

INDUSTRY FACT SHEET

2011 annual review of the total energy cost allowance

February 2011

In March 2010, we released our final determination of regulated electricity retail tariffs and charges for small customers from 2010 to 2013 (the 2010 determination). The regulatory package for the 2010 determination included annual reviews of the total energy cost allowances for 2011/12 and 2012/13 for each Standard Retailer.

We have commenced work on the 2011/12 annual review. The scope and processes for this annual review are outlined below.

What is the scope of the review?

The scope of the annual review was established in the 2010 determination and includes updating decisions on:

- ▼ The energy purchase cost allowance, including the Long Run Marginal Cost (LRMC) of generation and the market-based cost (which includes a volatility allowance). We will reset the energy purchase allowance in line with the higher of the LRMC and the market-based cost consistent with the approach laid down in our terms of reference.
- ▼ The cost allowances for complying with obligations under the RET, GGAS and ESS (ie, other 'green costs').
- ▼ The cost allowance for energy losses.

The annual review has no materiality threshold and is symmetrical, meaning that it provides for regulated retail tariffs to be adjusted to reflect any increase or decrease 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.

For 1 July 2011 regulated retail prices will be updated as part of our price compliance process to reflect the updated network tariffs as approved by the Australian Energy Regulator (AER). The NSW Government recently announced that electricity prices will not increase to pay for the Solar Bonus Scheme (solar feed-in tariff).

What is the methodology of the review?

We will use the same methodologies as were used in making the 2010 determination to conduct the annual review.

Using the same load profiles used in making the 2010 determination, we will update:

- ▼ The LRMC of generation on a standalone basis to meet the regulated load.
- ▼ 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.

For GGAS and RET costs we will use an incremental approach to calculate the LRMC of generation of meeting each scheme's respective target. The penalty price of the ESS will be used as a proxy for the price of energy savings certificates.

What assumptions are updated under the review?

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
- ▼ targets set by any mandatory green energy scheme
- ▼ market parameters of the WACC including the risk free rates and debt margin.

To calculate the cost allowance for energy losses we will update the network distribution and transmission loss factors only.

Changes since the 2010 determination

In updating cost allowances as part of the annual review, we will take into account the Commonwealth Government's decision to amend the Renewable Energy Target (now called the enhanced RET or eRET) and the deferral of the Carbon Pollution Reduction Scheme (CPRS):

- ▼ **Enhanced RET:** on 24 June 2010 the Commonwealth Parliament passed legislation to separate the RET into two parts from 1 January 2011 - the Small-scale Renewable Energy Scheme (SRES) and the Large-scale Renewable Energy Target (LRET).¹ Liable entities will need to meet obligations under both the LRET and SRES by acquiring and surrendering certificates created from both large and small-scale renewable energy technologies - large-scale generation certificates (LGCs) and small-scale technology certificates (STCs).
- ▼ **Deferral of the CPRS:** on 27 April 2010 the Commonwealth Government announced that it would delay the implementation of the CPRS until after the end of the current commitment period of the Kyoto Protocol (which ends in 2012) and reintroduce it only when there is greater clarity on the actions of other major economies including the US, China and India. Since then the Commonwealth Government has formed a multi party climate change committee to consider carbon pricing approaches.

Cost pass through applications

We have received cost pass through applications relating to the enhanced RET and deferral of CPRS from each of the Standard Retailers. The [cost pass through applications](#) are published on our website.

We will assess the applications to establish whether they meet the definition of a Pass Through Event, in particular a 'Regulatory Change Event'. We will also determine the incremental and efficient costs for each event and establish whether these costs satisfy the materiality threshold test. The cost pass through applications will be considered concurrently with the annual review.

Any cost pass through amounts that are approved by IPART would allow for additional costs in 2010/11 and be added to price changes for 2011/12 arising from the annual review.

¹ The enhanced RET received Royal Assent on 28 June 2010.

What is the process and timetable for the review?

Work on the annual review will commence in February 2011 and be completed in June 2011, in time for 1 July 2011 price changes.

The timetable for the annual review (Table 1) outlines a process involving a stakeholder information session in April 2011 on the draft report, including our consultant's (Frontier Economics) draft report, and for us to consider submissions and finalise our advice in a final report. We will advertise the date for the public hearing.

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 2011
Public Hearing - IPART consults on draft report	End - April 2011
Submission on draft report due (about 4 weeks from release of draft report)	Mid - May 2011
IPART final decision released, accompanied by consultant's report	Mid - June 2011
Price changes	1 July 2011