparison or analysis of the rate of switching for small business customers (less than 160 MWh per year) and same-sized residential customers. It also noted that experience in NSW to date suggested

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<sup>150</sup> 'Introducing FRC in South Australia: Dreams and Realities' speech by Lew Owens, Chairperson, Essential Services Commission of SA, 29 April 2003.

<sup>151</sup> ICRC, *Retail Prices for Non-contestable Electricity Customers: Draft Decision*, April 2006, p 26. The ICRC notes that churn rates were relatively low until the introduction by the South Australian Government of the \$50 electricity transfer rebate for concession card holders in March 2004, following a significant increase in the regulated electricity tariff rates.

<sup>152</sup> Peace Vaasaemg, *World Retail Energy Market Rankings*, June 2005.

<sup>153</sup> FRC for small retail customers was introduced in these markets from 1996 onwards.

<sup>154</sup> European Commission, *Third Benchmarking Report on the Implementation of the Internal Electricity and Gas Market*, 2004, p 9.

<sup>155</sup> European Commission, *Fourth Benchmarking Report on the Implementation of the Internal Electricity and Gas Market: Technical annexes*, p 5.

<sup>156</sup> Peace Vaasaemg, *World Retail Energy Market Rankings*, June 2005, p 5.

that the rate at which business customers have taken up negotiated contracts is not markedly different to the rate for residential customers.<sup>157</sup>

In submissions in response to the draft determination, several retailers questioned the Tribunal's expectations around the level of customer switching. EnergyAustralia submitted that the determination itself is likely to increase the level of competition in NSW and as a result, it would not be unreasonable for the Tribunal to opt for an estimate of customer retention at the lower end of the estimates recommended by Frontier Economics.<sup>158</sup> Australian Power and Gas also put the view that the determination has the potential to increase customer churn, and that this will result in falling customer retention rates. It also submitted that it is unrealistic to expect that retailers can retain residential customers for eight years when the average length of a contract currently offered by retailers is two to three years.<sup>159</sup>

In relation to the Tribunal's view that level of switching in NSW is unlikely to approach the rates seen in Victoria and South Australia, stakeholder responses were mixed. TRUenergy submitted that if the determination establishes the 'correct retail price settings', there is no reason to believe that levels of churn will not reach those in South Australia and Victoria.<sup>160</sup> However, it questioned some of the reasons the Tribunal provided to support its view. Specifically, TRUenergy submitted that the pensioner rebate scheme is no longer relevant in South Australia and was never relevant in Victoria, and that the price information services in these States had very little impact on customer transfers.<sup>161</sup>

In relation to the draft finding on the different number of years residential and business customers are expected to be retained, stakeholders did not provide any information to challenge this finding. However, TRUenergy noted that in the Tribunal's draft report stated that there is not strong evidence that levels of churn differ between these customer classes. Therefore, it suggested that on this basis, the Tribunal should use a customer retention period of six years for both classes of customer.

After considering stakeholders responses to the draft determination, the Tribunal accepts that the determination is likely to lead to increased competition in NSW; however, it still considers that there is uncertainty about whether increased levels of competition will translate to increased levels of customer switching. The Tribunal remains of the view that increased competitive rivalry between firms may compel retailers to offer their existing customers discounts or innovative price/service packages to entice them to renew their supply arrangements, or agree to new terms, instead of simply leading to higher rates of customer switching. As such, a market

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<sup>157</sup> Based on information provided to the Tribunal by the Standard Retailers on a confidential basis.

<sup>158</sup> EnergyAustralia submission, May 2007, p 25.

<sup>159</sup> Australian Power and Gas submission, May 2007, p 4.

<sup>160</sup> TRUenergy submission, May 2007, p 2.

<sup>161</sup> TRUenergy submission, May 2007, p 2.



may deliver competitive outcomes (in terms of market conduct and performance) but still have relatively low levels of customer churn.

The Tribunal notes that in a draft decision released in May of this year, the QCA concluded that the cost of retaining an existing customer is substantially lower than the cost of acquiring a new customer.<sup>162</sup> The QCA noted that an efficient retailer with an existing customer base is likely to be more focused on retaining existing customers than on acquiring new customers. The Tribunal considers that this supports its view that an increase in competitive activity will lead to greater effort on the part of retailers to retain customers already acquired and not simply increase the level of customer switching.

For the reasons set out above, the Tribunal remains of the view that levels of customer switching in NSW over the next three years are unlikely to reach the levels observed in Victoria and South Australia. In the absence of evidence to the contrary, the Tribunal still expects that comparative price information is likely to have been a contributing factor to the higher rates of customer switching in those states. The Tribunal recognises that not all of the other factors it provided in its draft report (and set out above) are relevant to both Victoria and South Australia. Nevertheless, it considers that no additional information has been provided to suggest that any of these factors should be ignored.

In relation to the number of years residential and business customers can be expected to be retained, the Tribunal based its draft finding on information provided by Frontier Economics. This information indicates that on average, residential customers can be expected to be retained for longer than business customers. While the Tribunal acknowledged that there is little other information available to suggest there is difference, it considers that stakeholders did not provide additional information that would lead it to change its view on this issue. Therefore, the Tribunal reaffirms its view that, on average, residential customers can be expected to remain with retailers for eight years and business customers for six years.

#### Considerations on the fixed and variable elements of mass market new entrant customer acquisition costs

Frontier Economics recommended that 100 per cent of customer acquisition costs be recovered on a per customer basis (with none to be recovered on a per MWh basis). The Tribunal agrees that this more closely reflects the nature of customer acquisition costs, which do not vary with energy usage. The Tribunal's findings on this issue are consistent with its draft findings.

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<sup>162</sup> Queensland Competition Authority *Draft Decision on the Benchmark retail cost index for electricity: 2006-07 and 2007/08*, May 2007, p 23.



### 7.2.3 Potential for double counting of costs in the retail cost allowances

The Tribunal is concerned that there is potential for costs to be double counted in estimating the retail operating cost and customer acquisition cost allowances.

While Frontier Economics has determined benchmarks based on the overall costs of the Standard Retailers as a proxy for mass market new entrant costs, it did not assess the Standard Retailers' costs in detail at a disaggregated level, nor was it asked to. While the Standard Retailers were asked to separately report on customer acquisition costs and retail operating costs in their information requests, their costs are based on their methods of cost allocation and categorisation.

The Tribunal is aware that approximately two-thirds of Standard Retailers' customer acquisition costs relate to transfer processes, and the remaining third relates to direct acquisition costs. The Tribunal considers that there is some scope for double counting between these costs. For example:

- ▼ the costs of labour associated with retailer transfer activities may also be accounted for, to some extent, in retail operating costs or call centre costs associated with telesales, and
- ▼ retail operating costs include the costs associated with retaining customers and potentially other costs that are not applicable to mass market new entrants.

However, there are also a number of factors that suggest that double counting of costs within the allowances for retail operating costs and customer acquisition costs is not a significant issue. For example:

- ▼ Frontier Economics carried out reasonableness tests of reported costs
- ▼ Frontier Economics confirmed that the figures reported by each of the three Standard Retailers relate only to electricity (and not gas or dual fuel)
- ▼ the Tribunal has compared the costs of the Standard Retailers with those provided by AGL Electricity (on a commercial in-confidence basis).

While the Standard Retailers' reported retail operating costs tend to be low compared with publicly available benchmarks, there is very little publicly available information on customer acquisition costs. Having reviewed the reported costs for each category at a disaggregated level and the other information available to it, the Tribunal has decided to reduce the retail cost allowance by \$5 to account for costs that have been included in both the retail operating cost and customer acquisition cost allowances.

As a result, the Tribunal's final finding on the allowance for mass market new entrant retail costs is \$105 per customer, per year. This is \$5 lower than the Tribunal's draft findings on these costs.

### 7.3 Mass market new entrant retail margin

**The Tribunal's final finding is that a mass market new entrant retail margin of 5 per cent of sales (EBITDA) is to be taken into account in setting the regulated retail tariff controls.**

The terms of reference require the Tribunal to include in its hypothetical retailer costs, an allowance for a retail margin for a mass market new entrant. Frontier Economics' final report recommended a retail margin in the range of 4 per cent to 6 per cent of total sales (EBITDA). Frontier Economics developed this range after applying three approaches, which resulted in the outcomes below:

- ▼ bottom-up approach – 4.3 to 5 per cent
- ▼ expected returns approach – 4.3 to 6.4 per cent
- ▼ benchmarking approach – 4 to 6 per cent.

In their submissions to the review, retailers suggested that the margin should be set at a minimum of five per cent. The reasons offered in support of this view included that:

- ▼ a mass market new entrant requires a higher margin than the Standard Retailers
- ▼ it would be more consistent with market observations, and
- ▼ the margin should recognise energy purchase risks and declining periods of customer retention.<sup>163</sup>

A mass market new entrant retailer faces a number of risks, some of which are not currently faced by the Standard Retailers. While the role of the retail margin is to compensate businesses (and ultimately their investors) for bearing risk, not all of the risks facing a mass market new entrant will be compensated for in the retail margin. Frontier Economics' final report included a detailed discussion of which risks are recognised under its approach.<sup>164</sup>

The bottom-up and expected returns approaches recommended by Frontier Economics did not include an allowance for non-systematic energy purchase risk or customer acquisition costs – these have each been addressed elsewhere in the cost allowances. Frontier Economics' benchmarking approach reviewed market evidence as well as recent regulatory decisions.<sup>165</sup> In reviewing the information provided by submissions and Frontier Economics, it is important to ensure that benchmarks are comparable in terms of the costs and risks they are designed to cover.

<sup>163</sup> For example, see Integral Energy submission, February 2007, pp 28-33 and AGL submission, February 2007, pp 2-3.

<sup>164</sup> Frontier Economics, *Mass market new entrant retail costs and retail margin, Final Report*, March 2007, pp 49-51.

<sup>165</sup> Frontier Economics, *Mass market new entrant retail costs and retail margin, Final Report*, March 2007, pp 63-67.

Differences in the operating cost breakdown of the retailing arms of energy firms also have an impact on the comparability of available benchmarks. For example, in some instances, the retail margin represents an EBIT margin while in other instances it represents EBITDA. In the work undertaken by Frontier Economics, depreciation has not been compensated for in the retail cost allowance but is included as a component of the retail margin, making the EBITDA the appropriate comparator. Frontier Economics suggested that EBITDA margins for a mass market new entrant are about one per cent higher than EBIT margins.<sup>166</sup>

In their submissions, Integral Energy and EnergyAustralia reviewed a range of evidence from company reports, independent experts' reports and brokers' reports.<sup>167</sup> The raw data for the listed firms provided coincides with the top of Frontier Economics' recommended ranges for EBITDA margins. In a report prepared for EnergyAustralia, KPMG also reviewed market evidence and concluded that this evidence suggests an appropriate EBIT margin in the range of 5-8 per cent. However, KPMG noted that estimated margins that exclude customer acquisition costs are likely to be significantly less than margins observed in the market.<sup>168</sup>

While there is undoubtedly some circularity with benchmarking against other regulatory decisions, it can nevertheless provide useful information about the reasonableness of the retail margin estimated using the bottom-up and the expected returns approaches. The analysis suggests that the allowance for the retail margin should be in the range of 1.5 per cent to 8 per cent (1.5 per cent to 5 per cent if Charles River Associates' reports to Victoria's Department of Infrastructure are excluded from the benchmark group). However, it is important to recognise that not all of these decisions are comparable in terms of the risks and costs they are designed to cover. For example, some regulatory decisions have provided an allowance for customer acquisition costs in the retail margin. The analysis is further complicated by the fact that the margin is not clearly defined in a number of the regulatory decisions listed.

The Tribunal's draft finding was that a retail margin (EBITDA) of 5 per cent (the mid point of Frontier Economics' recommended range) was appropriate. When making this finding, the Tribunal noted that Frontier Economics had assumed a one-for-one relationship between growth in electricity consumption and GDP as an input to the expected returns analysis. This assumption was based on analysis of data for electricity consumption for all customers. The Tribunal noted that the one-for-one assumption may not hold if the analysis was undertaken using consumption for only small retail customers.

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<sup>166</sup> Frontier Economics, *Mass market new entrant retail costs and retail margin, Final Report*, March 2007, p 68.

<sup>167</sup> Integral Energy submission, February 2007, p 32 and attachment to EnergyAustralia submission, February 2007, report prepared by KPMG, *Benchmarking retail operating costs and margins*, p 14.

<sup>168</sup> Frontier Economics, *Mass market new entrant retail costs and retail margin, Final Report*, March 2007, p 63.

In submissions in response to the draft determination, stakeholders generally supported a minimum retail margin of 5 per cent. New entrant retailers tended to suggest that 5 per cent is below market expectations over the longer term<sup>169</sup> and that it would be more appropriate to move to the higher end of the range determined by the expected returns analysis (around 6.4 per cent).<sup>170</sup> In response to the Tribunal's comments on the relationship between growth in electricity consumption and GDP, Integral Energy suggested that it would be inappropriate to change the assumptions underlying the expected returns calculation without undertaking further consultation.<sup>171</sup>

In making its final determination, the Tribunal asked Frontier Economics to consider whether its assumption of a one-for-one relationship between growth in electricity consumption and GDP would change if the analysis was undertaken for only small retail customers. Frontier Economics undertook significant statistical analysis in relation to this issue and provided a supplementary report to the Tribunal outlining its analysis and findings.<sup>172</sup> Using residential electricity consumption as a proxy for small retailer customers' consumption, Frontier Economics concluded that there was not sufficient evidence to suggest that its original assumption of a one-for-one relationship was invalid. On this basis, it has not changed its conclusions in relation to the retail margin and still recommends a range of 4 per cent to 6 per cent (EBITDA).

The Tribunal still considers that there is some doubt as to whether the relationship between the growth in electricity consumption for small retail customers and the growth in GDP is one-for-one. However, on the basis of Frontier Economics' conclusion that there is insufficient evidence to reject a one-for-one relationship, the Tribunal's final findings in relation to the retail margin are unchanged from its draft findings. The Tribunal considers that a retail margin of 5 per cent, which is the mid-point of the range recommended by Frontier Economics, is an appropriate allowance to include in its estimate of hypothetical retailer costs.

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<sup>169</sup> AGL submission, May 2007, p 2.

<sup>170</sup> TRUenergy submission, May 2007, p 2 and Australian Power & Gas submission, May 2007, p 5.

<sup>171</sup> Integral Energy submission, May 2007, p 29.

<sup>172</sup> Frontier Economics *The association between unexpected changes in electricity volume and GDP growth for residential customers*, May 2007.

## 8 | Calculating the total cost allowances and setting the regulated retail price controls

In setting the regulated retail price controls – that is, the R values used in calculating the weighted average price cap for regulated retail tariffs – the Tribunal was informed by its calculation of ‘hypothetical retailer’ costs, its assessment of how the Standard Retailers’ costs of supplying regulated customers will increase over the determination period, and its analysis of the different options for setting the tariff path over the period.

The section below provides an overview of the Tribunal’s final decision on the regulated retail price controls for each year of the determination period. The subsequent sections explain:

- ▼ the Tribunal’s calculation of hypothetical retailer costs for each year of the determination period
- ▼ its calculation of these hypothetical retailer costs per unit
- ▼ how it set the regulated retail price controls for each year of the determination.

## 8.1 Overview of the Tribunal's final decision on the regulated retail price controls

The Tribunal's final decision is to set the regulated retail price controls (R values) shown in Table 8.1 below.

**Table 8.1 R values in each year of the determination (\$2006/07)**

Description	2007/08	2008/09	2009/10
<b>Country Energy</b>			
Fixed R	69.5	77.3	85.9
Variable R:			
Single rate and time of use	72.5	72.9	73.2
Controlled load A	43.9	44.2	44.5
Controlled load B	58.4	60.3	62.1
<b>EnergyAustralia</b>			
Fixed R	69.5	77.3	85.9
Variable R:			
Single rate and time of use	67.2	70.1	73.0
Controlled load A	42.1	43.1	44.2
Controlled load B	53.8	56.2	58.8
<b>Integral Energy</b>			
Fixed R	69.5	77.3	85.9
Variable R:			
Single rate and time of use	70.7	74.8	79.0
Controlled load A	43.7	45.6	47.5
Controlled load B	54.1	57.5	61.1

**Note:** In the draft determination, the R values are expressed in 2007/08 dollars. In order to be comparable with the assessed cost allowances set out in this chapter the values from the draft determination have been deflated by a CPI of 3.1%.

These R values will be used in calculating the weighted average price cap that will be used to regulate the prices that each Standard Retailer charges customers on regulated retail tariffs. The Tribunal's decision on the R values will mean that in 2009/10 retailers will be able to increase regulated retail tariffs so that they fully recover the assessed costs of the Tribunal's 'hypothetical retailer', including energy costs, retail operating costs and retail margin, consistent with the terms of reference.

## 8.2 Tribunal's calculation of hypothetical retailer's costs

As Chapters 6 and 7 discussed, in line with its terms of reference, the Tribunal assessed the allowances required to cover the costs of a hypothetical retailer in each year of the determination period, including:

- ▼ energy costs, taking into account the planned phasing out of the ETEF and the electricity purchase costs for the regulated load for each Standard Retailer's supply area
- ▼ retail operating costs and retail margin for a mass market new entrant retailer.

The Tribunal then added these allowances together to obtain an aggregated cost figure for a hypothetical retailer in each standard supply area.

This approach is consistent with the approach the Tribunal used in making its draft determination. However, as Chapter 6 discussed, the Tribunal has included a mechanism to review the market-based electricity purchase cost allowance early in 2008/09 and 2009/10, which may result in changes to the energy cost allowance, and by implication to the hypothetical retailer's costs, for those years.

The Tribunal considers that its aggregated hypothetical retailer cost figures are likely to be higher than the efficient costs of the Standard Retailers, for the following reasons:

- ▼ The hypothetical retailer cost figures include customer acquisition costs which. As Chapter 7 discussed, the Standard Retailers do not incur these costs in relation to regulated customers. However, they will increasingly incur customer retention costs, as the NSW market becomes more competitive.
- ▼ Standard Retailers will still have access to the ETEF for a significant proportion of their regulated load until the end of the determination period, and therefore are not fully exposed to market risk.
- ▼ the Tribunal has allowed for a retail margin appropriate for a mass market new entrant, which could be higher than the margin a Standard Retailer requires under current circumstances. The Tribunal notes that the costs will very likely be appropriate for a standard retailer by 2010.

The aggregated hypothetical retailer costs could also be higher than those of efficient mass market new entrants, as these companies may engage in trading strategies that are lower cost and higher risk (but also efficient) compared to the one assumed by the Tribunal. In addition, the terms of reference required the Tribunal to assess the energy costs allowance on the basis of the regulated load only, which ignores the potential portfolio benefits that both Standard Retailers and mass market new entrant retailers could achieve in a broader market.

The Tribunal considers that while the determination includes a higher retail margin in recognition of the increasing risks faced by retailers during the determination period, over time competition will put downward pressure on the cost base and

provide a more diverse offering of prices and services; both of which will benefit customers in the longer term.

Table 8.2 provides an overview of the Tribunal's calculation of the hypothetical retailer's costs in each standard supply area for each year of the determination, and compares these costs with the cost allowances used in the 2004 determination (expressed in 2006/07 dollars).



**Table 8.2 Hypothetical retailer costs for each year of the determination compared with current cost allowances (\$2006/07)**

Description	2006/07 <sup>a</sup>	2007/08	2008/09	2009/10
	2004 determination	2007 determination		
Country Energy				
Electricity purchase cost (\$/MWh)	49	49	48	44
Green costs (\$/MWh)	3	5	5	6
NEM fees (\$/MWh)	1	1	1	1
Energy losses	13.6%	12.3%	12.3%	12.3%
<b>Total energy purchase cost (\$/MWh)</b>	<b>61</b>	<b>62</b>	<b>61</b>	<b>57</b>
Retail operating costs (\$/customer)	74	75	75	75
Customer acquisition costs (\$/customer)	-	35	35	35
Adjustment for double counting (\$/customer)	-	-5	-5	-5
<b>Total retail costs (\$/customer)</b>	<b>74</b>	<b>105</b>	<b>105</b>	<b>105</b>
Retail margin	2%	5%	5%	5%
EnergyAustralia				
Electricity purchase cost (\$/MWh)	49	57	55	51
Green costs (\$/MWh)	3	4	5	5
NEM fees (\$/MWh)	1	1	1	1
Energy losses	6.0%	6.8%	6.8%	6.8%
<b>Total energy purchase cost (\$/MWh)</b>	<b>57</b>	<b>66</b>	<b>65</b>	<b>61</b>
Retail operating costs (\$/customer)	74	75	75	75
Customer acquisition costs (\$/customer)	-	35	35	35
Adjustment for double counting (\$/customer)	-	-5	-5	-5
<b>Total retail costs (\$/customer)</b>	<b>74</b>	<b>105</b>	<b>105</b>	<b>105</b>
Retail margin	2%	5%	5%	5%
Integral Energy				
Electricity purchase cost (\$/MWh)	49	59	58	53
Green costs (\$/MWh)	3	5	5	6
NEM fees (\$/MWh)	1	1	1	1
Energy losses	8.6%	9.1%	9.1%	9.1%
<b>Total energy purchase cost (\$/MWh)</b>	<b>58</b>	<b>70</b>	<b>69</b>	<b>65</b>
Retail operating costs (\$/customer)	74	75	75	75
Customer acquisition costs (\$/customer)	-	35	35	35
Adjustment for double counting (\$/customer)	-	-5	-5	-5
<b>Total retail costs (\$/customer)</b>	<b>74</b>	<b>105</b>	<b>105</b>	<b>105</b>
Retail margin	2%	5%	5%	5%

<sup>a</sup> The 2006/07 allowance is based on the costs from the 2004 determination. Dollar values from the 2004 determination have been inflated from 2004/05 dollars to 2006/07 dollars.

In the 2004 determination depreciation is included in the retail operating costs and excluded from the margin (EBIT). The 2007 determination includes depreciation in the margin (EBITDA) and excludes it from the retail operating costs.

### 8.3 Tribunal's calculation of hypothetical retailer costs per unit

Once the Tribunal calculated the hypothetical retailer costs for each standard supply area for each year of the determination period, it disaggregated these costs to calculate the costs per unit for each year of the period.

The Tribunal broke down the hypothetical retailer costs on the same (or a similar) unit basis to the way prices are charged – for example, \$ per customer or \$ per MWh consumed – using the following process – it:

- ▼ broke down the assessed cost allowances down into fixed and variable costs
- ▼ expressed the fixed costs as dollars per customer per year
- ▼ allocated the variable costs (based on sales) to various types of supply (single rate and time of use (TOU), Controlled load A and Controlled load B) and expressed them as cents per kWh values, and
- ▼ allowed a retail margin on these costs plus estimated network charges for each of the different types of supply.

This process is similar to the one the Tribunal used in making its draft decision, except that for the final decision, the Tribunal allocated the variable costs in a way that resulted in a lower number of R values in the final determination.

In its response to the draft determination, EnergyAustralia expressed concerns with the way the 'peak', 'shoulder' and 'off-peak' values for TOU tariffs had been calculated.<sup>173</sup> In particular, it was concerned that the cost allowance for a customer on a single rate tariff was higher than for the same customer on a TOU tariff, particularly in 2008/09 and 2009/10. EnergyAustralia proposed using only one R value that would apply to both single rate and TOU tariffs.

The Tribunal did not take this approach for the draft determination, as it was concerned that using a single R value for both single rate and TOU tariffs required it to lock in the current peak/shoulder/off-peak usage profile for the TOU tariff, which could expose Standard Retailers to unnecessary risk. However, after discussing this issue with each of the Standard Retailers, the Tribunal no longer considers that this is a significant problem.

The Tribunal agrees that it is not appropriate for the determination to give the Standard Retailers an incentive to supply regulated customers on single rate in preference to TOU tariffs. The Tribunal also notes that such an outcome would not meet the requirement in the terms of reference for it to consider the impact of its determination on demand management, and would not support the COAG agreement to roll out smart meters.<sup>174</sup> The Tribunal considers that EnergyAustralia's proposal to apply one R value to both single rate and TOU tariffs is both a sensible

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<sup>173</sup> EnergyAustralia submission, May 2007, p 27.

<sup>174</sup> In February 2006, COAG agreed to do this progressively in order to improve price signals for energy consumers and investors – COAG Meeting *Communiqué*, 10 February 2006, p 5.

and practical solution, and is consistent with the Tribunal's decision to move to a more light-handed form of regulation.

Table 8.3 provides the hypothetical retailer costs per unit resulting from this process for each year of the determination period, and compares these with cost allowances for 2006/07 broken down on the same basis.

**Table 8.3 Hypothetical retailer costs per unit in each year of the determination compared with current cost allowances per unit (\$2006/07)**

Description	2006/07 <sup>a</sup>	2007/08	2008/09	2009/10
<b>Country Energy</b>				
Fixed retail costs - \$ per customer	62.5	85.9	85.9	85.9
Variable retail costs - \$ per MWh:				
Single rate and time of use	72.2	78.8	77.9	73.2
Controlled load A	43.7	43.3	43.5	44.5
Controlled load B	56.6	66.0	65.4	62.1
<b>EnergyAustralia</b>				
Fixed retail costs - \$ per customer	62.5	85.9	85.9	85.9
Variable retail costs - \$ per MWh:				
Single rate and time of use	64.1	78.3	77.6	73.0
Controlled load A	41.1	42.4	42.8	44.2
Controlled load B	51.4	61.3	61.0	58.8
<b>Integral Energy</b>				
Fixed retail costs - \$ per customer	62.5	85.9	85.9	85.9
Variable retail costs - \$ per MWh:				
Single rate and time of use	66.9	85.3	84.4	79.0
Controlled load A	41.9	45.9	46.3	47.5
Controlled load B	51.0	63.5	63.3	61.1

<sup>a</sup> The 2006/07 allowance is based on the R values included in the 2004 determination. Dollar values from the 2004 determination have been inflated from 2004/05 dollars to 2006/07 dollars. For Country Energy, costs are the weighted average urban and rural retail R values for Country Energy and (the former) Australian Inland Energy and Water.

## 8.4 How the Tribunal set the regulated retail price controls (R values)

After reviewing the hypothetical retailer costs per unit, and considering the current level of regulated retail tariffs, the Tribunal considered what regulated retail price controls (R values) would best match its objectives for the review.

In its draft decision, the Tribunal decided to set R values so that regulated retail tariffs would increase gradually over the determination period, and reach a level that reflects the hypothetical retailer costs in 2010. It considered that such a transition path was appropriate, given that Standard Retailers' risks and costs will increase gradually as the ETEF is phased out and the level of competition in the NSW market

increases. Further, the Tribunal considered that the hypothetical retailer's cost allowances more than recover the costs of a Standard Retailer while the ETEF remains.

The Tribunal developed its draft decision on the R values as follows:

- ▼ for 2009/10, the R values were set to reflect the hypothetical retailer costs (exactly)
- ▼ for 2007/08 and 2008/09, the R values were set to reflect the increase in regulated tariffs required to move tariffs smoothly from their current levels to the level that allows full recovery of the hypothetical retailer costs in 2009/10.

The Tribunal's key reasons for adopting this approach were that:

- ▼ the assessed cost allowances are likely to overstate the actual costs of supplying regulated retail customers in 2007/08 and 2008/09, as noted in section 8.2
- ▼ the Tribunal considered that there were benefits in providing for a stable and smooth tariff path – noting that the actual tariffs to customers will also be affected by network prices and the individual retailer's decisions on tariffs
- ▼ the approach would phase in the full efficient cost of purchasing electricity in the market in line with the reduction in the proportion of regulated load supported by the ETEF, and phase in a higher margin in line with the increase in the risk retailers face over the period.

In submissions on the draft determination, the retailers noted that the Tribunal's draft decision to transition towards the 2009/10 energy costs compounds the issue of the downward sloping energy cost curve over the determination period.<sup>175</sup> The retailers submitted that transitioning towards this point overlooks the costs in the previous two years, and may impact on the competitiveness of the market given that second tier retailers do not have access to the ETEF.

After considering the views expressed in submissions, the Tribunal notes that any transition path other than full cost recovery in every year necessarily means that tariffs in each year will not fully reflect the costs in that year. The Tribunal does not consider that full recovery of the hypothetical retailer costs in each year of the determination is appropriate. It considers that there are a number of factors that support the retention of the straight line transitioning approach. These factors include that:

- ▼ the Tribunal's view on the appropriate cost allowances has not changed significantly since the draft determination, although it has now introduced an annual review of the market-based electricity purchase cost allowance
- ▼ the hypothetical retailer costs do not reflect the actual costs of any particular retailer, or class of retailer, and are expected to overstate the costs of the Standard Retailers, as their regulated load is at least partly supported by the ETEF until 27 June 2010

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<sup>175</sup> For example, see EnergyAustralia submission, May 2007, p 19.

- ▼ the terms of reference require the Tribunal to ensure that tariffs recover the hypothetical retailer costs by 30 June 2010, and a straight line transition path meets this requirement while recognising that there are benefits for customers in providing a stable and smooth tariff path
- ▼ it is a simple, understandable, practical and pragmatic approach, whereas tariffs that followed the hypothetical retailer's costs would result in substantial increases in tariffs in the first two years of the determination period and tariff reductions in the final year.

For these reasons, and taking into account the impact on customers, the Tribunal reaffirms its decision to adopt a straight line transition path from current tariffs to the hypothetical retailer costs in 2009/10. The Tribunal recognises that unlike EnergyAustralia and Integral Energy, Country Energy's tariffs are currently about 6 per cent below the cost allowance for 2006/07. Therefore, the Tribunal has decided that Country Energy should be given additional flexibility to fully eliminate this existing under recovery in 2007/08.

Another important reason for retaining a straight line transition path in the final determination is that the Tribunal still expects that the Standard Retailers' actual costs as the ETEF is phased out will be close to the costs they will recover under this approach. However, as discussed in Chapter 6, there is potential for market based electricity purchase cost allowances for 2007/08 and 2008/09 to differ from those included in this decision. Based on advice from Frontier Economics, the Tribunal considers that retailers are likely to be protected against high electricity purchase costs in 2007/08, because their entire regulated load is supported by the ETEF in this year, and that other retailers are expected to have sufficient hedging cover for this period. However, the Tribunal is concerned about the impact of significantly higher costs in 2008/09 should they occur.

To address the risk that electricity purchase costs will be significantly different from the estimates of these costs used in making this determination, the Tribunal has incorporated an annual review of the market-based electricity purchase cost allowance. Significant changes in electricity purchase costs may mean that the transition path applied by the Tribunal is no longer appropriate. The Tribunal has decided that in the event that it revises the market-based electricity purchase cost allowance in 2008/09 and/or 2009/10, it will reconsider the transition path and recalculate the R values at that time to take that change into account. The Tribunal will not revisit the other cost allowances included in this determination.

The Tribunal's final decisions on the R values for each Standard Retailer in each year of the determination period are shown in Table 8.1. The Standard Retailers must use these R values in calculating the annual weighted average price cap for their regulated tariffs.

8 Calculating the total cost allowances and setting the regulated retail price controls

## 9 Outcomes for customers

In undertaking its review and making its final determination, the Tribunal has been guided by the terms of reference provided by the Minister for Energy (see Appendix A).

The Tribunal considers that higher retail electricity prices in NSW are justified, and indeed necessary, to ensure that the people in this state continue to have access to a safe and reliable supply of electricity. Over the next three years, the Electricity Tariff Equalisation Fund (ETEF) will be phased out and, as a consequence, NSW electricity arrangements will more closely resemble those in Victoria and South Australia. The energy cost component of retail electricity prices needs to be sufficient to attract efficient and economic investment in generation to NSW, and to enable retailers to meet their obligations regarding greenhouse gas emissions and purchases of renewable energy. Retail prices also need to be sufficient to recover the costs incurred in selling electricity in a competitive market, and to compensate retailers for the risks that they face. In addition, they need to be sufficient to recover investments in the distribution network associated with increased reliability standards and higher peak demand.

The Tribunal's final determination on regulated retail tariffs aims to meet these requirements and those set out in its terms of reference by providing for:

- ▼ higher allowances for electricity purchase costs for EnergyAustralia and Integral Energy
- ▼ higher allowances for retail operating costs and retail margin
- ▼ higher network costs to be passed through to customers.

As result of this final determination, the total average regulated price increases in each year of the determination will be 4.1 per cent for EnergyAustralia, 4.9 per cent for Integral Energy, and 3.7 per cent for Country Energy. Taking into account the effect of inflation in each year, these increases are expected to be 7.3, 8.1 and 7.0 per cent respectively.

The Tribunal has calculated the expected impact of its final determination on customer bills (taking into account the expected changes in inflation). This impact is discussed below.

## 9.1 Expected impact on customer bills

It is not possible to precisely forecast the increases in individual tariffs because, under the weighted average price cap (WAPC) approach, retailers have the flexibility to determine the level and structure of individual regulated tariffs. Under this form of regulation, the Tribunal stipulates the maximum increase in the level of average regulated prices a retailer can impose each year. At the individual tariff level, prices may increase at a higher or lower rate than the average.

However, given that the vast majority of customers in the EnergyAustralia and Integral Energy standard supply areas are on one or two tariffs, customers in these areas are likely to face price increases not substantially different from the average. The Tribunal expects that most of Country Energy's customers will also see price increases that are similar to the average. However, Country Energy has a number of obsolete tariffs that are below the cost of supply and the average increases shown below are likely to underestimate the increases for customers who are supplied on those tariffs.

The impact on customer bills will also depend on the balance between fixed and variable charges and the structure of network tariffs. In the draft report, the Tribunal estimated increases in annual bills assuming that the retail components of prices are the relevant fixed and variable R factors set out in the draft determination. Under the draft determination, the percentage increase for the fixed R was larger than the percentage increase for the variable R.

However, under the WAPC, the Standard Retailers have the flexibility to determine the level and structure of individual regulated tariffs. Therefore, the relative impacts of actual tariff changes on the bills of small and large consumers will depend on how the retailers set their prices to meet the average price increases (determined using the fixed and variable R values set out in this decision).

In this final report, for the purposes of presenting indicative outcomes for customer bills in 2007/08 to 2009/10, the Tribunal has simply applied the average increases in retail and (expected) network charges to the retail and network components of the 2006/07 bills.

Tables 9.1 – 9.3 show the estimated average nominal price increases for a typical small customer of each Standard Retailer. While these tables provide an indicative picture of likely nominal increases to bills for these customers (Tables 9.1, 9.2 and 9.3) actual customer bills may differ from those shown here.<sup>176</sup>

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<sup>176</sup> This information is indicative only and is based on the Tribunal's assumptions that the increase in CPI is 3.1 per cent.



**Table 9.1 Indicative increases in annual bills for typical customers of Country Energy (\$/customer, nominal, ex-GST)**

Description	2006/07 bill	2007/08 bill	2008/09 bill	2009/10 bill	Increase 2006/07 – 2007/08 (%)	Increase 2007/08 – 2008/09 (%)	Increase 2008/09 – 2009/10 (%)
<b>Residential</b>							
Low usage (3000 kWh per year)	604	658	697	739	8.9%	6.0%	6.0%
Medium usage – no controlled load (5600 kWh per year)	1,001	1,092	1,156	1,225	9.1%	5.9%	5.9%
Medium usage – with controlled load (8900 kWh per year)	1,197	1,308	1,385	1,466	9.3%	5.8%	5.9%
<b>Business</b>							
20 MWh per year	3,564	3,879	4,112	4,359	8.9%	6.0%	6.0%
40 MWh per year	6,904	7,518	7,968	8,446	8.9%	6.0%	6.0%
80 MWh per year	13,586	14,795	15,679	16,620	8.9%	6.0%	6.0%

**Note:** The 8900 kWh comprises 5,600 kWh on the single rate and 3,300 kWh on Controlled Load A.

The increases are expressed in nominal terms; therefore, they include expected changes in inflation over the period.

The 2006/07 bills are typical for Country Energy residential customers on main Urban Domestic tariff and Urban Domestic Off-peak 1 tariff. Non-residential customers are on the main Urban Business tariff.

**Table 9.2 Indicative increases in annual bills for typical customers of EnergyAustralia (\$/customer, nominal, ex-GST)**

Description	2006/07 bill	2007/08 bill	2008/09 bill	2009/10 bill	Increase 2006/07 – 2007/08 (%)	Increase 2007/08 – 2008/09 (%)	Increase 2008/09 – 2009/10 (%)
<b>Residential</b>							
Low usage (3000 kWh per year)	444	476	512	549	7.2%	7.5%	7.3%
Medium usage – no controlled load (5600 kWh per year)	724	777	834	896	7.2%	7.5%	7.3%
Medium usage – with controlled load (8900 kWh per year)	878	943	1,014	1,089	7.3%	7.6%	7.4%
<b>Business</b>							
20 MWh per year	2,650	2,842	3,054	3,278	7.2%	7.5%	7.3%
40 MWh per year	5,539	5,942	6,387	6,858	7.3%	7.5%	7.4%
80 MWh per year	11,316	12,141	13,054	14,018	7.3%	7.5%	7.4%

**Note:** The 8900 kWh comprises 5,600 kWh on the single rate and 3,300 kWh on Controlled Load A.

The increases are expressed in nominal terms; therefore, they include expected changes in inflation over the period.

The 2006/07 bills are typical for EnergyAustralia residential customers on the Domestic All time and Controlled Load-Off peak 1 tariff. Non-residential customers are on the General Supply All Time LV tariff.

**Table 9.3 Indicative increases in annual bills for typical customers of Integral Energy (\$/customer, nominal, ex-GST)**

Description	2006/07 bill	2007/08 bill	2008/09 bill	2009/10 bill	Increase 2006/07 – 2007/08 (%)	Increase 2007/08 – 2008/09 (%)	Increase 2008/09 – 2009/10 (%)
<b>Residential</b>							
Low usage (3000 kWh per year)	505	544	588	636	7.8%	8.1%	8.2%
Medium usage – no controlled load (5600 kWh per year)	824	888	960	1,039	7.8%	8.1%	8.2%
Medium usage – with controlled load (8900 kWh per year)	985	1,063	1,151	1,247	8.0%	8.3%	8.4%
<b>Business</b>							
20 MWh per year	2,724	2,935	3,172	3,430	7.7%	8.1%	8.1%
40 MWh per year	5,384	5,800	6,266	6,775	7.7%	8.0%	8.1%
80 MWh per year	10,702	11,528	12,454	13,466	7.7%	8.0%	8.1%

**Note:** The 8900 kWh comprises 5,600 kWh on the single rate and 3,300 kWh on Controlled Load A.

The increases are expressed in nominal terms; therefore, they include expected changes in inflation over the period.

The 2006/07 bills are typical for Integral Energy residential customers on the Domestic tariff and Off-peak 1 tariff. Non-residential customers are on the General Supply tariff.

## 10 Non tariff charges

The Tribunal has made its final decisions on the maximum allowable charge for each regulated retail charge (non-tariff charge) included in the *Electricity Supply Act 1995*. This Act defines a regulated retail charge as:

- ▼ a security deposit
- ▼ a late payment fee, or
- ▼ a fee for a dishonoured bank cheque.

In effect, this definition means that Standard Retailers can impose no other non-tariff charges (although they can pass through network miscellaneous charges).

The Tribunal established a working group comprising representatives of retailers, community welfare organisations and the Energy and Water Ombudsman of NSW (EWON) to provide information and comment on options for the above non-tariff charges. The Tribunal's decisions and considerations in relation to each charge are outlined below.

### 10.1 Security deposits

#### 10.1.1 Final decision

The Tribunal's final decision is that:

- ▼ Security deposits will remain at the levels specified in the 2004 Determination. That is, they will be either:
  - 1.5 times the average quarterly electricity account, or
  - 1.75 times the average 2-monthly electricity account, or
  - 2.5 times the average monthly electricity account.

The circumstances surrounding the charging and return of security deposits will be as set out in the 2004 Determination, with the following three additions:

- In general, a security deposit may only be required from a residential customer prior to connection. However, a security deposit can also be required from a residential customer within 12 months of connection if the customer entered into a payment plan and subsequently cancelled that plan and the other circumstances where a security deposit may be required apply.

- Centrepay is specified as an instalment plan for the purpose of applying the exemption on security deposits if a customer has agreed to pay by an instalment or payment plan.
- A Standard Retailer Supplier's recourse to a security deposit is limited to recovering amounts due to it in respect of charges related to the supply of electricity or connection services arranged by it and where:
  - the customer has failed to pay an electricity retail bill resulting in disconnection, or
  - the customer has failed to pay an electricity retail bill and has requested that the Standard Retail Supplier cease supplying electricity to that customer's supply address under a standard form customer supply contract.

This final decision differs from the draft decision on security deposits discussed in the Tribunal's draft report and determination by restricting retailers' recourse to security deposits to recovering amounts owed on a final bill when the customer initiates disconnection or is disconnected because of failure to pay a bill.

### 10.1.2 Tribunal's considerations

The Tribunal considered the level of security deposits and the circumstances in which a customer can be required to pay such a deposit. In submissions in response to the Tribunal's issues paper, retailers generally considered that the level of security deposits set in the 2004 Determination was appropriate. EWON submitted that there should be no increases.<sup>177</sup> NCOSS, while preferring that security deposits be abolished, put the view that if they were retained a cap should be placed on the amount, as in the 2004 Determination.<sup>178</sup> There was minimal comment on the level of security deposits in submissions responding to the draft report and determination.

After considering the various stakeholder views, the Tribunal is of the view that the security deposit levels in the 2004 Determination, which are based on multiples of an average bill, are implicitly indexed and remain appropriate. Therefore, it affirms its draft decision to keep security deposits at the levels specified in the 2004 Determination.

In relation to the circumstances surrounding the charging and return of security deposits, the 2004 Determination provides that a retail supplier may only require a customer to pay a security deposit at or before connection, and in the following circumstances:

- ▼ only where the customer has left a supply address without paying a debt, or
- ▼ has been responsible for the illegal use of electricity within the previous two years, or

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<sup>177</sup> EWON submission, October 2006, p 23.

<sup>178</sup> NCOSS submission, October 2006, p 4.

- ▼ does not have a satisfactory credit history and the retail supplier has offered the customer an instalment or payment plan and the customer has refused or failed to agree to that offer.

In its submission in response to the issues paper, Integral Energy proposed that these provisions be changed, so that retailers can require a customer to pay a security deposit any time in the life of a supply agreement.<sup>179</sup> EWON opposed this proposal, arguing that it would particularly disadvantage people in financial difficulty.<sup>180</sup> Working group discussions identified that the main issue for retailers was the need to close a perceived loophole under the current provisions – that is, that a new customer can avoid paying a security deposit by agreeing to pay his or her bills by an instalment or payment plan and then cancelling the plan once connected. Although working group members generally agreed that the Tribunal’s determination should address this issue, PIAC raised some concerns. In particular, it noted that there should be clear rules about the circumstances in which a security deposit can be required after connection.<sup>181</sup>

The Tribunal’s draft report and determination proposed that this issue be addressed by amending the current provisions in relation to security deposits so that in general, a retailer can only require a residential customer to pay a security deposit prior to connection; however, it can also require a security deposit from a residential customer within 12 months of connection if that customer entered into an instalment or payment plan and subsequently cancelled that plan (and the other circumstances where a security deposit may be required apply).

PIAC opposed this amendment on grounds that it is unfair to customers who are already experiencing financial difficulty.<sup>182</sup> NCOSS questioned the scale of the problem the amendment aims to address, and the impacts of it.<sup>183</sup> Integral Energy and EnergyAustralia supported the amendment, and noted that agreeing to enter a payment plan then cancelling the plan after connection is a known pattern of behaviour to avoid having to pay a security deposit.<sup>184</sup>

Under the current provisions, retailers can require customers to pay a security deposit at the time of connection if they are unable to demonstrate a satisfactory credit history, and elect not to enter into a payment plan offered by the retailer. The Tribunal’s aim in making provision for security deposits to be required after connection in certain circumstances is to close the loophole in these provisions described above. While the Tribunal acknowledges that some customers find it difficult to pay security deposits, it considers that the amendment described above is

<sup>179</sup> Integral Energy submission, September 2006, p 63.

<sup>180</sup> EWON submission, October 2006, p 23.

<sup>181</sup> Miscellaneous charges working group meeting, 22 November 2006.

<sup>182</sup> PIAC submission, 3 May 2007, p 11.

<sup>183</sup> NCOSS submission, 3 May 2007, p 7.

<sup>184</sup> EnergyAustralia submission, May 2007, p 30; Integral Energy submission 2 May 2007, p 30, Integral Energy email, 11 May 2007; Country Energy email, 11 May 2007.

consistent with the intent of the current provisions. Therefore, it affirms its draft decision to amend the current provisions so that retailers can require a customer to pay a security deposit within 12 months of connection if that customer entered into a payment plan and subsequently cancelled that plan (and the other circumstances where a security deposit may be required apply).

In its submission to the issues paper, EWON observed that some retailers do not recognise Centrepay as a payment plan for the purpose of applying the exemption from payment of a security deposit.<sup>185</sup> EWON argued that this is anomalous and places an unfair burden on people in receipt of government benefits. Centrepay, which is the free direct bill paying service offered to people receiving payment from Centrelink, allows those people to pay for services (including electricity) by having a regular amount deducted from their Centrelink payment. The Tribunal's draft determination proposed that this issue be addressed by amending the current provisions in relation to security deposits so that Centrepay is specified as a payment plan for this purpose. In general, stakeholders supported this amendment.<sup>186</sup> Therefore, the Tribunal affirms its draft decision to amend the provisions in this way.

EWON also expressed concern about the length of time retailers can hold security deposits. It noted that under the current arrangements, retailers must refund a security deposit after the customer has made four consecutive on-time payments. Therefore, if a customer is one or two days late in making the fourth payment, their retailer can retain their security deposit for another 12 months. EWON suggested that security deposits should be refunded after four on-time payments or two consecutive on-time payments.<sup>187</sup> PIAC also objected to the fact that retailers are not required to pay interest when they refund security deposits.<sup>188</sup>

The Tribunal considered the concerns raised and sought further comment from members of the miscellaneous charges working group on three options for amending requirements about the refunding of security deposits for residential customers. These options were that retailers must refund security deposit when the customer has:

1. paid a total of four electricity bills on time, or
2. paid all electricity bills on time for six months, or
3. paid all electricity bills in full at the end of six or 12 months (regardless of whether payment was on time).

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<sup>185</sup> EWON submission, October 2006, p 23.

<sup>186</sup> EnergyAustralia submission, May 2007, p 30; EWON submission, 2 May 2007, p 17; Integral Energy submission, 2 May 2007, p 30.

<sup>187</sup> EWON submission, 2 May 2007, p 17.

<sup>188</sup> PIAC submission, 3 May 2007, p 11.

Most of the retail supplier representatives who responded argued for the status quo, and opposed all three options. They particularly opposed the first and third options, which they considered would require significant system changes, be costly, and could not be implemented from 1 July 2007.<sup>189</sup> EnergyAustralia also advised the Tribunal that in practice it accommodates the issue of customers paying their bills a few days late by allowing three business days after the due date when determining whether a customer satisfies criteria for refunding a security deposit.<sup>190</sup> EWON recommended options 1 or 2 in its submission on the draft report and determination. The other non-retail supplier representatives of the working group did not specifically comment on the options.

Based on the information provided by members of the working group, the Tribunal is persuaded that it is costly to implement the first and third options. The Tribunal also notes that all three options are inconsistent with the approaches taken in other jurisdictions, and considers that introducing this interstate difference in the treatment of security deposits is not warranted. In addition, the Tribunal considers that requiring retailers to pay interest on security deposits would substantially increase the complexity and cost of administering security deposits. These increased costs are likely to be greater than the benefit to customers. For all these reasons, the Tribunal has decided to retain the current provisions in relation to the refund of security deposits.

The 2004 determination does not specify when a retailer may have recourse to a security deposit. Consistent with the regulation governing when a retailer may have recourse to a security deposits for customers on competitive contracts,<sup>191</sup> the Tribunal included a clause in the draft determination preventing Retail Suppliers from applying a security deposit to charges not related to the supply or connection of electricity.<sup>192</sup> The draft determination also stated that it did not prevent the topping up of security deposits if a retailer had applied a customer's security deposit to a customer's account.<sup>193</sup>

In its final determination, the Tribunal specified that security deposits may only be applied to a customer's account where a customer has failed to pay a bill resulting in disconnection, or in relation to a final bill where a customer moves, requests disconnection or transfers to another retailer. The Tribunal considers this removes ambiguity, allows Retail Suppliers reasonable access to security deposits, and is

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<sup>189</sup> AGL email, 7 May 2007; Country Energy email, 3 May 2007; EnergyAustralia email 14 May 2007, Integral Energy email, 10 May 2007.

<sup>190</sup> EnergyAustralia email, 14 May 2007.

<sup>191</sup> *Electricity Supply (General) Regulation 2001*, Schedule 2, clause 9.

<sup>192</sup> IPART, *Promoting retail competition and investment in the NSW electricity industry – Draft Report and Draft Determination*, April 2007 clause 20.6.

<sup>193</sup> IPART, *Promoting retail competition and investment in the NSW electricity industry – Draft Report and Draft Determination*, April 2007 clauses 20.4(c) and 20.5(c).



consistent with arrangements in other jurisdictions<sup>194</sup> and general industry practice. The Tribunal has deleted all reference to the topping up of security deposits, because it introduces changes in the way that security deposits are administered compared to the current determination and those changes were not properly consulted on and could be problematic for customers facing financial difficulty.

## 10.2 Late payment fee

### 10.2.1 Final decision

**The Tribunal has decided to set the maximum late payment fee at \$7.00, exclusive of GST. The Tribunal has also decided to retain the conditions under which retailers can charge late payment fees set in the 2004 Determination.**

### 10.2.2 Tribunal's considerations

The Tribunal has considered both the level of the late payment fee, and the conditions under which this fee can be charged. In relation to the level of the late payment fee, the 2000 and 2004 Determinations set this fee at \$5.00, exclusive of GST, and did not index the fee for inflation. For the 2007 determination, the Tribunal made a draft decision to increase the fee to \$7.00, exclusive of GST, and not index for inflation.

In making this draft decision, the Tribunal considered retailers' comments that:

- ▼ the costs associated with late payment have increased since the fee was set at \$5.00<sup>195</sup>
- ▼ the fee should be increased to approximately \$10 to \$12, or retailers should be able to charge 'fair and reasonable' fees<sup>196</sup>
- ▼ late payment fees should be aligned with those levied in other jurisdictions.<sup>197</sup>

The Tribunal also considered other stakeholder views, including that:

- ▼ late payment fees should only be increased on the basis of firm evidence of costs incurred<sup>198</sup>

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<sup>194</sup> Essential Services Commission of South Australia, Energy Retail Code ERC 01, March 2004, clause 8.7; Essential Service Commission Victoria, Energy Retail Code May 2007, clause 8.4.

<sup>195</sup> EnergyAustralia submission, September 2006, p 55, Integral Energy submission, September 2006, p 63.

<sup>196</sup> AGL submission, October 2006 p 19; Country Energy submission, September 2006, p 32; EnergyAustralia submission, September 2006, p 55; Integral Energy submission, September 2006, p 63; Origin Energy submission, September 2006, p 21.

<sup>197</sup> AGL submission, October 2006, p 19; Country Energy submission, September 2006, p 32, Integral Energy submission, September 2006, p 63.

<sup>198</sup> EWON submission, October 2006, p 24, PIAC submission, October 2006, p 15.



- ▼ late payment fees can have a significant impact on low income households.<sup>199</sup>

In addition, the Tribunal considered information provided by retailers on the estimated costs associated with late payment, including a confidential report prepared by KPMG for EnergyAustralia. Taking all of this information into account, it concluded that \$7.00 was an appropriate level for the late payment fee.

In response to the draft report and determination, consumer groups submitted that a maximum late payment fee of \$7.00 was too high.<sup>200</sup> Some also submitted that late payment fees should be abolished.<sup>201</sup> Other comments from community and consumer representatives included that:

- ▼ a 40 per cent increase in the late payment fee is unjustifiable, particularly in the context of price increases<sup>202</sup>
- ▼ the risks associated with late payment are an inherent part of doing business<sup>203</sup>
- ▼ the costs associated with late payments are already taken into account in the retail operating costs or retail margin<sup>204</sup>
- ▼ there is no evidence that late payment fees deter late payment<sup>205</sup>
- ▼ late payment fees are sometimes levied on customers who are exempted from the fee, and if a retailer cannot properly administer the fee and exemptions it should not be allowed to charge the fee<sup>206</sup>
- ▼ those genuinely unable to pay on time should be exempted from having to pay the fee.<sup>207</sup>

On the other hand, retailers tended to argue that \$7.00 is less than the costs associated with late payment. EnergyAustralia submitted that to be cost reflective, the late payment fee should be at least \$10.<sup>208</sup> Integral Energy submitted that the fee should be set at the same level as for gas.<sup>209,210</sup> Origin Energy argued that \$7.00 was not cost reflective in the context of small business customers.<sup>211</sup>

<sup>199</sup> EWON submission, October 2006, p 24; NCOSS submission, October 2006, p 4, PIAC submission, October 2006, p 15.

<sup>200</sup> EWON submission, May 2007, p 18, NCOSS submission, May 2007, p 7, PIAC submission, May 2007, p 12.

<sup>201</sup> NCOSS submission, May 2007, p 7, PIAC submission, May 2007, p 12, Redfern Legal Centre submission, May 2007, p 1.

<sup>202</sup> Council on the Ageing (NSW) submission, p 3, NCOSS submission, May 2007, p 7, PIAC submission, May 2007, p 12.

<sup>203</sup> PIAC submission, May 2007, p 12.

<sup>204</sup> PIAC submission, May 2007, p 12.

<sup>205</sup> EWON submission, May 2007, p 19, NCOSS submission, May 2007, p 7, PIAC submission, May 2007, p 12.

<sup>206</sup> EWON submission, May 2007, p 18, PIAC submission, May 2007, p 12.

<sup>207</sup> EWON submission, May 2007, p 19.

<sup>208</sup> EnergyAustralia submission, May 2007, p 31.

<sup>209</sup> Integral Energy submission, May 2007, p 30.

The terms of reference for the Tribunal's review require it to focus on setting regulated retail charges that are cost reflective. They do not require it to consider the deterrent effects of the late payment fee when setting the maximum charge. Therefore, in considering the late payment fee, the Tribunal has focused only on issues of cost reflectivity and the circumstances in which the fee can be levied.

In support of its claim that the costs associated with late payment are higher than \$7.00, EnergyAustralia submitted revised estimates of these costs prepared by KPMG for EnergyAustralia.<sup>212</sup> These revised estimates are higher than those submitted by EnergyAustralia prior to the draft determination, as they now include the costs associated with field visits undertaken to collect payment or a promise of payment. The retailers' revised estimates considered by the Tribunal in coming to its final determination range from \$10 to \$15.70.<sup>213</sup>

In reviewing the estimates provided by retailers, the Tribunal considered the potential for double recovery of costs through late payment fees and the allowance for retail costs. In its estimate of retail costs, Frontier Economics has taken account of the Standard Retailers' estimates of billing and revenue collection costs. These costs typically include the costs of reminder notices and follow-up calls on unpaid bills, although it is difficult to determine the degree of double counting. The Tribunal has accounted for some of the costs associated with late payment in the allowance for retail costs (see Chapter 7) and considers that setting the late payment fee at \$7.00 (ie, below the estimated range of these costs) takes this into account.

For all of the above reasons, the Tribunal affirms its draft decision to set the late payment fee at a maximum level of \$7.00, exclusive of GST, not indexed for inflation.

In relation to the circumstances in which the late payment fee can be charged, the Tribunal affirms its draft decision to retain the current conditions under which late payment fees may be levied or waived. Under these conditions, late payment fees must be waived where:

- ▼ a customer has contacted a welfare agency for assistance
- ▼ all or part payment is by a voucher issued under the Energy Accounts Payment Assistance Scheme, or
- ▼ where considered appropriate by the Energy and Water Ombudsman.

In its submission to the Tribunal, EWON observed that it is not unusual for electricity customers to contact its office to complain that they have been charged a late payment fee, even though one of the above circumstances applies.<sup>214</sup> For example, EWON noticed that a person who paid his last payment prior to

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<sup>210</sup> Gas late payment fees in NSW range from \$0 to \$10.60

<sup>211</sup> Origin Energy submission, May 2007, p 5.

<sup>212</sup> EnergyAustralia submission, May 2007, Appendix C.

<sup>213</sup> Range based on information provided by standard retailers on a confidential basis.

<sup>214</sup> EWON submission, May 2007, p 18.

disconnection with \$90 of Energy Accounts Payment Assistance vouchers had nevertheless been charged a late payment fee. The Tribunal agrees with EWON that this situation should not occur. The Tribunal reminds retailers that the exemptions and restrictions on charging of late payment fees are binding requirements under the Determination.

### 10.3 Dishonoured cheque fee

#### 10.3.1 Final decision

The Tribunal has decided to retain the level of the dishonoured cheque fee at two times the regular (GST-exclusive) fee charged by the bank or financial institution. This fee may only be charged where the retail supplier actually incurs a bank or financial institution fee for the dishonoured cheque.

#### 10.3.2 Tribunal's considerations

Stakeholder submissions and the working group did not raise any significant concerns about the level of charge for a dishonoured cheque. The Tribunal notes that the average dishonoured cheque fees charged to customers have remained fairly constant since 2004. However, concerns were raised about the circumstances in which retailers can charge fees related to other forms of dishonoured payments.

The Electricity Supply Act's definition of a regulated retail charge does not allow retailers to charge retail customers for non-cheque dishonoured payments. For example, retailers may incur a charge from the bank or financial institution when a customer defaults on a payment made by direct debit. In their submissions in response to the issues paper and the working party discussions, retailers expressed their concern about the differential treatment of defaults on cheques and defaults on other forms of payment.<sup>215</sup> Most retailers argued that the Electricity Supply Act should be amended to allow dishonour fees to be charged on other payment options. Retailers incur additional costs when payments are dishonoured, such as bank charges, cancelling and re-establishing direct debit plans, customer contact and mail outs.

In its draft report, the Tribunal indicated that it would recommend that the Government consider amending the Electricity Supply Act to allow Standard Retailers to charge a fee for dishonoured direct debit payments.

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<sup>215</sup> AGL submission, October 2006, p 20; Country Energy submission, September 2006 p 32; Integral Energy submission, September 2006, p 64; Origin Energy submission, September 2006, p 22.

However, EWON cautioned that customers defaulting on non-cheque payments will also be charged a fee by the bank or financial institution and a further fee from the retailer may have a significant impact on disadvantaged customers. EWON further argued that the charge should be based on demonstrable retailer costs with consideration given to protecting vulnerable customers from rises in the ratio of consumption charges to fees.<sup>216</sup> PIAC questioned whether retailers incur bank charges for dishonoured direct debits, and did not support the Tribunal's proposed recommendation on the grounds that it would adversely affect those suffering financial hardship.<sup>217</sup>

The Standard Retailers have advised the Tribunal that banks charge them approximately \$2.50 to \$3.00 per dishonoured direct debit payment.<sup>218</sup> However, the data they provided did not allow the Tribunal to estimate their aggregate costs of non-cheque defaults. However, one retailer's financial institution charges for dishonoured non-cheque payments were five times its charges for dishonoured cheque payments. The Tribunal considers that it is anomalous that retailers are able to charge a fee for a dishonoured cheque payment, but are not able to charge a similar fee for dishonoured non-cheque payments.

The Tribunal recommends that the Government amend the Electricity Supply Act to allow Standard Retail Suppliers to charge a fee for non-cheque dishonoured payments.

It should be noted that the Tribunal has not reviewed the appropriate level for such a fee, nor made provision for the fee to be introduced under its current determination. In establishing the level of the charge, the Tribunal recommends that only incremental costs be recovered through the charge.

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<sup>216</sup> EWON submission, May 2007, p 20.

<sup>217</sup> PIAC submission, May 2007, p 13.

<sup>218</sup> Email from Country Energy 11 May 2007, email from Integral Energy 16 May 2007.





## A Terms of Reference

**Terms of reference for an investigation and report by the Independent Pricing and Regulatory Tribunal on regulated retail tariffs and regulated retail charges to apply between 1 July 2007 and 30 June 2010 under Division 5 of Part 4 of the *Electricity Supply Act 1995*.**

### Reference to the Tribunal under section 43EA

The Minister refers to the Tribunal for investigation and report under section 43EB of the Act:

The determination of regulated retail tariffs and regulated retail charges to apply to small retail customers in each standard retail supplier's supply district in New South Wales for the period from 1 July 2007 to 30 June 2010.

### Background

In accordance with its commitment to retain the offer of regulated retail tariffs, the Government has extended the current scheme for regulated retail tariffs and charges to apply to small retail customers supplied under a standard form contract. A regulatory amendment will be made for these purposes under section 43EJ of the *Electricity Supply Act 1995* to allow the Tribunal to make a further determination of regulated retail tariffs and charges that will apply from 1 July 2007 to 30 June 2010. The Electricity Tariff Equalisation Fund (ETEF) arrangement will be phased out between September 2008 and June 2010 in accordance with the recently revised ETEF Payment Rules.

Since January 2002, every electricity customer in NSW has had the option to negotiate a retail supply contract with any licensed retailer. Small retail customers who do not seek supply from the competitive market are deemed to receive electricity under a 'standard form' customer supply contract from their 'standard retail supplier'. Customers can also switch backwards and forwards between these alternatives. These arrangements were designed to encourage customers to test the market by providing an assurance that they can return to regulated retail tariffs. Approximately six hundred thousand NSW customers have now moved on to negotiated tariffs at lower prices.

While retail competition has delivered benefits for those participating in the market, the majority of residential and some small business customers have chosen to remain on standard form customer supply contracts which include regulated retail tariffs and charges determined by the Tribunal.

International and national experience shows that the level of regulated retail tariffs relative to market based prices is the key determinant of how many eligible customers remain on regulated arrangements. For example, if regulated retail tariffs do not adequately reflect all of the costs of supply to small retail customers, both those customers and prospective competing retailers have little incentive to enter the competitive market. Regulated tariffs set below the cost of supply will also inhibit investment in the new generation required as the demand/supply balance tightens, as investors will not be able to recover their costs. Therefore, in order to promote retail competition and investment, regulated retail tariffs which are below the cost of supply should be moved to full cost reflectivity.

### Matters for consideration

For the purposes of section 43EB (2)(a) of the *Electricity Supply Act 1995*, the matters the Tribunal is to consider in making its investigation and report on the setting of tariffs for small retail customers to apply from 1 July 2007 to 30 June 2010 include:

- ▼ An allowance for electricity purchase costs based on an assessment of the long-run marginal cost of electricity generation from a portfolio of new entrant generation to supply the load profile of customers remaining on regulated retail tariffs.
- ▼ Mass market new entrant retail costs.
- ▼ Mass market new entrant retail margin.
- ▼ An allowance based on long run marginal cost for retailer compliance with any Commonwealth mandatory renewable energy target (MRET) requirements and the licence requirements relating to the NSW Greenhouse Gas Benchmark Scheme, which takes in to account price and volume.
- ▼ Energy losses as published by the National Electricity Market Management Company (NEMMCO).
- ▼ A mechanism to ensure network charges as determined by the Tribunal and the Australian Competition and Consumer Commission (ACCC) and the Australian Energy Regulator (AER) are fully recovered.
- ▼ Fees (including charges for ancillary services) as imposed by NEMMCO under the National Electricity Code.
- ▼ An allowance for expected movements in regulated components and NEMMCO fees.



- ▼ A mechanism to address any new, compulsory scheme that imposes material costs on the retailer. For example, the potential for an inter-jurisdictional emission trading scheme.
- ▼ Recognition that ETEF will cease operation within the determination period.
- ▼ Recognition of hedging, risk management and transaction costs faced by retailers in the absence of the ETEF.
- ▼ Recognition of the forecasting risks faced by retailers in the absence of the ETEF.
- ▼ Recognition of Net System Load Profiles (NSLP's) for each standard retailer, as well as projected future changes in those net system load profiles.
- ▼ The requirement in the NSW Greenhouse Plan to require energy retailers to offer a 10 per cent Green Power component to all new (or moving) residential customer.
- ▼ The potential to simplify regulated tariff structures including the potential to remove obsolete tariffs.

For the purposes of section 43EB (2)(b) of the *Electricity Supply Act 1995*, the Tribunal must consider the Government's policy aim of reducing customers' reliance on regulated prices and the effect of its determination on competition in the retail electricity market. The level of regulated prices for small retail customers is a crucial factor in encouraging new entry in the retail sector. If the level is set too low, it is not possible for new retailers to attract small retail customers away from the regulated price. This can reduce scale economies for new entrants, increasing their costs and making it more difficult for them to compete. More specifically, the Tribunal is to take account of the following matters in undertaking its review:

- ▼ ensuring regulated tariffs cover the costs listed above
- ▼ consider the impact on demand management.

The determination should ensure that:

- ▼ regulated retail tariffs and regulated retail charges are at cost reflective levels (including all the costs listed above) for all small retail customers by 30 June 2010
- ▼ the setting of any 'price constraint' should allow the further rationalisation of regulated retail tariffs and movement to full cost recovery over the determination period.

The Tribunal should also consider and report on the basis for regulating miscellaneous charges and security deposits.

## Consultation

The Tribunal should consult with stakeholders, conduct public hearings or workshops and consider submissions, within the timetable for the investigation and report. The Tribunal must make its report available to the public.

## Timing

The Tribunal is to investigate and provide a report of its determination of regulated retail tariffs and charges by 14 June 2007.

## Definitions

*Regulated retail tariff* means a tariff for or in relation to the supply of electricity required to be charged to a small retail customer under a standard form customer supply contract, being a tariff specified in a determination in force under Division 5 of Part 4 of the *Electricity Supply Act 1995*.

*Small retail customer* means a customer that consumes electricity at less than 160MWh per year as prescribed in clause 7 of the *Electricity Supply (General) Regulation 2001*. A small retail customer is eligible for supply under a standard form customer supply contract.

*Standard retail supplier* means a retail supplier to whose retail supplier's licence is attached a standard retail supplier's endorsement. A standard retail supplier must impose tariffs and charges for or in relation to supplying electricity under a standard form customer supply contract in accordance with any relevant determination of the Tribunal under Division 5 of the *Electricity Supply Act 1995*.

*Standard form customer supply contract* means a contract entered into under Division 3 of Part 4 of the *Electricity Supply Act 1995*.

*Mass market new entrant* means a new market entrant that is of sufficient size to achieve economies of scale.

## B Background and regulation of electricity

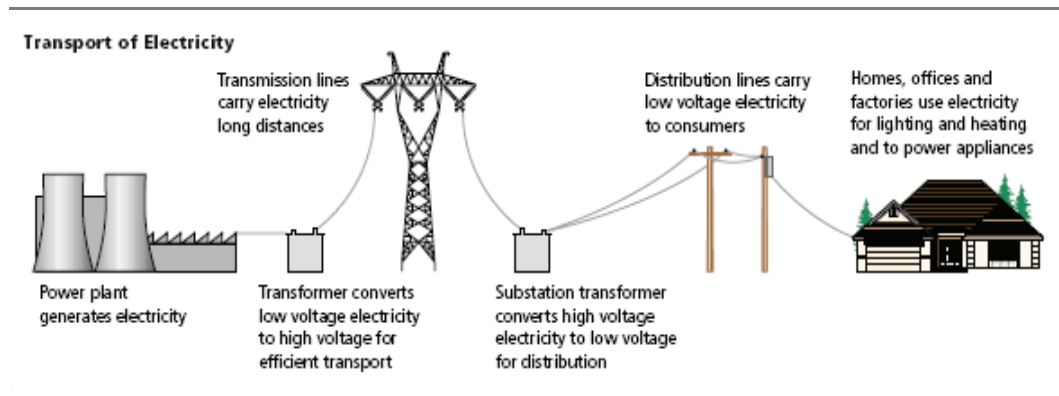
This appendix gives an overview of the electricity supply chain, what is regulated by this determination, and the components of regulated retail prices.

The energy reform process introduced in the 1990s by the Council of Australian Governments involved restructuring the traditionally vertically integrated energy industry so that consumers could benefit from competition where possible. Within the national framework for competition, State governments have also pursued their own reform policies and regulatory arrangements in retail energy markets.

### B.1 Structure of the electricity industry

Traditionally the electricity industry in NSW was made up of large vertically integrated companies that controlled most parts of the supply chain, including generation, transportation and retail of electricity (see Figure B.1).

**Figure B.1 The Electricity Supply Chain**



**Source:** NEMMCO An introduction to Australia's national electricity market, June 2005, p 3.

As part of the process of industry reform, these vertically integrated companies were broken into segments so that customers could benefit from competition in the areas that could be contestable – electricity generation and retail. Legislation was introduced to regulate the areas that relied on monopoly owned infrastructure – transmission and distribution (now regulated via the National Electricity Rules) – to ensure that access to necessary infrastructure was made available on reasonable terms and conditions.

Initially, parts of the retail market remained a monopoly and were regulated. However, over the past few years, the NSW Government has progressively introduced retail competition into the electricity market. Large consumption electricity customers have been able to choose their retailer since 1 July 1998. Competition, or contestability, for other customers was introduced in stages, with all customers able to choose their electricity retailer from 1 January 2002.

## B.2 Regulation of retail prices in NSW

The Tribunal has been asked to continue to regulate retail prices for small retail customers (defined as customers that use less than 160MWh of electricity per year, equivalent to an annual bill of approximately \$20,000) who do not choose to enter the competitive electricity market by signing a negotiated contract. These customers remain on a standard electricity supply contract. This determination regulates the prices of electricity for small retail customers on standard electricity supply contracts.

Each area in NSW has a nominated Standard Retail Supplier. The *Electricity Supply Act 1995* (the Act) requires Standard Retail Suppliers to make supply available on the tariffs and charges set by a determination of the Tribunal. Standard Retail Suppliers and new entrant retailers may also offer customers competitive or negotiated contracts. These contracts are not regulated by the Tribunal and the prices charged under them are negotiated between retailer and customer.

There are three Standard Retail Suppliers in NSW for which the Tribunal determines regulated retail tariffs. Each is Government-owned and is also involved in the distribution of electricity in NSW. The Standard Retail Suppliers and the areas in which they are required to offer regulated tariffs are:

- ▼ EnergyAustralia – Sydney, Central Coast and Hunter regions.
- ▼ Integral Energy – Western Sydney, Blue Mountains, Southern Highlands, Illawarra and Shoalhaven regions.
- ▼ Country Energy – remainder of NSW.

## B.3 How tariffs are structured

There are two main components of retail electricity tariffs – network charges and retail charges. Network charges (N) are governed by the Tribunal's 2004 network determination and are passed through directly into the retail tariffs.<sup>219</sup> This determination sets the retail component (R) of the charge. Within both components there are fixed (that do not vary with electricity usage) and variable charges (that depend on the amount of electricity used). A customer's total bill is the sum the network and retail components.

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<sup>219</sup> The Tribunal's 2004 network determination applies from 1 July 2004 to 30 June 2009. It is expected that the Australian Energy Regulator will make a price determination to apply from 1 July 2009.

The components of the tariffs are explained in more detail in the table below.

**Table B.1 Components of regulated retail tariffs**

Component of target	Elements of each component	Nature of the elements	Factors that affect the value of each element
N component	Applicable network tariff	May be a combination of a fixed network charge (\$/customer), variable network charges (c/kWh) and any other charge (e.g. maximum demand/capacity charge)	Network tariffs are set outside the retail determination and differ between regions and customers with different characteristics (eg, business/residential). The same network tariff applies to a customer irrespective of its retailer
R component	'Fixed R'	Fixed retail charge expressed in \$ per customer per year	Fixed R is set by the retail determination at the same level for every customer in NSW. Fixed R is set to enable retailers to recover retail costs that do not vary with electricity usage
	'Variable R'	Variable retail charge expressed in cents per kWh	Variable R is set by the retail determination and is different for: <ul style="list-style-type: none"> <li>- each retailer</li> <li>- urban and rural areas</li> <li>- different types of supply</li> </ul> Variable R is set to enable retailers to recover retail costs that do vary with electricity usage

#### B.4 Interstate comparison of electricity bills

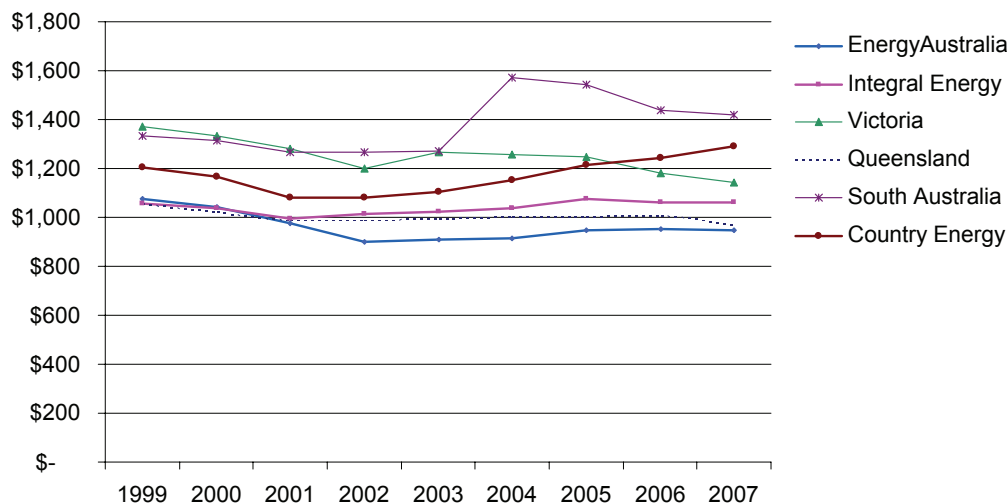
Figures B.1 and B.2 compare annual electricity bills since 1999 for small retail customers on regulated tariffs in Queensland, Victoria, South Australia and New South Wales.

For this purpose, two scenarios have been chosen:

- ▼ Small residential customers on a standard regulated tariff consuming 7,500 kWh pa (no off peak) – Figure B.2.
- ▼ Small business customers consuming 30 MWh pa (no off peak) on a standard regulated tariff – Figure B.3.

It should be noted that some of the differences in tariffs can be explained by differing network charges which vary between geographic regions.

**Figure B.2 Interstate comparison of annual bills for residential customers Standard regulated residential tariffs – 7,500 kWh without off peak (\$2006/07)**

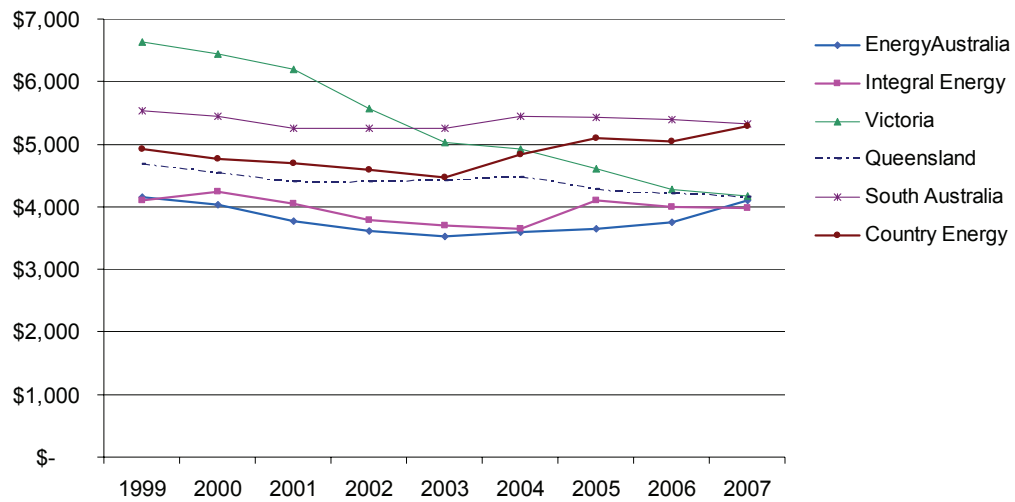


**Data source:** Data obtained from: ESAA Electricity Prices (1999-2004); NSW regulated retail price submissions to IPART (2005-06); Victoria, South Australia, Queensland Government Gazettes (2005/06).

Residential customers on regulated tariffs in NSW have generally paid less for electricity than their equivalents in South Australia and Victoria, although since 2005 the Country Energy residential customer bill has exceeded the Victorian annual bill. This pattern is also true for residential customers on off peak electricity tariffs.

The trend for business customers on regulated tariffs is similar, with NSW prices consistently below those for South Australia. A sustained fall in the annual bills for business customers in Victoria has meant that Queensland, Integral Energy, EnergyAustralia and Victorian annual bills are currently at similar levels. Country Energy annual bills have risen gradually and are now equivalent to those paid by Queensland small business customers.

**Figure B.3 Interstate comparison of annual electricity bills for small business customers Standard regulated small business tariffs – 30 MWh without off peak (\$2006/07)**



**Data source:** Data obtained from: ESAA Electricity Prices (1999-2004); NSW regulated retail price submissions to IPART (2005-06); Victoria, South Australia, Queensland Government Gazettes (2005/06).





## C Additional information on the current level of competition

This appendix discusses the Tribunal's analysis on the extent to which certain customer groups within the metropolitan and non-metropolitan markets of NSW have been able to access the competitive market. The information presented is sourced from the Tribunal's 2006 Household Survey and from the Standard Retailers.

### C.1 Customers on hardship programs

Information provided by the Standard Retailers suggests that customers on hardship programs with the Standard Retailers are just as likely to enter the competitive market as the broader customer base. EnergyAustralia indicated that 40 per cent of the customers on its hardship program are on negotiated contracts, relative to 42 per cent of its overall customer base. Integral Energy indicated that 17 per cent of customers on its hardship program are on negotiated contracts, relative to 24 per cent of its overall customer base. Country Energy indicated that 15 per cent of customers on its hardship program are on negotiated contracts, relative to 2 per cent its overall customer base.

Information provided by the Standard Retailers on the characteristics of customers on their hardship programs indicates that vulnerable customers are more likely to be those on lower income bands, and in the case of Country Energy's hardship program, they are increasingly likely to be drought affected customers. This is in broadly in line with results from the 2006 Household Survey which indicate that low income customers are more likely to have:

- ▼ approached their supplier because they have been unable to pay electricity bills
- ▼ sought financial help with bills (for example, from charities like the Salvation Army)
- ▼ have had their electricity disconnected for not paying their bill.

Information provided by the Standard Retailers indicates that customers on their hardship programs are likely to consume more electricity than the average customer. The Standard Retailers have provided information that shows that the average customer on their hardship program consumes more than 10 MWh per annum, which is above the consumption level of a typical EnergyAustralia, Integral Energy and Country Energy residential customer.<sup>220</sup> Results from the 2006 Household

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<sup>220</sup> Results from the 2006 Household Survey indicate that the average residential household electricity consumption in the greater Sydney area in 2006 was 7,893 kWh. Country Energy notes that the average residential customer consumes around 7,700 kWh per annum.

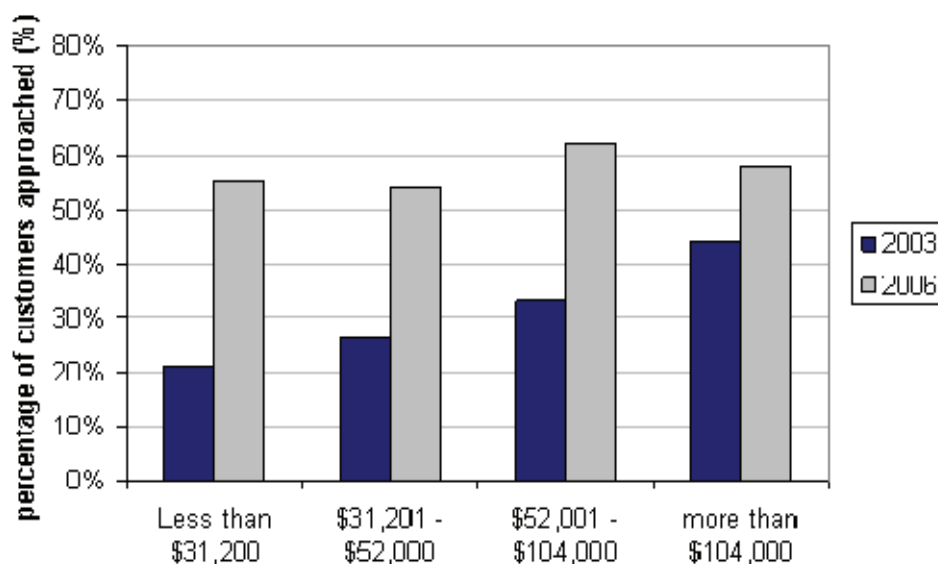
Survey indicate that households with a concession card use on average less electricity compared with those households without a concession card. The difference in consumption between customers on hardship programs and customers with a concession card may reflect differences in the eligibility requirements between the programs.

## C.2 Low-income customers

The available information indicates that low-income customers in the greater Sydney area are being offered negotiated contracts by other suppliers to a similar extent as higher income customers. Low-income customers in the metropolitan area are also accepting these contracts to a similar extent as the wider customer base.

As noted in the draft report, the results from the 2006 Household Survey indicate that all income groups across the greater Sydney region have been offered negotiated contracts by other suppliers to broadly the same degree (Figure C.1 below).<sup>221</sup> This represents a change from the 2003 Household Survey, which found that higher income households were more likely to be targeted than those in lower income brackets.

**Figure C.1 Relationship between competitive offers from other suppliers and income**

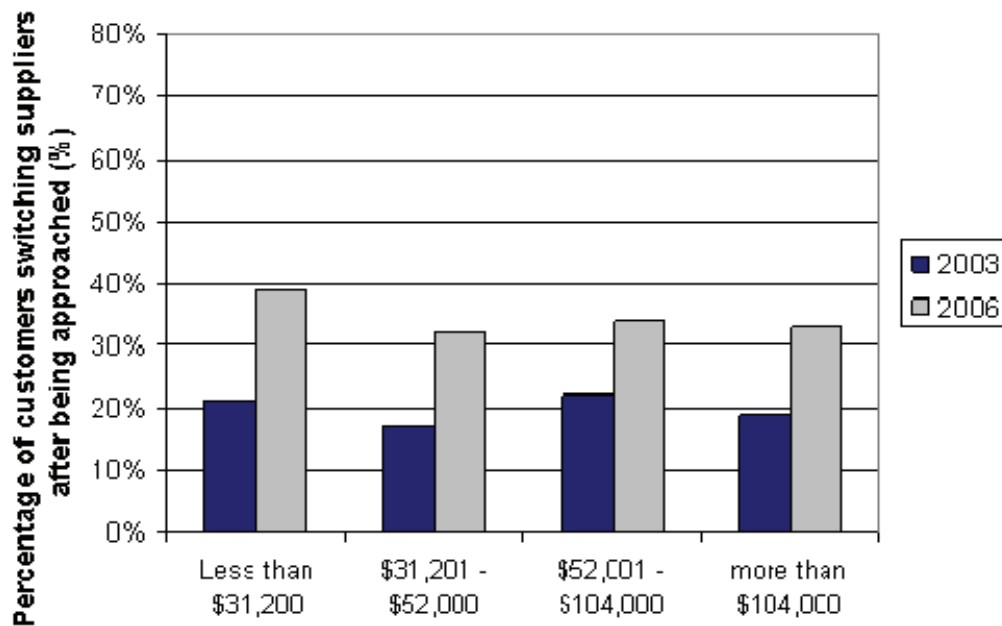


**Data source:** IPART: Results from 2006 Household Survey.

<sup>221</sup> 'Approach' must be a phone call, household visit, a specific letter addressed to occupants or a 'flyer' in the letterbox. A general notice attached to a bill is *not* defined as an approach.

Results from the 2006 Household Survey also indicate that all income groups across the greater Sydney region have been accepting negotiated contracts from other suppliers after being approached to broadly the same degree (Figure C.2). This is in line with the 2003 Household survey.

**Figure C.2 Percentage of electricity customers switching supplier after being approached, by income category**



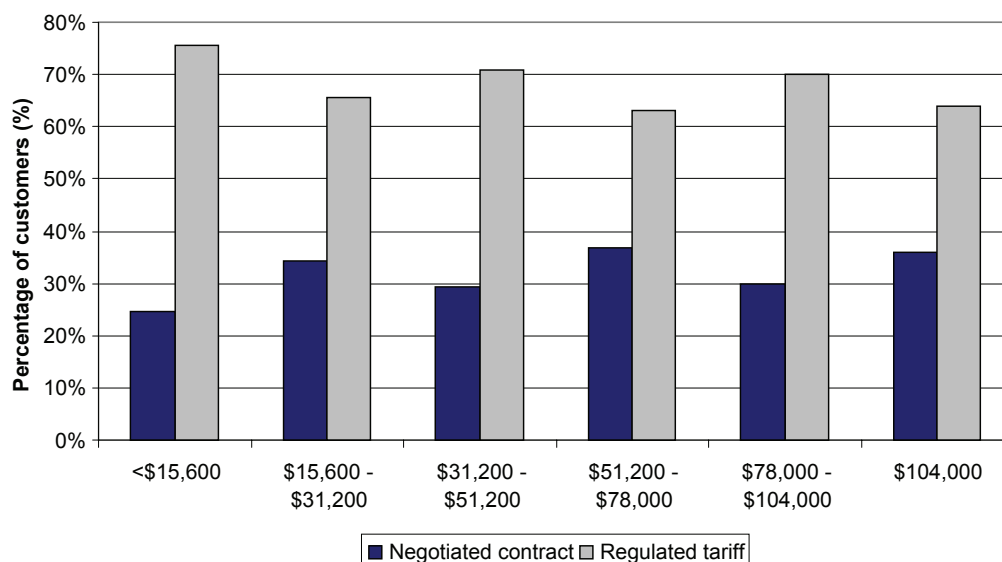
Data source: IPART: Results from 2006 Household Survey.

Information provided by the Standard Retailers indicates that customers from low-income suburbs were just as likely to move onto a negotiated contract.

Figure C.3 shows the proportion of customers with EnergyAustralia in its standard supply area on regulated tariffs and on negotiated contracts by customer income.<sup>222</sup> While customers with the lowest income (less than \$15,600) have the greatest reliance on regulated tariffs (around 75 per cent) there is no clear relationship between income and the extent to which customers are on regulated tariffs and negotiated contracts.

<sup>222</sup> For the purpose of this analysis customer income has been estimated based on the census collection district (CCD) the customer resides in. There are approximately 250 households per CCD. The income data is sourced from a model developed by RDA Research, which utilises a variety of inputs including the ABS and HES survey. EnergyAustralia do not collect income data regarding its customers.

**Figure C.3 Relationship between estimated income and the proportion of customers on negotiated contracts with EnergyAustralia in its standard supply area**

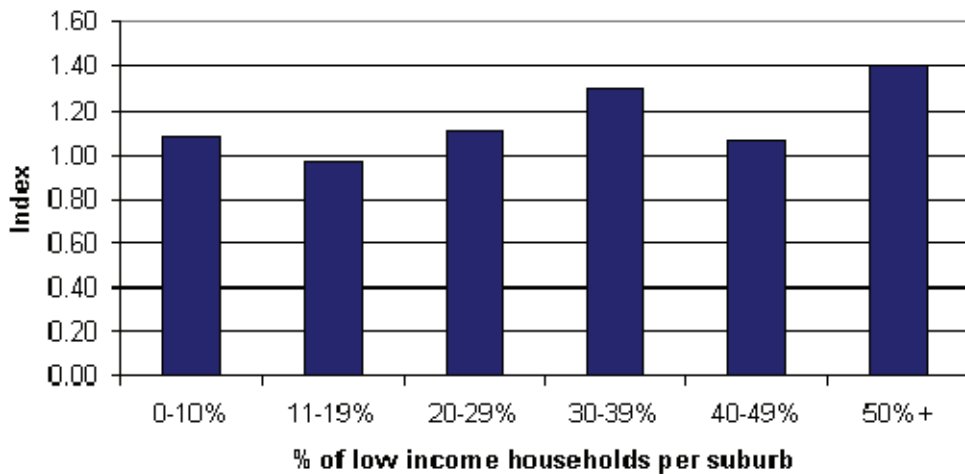


**Data source:** Information provided by EnergyAustralia.

Figure C.4 below shows that in the Integral Energy standard supply area, customers in suburbs with a higher proportion of low-income households are more likely to have switched supplier.<sup>223</sup> For example, customers in suburbs in which more than 50 per cent of households have low incomes are more than 40 per cent more likely to switch suppliers (an index of 1.4) than the overall Integral Energy residential customer base (an index of 1.0).

<sup>223</sup> Integral Energy has indicated that this information was compiled from 2001 ABS Census Data. Suburbs were graded according to the share of households with less than \$500 average weekly household income as a share of total households. Integral Energy has indicated that this information only includes metropolitan suburbs, as non-metropolitan household income data was not available.

**Figure C.4 Recent switching by percentage of estimated low-income households per suburb – Integral Energy standard supply area**

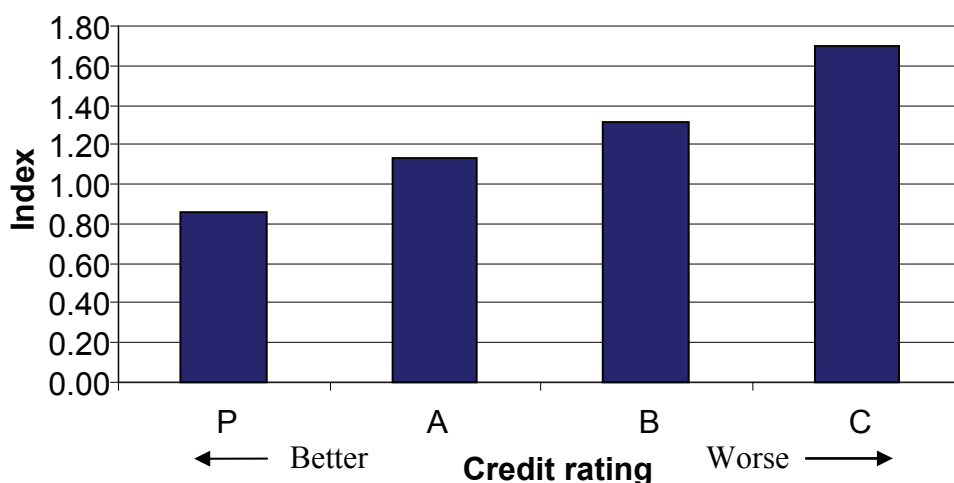


**Data source:** Information provided by Integral Energy.

### C.3 Customers with poor credit ratings

Information provided by Integral Energy indicates that customers with poor credit ratings are more likely to have switched supplier than the overall Integral Energy residential customer base (Figure C.5).<sup>224</sup>

**Figure C.5 Recent switching by credit rating - Integral Energy standard supply area**



**Data source:** Information provided by Integral Energy.

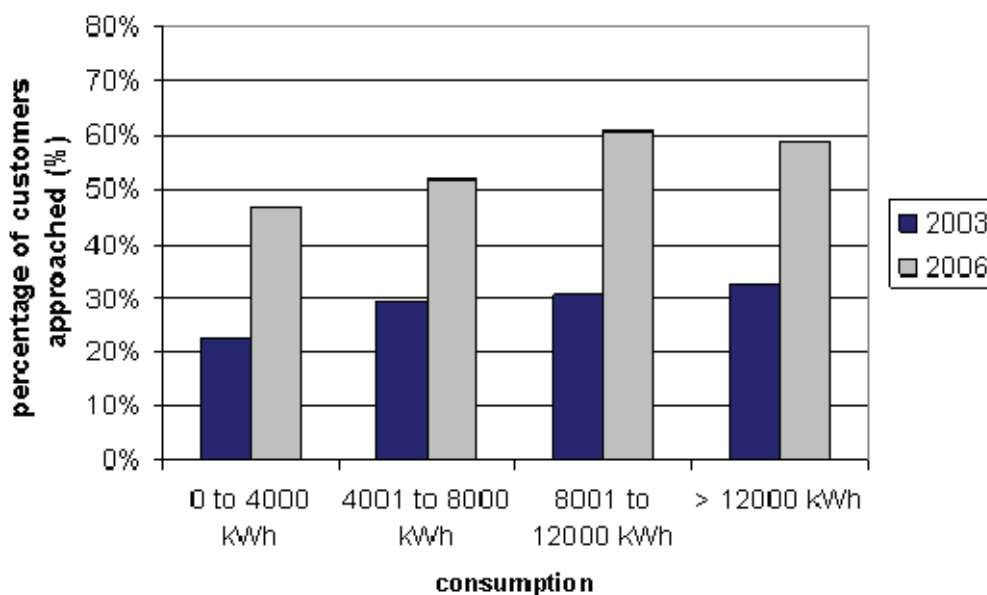
<sup>224</sup> Customers' credit ratings have been determined based on Integral Energy's internal business rules.

## C.4 Low-consumption customers

Information provided by the Standard Retailers and the results from the 2006 Household Survey indicate that low consumption customers in the greater Sydney area are being approached by other suppliers to a similar extent as higher consumption customers. Results from the Household Survey also indicate that low consumption customers in the greater Sydney area are more likely to switch suppliers after being approached than higher consumption customers. While Standard Retailers' low consumption customers are less likely to have signed a negotiated contract than their medium to high-consumption customers, the proportion of low-consumption customers signing contracts with the Standard Retailers has increased significantly since 2003/04.

Figure C.6 shows that customers with low consumption levels in the greater Sydney region are almost as likely to have been approached to switch suppliers as those with higher consumption. This represents a change since the 2003 Household Survey, which found that higher consumption customers were more likely to be targeted than lower consumption customers.

**Figure C.6 Relationship between competitive offers from other suppliers and consumption**



Data source: IPART: Results from 2006 Household Survey.

Table C.1 below shows that the number of low- and medium-consumption residential customers (less than 10 MWh per annum) on negotiated contracts with the Standard Retailers increased significantly between 2003/04 – 2005/06.

**Table C.1 Consumption characteristics of small retail customers on negotiated contracts with Standard Retailers 2003/04 – 2005/06**

	2003/04	2004/05	2005/06
<b>Residential</b>			
Up to 5 MWhs per annum	38,002	68,866	107,596
5.1 to 10 MWhs per annum	118,612	204,759	253,979
10.1 to 15 MWhs per annum	87,302	121,989	120,170
15.1 to 20 MWhs per annum	33,803	40,389	37,184
20.1 to 160 MWhs per annum	17,587	20,846	19,246
Total small residential customers	295,307	456,849	538,175
<b>Business</b>			
Up to 20 MWhs per annum	27,474	28,800	22,666
20.1 to 40 MWhs per annum	15,254	15,074	10,737
40.1 to 60 MWhs per annum	7,309	6,797	5,123
60.1 to 100 MWhs per annum	6,389	6,139	4,668
100.1 to 160 MWhs per annum	3,439	3,701	2,921
Total small business customers	59,866	60,511	46,115
Total small customers	355,172	517,360	584,290

**Source:** Information provided by Standard Retailers.

Table C.2 below shows that the proportion of small-consumption customers (less than 5 MWh per annum) on negotiated contracts with Standard Retailers is less than the proportion of medium- and large-consumption customers on contracts with the Standard Retailers.<sup>225</sup>

**Table C.2 Proportion of small retail customers on negotiated contracts with Standard Retailers 2003/04 – 2005/06**

	2003/04	2004/05	2005/06
<b>Residential</b>			
Up to 5 MWhs per annum	3.9%	6.9%	11.7%
5.1 to 10 MWhs per annum	11.2%	19.6%	25.0%
10.1 to 15 MWhs per annum	21.4%	31.1%	31.1%
15.1 to 20 MWhs per annum	27.4%	34.7%	31.6%
20.1 to 160 MWhs per annum	26.0%	32.6%	28.2%
<b>Business</b>			
Up to 20 MWhs per annum	13.2%	13.5%	11.0%
20.1 to 40 MWhs per annum	37.4%	37.2%	28.0%
40.1 to 60 MWhs per annum	40.0%	39.8%	30.2%
60.1 to 100 MWhs per annum	40.6%	41.2%	31.3%

**Source:** Information provided by Standard Retailers.

<sup>225</sup> This data represents the number of small retail customers on negotiated contracts with the Standard Retailers as a proportion of the total small retail customers with the Standard Retailers.

While the Tribunal does not have information on the consumption characteristics of customers who have taken up contracts with second tier retailers, results from the 2006 Household Survey indicate that low consumption customers were more likely to change supplier after being approached. Almost 38 per cent of households using less than 4 MWh switched supplier after being approached, compared to 30 per cent of households consuming between 8 -12 MWh. This result differs from the 2003 survey results where higher consuming households were more likely to switch suppliers after being approached.

The Tribunal considers that information provided by the Standard Retailers and the results from the 2006 Household Survey indicate that the proportion of small customers exercising choice in the competitive market has increased significantly since 2003/04. While a proportion of these customers may be dual fuel customers who are attractive to retailers because they are large overall energy consumers, these data indicate that low- and medium-consumption electricity customers are able to negotiate contracts in the competitive market.

## C.5 Residential vs business customers

Table C.3 below shows that a similar proportion of small residential customers (21.5 per cent) and of small business customers (16.1 per cent) have signed negotiated contracts with the Standard Retailers.

**Table C.3 Proportion of small retail customers on negotiated contracts with Standard Retailers 2003/04 – 2005/06**

	2003/04	2004/05	2005/06
<b>Residential</b>			
Total small residential customers on contracts	295,307	456,849	538,175
Total small residential customers	2,632,659	2,608,606	2,506,078
% of total small residential customers	11.2%	17.5%	21.5%
<b>Business</b>			
Total small business customers on contracts	59,866	60,511	46,115
Total small business customers	292,698	296,076	286,838
% of total small business customers	20.5%	20.4%	16.1%

**Source:** Information provided by Standard Retailers.

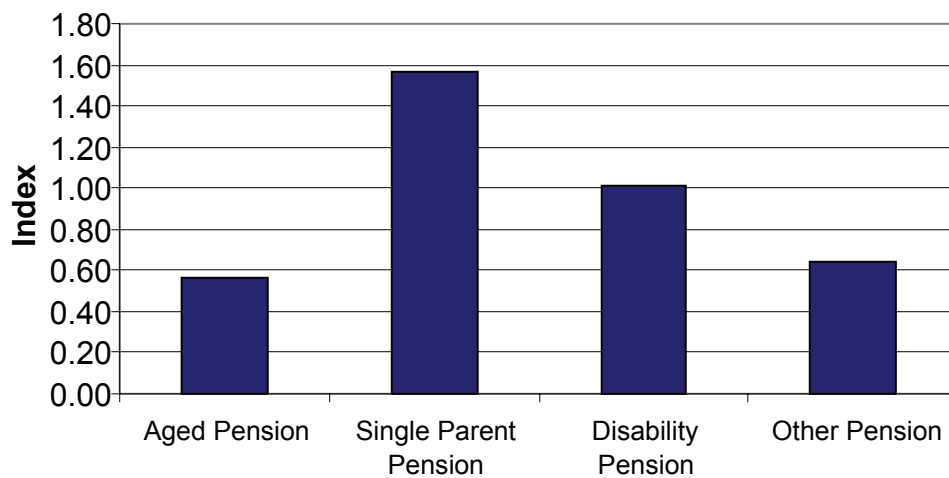
While the Tribunal does not have information on the characteristics of customers who have signed negotiated contracts with second tier retailers, the Tribunal considers that it is likely that residential customers are accessing the competitive market to a similar extent as business customers.



## C.6 Customers on a pension

Information provided by Integral Energy indicates that in the Integral Energy standard supply area, different pensioner groups have been switching retailers at different rates. Figure C.7 below shows that while aged pensioners are less likely to switch retailers, single parent pensioners (those most likely to be suffering financial distress) are more than 50 per cent more likely (index of over 1.5) to switch retailers than the overall Integral Energy residential customer base (index of 1.0).

**Figure C.7 Recent switching by pensioner type -Integral Energy standard supply area**



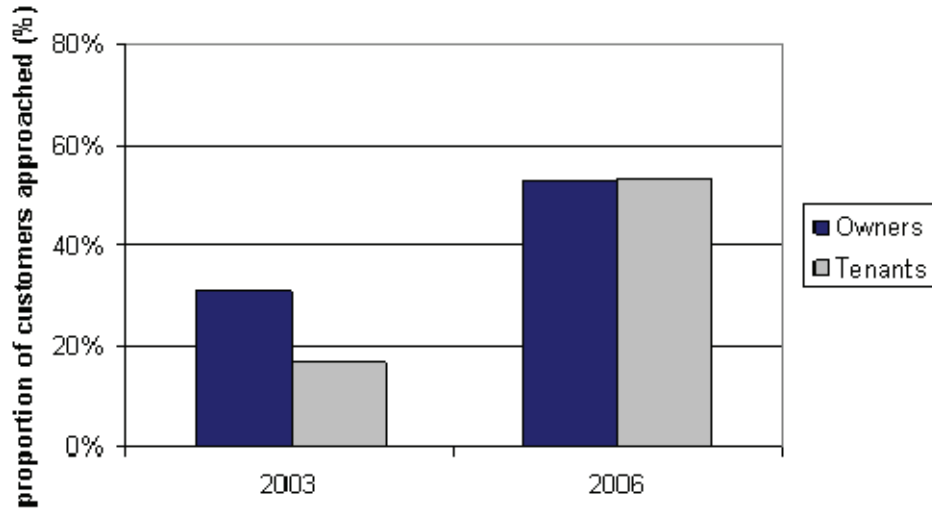
**Data source:** Information provided by Integral Energy.

## C.7 Customers in rental accommodation

Results from the 2006 Household Survey indicate that homeowners and tenants (renters) are being approached by other suppliers to the same extent. Again this is a change from the 2003 Household Survey, which found that customers who were homeowners were more likely to be offered contracts from other suppliers than renters (Figure C.8).

Results from the 2006 Household Survey also indicate that homeowners and tenants are equally likely to change electricity supplier if they are approached. This is in line with results from the 2003 Household Survey.

**Figure C.8 Relationship between competitive offers from other suppliers and home ownership**



**Data source:** IPART: Results from 2006 Household Survey.

## D Weighted average cost of capital (WACC)

The calculation of cost allowances for the long-run marginal cost of electricity, the retail margin and the customer acquisition cost allowance, require the use of a discount rate as an input assumption.

The weighted average cost of capital (WACC) for a business is typically used as the discount rate. The WACC for a business is the expected cost of the various classes of capital (such as debt and equity), weighted to take into account the proportion of its total capital that each class represents.

Typically the Tribunal has considered an appropriate WACC for network businesses such as electricity and gas networks, rail networks or metropolitan and bulk water delivery. However, this review is for a retail function which arguably is more risky and the WACC impacts differently on the retail price than it does in the context of a network price review.

There are a number of input parameters to consider in determining an appropriate WACC range. Interest rates, inflation and debt margin are dependent on current market rates. The market risk premium, tax rate and dividend imputation factor do not vary with the nature of the business. However, the equity beta, capital structure and debt margin vary with the nature of the business.

The Tribunal recognises that the appropriate rate of return for an electricity retail business would not necessarily be the same as that for any other business for which the Tribunal has determined a rate of return.

In its draft report, Frontier Economics adopted a pre-tax real WACC of 8.1 per cent. Following the release of the draft report, the Tribunal updated the parameters to reflect current market rates (interest rates, inflation and debt margin).<sup>226</sup> For the final report and determination the parameters have again been updated for market changes. As Table D.1 depicts the resulting real pre tax return range is 7.2 to 9.9 per cent (compared with 7.3 to 9.9 per cent for the draft report), with a mid point of 8.6 per cent. The mid point is the same as in the draft report.

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<sup>226</sup> The methodology used to calculate interest rates, inflation and the debt margin is consistent with the Tribunal's approach in its most recent WACC decision. See IPART, *Bulk Water Prices for State Water Corporation and Water Administration Ministerial Corporation from 1 October 2006 to 30 June 2010 - Final Report*, September 2006.

The Tribunal requested Frontier Economics to use the resulting pre-tax real WACC of 8.6 per cent in its long-run marginal cost, retail margin and customer acquisition cost allowance calculations.

The parameters that underlie the WACC of 8.6 per cent are set out in Table D.1 below.

**Table D.1 Rate of return range and parameters**

Parameters	WACC in draft determination and report	Updated WACC <sup>a</sup>
Nominal risk free rate	5.90%	5.91%
Real risk free rate	2.80%	2.71%
Inflation	3.00%	3.12%
Market risk premium	5.5 - 6.5%	5.5 - 6.5%
Debt margin	1.1 - 1.4%	0.98 - 1.34%
Debt to total assets (capital structure)	30-40%	30-40%
Dividend imputation factor (gamma)	0.5 - 0.3	0.5 - 0.3
Tax rate	30%	30%
Asset beta	0.6 - 0.8	0.6 - 0.8
Equity beta	0.80 - 1.2	0.8 - 1.2
Cost of equity (nominal post tax)	10.3 - 13.7%	10.3 - 13.7%
Cost of debt (nominal pre-tax)	6.9 - 7.2%	6.9 - 7.3%
WACC range (real pre-tax)	7.3 - 9.9%	7.2 - 9.9%
WACC (real pre-tax) mid-point	8.6%	8.6%

a. Updated as at 30 April 2007. Due to the complexity of the analysis of energy purchase costs and retail margin, this was the latest practical date that would allow Frontier Economics to provide advice and for the Tribunal to consider this advice and incorporate it in this report and determination.

The Tribunal notes Frontier has used a range for the debt to total assets ratio of 30 - 40 per cent. The Tribunal considers it appropriate to adopt a lower level of notional gearing for a retail business than its usual assumption for a network business (60 per cent), as an electricity retailer is likely to have more fluctuating cashflows and higher operational risk and therefore may support less debt funding.

The range for the asset beta of 0.6 - 0.8 was based on its analysis of comparable firms both in Australia, the United Kingdom and in the United States and the WACC parameters adopted by ESCOSA in its recent retail determination.

The Tribunal notes that the market risk premium, tax rate and the dividend imputation factor parameters set out in Table D.1 are consistent with its most recent WACC decision.<sup>227</sup>

<sup>227</sup> See IPART, *Bulk Water Prices for State Water Corporation and Water Administration Ministerial Corporation from 1 October 2006 to 30 June 2010 - Final Report*, September 2006.

The Tribunal asked Frontier Economics to provide analysis on the sensitivity of the long-run marginal cost calculation to a change in the WACC. As indicated in Frontier Economics' report, a 1 percentage point change in the WACC produces a variation in the long-run marginal cost of about 6.5 per cent or \$2.50 to \$3.50 per MWh.<sup>228</sup>

The Tribunal also asked Frontier Economics to provide analysis on the sensitivity of the retail margin to a change in the WACC. In its report, Frontier Economics notes that changing the WACC can have a number of different effects depending on whether the value of the business and consequently the estimated value per customer are held constant.<sup>229</sup> As such the Tribunal notes that the net effect of changing the WACC on the retail margin is uncertain. In its draft report, Frontier Economics' expected returns approach provided an EBITDA margin of 4.4 – 6.4 per cent using a WACC of 8.1 per cent. As indicated in Frontier Economics' final report, increasing the WACC to 8.6 per cent, and adjusting other inputs to the expected returns approach to reflect updated results for energy costs and retail costs, resulted in the EBITDA margin being 4.3 – 6.4 per cent.<sup>230</sup>

In its report, Frontier Economics notes that changing the WACC has an impact on the customer acquisition cost allowance. As indicated in Frontier Economics' report, a 1 per cent increase in the WACC will lead to a \$1 increase in the customer acquisition cost allowance, while a 1 per cent decrease in the WACC will lead to a \$1 decrease in the customer acquisition cost allowance.<sup>231</sup>

Having had regard to Frontier Economics' analysis, its own research, the sensitivity analysis and submissions, the Tribunal concluded that it is appropriate to use in its determination a real pre tax rate of return of 8.6 per cent as a discount rate in calculating cost allowances for long-run marginal cost, the retail margin and customer acquisition costs.

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<sup>228</sup> Frontier Economics, *Energy costs*, Final Report, March 2007, p 16.

<sup>229</sup> Frontier Economics, *Mass market new entrant retail costs and retail margin*, Final Report, March 2007, p 62.

<sup>230</sup> Frontier Economics, *Mass market new entrant retail costs and retail margin*, Final Report, March 2007, p 68.

<sup>231</sup> Frontier Economics, *Mass market new entrant retail costs and retail margin*, Final Report, March 2007, p 19.

D Weighted average cost of capital (WACC)

## E List of submissions

List of submissions received on the Issues Paper:

Organisation	Date
ActewAGL <sup>a</sup>	29 September 2006
AGL	13 October 2006
Country Energy	7 September 2006
Delta Electricity	9 October 2006
Energy and Water Ombudsman (EWON)	6 October 2006
Energy Retailers Association of Australia (ERAA)	9 October 2006
EnergyAustralia	7 September 2006
ER Walshe Heat Treatment	25 October 2006
ER Walshe Heat Treatment	8 November 2006
Integral Energy	7 September 2006
Macquarie Generation	6 October 2006
National Council of Social Services (NCOSS)	5 October 2006
Origin Energy	10 October 2006
Public Interest Advocacy Centre (PIAC)	17 October 2006
The Pastoralists' Association of West Darling	4 October 2006
Total Environment Centre (TEC)	5 October 2006
TRUenergy	6 October 2006

<sup>a</sup> Confidential submission.

List of submissions received on Frontier Economics' draft reports:

Organisation	Date
AGL	2 February 2007
Country Energy	2 February 2007
Delta Electricity	6 February 2007
EnergyAustralia	6 February 2007
Eraring Energy	2 February 2007
Integral Energy	2 February 2007
Macquarie Generation	2 February 2007
Origin Energy	7 February 2007
Public Interest Advocacy Centre (PIAC)	7 February 2007
TRUenergy	2 February 2007

List of submissions received on the draft report and draft determination:

Organisation	Date
AGL	2 May 2007
Australian Power and Gas	2 May 2007
Council on the Ageing (NSW)	2 May 2007
Country Energy	2 May 2007
Energy and Water Ombudsman (EWON)	2 May 2007
EnergyAustralia	2 May 2007
Individual <sup>a</sup>	4 May 2007
Individual <sup>a</sup>	17 May 2007
Integral Energy	2 May 2007
Jackgreen (International)	2 May 2007
National Council of Social Services (NCOSS)	7 May 2007
National Council of Social Services (NCOSS)	3 May 2007
Older Women's Network NSW Sutherland Group	2 May 2007
Origin Energy	2 May 2007
Public Interest Advocacy Centre (PIAC)	3 May 2007
Redfern Legal Centre	4 May 2007
TRUenergy	1 May 2007

<sup>a</sup> Confidential submission.



## Determination No 1, 2007

### NSW Electricity Regulated Retail Tariffs and Charges 2007 to 2010

Reference No. 06/40

June 2007



## Part 1

### Preliminary

#### 1. Background

- (1) The *Tribunal* received a referral from the *Minister* dated 30 June 2006 under section 43EA of the *ESA* to investigate and report on the determination of *regulated retail tariffs* and *regulated retail charges* to apply to *small retail customers* in each *standard retail supplier's supply district* in New South Wales for the period from 1 July 2007 to 30 June 2010.
- (2) In its investigation the *Tribunal* consulted with *standard retail suppliers*, undertook a public consultation and received information and submissions from the *standard retail suppliers*, *second-tier retail suppliers* and other interested parties in accordance with section 43EE of the *ESA*.
- (3) This determination is made under section 43EB of the *ESA*, pursuant to the *Minister's referral*. The *Tribunal's* report on its investigation accompanies this determination.
- (4) Under section 34 of the *ESA*, all *small retail customers* who own or occupy *premises* that are within a *standard retail supplier's supply district*, and that are connected or have a right to be connected to a *distribution system*, have a right to elect to be *supplied* with electricity at those *premises* by the *standard retail supplier* under a *standard form customer supply contract*.
- (5) Under section 36 of the *ESA*, it is a condition of a licence held by a *standard retail supplier* that the *standard retail supplier*, in imposing tariffs and charges for or in relation to the *supply* of electricity under a *standard form customer supply contract*, must impose them in accordance with this determination.

#### 2. Application of this determination

- (1) This determination commences on the date of its publication in the *Gazette* by the *Minister*.
- (2) This determination applies to all *standard retail suppliers*, namely:
  - (a) EnergyAustralia
  - (b) Integral Energy Australia
  - (c) Country Energy.

- (3) This determination specifies the methodology for determining the *regulated retail tariffs* and *regulated retail charges* that *standard retail suppliers* can charge *small retail customers*:

- (a) whose *premises* are in the *standard retail supplier's supply district*; and
- (b) who are *supplied* electricity at those *premises* by the *standard retail supplier* under a *standard form customer supply contract*,

during the period from 1 July 2007 to 30 June 2010.

### **3. Replacement of Determination No. 1 of 2004**

- (1) From 1 July 2007, this determination replaces the *Tribunal's previous retail determination*.
- (2) The replacement does not affect anything done or omitted to be done, or rights or obligations accrued, under that determination prior to its replacement.

### **4. Structure**

- (1) Part 2 specifies the methodology for determining *regulated retail tariffs* to apply during the *period of this determination*.
- (2) Part 3 specifies the procedures for determining compliance with Part 2.
- (3) Part 4 specifies the maximum *regulated retail charges* to apply during the *period of this determination* and the manner in which such charges may be imposed.

### **5. Definitions and interpretation**

Italicised words and phrases are defined in Part 5. Interpretation provisions are also set out in that Part.

## Part 2

### Regulated Retail Tariffs

#### 6. Application

This Part specifies the methodology for determining *regulated retail tariffs* to apply during the *period of this determination*.

#### 7. Weighted average price cap

##### 7.1 Weighted average price cap formula

A *standard retail supplier* must ensure that, for each *year of this determination*, all of its *regulated retail tariffs* comply with the following weighted average price cap formula:

$$\sum_{i=1}^n \sum_{j=1}^m P_{ij}^t . q_{ij}^{t-1} \leq \sum_{i=1}^n \sum_{j=1}^m C_{ij}^t . q_{ij}^{t-1} + PT^t \quad i=1,2,\dots,n \text{ and } j=1,2,\dots,m$$

Where:

the *standard retail supplier* has *n* *regulated retail tariffs* which each have up to *m* *components*

$P_{ij}^t$  is the proposed price to be charged by the *standard retail supplier* for *component j* of *regulated retail tariff i* in *year t* (exclusive of any rebates offered to the *customer* and funded by the *standard retail supplier*)

$q_{ij}^{t-1}$  is the quantity of *component j* of *regulated retail tariff i* in *year t-1* (being the *year* immediately preceding *year t*), calculated as follows:

- (a) where quantity relates to electricity consumption or demand, this is equal to the consumption or demand for *year t-1* estimated by the *standard retail supplier* (in MWh or other relevant units) and approved by the *Tribunal* under clause 15.3
- (b) where quantity relates to number of *customers*, this is equal to the actual number of *customers* of that *standard retail supplier* on 31 December in *year t-1*

$C_{ij}^t$  is the value set by the *Tribunal* for *component j* of *regulated retail tariff i* in relation to *year t* in accordance with clause 7.2

$PT^t$  is the *annual pass through amount* allowed or required by the *Tribunal* for *year t* in accordance with clause 17.

An illustrated example of the application of the formula is set out in the report accompanying this determination.

## 7.2 Value of C: regulated price control (N+R)

For the purpose of clause 7.1,  $C_{ij}^t$  is calculated as follows:

$$C_{ij}^t = N_{ij}^t + R_{ij}^t$$

Where:

$N_{ij}^t$  is the actual *network use of system charge* plus any *demand management levy* payable by the *standard retail supplier* to the DNSP for *component j* of *regulated retail tariff i* in the year *t*

$R_{ij}^t$  is the retail value set by the *Tribunal*, comprising:

- (i) for each *customer* of the *standard retail supplier*, the relevant amount for each *standard retail supplier* set out in clause 7.3 ( $FixedR_c^t$ ); and
- (ii) for *component j* of *regulated retail tariff i* in the year *t*, the relevant amount for each *standard retail supplier* set out in clause 7.4 ( $VariableR_{ij}^t$ ).

For the purpose of (i), each *customer* is counted only once, even if more than one *regulated retail tariff* applies to that *customer* (such as a *primary tariff* and a *controlled load tariff*) or any of those *regulated retail tariffs* has more than one *component*.

## 7.3 Value of Fixed R

For the purpose of clause 7.2(i),  $FixedR_c^t$  for each *standard retail supplier* is calculated as follows:

- (a) for the 2007/08 year:

$FixedR_c^{2007/8}$  is the relevant amount for 2007/08 set out in the following table

- (b) for the 2008/09 year:

$FixedR_c^{2008/9}$  is the relevant amount for 2008/09 set out in the following table multiplied by  $(1 + \Delta CPI_{07})$  or, if the *Tribunal* determines another amount in accordance with clause 16.2(b)(ii), that other amount

- (c) for the 2009/10 year:

$FixedR_c^{2009/10}$  is the relevant amount for 2009/10 set out in the following table multiplied by  $(1 + \Delta CPI_{07}) \times (1 + \Delta CPI_{08})$  or, if the *Tribunal* determines another amount in accordance with clause 16.2(b)(ii), that other amount

**Fixed R (\$ per customer per year, exclusive of GST)**

Year	Fixed R
2007/08	71.7
2008/09	79.7
2009/10	88.6

**7.4 Value of Variable R**

For the purpose of clause 7.2(ii),  $VariableR_{ij}^t$  is calculated as follows:

- (a) for the 2007/08 year:

$VariableR_{ij}^{2007/8}$  is the relevant amount for each *standard retail supplier* for 2007/08 set out in the relevant table below

- (b) for the 2008/09 year:

$VariableR_{ij}^{2008/9}$  is the relevant amount for each *standard retail supplier* for 2008/09 set out in the relevant table below multiplied by  $(1 + \Delta CPI_{07})$  or, if the *Tribunal* determines another amount in accordance with clause 16.2(b)(ii), that other amount

- (c) for the 2009/10 year:

$VariableR_{ij}^{2009/10}$  is the relevant amount for each *standard retail supplier* for 2009/10 set out in the relevant table below multiplied by  $(1 + \Delta CPI_{07}) \times (1 + \Delta CPI_{08})$  or, if the *Tribunal* determines another amount in accordance with clause 16.2(b)(ii), that other amount

**Variable R (c/kWh, exclusive of GST): EnergyAustralia**

Year	standard and time of use	controlled load A	controlled load B
2007/08	6.93	4.34	5.54
2008/09	7.22	4.45	5.80
2009/10	7.53	4.55	6.06

**Variable R (c/kWh, exclusive of GST): Integral Energy Australia**

Year	standard and time of use	controlled load A	controlled load B
2007/08	7.29	4.51	5.58
2008/09	7.71	4.70	5.93
2009/10	8.15	4.90	6.30

**Variable R (c/kWh, exclusive of GST): Country Energy**

Year	standard and time of use	controlled load A	controlled load B
2007/08	7.48	4.53	6.02
2008/09	7.51	4.56	6.21
2009/10	7.55	4.59	6.41

For the purposes of the above tables:

**standard and time of use rates** apply to all of a *customer's* electricity consumption other than a *customer's controlled load*

**controlled load A rates** apply in respect of a *customer's controlled load* where that load is active only during *off-peak periods*

**controlled load B rates** apply in respect of a *customer's controlled load* where that load is active both during *off-peak periods* and at times other than *off-peak periods*.



## 8. Threshold for price increases (Country Energy)

### 8.1 Threshold

Subject to clause 8.2, Country Energy must ensure that, for each *year of this determination*, each of its *regulated retail tariffs* complies with the following formula:

$$\frac{\sum_{j=1}^m P_{ij}^t \cdot q_{ij}^{t-1}}{\sum_{j=1}^m P_{ij}^{t-1} \cdot q_{ij}^{t-1}} \leq \frac{\sum_{i=1}^n \sum_{j=1}^m C_{ij}^t \cdot q_{ij}^{t-1} + PT^t}{\sum_{i=1}^n \sum_{j=1}^m C_{ij}^{t-1} \cdot q_{ij}^{t-1} + PT^{t-1}} + 0.05 \quad i=1,2,\dots,n \text{ and } j=1,2,\dots,m$$

Where:

Country Energy has *n* *regulated retail tariffs* which each have up to *m* *components*

$P_{ij}^t$ ,  $q_{ij}^{t-1}$ ,  $C_{ij}^t$  and  $PT^t$  have the meanings given to those terms in clause 7

$P_{ij}^{t-1}$  is the price charged by the *standard retail supplier* for *component j* of *regulated retail tariff i* in *year t-1*

$C_{ij}^{t-1}$  is the value set by the *Tribunal* for *component j* of *regulated retail tariff i* in relation to *year t-1* in accordance with:

- (a) the *Tribunal's previous retail determination* (where the *year t* is the 2007/08 year); and
- (b) clause 7.2 (where the *year t* is any other *year of this determination*)

$PT^{t-1}$  is the *annual pass through amount* allowed or required by the *Tribunal* for *year t-1* in accordance with clause 17 (which, where the *year t* is the 2007/08 year, is zero).

An illustrated example of the application of the formula is set out in the report accompanying this determination.

### 8.2 Justified non-compliance

Country Energy need not comply with clause 8.1 with respect to any particular *regulated retail tariff* if the *Tribunal* has notified Country Energy in writing that it is satisfied that the proposed increase in that *regulated retail tariff* would increase cost-reflectivity.

### 8.3 Price changes

- (a) A *standard retail supplier* may only change the price for any *regulated retail tariff* or *regulated retail tariff component* for any year of this determination:
  - (i) with effect from 1 July of that *year* (or from any other date in that *year* determined by the *Tribunal*); and
  - (ii) if the *Tribunal* has notified the *standard retail supplier* in writing that it is satisfied that the proposed price changes comply with this determination.
- (b) Clause 8.3(a) applies even where a *pass through event* occurs.

## 9. Introducing new tariffs

- (a) A *standard retail supplier* may only introduce a *new regulated retail tariff* for any year of this determination:
  - (i) with effect from 1 July of that *year* (or from any other date in that *year* determined by the *Tribunal*); and
  - (ii) if the *Tribunal* has notified the *standard retail supplier* in writing that the *Tribunal* is satisfied that:
    - (A) exceptional circumstances exist which warrant the introduction of the *new regulated retail tariff*; and
    - (B) the *standard retail supplier* complies with this determination.
- (b) Nothing in this clause 9 prevents a *standard retail supplier* from introducing a *new regulated retail tariff component* to form part of an existing *regulated retail tariff*.

## 10. Abolition of tariffs

### 10.1 Abolishing obsolete tariffs

- (a) A *standard retail supplier* may cause any of its *regulated retail tariffs* to become *obsolete* at any time during the *period of this determination*.
- (b) A *standard retail supplier* may only abolish a *regulated retail tariff*:
  - (i) with effect from 1 July of any *year of this determination* (or from any other date in that *year* determined by the *Tribunal*);
  - (ii) if the *regulated retail tariff* is *obsolete*; and
  - (iii) if the *Tribunal* has notified the *standard retail supplier* in writing that the *Tribunal* is satisfied that the *standard retail supplier's* proposal complies with this determination.

- (c) Nothing in this clause 10.1 prevents a *standard retail supplier* from removing a *regulated retail tariff component* from an existing *regulated retail tariff*.

## **10.2 Additional conditions for Country Energy**

Country Energy must ensure that:

- (a) if it abolishes a *regulated retail tariff*; and
- (b) as a result a *customer* is transferred from the abolished *regulated retail tariff* to another *regulated retail tariff*,

then either:

- (c) the price applying to the two *regulated retail tariffs* (including level and structure) is the same; or
- (d) the *Tribunal* has notified Country Energy in writing that it is satisfied that the proposed abolition and consequent *customer* transfers are appropriate (having regard to the information submitted by Country Energy under clause 15.2(d)(iv)).

## **11. Green premiums**

Nothing in this determination affects the ability of a *standard retail supplier* to charge a *customer* for *green premiums*, in addition to *regulated retail tariffs*, where the *customer* so elects.

## **12. Pass through of other network charges**

Nothing in this determination prevents a *standard retail supplier* from passing through to a *customer* any network charges other than *network use of system charges* charged by the *customer's DNSP* that are specific to that *customer* (for example, meter test fees), if the *standard retail supplier* would otherwise be entitled to do so. However, the *standard retail supplier* may not charge any additional fees in respect of the pass through of these charges (for example, for administration).

## Part 3

### Compliance

#### 13. Application

This Part specifies the procedures for determining compliance with Part 2.

#### 14. Timetable

Set out below is the timetable referred to in this Part.

Action	Due Date
1 <i>Standard retail suppliers</i> to submit to the Tribunal details of any <i>pass through event</i> proposed for the year <i>t</i>	1 March of the year <i>t-1</i>  (or other date set by the Tribunal)
2 Tribunal to conduct review of <i>market based electricity purchase cost allowance</i> for the year <i>t</i> (where the year <i>t</i> is the 2008/09 year or 2009/10 year)	1 March of the year <i>t-1</i>  (or other date set by the Tribunal)
3 Tribunal to notify <i>standard retail suppliers</i> of its decision whether or not to approve an amount in respect of any <i>pass through event</i> for the year <i>t</i>	20 May of the year <i>t-1</i>  (or other date set by the Tribunal)
4 Tribunal to publish final report and determination on its <i>market based electricity purchase cost allowance</i> review for the year <i>t</i> (where the year <i>t</i> is the 2008/09 year or 2009/10 year)	20 May of the year <i>t-1</i>  (or other date set by the Tribunal)
5 <i>Standard retail suppliers</i> to submit to the Tribunal their <i>annual pricing proposal</i> (for the year <i>t</i> )	1 June of the year <i>t-1</i>  (or other date set by the Tribunal)
6 Tribunal to notify <i>standard retail suppliers</i> whether satisfied/not satisfied with <i>annual pricing proposal</i> (for the year <i>t</i> )	10 business days after submission by <i>standard retail suppliers</i> of <i>annual pricing proposal</i>  (or other date set by the Tribunal)
7 Final date for <i>standard retail suppliers</i> to submit to the Tribunal an alternative <i>annual pricing proposal</i> (for the year <i>t</i> )	20 June of the year <i>t-1</i>  (or other date set by the Tribunal)

Action	Due Date
8    Final date for <i>Tribunal</i> to notify whether satisfied/ not satisfied with alternative <i>annual pricing proposal</i> (for the year <i>t</i> )	26 June of the year <i>t-1</i> (or other date set by the <i>Tribunal</i> )
9    Commencement of retail price changes(for the year <i>t</i> )	1 July of the year <i>t</i> (or other date set by the <i>Tribunal</i> )

## 15. Annual pricing proposal

### 15.1 Submission and assessment

- (a) For prices to apply during each *year of this determination* (the *year t* for the purposes of this clause 15.1) each *standard retail supplier* must submit to the *Tribunal* an *annual pricing proposal* for that *year*, containing the information in clause 15.2.
- (b) The *annual pricing proposal* must be submitted to the *Tribunal* by no later than:
  - (i) 18 June 2007 (for the 2007/08 *year*); and
  - (ii) the date specified in item 5 of the timetable in clause 14 (for any other *year*).

### 15.2 Contents

The *annual pricing proposal* submitted by a *standard retail supplier* under clause 15.1(a) for each *year of this determination* must contain the following information:

- (a) the *standard retail supplier's* application of the weighted average price cap formula set out in clause 7.1 to all of its *regulated retail tariffs*, together with all necessary supporting calculations and information including:
  - (i) the proposed prices to be charged by the *standard retail supplier* for each of the *standard retail supplier's regulated retail tariff components* in the *year t*;
  - (ii) estimated quantities of each of the *standard retail supplier's regulated retail tariff components* supplied by the *standard retail supplier* in the *year t-1* and the basis for those estimates;
  - (iii) details of how the proposed prices incorporate any *annual pass through amount* allowed or required by the *Tribunal* under clause 17; and
  - (iv) for any new *regulated retail tariff component* for an existing *regulated retail tariff* proposed by the *standard retail supplier* for the *year t* (which was not part of that *regulated retail tariff* in the *year t-1*), reasonable estimated quantities of electricity supply in MWh, number of customers or other relevant quantity units, assuming for that *regulated retail tariff* the same consumption and load profile as in the *year t-1*,

with all prices submitted under this clause to be calculated to 2 decimal places;

- (b) if the *standard retail supplier* proposes to introduce a *new regulated retail tariff*:
  - (i) details of the proposed *new regulated retail tariff*; and
  - (ii) why the *standard retail supplier* considers that:
    - (A) exceptional circumstances exist; and
    - (B) those circumstances warrant the introduction of the proposed *new regulated retail tariff*;
- (c) details of any *regulated retail tariffs* that:
  - (i) have become *obsolete* in the year *t-1*;
  - (ii) the *standard retail supplier* proposes to make *obsolete* in the year *t*; and
  - (iii) the *standard retail supplier* proposes to abolish in the year *t*;
- (d) for Country Energy:
  - (i) Country Energy's application of the threshold for price increases set out in clause 8 to each of its *regulated retail tariffs* proposed for the year *t* (together with all necessary supporting calculations and information);
  - (ii) a list of those proposed *regulated retail tariffs* (if any) that would exceed this threshold, and by how much;
  - (iii) for those *regulated retail tariffs*, an explanation of why Country Energy considers that the price increases proposed would increase cost-reflectivity; and
  - (iv) for those *regulated retail tariffs* that Country Energy proposes to abolish which would result in a *customer* being transferred from that *regulated retail tariff* to another *regulated retail tariff*, an explanation of whether the price applying to the two *regulated retail tariffs* (including level and structure) is the same, or if not, why Country Energy considers that the abolition and transfer is nonetheless appropriate;
- (e) the amounts of the relevant average *electricity retail bills* (as referred to in clause 22.2(b)); and
- (f) any other information required by the *Tribunal* to satisfy itself that the *standard retail supplier's annual pricing proposal* complies with this determination.

### 15.3 Notification of whether or not the Tribunal is satisfied

By the date specified in item 6 of the timetable in clause 14 (or before 1 July 2007, for the 2007/08 year), the *Tribunal* will notify the *standard retail supplier* whether or not the *Tribunal* is satisfied:

- (a) that the *annual pricing proposal* complies with the requirements of clause 15.2;
- (b) with the *standard retail supplier's* estimates of quantities; and
- (c) that the *regulated retail tariffs* set out in those documents comply with all applicable requirements of this determination, including where relevant:
  - (i) the weighted average price cap formula under clause 7.1;
  - (ii) the restriction on introducing *new regulated retail tariffs* under clause 9, except to the extent approved by the *Tribunal*;
  - (iii) the threshold for price increases for Country Energy under clause 8.1, except to the extent of any non-compliance approved by the *Tribunal*; and
  - (iv) the additional conditions for Country Energy under clause 10.2.

### 15.4 If the Tribunal is satisfied

- (a) If the *Tribunal* notifies the *standard retail supplier* that it is satisfied with each of the matters referred to in clause 15.3, then the *regulated retail tariff* prices set out in the *annual pricing proposal* will be the applicable prices for those *regulated retail tariffs* for the year to which the *annual pricing proposal* relates.
- (b) A *standard retail supplier* must comply with any relevant regulatory requirements in relation to the publication of changes to its *regulated retail tariff* prices (for example, under clause 21 of the *Electricity Supply (General) Regulation 2001 (NSW)*).

### 15.5 If the Tribunal is not satisfied: alternative pricing proposal

- (a) If the *Tribunal* notifies the *standard retail supplier* that it is not satisfied with any of the matters referred to in clause 15.2, the *standard retail supplier* must submit to the *Tribunal* an alternative *annual pricing proposal* by the date specified in item 7 of the timetable in clause 14.
- (b) If the *standard retail supplier* has submitted an alternative *annual pricing proposal* under clause 15.5(a), the *Tribunal* will notify the *standard retail supplier* whether or not the *Tribunal* is satisfied with each of the matters referred to in clause 15.3 in respect of the *standard retail supplier's* alternative *annual pricing proposal*, by the date specified in item 8 of the timetable in clause 14.
- (c) If the *Tribunal* notifies the *standard retail supplier* that it is so satisfied, then clause 15.4 will apply in respect of the *standard retail supplier's* alternative *annual pricing proposal*.



- (d) If the *Tribunal* notifies the *standard retail supplier* that it is not so satisfied, then the default arrangements in clause 15.6 apply.

## 15.6 Default arrangements

- (a) Subject to clause 15.6(b), if for any *year of this determination* (*year t*, for the purposes of this clause 15.6) the *Tribunal* has not received from a *standard retail supplier* a *compliant annual pricing proposal* for that *year* by:
- (i) 1 July 2007 (where that *year t* is the first *year of this determination*); or
  - (ii) the date specified in item 7 of the timetable in clause 14 (for any other *year of this determination*),

then the *standard retail supplier's* prices for that *year t* will be the same as those for the immediately preceding *year t-1*.

- (b) If clause 15.6(a) applies to a *standard retail supplier* for any *year of this determination*, then the *Tribunal* may allow (on a date set by the *Tribunal*) the *standard retail supplier* to change its *regulated retail tariff* prices during that *year* so as to reflect the *regulated retail tariff* prices set out in any *compliant annual pricing proposal* subsequently submitted by the *standard retail supplier*.

## 15.7 Submission of information separate from annual pricing proposal

If, for the purposes of clauses 8.3, 9 or 10 the *Tribunal* determines a date other than 1 July for price changes, introduction of *new regulated retail tariffs* or abolition of *regulated retail tariffs*, the *Tribunal* may require a *standard retail supplier* to submit any of the information referred to in clause 15.2 separately from an *annual pricing proposal*.

## 16. Review of market based electricity purchase cost allowance

### 16.1 Market based electricity purchase cost allowance

For the purpose of this clause 16 the *market based electricity purchase cost allowance* (for each *standard retail supplier* for each *year*) as at the time a review of that allowance by the *Tribunal* is due under clause 16.2, will be taken to be:

- (a) the amount for that *standard retail supplier* for that *year* set out in the table below; or
- (b) any *revised amount* taken to be the *market based electricity purchase cost allowance* for that *standard retail supplier* for that *year* under clause 16.2(b)(i).

#### Market based electricity purchase cost allowance (\$2007/08 per MWh)

Retailer	2007/08	2008/09	2009/10
Country Energy	50.2	49.1	45.1
EnergyAustralia	57.3	56.0	51.3
Integral Energy	59.6	58.5	53.9

## 16.2 Review mechanism

- (a) From 1 March of each of 2008 and 2009, the *Tribunal* will:
  - (i) conduct a review of the *market based electricity purchase cost allowance* (**review**) for each *standard retail supplier* for each remaining year; and
  - (ii) determine any revised amount which the *Tribunal* considers reflects the *market based electricity purchase cost allowance* for each *standard retail supplier* for each remaining year (each a **revised amount**) as a result of that review.
- (b) If, for any *standard retail supplier* for any remaining year, that *revised amount* is more than 10 per cent higher or lower than the *market based electricity purchase cost allowance* for that *standard retail supplier* for that year for the purposes of clause 16.1(b), then:
  - (i) that *revised amount* (determined under clause 16.2(a)(ii)) will be taken as the *market based electricity purchase cost allowance* for that *standard retail supplier* for that year; and
  - (ii) the *Tribunal* will determine a revised  $FixedR_c^t$  and  $VariableR_{ij}^t$  (in \$2007/08) to apply for that *standard retail supplier* for that year for the purposes of clauses 7.3 and 7.4, taking into account:
    - (A) that *revised amount*; and
    - (B) the transitioning of *regulated retail tariffs* to full cost reflectivity by the 2009/10 year.
- (c) If, for any *standard retail supplier* for any remaining year, that *revised amount* (determined under clause 16.2(a)(ii)) is not more than 10 per cent higher or lower than the *market based electricity purchase cost allowance* for that *standard retail supplier* for that year, then:
  - (i) the relevant amount for  $FixedR_c^t$  and  $VariableR_{ij}^t$  for that *standard retail supplier* for that year as set out in clauses 7.3 and 7.4 (or as previously determined for the purposes of those clauses) will continue to apply; and
  - (ii) the relevant *market based electricity purchase cost allowance* for that *standard retail supplier* for that year as set out in clause 16.1(b) (or as previously determined for the purposes of that clause) will continue to apply.

## 16.3 Consultation

- (a) Prior to making a determination under clauses 16.2(a)(ii) and 16.2(b)(ii), the *Tribunal* will:
  - (i) issue a draft report of its findings; and
  - (ii) consult on such matters (if any) arising out of its *review* as the *Tribunal* considers appropriate with the *standard retail suppliers* and such other persons (if any) as the *Tribunal* considers appropriate.
- (b) By the date specified in item 4 of the timetable in clause 14, the *Tribunal* will publish a final report of its *review* and of its determination under clauses 16.2(a)(ii) and 16.2(b)(ii), including the reasons for such determination.

## 17. Cost pass throughs

### 17.1 Materiality threshold

For the purposes of this clause 17:

- (a) ***positive change event***, for a *standard retail supplier*, means a *pass through event* which results in the *standard retail supplier* incurring *materially* higher costs in providing *pass through services* than it would have incurred but for that event;
- (b) ***negative change event***, for a *standard retail supplier*, means a *pass through event* which results in the *standard retail supplier* incurring *materially* lower costs in providing *pass through services* than it would have incurred but for that event; and
- (c) ***materially***:
  - (i) (for a *positive change event*) means:
    - (A) an event which results in the *standard retail supplier's* efficient, incremental and justified average annual costs incurred (or likely to be incurred) during the *period of this determination* exceeding 0.25% of the *standard retail supplier's* total revenue (inclusive of *network use of system charge* components of *retail tariffs*) for the *year* in which the event occurs; and
    - (B) as conclusively evidenced by the *Tribunal's* determination of a *total positive pass through amount* for that event.
  - (ii) (for a *negative change event*) means:
    - (A) an event which results in the *standard retail supplier's* average annual costs saved (or likely to be saved) during the *period of this determination* (after taking all reasonable steps to maximise those cost savings) exceeding 0.25% of the *standard retail supplier's* total revenue (inclusive of *network use of system charge* components of *retail tariffs*) for the *year* in which the event occurs; and
    - (B) as conclusively evidenced by the *Tribunal's* determination of an *total negative pass through amount* for that event.

## 17.2 Pass through event

- (a) If a *standard retail supplier* reasonably considers that a *positive change event* for that *standard retail supplier* has occurred, the *standard retail supplier* may seek the *Tribunal's* approval to pass through to *customers* an amount in respect of that *positive change event*.
- (b) If a *standard retail supplier* or the *Tribunal* reasonably considers that a *negative change event* for that *standard retail supplier* has occurred, the *Tribunal* may require the *standard retail supplier* to pass through to *customers* an amount in respect of that *negative change event*.
- (c) If a *standard retail supplier* wishes to pass through an amount to *customers* in the year *t* in respect of a *positive change event*, the *standard retail supplier* must give notice to the *Tribunal* by the date specified in item 1 of the timetable in clause 14.
- (d) A *standard retail supplier* must give the *Tribunal* notice of a *negative change event* by the date specified in item 1 of the timetable in clause 14, where the *standard retail supplier*:
  - (i) becomes aware before that date that the *negative change event* has occurred; and
  - (ii) has not previously notified the *Tribunal* of that *negative change event*.
- (e) The notices under clauses 17.2(c) and (d) must contain the information required under clauses 17.3 and 17.4.

## 17.3 Positive change event

- (a) The *standard retail supplier's* notice under clause 17.2(c) must be in writing and must specify:
  - (i) the details of the *positive change event*;
  - (ii) the date the *positive change event* occurred;
  - (iii) the increase in costs in the provision of *pass through services* that the *standard retail supplier* has incurred since 1 July 2007 and is likely to incur during the *period of this determination* as a result of the *positive change event*, including supporting documentation demonstrating that the cost increase is efficient, incremental and justified;
  - (iv) the total amount that the *standard retail supplier* proposes to pass through to *customers*; and
  - (v) the amount that the *standard retail supplier* proposes to pass through to *customers* in each year of *this determination*.
- (b) If the *Tribunal* receives a statement under clause 17.3(a) in relation to a *positive change event*:

- (i) the *Tribunal* will determine whether that *positive change event* occurred; and
- (ii) if the *Tribunal* determines that the *positive change event* occurred, the *Tribunal*, taking into account the matters referred to in clause 17.5, will determine:
  - (A) the amount which should be passed through to *customers* (the ***total positive pass through amount*** in respect of that *positive change event* for the *standard retail supplier*); and
  - (B) the amount of that *total positive pass through amount* that should be passed through to *customers* in each *year of this determination* (each an ***annual positive pass through amount*** in respect of the *relevant year*).
- (c) A *standard retail supplier* must provide the *Tribunal* with such information as the *Tribunal* requires for the purpose of making a determination under clause 17.3(b) within the time specified by the *Tribunal* in a notice provided to the *standard retail supplier* for that purpose.

#### 17.4 Negative change event

- (a) The *standard retail supplier's* notice under clause 17.2(d) must be in writing and must specify:
  - (i) the details of the *negative change event*;
  - (ii) the date the *negative change event* occurred;
  - (iii) the costs in the provision of *pass through services* that the *standard retail supplier* has saved since 1 July 2007 and is likely to save during the *period of this determination* as a result of the *negative change event*, including supporting documentation demonstrating that all reasonable steps have been taken to maximise the cost savings;
  - (iv) the total amount of those saved costs that the *standard retail supplier* proposes should be passed through to *customers*; and
  - (v) the amount of those saved costs that the *standard retail supplier* proposes should be passed through to *customers* in each *year of this determination*.
- (b) If a *negative change event* for a *standard retail supplier* occurs (whether or not the *standard retail supplier* notifies the *Tribunal* of the occurrence of that *negative change event*) and the *Tribunal* determines to impose a requirement on the *standard retail supplier* in relation to that *negative change event* as described in clause 17.2(b), the *Tribunal* will determine:
  - (i) the required *pass through amount* in respect of that *negative change event* for the *standard retail supplier*; and

- (ii) taking into account the matters referred to in clause 17.5:
  - (A) the amount which should be passed through to *customers* (the ***total negative pass through amount*** in respect of that *negative change event* for the *standard retail supplier*); and
  - (B) the amount of that *total negative pass through amount* that should be passed through to *customers* in each year of this determination (each an ***annual negative pass through amount*** in respect of the relevant year).
- (c) A *standard retail supplier* must provide the *Tribunal* with such information as the *Tribunal* requires for the purpose of making a determination under clause 17.4(b) within the time specified by the *Tribunal* in a notice provided to the *standard retail supplier* for that purpose.

## 17.5 Consultation and factors to be taken into account in determination

- (a) Prior to making a determination under clause 17.3(b) or 17.4(b), the *Tribunal* will consult on such matters arising out of the relevant *pass through event* as the *Tribunal* considers appropriate with the relevant *standard retail suppliers* and such other persons as the *Tribunal* considers appropriate.
- (b) In making a determination under clause 17.3(b) or 17.4(b), the *Tribunal* will take into account:
  - (i) the matters and proposals set out in any statement given to the *Tribunal* by the relevant *standard retail supplier* under clause 17.3(a) or 17.4(a);
  - (ii) in the case of a *positive change event*, the increase in costs in the provision of *pass through services* that the *standard retail supplier* has incurred since 1 July 2007 and is likely to incur until the end of the *period of this determination* as a result of the *positive change event*;
  - (iii) the implications for efficient costs of the *standard retail supplier's* decisions and actions, including whether:
    - (A) in the case of a *positive change event*, the *standard retail supplier* has taken or omitted to take any action where such action or omission has increased the magnitude of the costs incurred in respect of that *positive change event*;
    - (B) in the case of a *negative change event*, the *standard retail supplier* has taken all reasonable steps to maximise the cost savings in respect of that *negative change event*;
  - (iv) the time cost of money based on the rate of return on capital of the *standard retail supplier* (being 8.6% real pre-tax weighted average cost of capital);

- (v) the need to ensure that the *standard retail supplier* does not recover costs under this clause 17 to the extent provision for such costs has already been made or otherwise taken into account for the purposes of this determination;
- (vi) the need to ensure that the *standard retail supplier* only recovers any actual or likely increment in efficient costs under this clause 17 to the extent that such increment is solely as a consequence of a *pass through event*;
- (vii) in the case of a *regulatory change event* that is a *positive change event*, any costs that the *standard retail supplier* has incurred prior to, but in preparation for, the occurrence of that *regulatory change event*;
- (viii) in the case of a *tax change event*, any change in the way another tax is calculated, or the removal or imposition of another tax, which, in the *Tribunal's* opinion, is complementary to the *tax change event* concerned;
- (ix) any delay on the part of the *standard retail supplier* in seeking the *Tribunal's* approval to pass through to *customers* an amount in respect of any *positive change event*; and
- (x) any other factors the *Tribunal* considers relevant.

## Part 4

### Regulated Retail Charges

#### 18. Application

- (a) This Part specifies:
- (i) the maximum *regulated retail charges* to apply during the *period of this determination*; and
  - (ii) the manner in which such charges may be imposed.
- (b) A *standard retail supplier* may not impose on or require from a *customer* a security deposit, late payment fee or fee for a dishonoured cheque (whether or not described in those terms) except as permitted by this Part.

#### 19. Maximum regulated retail charges

Set out below is the Table referred to in this Part.

Table		
Maximum regulated retail charges (exclusive of GST)		
Item	Regulated retail charge	Maximum amount
1	Fee for a dishonoured cheque	2 times the regular GST-exclusive fee charged by the bank or other financial institution to which the cheque is presented.
2	Late payment fee	\$7.00
3	Security deposit	<ul style="list-style-type: none"><li>For <i>customers</i> whose <i>electricity retail bills</i> are issued quarterly, 1.5 times the <i>standard retail supplier's</i> average quarterly <i>electricity retail bill</i>; or</li><li>For <i>customers</i> whose <i>electricity retail bills</i> are issued 2-monthly, 1.75 times the <i>standard retail supplier's</i> average 2-monthly <i>electricity retail bill</i>; or</li><li>For <i>customers</i> whose <i>electricity retail bills</i> are issued monthly, 2.5 times the <i>standard retail supplier's</i> average monthly <i>electricity retail bill</i>,</li></ul> where the relevant amounts are the GST-exclusive amounts of those bills.



## 20. Fee for a dishonoured cheque

- (a) The maximum that a *standard retail supplier* may charge a *customer* for a dishonoured cheque is the corresponding amount listed in item 1 of the Table.
- (b) A *standard retail supplier* may only impose such a charge if the *standard retail supplier* actually incurs a bank or other financial institution fee for that dishonoured cheque.

## 21. Late payment fee

### 21.1 Maximum amount of a late payment fee

The maximum late payment fee that a *standard retail supplier* may charge a *customer* for late payment of an *electricity retail bill* is the corresponding amount listed in item 2 of the Table.

### 21.2 Imposing a late payment fee

- (a) A maximum of one late payment fee may be levied on each *electricity retail bill*.
- (b) A late payment fee may only be levied:
  - (i) on or after the date which is at least 5 *business days* after the due date shown on the *electricity retail bill* that is the subject of the late payment; and
  - (ii) after the *customer* has been notified in advance that the late payment fee will be charged if the *electricity retail bill* is not paid, or alternative payment arrangements entered into, within 5 *business days* of the due date.
- (c) A late payment fee must not be levied in relation to an *electricity retail bill*:
  - (i) during the period of an extension of time within which the *customer* may pay the *electricity retail bill*, agreed between the *standard retail supplier* and the *customer*; or
  - (ii) where a *customer* has made a billing related complaint in relation to the *electricity retail bill* to the *Ombudsman* or another external dispute resolution body where that complaint is unresolved; or
  - (iii) during the period of an instalment arrangement entered into between a *customer* and the *standard retail supplier* to pay the *electricity retail bill*.

### 21.3 Waiver of late payment fee

A late payment fee must be waived:

- (a) where the *standard retail supplier* is aware that the *customer* has contacted a welfare agency or support service for assistance; or
- (b) where payment or part payment is made by *EAPA voucher*; or

- (c) on a case by case basis as considered appropriate by the *Ombudsman*.

## **22. Security deposit**

### **22.1 Types of security deposit**

- (a) A *standard retail supplier* must accept the following types of security deposits:
  - (i) those methods of payment referred to in clause 30 of the *Electricity Supply (General) Regulation 2001*;
  - (ii) *annual security levies* from business customers only;
  - (iii) bankers' guarantees from business customers only; and
  - (iv) Department of Housing guarantees from residential customers only.
- (b) A *standard retail supplier* may not require a residential customer to provide an *annual security levy* or a banker's guarantee.

### **22.2 Maximum amount of a security deposit**

- (a) The maximum security deposit that a *standard retail supplier* may require from a customer is the corresponding amount calculated in accordance with one of the methods shown in item 3 of the Table.
- (b) The amounts of the relevant average *electricity retail bills* will vary between *standard retail suppliers*, depending on average *regulated retail tariff* levels and average consumption. For the purpose of calculating the maximum amount of a security deposit in item 3 of the Table, the *standard retail supplier* must calculate the amounts of the relevant average *electricity retail bills* as part of the process of setting *regulated retail tariffs*, and post the amount up to the maximum amount of the required security deposits on its tariff schedule.

### **22.3 Requiring a security deposit**

A *standard retail supplier* may only require a customer to provide a security deposit:

- (a) in the case of a residential customer, in the circumstances set out in clause 22.4;
- (b) in the case of a business customer, in the circumstances set out in clause 22.5.

### **22.4 Security deposits from residential customers**

- (a) Prior to the commencement of *supply* under a *standard form customer supply contract* with a residential customer, a *standard retail supplier* may require a security deposit from that customer only if the customer:
  - (i) has an outstanding debt owed to the *standard retail supplier* in relation to an *electricity retail bill* and the customer has refused and refuses to make an arrangement to pay that debt; or
  - (ii) has been responsible for the illegal use of electricity within the previous two years; or

- (iii) does not have a satisfactory credit history in the reasonable opinion of the *standard retail supplier*, and the *standard retail supplier* has offered the *customer* a *payment plan* and the *customer* has refused or failed to agree to the offer.
- (b) After the commencement of *supply* under a *standard form customer supply contract* with a residential *customer*, a *standard retail supplier* may require a security deposit from that *customer* only if:
  - (i) the security deposit is sought within 12 months after the commencement of the *standard form customer supply contract*;
  - (ii) the *customer* entered into a *payment plan* with the *standard retail supplier* at the commencement of the *standard form customer supply contract*;
  - (iii) the *customer* has cancelled that *payment plan* but has not requested that the *standard retail supplier* cease *supplying* electricity to the *customer's supply address*; and
  - (iv) one or more of the circumstances in clause 22.4(a) (i) to (iii) exists.

## 22.5 Security deposits from business customers

- (a) Prior to the commencement of *supply* under a *standard form customer supply contract* with a business *customer*, a *standard retail supplier* may require a security deposit from that *customer* only if that *customer*:
  - (i) does not have a satisfactory credit history in the reasonable opinion of the *standard retail supplier*; or
  - (ii) is a new business; or
  - (iii) has been responsible for the illegal use of electricity within the previous two years.
- (b) After the commencement of *supply* under a *standard form customer supply contract* with a business *customer*, a *standard retail supplier* must not require a security deposit from that *customer*.

## 22.6 Recourse to a security deposit

A *standard retail supplier* may have recourse to a security deposit, to recover amounts due to that *standard retail supplier* in respect of charges related to the *supply* of electricity or connection services arranged by that *standard retail supplier* where:

- (a) the *customer* has failed to pay an *electricity retail bill* resulting in disconnection; or
- (b) the *customer* has failed to pay an *electricity retail bill* and has requested that the *standard retail supplier* ceases *supplying* electricity to that *customer's supply address* under a *standard form customer supply contract*.

## **22.7 Return of security deposits**

- (a) Subject to clause 22.9, a *customer* who is required to pay a security deposit and who pays in a form contemplated by clause 30 of the *Electricity Supply (General) Regulation 2001* (other than for an *annual security levy*) is eligible for that deposit to be refunded when the *customer* has completed:
  - (i) for residential *customers* - on time payment of all *electricity retail bills* for one year from the date of the first *electricity retail bill*; or
  - (ii) for business *customers* - on time payment of all *electricity retail bills* for two years from the date of the first *electricity retail bill* and has maintained a satisfactory credit rating in the reasonable opinion of the *standard retail supplier* over that period.
- (b) The *standard retail supplier* must, within 10 *business days* of the relevant events in clause 22.7(a) occurring:
  - (i) inform the *customer* in writing of the amount that is refundable; and
  - (ii) repay the security deposit as directed by the *customer*.

## **22.8 Maximum duration of requirement for annual security levy or guarantee**

- (a) Subject to clause 22.9, a *customer* who is required to pay a security deposit and does so in the form of an *annual security levy* or guarantee is eligible for the *annual security levy* to cease or the guarantee to be discharged when the *customer* has completed:
  - (i) for residential *customers* – on time payment of all *electricity retail bills* for one year from the date of the first *electricity retail bill*; or
  - (ii) for business *customers* – on time payment of all *electricity retail bills* for two years from the date of the first *electricity retail* and has maintained a satisfactory credit rating in the reasonable opinion of the *standard retail supplier* over that period.
- (b) The *standard retail supplier* must, within 10 *business days* of the relevant events in clause 22.8(a) occurring, inform the *customer* that an *annual security levy* or guarantee is no longer required and (in the case of a guarantee) discharge the guarantee.

## 22.9 Cessation of supply

- (a) Subject to clauses 22.6 and 22.7, if a *standard retail supplier* requires a *customer* to pay a security deposit (other than in the form of an *annual security levy* or *guarantee*), the *customer* has provided the security deposit, and:
  - (i) the *customer* requests that the *standard retail supplier* ceases supplying electricity to the *customer's supply address* under a *standard form customer supply contract*; or
  - (ii) the *customer* has been disconnected,the *standard retail supplier* must, within 10 *business days* of the *customer* ceasing to take *supply* or disconnection (whichever is the case):
  - (iii) inform the *customer* in writing of the amount of the security deposit that is refundable; and
  - (iv) repay the amount of the security deposit that is refundable as directed by the *customer*.
- (b) If a *standard retail supplier* requires a *customer* to provide a security deposit in the form of a *guarantee*, and the *customer* requests that the *standard retail supplier* ceases supplying electricity to the *customer's supply address* under a *standard form customer supply contract*, the *standard retail supplier* must, within 10 *business days* of the *customer* ceasing to take *supply*, inform the *customer* in writing that the *guarantee* is no longer required and discharge the *guarantee*.
- (c) Clause 22.9(a) and (b) do not apply if the *customer*, upon the cessation of *supply* at a *supply address*, commences taking *supply* from the *standard retail supplier* at another *supply address* under a *standard form customer supply contract*.

## Part 5

### Definitions and Interpretation

#### 23. Definitions

In this determination:

*2007/08 year* means the period from 1 July 2007 to 30 June 2008

*2008/09 year* means the period from 1 July 2008 to 30 June 2009

*2009/10 year* means the period from 1 July 2009 to 30 June 2010

*annual negative pass through amount* is defined in clause 17.4(b)

*annual pass through amount*, for any year, means any *annual positive pass through amount* for that year less any *annual negative pass through amount* for that year

*annual positive pass through amount* is defined in clause 17.3(b)

*annual pricing proposal* means the document described in clause 15

*annual security levy* means a form of security deposit payable annually by the customer which is not refundable to the customer

*applicable law* means:

- (a) any legislation of the Commonwealth Parliament or the Parliament of New South Wales, and any regulation, order, rule or other instrument made under such legislation (including the *National Electricity Law*, NERs and rules made under section 63C of the *ESA*);
- (b) any *retail supplier's licence*; and
- (c) any code, rules and guidelines which is or are binding on a *standard retail supplier*

*authority* means:

- (a) any government or any Minister, agency, department, instrumentality or other authority of government; and
- (b) the *Tribunal*, the Australian Energy Markets Commission, the Australian Energy Regulator or NEMMCO,

but does not include a State owned corporation as that expression is defined in the *State Owned Corporations Act 1989 (NSW)*

*business day* means a day other than a Saturday, Sunday, public holiday or bank holiday in all of New South Wales

**compliant annual pricing proposal** means a *standard retail supplier's annual pricing proposal* for which the *Tribunal* has notified the *standard retail supplier* that the *Tribunal* is satisfied of each of the matters referred to in clause 15.3

**component** means *regulated retail tariff component*

**controlled load** means a load which is active only at certain times, where such times are determined and controlled by the network

**controlled load tariff** means a *regulated retail tariff* in respect of a *controlled load*

**CPI** means the consumer price index, All Groups for the weighted average of eight capital cities as published by the Australian Bureau of Statistics, or if the Australian Bureau of Statistics does not or ceases to publish the index, then *CPI* will mean an index determined by the *Tribunal* that is its best estimate of the index

$\Delta CPI_{07}$  means the change in *CPI* between the 2006 and 2007 calendar years, calculated to 2 decimal places as follows:

$$\Delta CPI_{07} = \left( \frac{CPI_{Mar\ 2007} + CPI_{Jun\ 2007} + CPI_{Sep\ 2007} + CPI_{Dec\ 2007}}{CPI_{Mar\ 2006} + CPI_{Jun\ 2006} + CPI_{Sep\ 2006} + CPI_{Dec\ 2006}} - 1 \right)$$

where *CPI* is as defined above and where the corresponding subtext (for example Jun2007) means the *CPI* for the quarter and of the year indicated (in the example, the quarter ending in June of the year 2007)

$\Delta CPI_{08}$  means the change in *CPI* between the 2007 and 2008 calendar years, calculated to 2 decimal places as follows:

$$\Delta CPI_{08} = \left( \frac{CPI_{Mar\ 2008} + CPI_{Jun\ 2008} + CPI_{Sep\ 2008} + CPI_{Dec\ 2008}}{CPI_{Mar\ 2007} + CPI_{Jun\ 2007} + CPI_{Sep\ 2007} + CPI_{Dec\ 2007}} - 1 \right)$$

where *CPI* is as defined above and where the corresponding subtext (for example Jun2007) means the *CPI* for the quarter and of the year indicated (in the example, the quarter ending in June of the year 2007)

**customer** means a *small retail customer* under a *standard form customer supply contract*. For any purpose under this determination that involves counting or determining the number of customers, each relevant *NMI* is to be regarded as one customer

**customer hardship program** means any program which imposes obligations on a *standard retail supplier* to assist *customers* in financial or other difficulty, to the extent that compliance with such obligations is not funded by a government or third party

**demand management levy** means any levy, tariff, fee, charge, duty, tax or impost of any kind imposed on a *DNISP* by the Government of New South Wales or the Commonwealth Government in connection with or relating to the supply of electricity to, or the consumption of electricity by, any *distribution customer*

*derivative* has the meaning given to that term in under the *Corporations Act 2001* (Commonwealth)

*distribution customer* has the meaning given to that term under the *NERs*

*distribution system* has the meaning given to that term under the *ESA*

*DNSP* means a distribution network service provider (as that term is defined in the *ESA*)

*EAPA voucher* means a voucher issued under the Energy Accounts Payments Assistance Scheme administered by the NSW Department of Energy, Utilities and Sustainability

*electricity retail bill* means a bill issued by a *standard retail supplier* for the supply of electricity, or connection services arranged, by the *standard retail supplier*

*energy loss factor* means a factor that is applied to adjust cost or quantities in relation to the wholesale purchase of electricity to reflect the physical losses of energy arising during the transporting of energy over transmission systems and *distribution systems*

*energy losses* means the physical losses of energy arising during the transporting of energy over transmission systems and *distribution systems*

*ESA* means the *Electricity Supply Act 1995* (NSW)

*Gazette* means the New South Wales Government Gazette

*green energy outcome* means:

- (a) an increase in the amount of electricity that is generated from renewable energy sources or other sources of energy that provide improved environmental outcomes; or
- (b) additional investment in technologies that reduce or offset greenhouse gas emissions attributable to electricity generation; or
- (c) reduced consumption of electricity

*green energy scheme* means any mandatory scheme that imposes financial obligations on a *standard retail supplier* in order to produce one or more *green energy outcomes*, but does not include any scheme to the extent to which the *standard retail supplier* can recover its costs of that scheme from *customers* through *green premiums*

*green energy costs* means costs of compliance with any *green energy scheme*

*green premium* means an amount voluntarily payable by a *customer* that is intended to result in, or contribute towards, one or more *green energy outcomes*. Where a *tariff* for the supply of such electricity does not separately identify the component attributable to *green energy outcomes*, the green premium is that part of the *tariff* that exceeds the *tariff* that would apply to a *customer* in the same circumstances were it not for the *green energy outcomes*



**GST** means the Goods and Services Tax as defined in *A New Tax System (Goods and Services Tax) Act 1999 (Cth)*

***inclining block tariff*** means a *regulated retail tariff* under which customers pay an initial lower price per kWh for energy consumed up to a defined threshold level of consumption and a higher price per kWh for energy consumed above that threshold

**kWh** means kilowatt hours

***last resort supply event*** has the meaning given to that term under clause 59 of the *Electricity Supply (General) Regulation 2001 (NSW)*

***market based electricity purchase cost allowance*** for a *standard retail supplier* for a year, means an allowance made by the Tribunal for that *standard retail supplier's* costs of purchasing electricity under *wholesale supply arrangements* in order to supply electricity under its *regulated load* but not including any *volatility allowance*, *green energy costs*, *NEMMCO fees*, any costs related to *energy losses* or any other costs relating to the *standard retail supplier's* retail supply business or the recovery of any retail margin relating to that business.

***materially*** is defined in clause 17.1(c)

**Minister** means the Minister for Energy

***Minister's referral*** means the referral to the *Tribunal* from the *Minister* referred to in clause 1(1)

**MWh** means megawatt hours

***National Electricity Law*** means the National Electricity Law set out in the Schedule to the *National Electricity (South Australia) Act 1996 (SA)*

***negative change event*** is defined in clause 17.1(b)

***negative pass through amount*** means an amount to be passed through to *customers* as a result of a *negative change event*

**NEMMCO** means the National Electricity Market Management Company Limited ACN 072 010 327

***NEMMCO direction fees*** means fees imposed by NEMMCO under clause 3.15.8 of the NERs

***NEMMCO fees*** means *NEMMCO participant fees*, *NEMMCO direction fees* and *NEMMCO reserve trader fees*

***NEMMCO participant fees*** means "Participant fees" as defined under the NERs

***NEMMCO reserve trader fees*** means fees imposed by NEMMCO under clause 3.15.9 of the NERs

**NERs** means the National Electricity Rules approved in accordance with the *National Electricity Law*

**network use of system charge** means the charge levied by a DNSP on a *standard retail supplier* for *use of system services* provided by a network service provider (being a "Network Tariff" as defined in the *Tribunal's network determination*)

**new regulated retail tariff** means a *regulated retail tariff* that was not in existence as at 30 June 2007

**NMI** means National Metering Identifier, and is as defined in the *NERs*

**obsolete**, in relation to a *regulated retail tariff*, means a *regulated retail tariff* that is no longer being offered by a *standard retail supplier* to customers seeking to enter, or entering into, a *standard form customer supply contract* with that *standard retail supplier*

**off-peak periods** means:

- (a) in relation to a *standard retail supplier's time of use tariffs*, those periods that the *standard retail supplier* applied as off-peak periods for that purpose, as at 30 June 2007, or any variations to those times which are notified to the *Tribunal*, applied and published by the *standard retail supplier* on its website; and
- (b) in relation to a *standard retail supplier's controlled load tariffs*, those periods (whether fixed or variable) that the *standard retail supplier* from time to time applies as off-peak periods for that purpose

**Ombudsman** means the Energy and Water Ombudsman NSW or any other electricity industry ombudsman under an approved electricity industry ombudsman scheme under the *ESA*

**pass through event** means a *regulatory change event* or a *tax change event*

**pass through services** means services of or in relation to *supplying* electricity to *small retail customers* under a *standard form customer supply contract*

**payment plan** means an arrangement entered into between a *standard retail supplier* and a *customer*, for the payment of charges incurred after the commencement of the plan, that involves either or both of:

- (a) automated payment, including;
  - (i) direct debit; or
  - (ii) CentrePay, the free direct bill-paying service offered to persons receiving payments from Centrelink allowing those persons to pay for services (including *electricity retail bills*) by having a regular amount deducted from their Centrelink payment; or
- (b) advance payment (whether in advance of the services being provided, or after the services have been provided but in advance of the time that an *electricity retail bill* would ordinarily be issued), but not including a security deposit

**peak periods** means, for a *standard retail supplier*, those periods that the *standard retail supplier* applied as peak periods, for the purposes of its *time of use tariffs*, as at 30 June 2007, or any variations to those times which are notified to the *Tribunal*, applied and published by the *standard retail supplier* on its website

**period of this determination** means the period referred to in clause 2(3)

**positive change event** is defined in clause 17.1(a)

**positive pass through amount** means an amount to be passed through to *customers* as a result of a *positive change event*

**premises** has the meaning given to that term in the *ESA*

**regulated load**, for a *standard retail supplier* means the load for all *customers* in that *standard retail supplier's supply district*, as used by the *Tribunal* in making this determination (as at its commencement)

**regulated retail charge** means a security deposit, late payment fee or fee for a dishonoured cheque of an amount specified in this determination

**regulated retail tariff:**

- (a) when used in clause 1(1), has the meaning given to that term in the *ESA*; and
- (b) when used anywhere else in this determination, means a *tariff* for or in relation to the supply of electricity charged by a *standard retail supplier* to a *small retail customer* under a *standard form customer supply contract*, excluding:
  - (i) *green premiums*; and
  - (ii) *regulated retail charges*,

which may include a number of *regulated retail tariff components* (if offered by the *standard retail supplier* as a single *tariff*)

**regulated retail tariff component** means a component of a *regulated retail tariff*; for example:

- (a) a *time of use tariff* might have 4 components, for example:
  - (i) peak, shoulder and off-peak components (each expressed in cents/kWh)
  - (ii) (a service availability charge (expressed in cents/day)
- (b) an *inclining block tariff* might have 3 components, for example:
  - (i) a price (expressed in cents/kWh) for that part of the consumption which is between 0 and X kWh
  - (ii) another (higher) price (also expressed in cents/kWh) for that part of the consumption that exceeds X kWh
  - (iii) a service availability charge (expressed in cents/day)

*regulatory change event* means:

- (a) a decision made by any *authority*;
- (b) the coming into operation of an *applicable law*; or
- (c) the coming into operation of an amendment to or revocation of an *applicable law*,  
on or after 14 June 2007 that:
  - (d) has the effect of substantially varying:
    - (i) the nature, scope, standard or risk of the *pass through services*; or
    - (ii) the manner in which a *standard retail supplier* is required to undertake any activity in order to provide the *pass through services*, including obligations under any:
      - (A) *green energy scheme* (subject to paragraph (j));
      - (B) *customer hardship program*; or
      - (C) *last resort supply event*; and
  - (e) results in a *standard retail supplier* incurring during the *period of this determination* materially higher or materially lower costs in providing the *pass through services* than it would have incurred but for that event,

but does not include:

- (f) the making of this determination;
- (g) a *tax change event*;
- (h) any decision, determination or ruling in relation to *energy loss factors*;
- (i) the phasing out of the Electricity Tariff Equalisation Fund (as defined in the *ESA*); or
- (j) the coming into operation of the New South Wales Renewable Energy Target scheme (however named) to the extent that that scheme is substantially similar to the proposed scheme of that name announced by the New South Wales Government prior to the commencement of this determination.

**relevant tax** means any tax, levy, impost, deduction, charge, rate, duty or withholding which is levied or imposed by a government or any Minister, agency, department, instrumentality or other *authority* payable by a *standard retail supplier* other than:

- (a) income tax and capital gains tax;
- (b) stamp duty, financial institutions duty and bank accounts debits tax;
- (c) *NEMMCO participant fees*;
- (d) fees payable by a *standard retail supplier* in respect of a *retail supplier's licence*;
- (e) penalties, charges, fees and interest on late payments, or deficiencies in payments, relating to any tax; or
- (f) any tax that replaces or is equivalent or similar to any of the taxes referred to in (a) to (d) above (including any State equivalent tax),

but including *NEMMCO reserve trader fees* and *NEMMCO direction fees*

**retail supplier's licence** means any licence that authorises operations in the electricity retail market in New South Wales (including any retail supplier's licence granted under the ESA)

**review** is defined in clause 16.2 (a)(i)

**revised amount** is defined in clause 16.2 (a)(ii)

**second-tier retail supplier** means a second-tier customer under the *NERs* that also holds a *retail supplier's licence*

**shoulder periods** means, for a *standard retail supplier*, those periods that the *standard retail supplier* applied as shoulder periods, for the purposes of its *time of use tariffs*, as at 30 June 2007, or any variations to those times which are notified to the *Tribunal*, applied and published by the *standard retail supplier* on its website

**small retail customer** has the meaning given to that term in the *ESA*

**standard form customer supply contract** has the meaning given to that term in the *ESA*

**standard retail supplier** has the meaning given to that term in the *ESA* (namely, EnergyAustralia, Integral Energy Australia and Country Energy)

**supply** has the meaning given to that term in the *ESA*

**supply address**: each *NMI* is considered to be a single supply address

**supply district** has the meaning given to that term in the *ESA*

***tariff*** means, depending on the context:

- (a) a price (or set of prices for different components); and/or
- (b) the set of circumstances in which (including the group of persons to whom) that price or set of prices will apply

***tax change event*** means:

- (a) the imposition of a *relevant tax*,
- (b) the removal of a *relevant tax*; or
- (c) a change in (or a change in the application or official interpretation of) a *relevant tax* or the way in which a *relevant tax* is calculated;

which:

- (d) occurs on or after 14 June 2007; and
- (e) results in a *standard retail supplier* incurring during the *period of this determination* materially higher or materially lower costs in providing *pass through services* than it would have incurred but for that event

***taxable supply*** is as defined in *A New Tax System (Goods and Services Tax) Act 1999 (Cth)*

***time of use tariff*** means a *regulated retail tariff* for which different rates apply depending upon the time of consumption

***total negative pass through amount*** is defined in clause 17.4(b)

***total positive pass through amount*** is defined in clause 17.3(b)

***Tribunal*** means the Independent Pricing and Regulatory Tribunal of New South Wales established under the *Independent Pricing and Regulatory Tribunal Act 1992 (NSW)*

***Tribunal's network determination*** means the *Tribunal's* determination entitled "NSW Electricity Distribution Pricing 2004/05 to 2008/09" (Determination No. 2 of 2004)

***Tribunal's previous retail determination*** means Determination No. 1 of 2004

***use of system services*** has the meaning given to that term under the *NERs*

***volatility allowance*** means an allowance for the risks associated with price variation caused by normal system volatility to be taken into account through an allowance for the cost of holding working capital required to withstand the resulting cashflow variations

***wholesale supply arrangement*** has the meaning given to that term in the *ESA* and includes any *derivatives* relating to electricity supplied under such an arrangement

***year*** means *year of this determination*

*year of this determination* means the 2007/08 year, the 2008/09 year or the 2009/10 year.

## 24. Interpretation

In this determination:

- (a) a construction that would promote the purpose or object expressly or impliedly underlying the *ESA* is to be preferred to a construction that would not promote that purpose or object;
- (b) the reference to an Act, legislation or law includes regulations, rules, codes and other instruments under it and consolidations, amendments, re-enactments or replacements of them;
- (c) words importing the singular include the plural and vice versa (for instance, the reference to a *regulated retail tariff* includes *regulated retail tariffs* and vice versa);
- (d) where a word is defined, other grammatical forms of that word have a corresponding meaning;
- (e) headings are for convenience only and do not affect the interpretation of this determination;
- (f) a reference to a person includes any company, partnership, joint venture, association, corporation, other body corporate or government agency; and
- (g) a reference to any agency or body (including a *standard retail supplier*), if that agency or body ceases to exist or is reconstituted, renamed or replaced, or has its powers or functions removed (**defunct body**), means the agency or body which performs most closely the functions of the defunct body.

## 25. GST

All prices and calculations under this schedule are exclusive of *GST*. A *standard retail supplier* may charge *customers* an additional amount equal to the *GST* payable by the *standard retail supplier* in respect of any *taxable supply* to which the amounts relate.

## 26. Clarification

The *Tribunal* may publish a clarification notice in the *Gazette* to correct any manifest error or to clarify any part of this determination as if that clarification notice formed part of this determination.

