FACT SHEET

Updating regulated electricity price increases for 1 July 2012

December 2011

The Independent Pricing and Regulatory Tribunal of NSW (IPART) is responsible for regulating electricity prices for around two-thirds of residential and small business customers in NSW. These are the prices that EnergyAustralia (owned by TRUenergy) and Integral Energy and Country Energy (both owned by Origin Energy) – the Standard Retailers in this State – charge customers who have not signed a market contract with either them or another retailer. We do not set prices for customers that have signed a market contract with a retailer.

In June 2011 we estimated the regulated price increases that would apply on 1 July 2012 to be 10.0%, 2.0% and 9.5% for EnergyAustralia, Integral Energy and Country Energy respectively. These estimated price increases predominately reflect the increasing costs of transporting electricity to your premises (network costs). These estimates did not include the impact of any carbon price.

We have now commenced our review of electricity retail prices for 1 July 2012. This review is an update to set the 1 July 2012 price increase, using the approach set out in the 2010 determination.

The background to the review as well as the scope, processes and timing of the review including the opportunities for stakeholder are outlined in more detail below.

Changes since the 2011 price change

In updating the 1 July 2012 price increase, we will take into account the Commonwealth Government's legislation to introduce a carbon price from 1 July 2012 as well as updated green scheme obligations on retailers:

- **Introduction of a carbon price**: on 8 November 2011 the Commonwealth Government passed legislation to introduce a carbon price on 1 July 2012 of $23/tonne. The legislation includes a fixed price path for the first 3 years of the scheme before transitioning to a market price.

- **Additional green scheme obligations:** on 29 July 2011 the ORER announced that the number of certificates created in 2011 under the small scale renewable energy scheme (SRES) by households with solar PV units may significantly exceed the forecast. Under the SRES retailers are required to purchase a certain number of these certificates and this obligation[1] is published by ORER annually. If this obligation for 2012 is revised upwards retailers may incur additional costs to those assumed in setting prices from 1 July 2011. The Standard Retailer's have indicated that should this obligation be revised upwards they would apply to pass through these additional costs to customers from 1 July 2012.
- The NSW Government has announced that it will recover some of the costs of the Solar Bonus Scheme through a levy on electricity prices.[2]

What is the scope of the review?

Standard Retailers set their electricity prices within a price cap determined by IPART. This price cap is made up of the following components:

- **Retail** component (or R values) which consists of allowances for the costs of purchasing energy, green costs and retail costs.
- **Network** component which reflects the actual network prices approved annually by the AER. These prices reflect the costs of transporting electricity across the network as well as any levy imposed on network businesses (such as the Climate Change Levy which will recover costs of the Solar Bonus Scheme).

Each of these components represents around half of a customer's bill (refer to Box 1 below). The retail component is set out in our 2010 determination and updated annually through these reviews. The network component is approved annually by the AER and we pass this through into electricity prices. This review is an update to set the 1 July 2012 price increase, using the approach set out in the 2010 determination.

1 The obligation on retailers is known as the Small-scale Technology Percentage (STP).

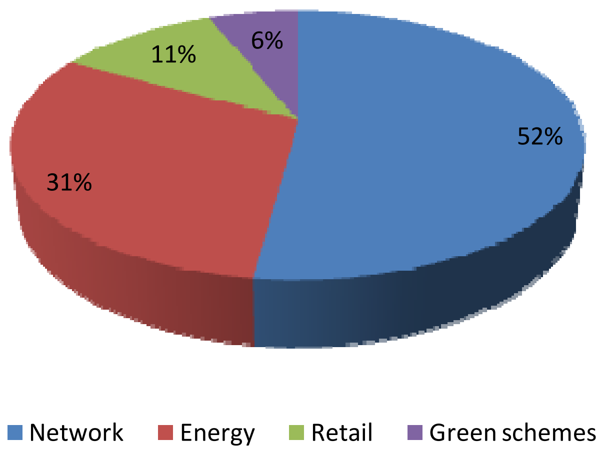
2 The NSW Government announced that the Climate Change Fund levy would recover an additional $100 million in 2012/13 (bringing the total contributions to $250m), increasing to an additional $150 million per annum from 2013/14 – 2016/17. NSW Budget 2011/12 – Budget Paper 2, chapter 5, p 3.

Box 1 What are the cost components of an electricity bill in 2011/12

Electricity retailers purchase electricity in wholesale markets, pay for transport of this electricity and package it with retail services for sale to customers.

A customer's bill is therefore made out of the following components:

- **Network costs**, which are the costs of transporting electricity from the generators to customers via the transmission and distribution networks.
- **Energy costs,** which include the costs of purchasing electricity from generators on the wholesale electricity market.
- **Green costs,** which include the costs of complying with several green (or climate change mitigation) schemes, as required by the Federal and NSW Governments.
- **Retail costs,** which includes the costs of running the retail business (including call centre costs, billing costs, etc) and making an appropriate profit.



As part of the review we will:

- Update the allowances for energy costs for 2012/13, including:
  - The energy purchase cost allowance, including the Long Run Marginal Cost (LRMC) of generation and the market-based cost. We will reset the energy purchase allowance in line with the higher of the LRMC and the market-based cost consistent with the approach specified in the terms of reference.
  - The cost allowance for energy losses.
- Update the allowances for green costs for 2012/13 including the cost of complying with obligations under the Renewable Energy Target scheme, Greenhouse Gas Reduction Scheme (GGAS) and Energy Saving Scheme (ESS).
- Pass through updated network prices for 2012/13 following the prices being approved by the Australian Energy Regulator (AER).

The allowances for 2012/13 determined as part of this review will replace those included in our decision released in June 2011. As a result regulated retail prices will be adjusted to reflect any change in the Standard Retailers' efficient total energy costs.

The annual review does not consider retail operating costs, customer acquisition costs or the retail margin. However, as part of the annual review, we will recalculate the retail margin in dollar terms so that it continues to reflect our final decision, which is expressed as a fixed percentage of each Standard Retailers' total costs.

Concurrent with this annual review we will also consider any applications by Standard Retailers to pass through to customers any incremental costs associated with changes to retailers' liabilities under the SRES. We may also initiate a negative cost pass through if this obligation is materially revised downwards.

What is the methodology of the review?

We will use the same methodologies as were used in making the 2010 determination to conduct this review. We have engaged Frontier Economics to provide advice on the updated energy purchase cost allowance.

To update the energy purchase cost allowance for 2012/13 we will use the same load profiles used in making the 2010 determination, and will:

- Update the LRMC of generation on a standalone basis to meet the regulated load.
- Update the market-based cost to meet the regulated load - this involves modelling the efficient mix of contract and spot price exposure for each Standard Retailer, and including an allowance for volatility. The market-based cost will be based on the conservative point on the efficient frontier (least risk position). In determining the market based cost, we will consider simulations of forward market prices (as was done in the 2010 determination) and any publicly available electricity forward price market data which we regard as appropriate in the portfolio optimisation model. However, we will maintain a point in time approach regardless of the source of the forward price data.
- Set the energy purchase cost as the higher of the LRMC or market-based cost as required in our terms of reference.

To update the allowance for the costs of complying with green schemes in 2012/13 we will:

- **GGAS and LRET** - use an incremental approach to calculate the LRMC of generation of meeting each scheme's respective target.
- **SRES** - use the binding liability for 2012 prescribed by legislation as well as the non-binding estimate for 2013 published by ORER.
- **ESS** - use the penalty price of the scheme as a proxy for the price of energy savings certificates and the ESS targets.

In calculating the energy purchase cost and green cost allowances for each Standard Retailer we will update the following input assumptions where appropriate:

- capital costs of generation
- fuel and other operating costs of generation
- growth in electricity demand in the NEM
- industry ownership structure and generation availability/capacity
- carbon prices (see further detail below)
- targets set by any mandatory green energy scheme
- market parameters of the WACC including the risk free rates and debt margin.

To assess any application to pass through the incremental costs of complying with the SRES we will assess:

- whether the event qualifies as a Pass Through Event as defined in our determination
- whether the event results in materially higher or lower costs for the Standard Retailers (ie, the change in costs must pass the materiality threshold test in our 2010 determination)
- the level of the appropriate pass through amounts for the event

Any cost pass through amounts that we approve would allow for additional costs in 2011/12 to be included in the price change from 1 July 2012.

How will we include the impacts of the carbon price?

A carbon price will place a cost on carbon emissions. This will push up the cost of electricity generation, wholesale electricity prices, and thus push up the retail price of electricity. This is intended to send price signals to electricity consumers about the environmental impact of their consumption, and thereby reduce overall consumption and the associated carbon pollution.

Our approach to including a carbon price was set out in our 2010 determination and involves incorporating the cost of carbon in both our estimates of the LRMC of generation and the market based cost using a carbon inclusive approach.

This approach factors the costs of carbon into generator's short run marginal costs (SRMC) consistent with the way a generator considers the cost of fuel.

- For the market based cost, these carbon costs feed into the bidding decisions made by generators in relation to the price and quantity of electricity they are willing to sell into the National Electricity Market. Ultimately the carbon costs faced by different generators are reflected in the price of wholesale electricity.

- For the LRMC of generation, these carbon costs are considered alongside other short run and long run costs (such as capital costs) in building a theoretical generation system that is able to supply the regulated load at least cost.

We have previously noted that using a carbon inclusive approach avoids making assumptions about the extent to which a carbon price will be reflected in wholesale electricity prices. These assumptions have typically been highly variable and dependent upon the characteristics of the market and the timeframe over which the impact is considered. Rather, under our approach the impact of carbon on a retailer's energy purchase costs is an output of the modelling. The impact has typically been lower under the LRMC approach compared to the market based cost. This is because:

- The LRMC of generation is a theoretical framework in which investment is able to respond immediately to the carbon price, which leads to an 'immediate' change in the proportion of gas fired plant and therefore the emission intensity of this theoretical system.
- Under the market based cost the impact of the carbon price on wholesale electricity prices will be a function of the existing generation system which is highly carbon intensive and less responsive in the short term to a carbon price than the theoretical LRMC framework described above.

What is the process and timetable for the review?

Consultation on the review of prices from 1 July 2012 will commence in April 2012 and be completed in June 2012, in time for 1 July 2012 price changes. This will enable us to update the costs of complying with the SRES, including considering the binding liability for 2012 prescribed by legislation as well as the non-binding estimate for 2013 published by ORER.[3]

The timetable for the review (Table 1) outlines a process involving a stakeholder information session in April 2012 on the draft report, including inviting submissions, and for us to consider submissions and finalise our advice in a final report. We will advertise the date for the public hearing.

3 Before 31 March each year, the *Renewable Energy (Electricity) Regulations 2001 (Cth)* will prescribe the binding STP for that year, and ORER must publish non-binding estimates of the STP for the next 2 years.

Table 1 Timetable for the annual review of total energy cost allowance

Events	Indicative Time
IPART draft decision released, accompanied by consultant's report	Mid - April 2012
Public Hearing - IPART consults on draft report	End - April 2012
Submission on draft report due (4 weeks from release of draft report)	Mid - May 2012
IPART final decision released, accompanied by consultant's report	Mid -June 2012
Price changes	1 July 2012

Stakeholders who are interested in receiving email updates on this review should send their contact details to:

ipart@ipart.nsw.gov.au