

# **Review of Gas and Electricity Regulated Retail Tariffs**

## **Issues Paper**

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



# Review of Gas and Electricity Regulated Retail Tariffs

## Issues Paper

**Discussion Paper DP70**

**October 2003**

**ISBN 1 877049 32 8**

This work is copyright. The *Copyright Act 1968* permits fair dealing for study, research, news reporting, criticism and review. Selected passages, tables or diagrams may be reproduced for such purposes provided acknowledgement of the source is included.

### **Request for Submissions**

Submissions are invited from interested parties to all Tribunal investigations. Unless confidentiality is sought, the submissions are generally available for public inspection at the Tribunal's offices and will be available on-line in PDF format from the time of processing of the submission until 3-4 weeks after the release of the final report of an inquiry. The Tribunal exercises its discretion not to exhibit any submissions based on their length or content (containing material that is defamatory, offensive, or in breach of any law).

Submissions must be made in writing and should be sent to the postal address, fax number or email address below. Where possible, submissions should be provided in a computer readable format (eg, word processor, PDF or spreadsheet) either on disk or by email.

Submissions from energy retailers should be received by 24 November 2003.

Submissions from other stakeholders should be received by 2 February 2004.

Submissions should be sent to:

**Review of Gas and Electricity Regulated Retail Tariffs**

Independent Pricing and Regulatory Tribunal

PO Box Q290

QVB Post Office NSW 1230

Email: [ipart@ipart.nsw.gov.au](mailto:ipart@ipart.nsw.gov.au)

Submissions will be treated consistent with the *Privacy and Personal Information Act 1998*.

### **Separation between electricity and gas issues**

Where material contained in submissions is intended to be specific to either electricity or gas it should be clearly marked as such.

### **Confidentiality**

Special reference must be made to any issues in submissions for which confidential treatment is sought and all confidential parts of submissions must be clearly marked. *However, it is important to note that confidentiality cannot be guaranteed as the Freedom of Information Act and section 22A of the Independent Pricing and Regulatory Tribunal Act provide measures for possible public access to certain documents.*

### **Public Information about the Tribunal's activities**

Information about the role and current activities of the Tribunal, including copies of latest reports and submissions can be found on the Tribunal's website at [www.ipart.nsw.gov.au](http://www.ipart.nsw.gov.au).

***Inquiries regarding this review should be directed to:***

***Ineke Ogilvy ☎ 02 9290 8473***

***Michael Seery ☎ 02 9290 8421***

**Independent Pricing and Regulatory Tribunal of New South Wales**

Level 2, 44 Market Street, Sydney NSW 2000

☎ (02) 9290 8400 Fax (02) 9290 2061

[www.ipart.nsw.gov.au](http://www.ipart.nsw.gov.au)

**All correspondence to: PO Box Q290, QVB Post Office NSW 1230**

# TABLE OF CONTENTS

<b>1</b>	<b>INTRODUCTION</b>	<b>1</b>
1.1	Review process and timetable	1
1.2	Key issues	2
<b>2</b>	<b>COMPETITION AND REGULATION OF RETAIL ENERGY</b>	<b>3</b>
2.1	Structure of the national energy industry	3
2.2	Competition and industry reform in NSW	4
2.3	Retail regulation in NSW	4
2.3.1	Electricity regulation	5
2.3.2	Gas regulation	6
<b>3</b>	<b>WHAT IS THE MOST APPROPRIATE FORM OF REGULATION?</b>	<b>7</b>
3.1	Target tariffs and price paths	7
3.2	Price constraints	7
3.3	Alternative forms of regulation	8
<b>4</b>	<b>WHAT ARE THE APPROPRIATE LEVELS OF COSTS TO BE RECOVERED?</b>	<b>9</b>
4.1	Electricity purchase costs	9
4.2	Wholesale gas costs	9
4.3	Network charges	10
4.4	Retail operating costs	10
4.5	Retail margin	10
4.6	Other costs	11
<b>5</b>	<b>WHAT IS THE MOST APPROPRIATE STRUCTURE FOR REGULATED TARIFFS?</b>	<b>12</b>
5.1	Appropriateness of inclining block structures	12
5.2	Customer choice or 'plain vanilla'?	13
<b>6</b>	<b>ON WHAT BASIS SHOULD NON-TARIFF CHARGES BE REGULATED?</b>	<b>14</b>
6.1	Current non-tariff charges	14
6.2	Network charges	15
6.3	Retail charges	16
<b>APPENDIX 1</b>	<b>TERMS OF REFERENCE FOR ELECTRICITY REVIEW</b>	<b>17</b>
<b>APPENDIX 2</b>	<b>THE COSTS OF SUPPLYING ENERGY</b>	<b>20</b>
<b>APPENDIX 3</b>	<b>ENERGY NON-TARIFF CHARGES (INCLUDING NETWORK CHARGES)</b>	<b>24</b>



## 1 INTRODUCTION

During the transition to effective retail competition in the national energy markets, the Independent Pricing and Regulatory Tribunal of NSW (the Tribunal) is responsible for setting the *regulated retail tariffs* that electricity and gas retailers operating in the state can charge their small retail customers.<sup>1</sup> These regulated tariffs act as *safety net* or *default* prices for customers who do not choose to participate in the competitive market. The Tribunal is also responsible for regulating the non-tariff charges (or *regulated retail* or *miscellaneous* charges) that energy retailers can charge small retail customers.

To date, the Tribunal has regulated default tariffs and charges for electricity through a determination provided to the NSW Minister for Energy, and for gas through a set of Voluntary Pricing Principles (VPPs) agreed with individual retailers. The current electricity determination will expire on 30 June 2004, and the Minister has asked the Tribunal to determine appropriate default retail tariffs and charges for a further three years until 30 June 2007 (see Appendix 1 for the Terms of Reference). The various gas VPPs are also due to expire on 30 June 2004, and as it is Government policy that regulated gas tariffs continue the Tribunal will regulate default tariffs and charges for the same period.

Due to the different legislative provisions, the Tribunal will conduct separate reviews and make separate decisions on regulated tariffs and charges for electricity and for gas. However, it intends to conduct these reviews at the same time. In addition, due to the similarities between the issues for electricity and gas, the Tribunal has decided to release a combined issues paper for both reviews. After it has considered the submissions it receives in response to this paper, particularly those that address the appropriate degree of consistency between the sectors, it may decide to seek and consider separate comments on issues specific to gas or electricity.

### 1.1 Review process and timetable

In undertaking its reviews, the Tribunal will consider:

- the costs associated with supplying energy to small retail customers
- the need to ensure that regulated retail prices continue to move towards cost reflective levels for all small retail customers
- the basis for regulating non-tariff charges.

As part of the review process, the Tribunal will consult with stakeholders and undertake analysis. It will request all standard gas and electricity retailers in NSW to provide specified information on their costs and other relevant matters, and invite retailers and other stakeholders to make submissions to the reviews. It will also hold public forums to provide further opportunities for stakeholders to express their views. In addition, it will engage a consultant to undertake a review of appropriate retail costs, retail margin and electricity purchase costs, review the information provided by retailers, and undertake its own analysis.

---

<sup>1</sup> *Small retail customers* for electricity and gas are defined in the *Electricity Supply Act 1995* and the *Gas Supply Act 1996* respectively.

The Tribunal is required by the Terms of Reference to finalise its determination for default electricity prices by 1 May 2004. It aims to finalise its review of default gas prices by the same date. An indicative timetable for both reviews is set out below. The Tribunal will provide updates to the timetable on its website ([www.ipart.nsw.gov.au](http://www.ipart.nsw.gov.au)). Details on how to make a submission are provided on the page facing the Table of Contents.

<b>Action</b>	<b>By</b>
Release issues paper	October 2003
Send information request to standard retailers	October 2003
Receive all information and submissions from standard retailers	24 November 2003
Hold public forum for retailers to present their views	December 2003
Release consultant's report on cost benchmarks and wholesale energy costs	December 2003
Receive all submissions from other stakeholders	2 February 2004
Hold public meetings	February 2004
Release draft report(s)	Early March 2004
Receive all submissions on draft report(s)	April 2004
Release final report(s)	May 2004

### 1.2 Key issues

To assist stakeholders in making submissions, the Tribunal has identified four key issues on which it particularly seeks comment, including:

- What is the most appropriate form of regulation for retail tariffs?
- What are the appropriate levels of costs to be recovered?
- What is the most appropriate structure for retail tariffs, including the role of 'plain vanilla' tariffs?
- On what basis should non-tariff charges be regulated?

The Tribunal also welcomes comment on the appropriate level of consistency between the regulation of electricity and gas default tariffs and charges. The next chapter provides background on the electricity and gas industries and the current regulatory and legislative framework for each. Chapters 3 to 6 discuss the key issues in detail.



## 2 COMPETITION AND REGULATION OF RETAIL ENERGY

In the 1990s, the Council of Australian Governments introduced a process to reform the energy industry, which involved restructuring the supply chain so that consumers could benefit from competition where possible. A National Competition Policy was developed, which established a national framework for many elements of the supply chain. This policy has been progressively implemented by State governments, which have also pursued their own reform policies and regulatory arrangements in retail energy markets.

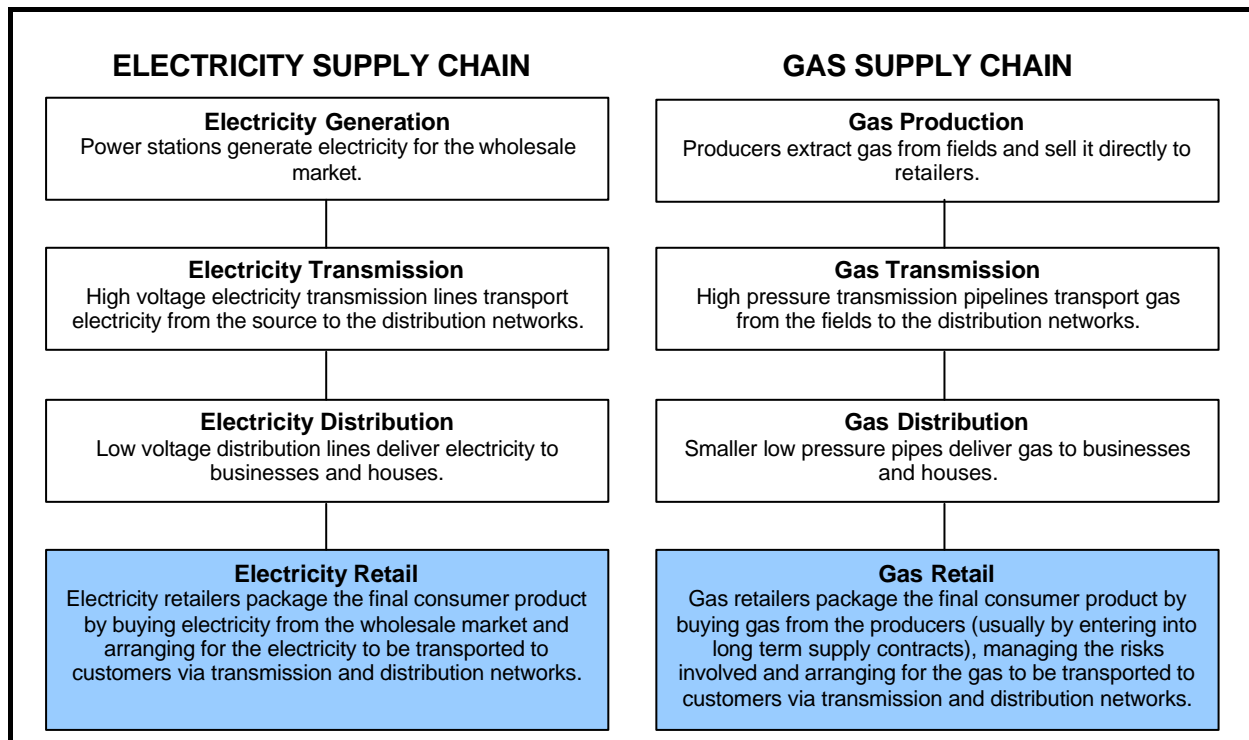
This chapter provides an overview of the structure of the national energy industry, retail competition and industry reform in NSW, and the regulatory and legislative framework for retail energy prices in NSW.

### 2.1 Structure of the national energy industry

Traditionally, the energy industry in Australia was made up of large, vertically integrated gas and electricity companies that controlled most parts of the supply chain, including the production, transmission and retail of electricity and gas. As part of the process of industry reform, these companies were restructured to facilitate the introduction of competition in the parts that are potentially contestable – such as gas production, electricity generation and gas and electricity retail.

Legislation has been introduced to regulate the areas that rely on monopoly-owned infrastructure, such as energy transmission and distribution, to ensure that access to necessary infrastructure was made available on reasonable terms and conditions. This legislation includes the *National Electricity Code* and the *National Third Party Access Code for Natural Gas Pipeline Systems*.

**Box 2.1 Energy supply chains**



## 2.2 Competition and industry reform in NSW

Over the past few years, the NSW Government has progressively introduced retail competition into the energy market. Large volume electricity customers have been able to choose their retailer since 1 July 1998, and large volume gas customers have been able to since October 1999. Contestability for other customers was introduced in stages, and all customers have been able to choose their electricity and gas retailers since 1 January 2002.

Extending choice and competition to all retail customers is predicated on the principle that an efficient, competitive market can deliver benefits for customers in terms of both price and quality of service. However, it will take time for retail competition to take full effect. In the meantime, some form of ongoing or transitional regulation is necessary to ensure that vulnerable customers are not disadvantaged.

While some small retail customers have chosen to negotiate electricity and/or gas supply contracts with a retailer of their choice, the majority remain on 'standard form' customer supply contracts, which include regulated tariffs and charges determined by the Tribunal.

As retail competition becomes more effective, regulation of prices should become more light-handed. The Tribunal needs to consider the effectiveness or otherwise of competition so that it can determine the appropriate form of regulation and nature of regulated tariffs. While switching rates are not the only indicator of the success of competition, at this point in time it is the only available (in aggregate) indicator. Current data shows that 448,007 small retail customers<sup>2</sup> have entered into negotiated contracts for electricity and gas with either their existing retailer or a different retailer.<sup>3</sup>

## 2.3 Retail regulation in NSW

Since retail competition was introduced, the need to regulate energy tariffs and charges in NSW has been reduced. However, there is still a need for regulated retail prices for small retail customers. These default prices protect customers that do not choose to participate in the competitive market, and encourage customers to test the market by providing a safety net to which they can return if their market experience is unsatisfactory.

The Government asked the Tribunal to continue to set regulated retail prices for small retail customers to facilitate the smooth transition to a competitive retail market. In relation to electricity tariffs, it asked that the Tribunal keep the regulatory arrangements as simple as possible, and to have regard to the costs of supplying regulated customers when determining the appropriate tariff levels.

In NSW, the legislative requirements for the retail regulation of electricity and gas differ, and so the Tribunal's role in regulating prices for each also differs. An overview of the current regulatory arrangements in each sector is provided below.

---

<sup>2</sup> There are approximately 3 million electricity customers in NSW. However, the 448,007 small retail customers who have switched comprise both electricity and gas customers. Therefore it is not possible to calculate a simple ratio of customers who have entered a negotiated contract.

<sup>3</sup> NSW Ministry of Energy and Utilities, *Customers Exercising Choice*, August 2003, available from the Ministry's website at [www.energy.nsw.gov.au](http://www.energy.nsw.gov.au).

### 2.3.1 Electricity regulation

The Tribunal regulates retail prices for small retail customers using less than 160MWh of electricity per year (equivalent to an annual bill of approximately \$16,000) and who do not choose to enter into a negotiated contract.

Each area in NSW has a nominated standard retail supplier, which is generally the incumbent electricity retailer (see Map 1, below). These standard retail suppliers –which currently include Australian Inland, Country Energy, EnergyAustralia and Integral Energy –are required under the *Electricity Supply Act 1995* to impose tariffs and charges in accordance with the relevant Tribunal determination.

The current determination was released in December 2000 and applies to all standard retail suppliers in NSW until 30 June 2004.<sup>4</sup> It sets target tariffs based on network and retail components of the cost of supplying regulated customers (the ‘N+R’ formula). The determination also sets limits on increases in prices. Copies of the current determination and mid-term review are available on the Tribunal’s website ([www.ipart.nsw.gov.au](http://www.ipart.nsw.gov.au)).

**Map 1 Standard Suppliers of Electricity in NSW by region**



Source: Energy and Water Ombudsman NSW.<sup>5</sup>

<sup>4</sup> Certain costs of supply were also considered by the Tribunal as part of a mid-term review in 2002. See *Regulated retail prices for Electricity to 2004*, Recommendation and Report, December 2000 and *Mid-term review of regulated retail prices for electricity to 2004*, Report and Determination to the Minister for Energy, June 2002.

<sup>5</sup> This map is to be used for indicative purposes only. It is intended as a guide and may not accurately identify the standard retail supplier in a particular area.

### 2.3.2 Gas regulation

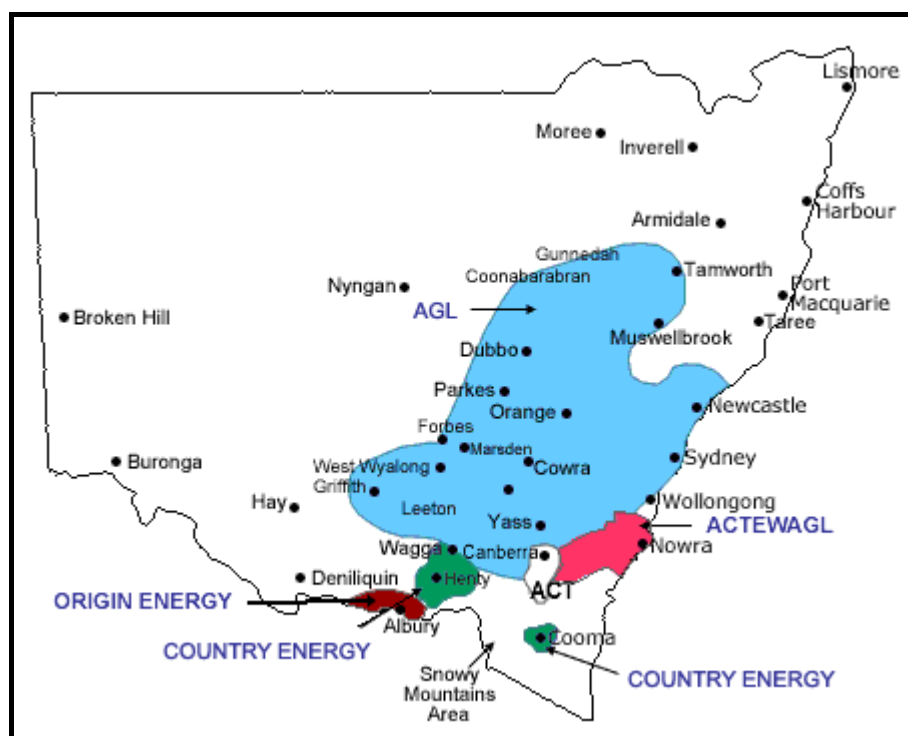
The Tribunal regulates retail prices for small retail customers in NSW using less than 1 Terajoule (TJ) of gas per year (equivalent to an annual bill of approximately \$12,500).

As for electricity, each region of NSW has a nominated standard gas retail supplier (see Map 2, below), which is generally the incumbent gas retailer. There are currently five standard gas retail suppliers—including AGL Retail Energy, ActewAGL, Country Energy, Origin Energy and Allgas.<sup>6</sup>

Under the *Gas Supply Act 1996*, the Tribunal has the power to impose a Gas Pricing Order (GPO) that fixes natural gas tariffs and other charges. However, to date, it has not chosen to regulate retail gas prices in this way, but has used Voluntary Pricing Principles (VPPs) instead. The Tribunal has agreed a separate set of VPPs with each standard retail supplier of gas in NSW, with the exception of Allgas in Tweed Heads where regulated Queensland prices currently apply.<sup>7</sup>

Each set of VPPs details the agreed tariff plan or price path for the retailer over the regulatory period, and generally incorporates constraints that limit the increases that can be imposed on customers over the term of the VPPs. All current VPPs expire on 30 June 2004. A copy of each set of VPPs is available on the Tribunal’s website ([www.ipart.nsw.gov.au](http://www.ipart.nsw.gov.au)).

**Map 2 Standard Suppliers of Gas in NSW by region**



Source: Energy and Water Ombudsman NSW.<sup>8</sup>

<sup>6</sup> Allgas is the standard supplier for Tweed in Northern NSW serving approximately 100 customers.

<sup>7</sup> There are currently two sets of VPPs agreed with ActewAGL as it became the standard supplier for the Shoalhaven area following the agreement of the first set of VPPs.

<sup>8</sup> This map is to be used for indicative purposes only. It is intended as a guide and may not accurately identify the standard supplier in a particular area.

### **3 WHAT IS THE MOST APPROPRIATE FORM OF REGULATION?**

The legislative requirements for regulating electricity and gas default tariffs for small retail customers allow the Tribunal some flexibility in the form of regulation that it uses. Currently, many of the customers on regulated tariffs are paying prices that are lower than the costs to supply them with gas or electricity. These customers are unlikely to choose to participate in the competitive market, as doing so would result in them paying more for their energy. At the same time, other customers are paying prices that are higher than the cost to supply through ‘over-recovering’ tariffs. The Tribunal considers that the primary objective in setting the form of regulation for both sectors should be to move all regulated tariffs towards cost-reflective levels without exposing customers on under-recovering tariffs to unacceptable price shocks. Whether prices are increasing or decreasing, the Tribunal also needs to consider the impact of these price changes on the regulated businesses.

This view is in line with the Terms of Reference for the electricity determination. It is also in line with the current form of regulation for both electricity and gas, which use target tariffs and price paths respectively to move towards cost reflectivity, and price constraints to prevent price shocks. These aspects of the current forms of regulation, and alternative forms of regulation are discussed below.

#### **3.1 Target tariffs and price paths**

For electricity, the Tribunal’s current determination establishes a ‘target level’ for tariffs and a transitional process to move them to that level over time. The target tariffs were set using the ‘N+R’ formula. The ‘N’ component represents the network element of the tariffs (the amount retailers are charged by the local distribution network service provider) and ‘R’ represents the retail component, which is derived from the cost of supply and set by the Tribunal. If the average price of electricity for customers on a particular electricity tariff is greater than the target price set by the Tribunal based on the ‘N+R’ calculation, it is ‘over recovering’ costs.

For gas, the current Voluntary Pricing Principles (VPPs) set price paths for final retail prices. These price paths are often expressed in terms of the movement of individual tariffs in relation to the CPI over time, rather than as a particular dollar amount for each period. Although not explicit in the Tribunal’s regulatory approach for gas, in agreeing to the final retail prices in each of the VPPs, the Tribunal has considered the costs of providing the service under each tariff (including field price of gas, network charges and retail costs).

#### **3.2 Price constraints**

As discussed above, for both electricity and gas, the Tribunal has set a path (or process for transition) to move individual tariffs towards cost reflective levels over time. To reduce price shocks to customers, the Tribunal has set price constraints that limit the tariff increases that regulated retailers can impose on customers supplied under standard form contracts.

For example, the mid-term review of regulated electricity prices set the following constraints on price rises (for each year, for the same pattern and volume of consumption):<sup>9</sup>

- average prices across all small retail customers must not increase by more than the percentage change in CPI
- over-recovering and recovering tariffs must not increase in nominal terms
- the annual bill for any residential customer must not increase by more than the greater of \$25 or the percentage change in CPI + 2%
- the annual bill for any business customer must not increase by more than the greater of \$50 or the percentage change in CPI + 5%.

Similar price constraints are incorporated into the current gas VPPs.

In some cases, price constraints may mean that regulated retail tariffs will not reach cost reflective levels by June 2007. In these circumstances it may be appropriate that the Tribunal considers setting retail tariffs for new customers (or new connections) at cost reflective levels. This would mean, however, that similar customers in the same area would be on different tariffs.

### 3.3 Alternative forms of regulation

There are many alternatives to the forms of regulation currently used by the Tribunal. For example, these include:

- removing price constraints and relying on restrictions in the movement of average prices of given tariff categories relative to a target level
- removing constraints on the average price of tariff categories and relying purely on per customer price constraints
- replacing all existing constraints with a single CPI-X constraint to apply to all tariff categories
- altering the volume bands within which price limits or constraints are tested
- setting a single price constraint that applies on average to all categories (rather than having specific constraints for specific categories of tariffs)
- establishing a direct pass-through of actual costs, such as wholesale electricity and gas costs, rather than using forecast costs – subject to the application of price constraints.

Each of these involves potential advantages and disadvantages and is associated with different levels of flexibility for the retailers. The different approaches are also likely to have implications for price shocks to different customers and varying impacts on competition.

*The Tribunal seeks comment on what form of regulation will best assist the Tribunal in meeting its objectives of moving all regulated tariffs towards cost-reflective levels without exposing customers on under-recovering tariffs to unacceptable price shocks.*

---

<sup>9</sup> IPART, *Mid-term Review of Regulated Retail Prices for Electricity to 2004*, June 2002, p 9.

## 4 WHAT ARE THE APPROPRIATE LEVELS OF COSTS TO BE RECOVERED?

If default tariffs are set too low, they may hamper the development of competition because new retailers will find it difficult to offer a more attractive service to customers. If they are tariffs set too high, they may encourage customers to switch retailers. However, if default tariffs set at cost reflective levels, they should operate in a ‘neutral manner’ and strengthen the incentives on retailers to operate efficiently.

Each of the cost components incurred in supplying energy to regulated customers, and the way in which they are currently recovered through default tariffs, are discussed below. The approach the Tribunal has used in the past to calculate the level of each component and how these levels compare with those in other jurisdictions are summarised in Appendix 2.

### 4.1 Electricity purchase costs

The Tribunal currently incorporates wholesale electricity purchase costs into retail electricity prices based on the long run marginal cost (LRMC) of electricity generation.<sup>10</sup> Within the range determined by the Tribunal, individual retailers receive different cost allowances as a result of applying each retailer’s actual load profile for customers on regulated tariffs.

There are a number of different LRMCs associated with different generation technologies and LRMC is not necessarily static over time. It will depend on factors such as:

- the cost of potential fuels for generation (for example, coal and gas)
- taxes, charges and subsidies
- environmental standards
- the size and utilisation of electricity and gas transmission networks (for example, the extent of interconnection between different states).

### 4.2 Wholesale gas costs

In contrast to electricity purchase costs, wholesale gas costs have generally been recovered on a company-specific basis, according to the contractual arrangements in place for each regulated retailer. The Tribunal will consider how to determine an appropriate benchmark cost of gas going forward and intends to consider the following issues:

- whether the benchmark should be based on the LRMC of gas supply or likely contract prices over the next three years
- whether the Tribunal should consider firm specific costs or determine an industry wide benchmark
- whether and how to adjust any industry wide benchmark to take into account firm specific issues such as load profile.

---

<sup>10</sup> The previous Terms of Reference required the Tribunal to use LRMC. The current Terms of Reference also impose this requirement.

### 4.3 Network charges

Network charges include transmission and distribution charges. Most transmission and distribution charges are subject to third party access legislation. This legislation establishes the terms and conditions that infrastructure owners can charge for the use of network facilities, including the tariffs they can charge. Distribution network charges are regulated by the Tribunal, and transmission network charges are regulated by the ACCC under the *National Electricity Code* and the *National Third Party Access Code for Natural Gas Pipeline Systems*.

Retailers necessarily incur network costs in supplying energy to customers. In setting retail prices in the past, the Tribunal has allowed both electricity and gas retailers to pass transmission and distribution charges directly through to customers on regulated tariffs.

The Tribunal is currently in the process of determining the charges that DNSPs in NSW will charge retailers for the use of distribution infrastructure from 1 July 2004. As a result, the applicable charges can be incorporated directly into its retail determination for electricity prices. The Tribunal will begin an assessment of network access arrangements for NSW gas distribution service providers in early 2004. The retail mechanism for gas will need to incorporate a mechanism to pass through any variations to network charges.

### 4.4 Retail operating costs

In addition to wholesale and network costs, retailers incur expenses at the retail stage of energy supply. Retail-specific costs include billing, marketing, costs associated with providing customer advisory services and handling complaints, and time spent negotiating supply and network agreements. The Tribunal has previously incorporated retail costs into regulated tariffs based on a benchmark of annual retail operating costs for both electricity and gas retailers including an allowance for costs associated with retail contestability.

The Tribunal aims to ensure that retail operating cost benchmarks represent efficient retail operating costs to provide appropriate incentives for retailers to operate efficiently. The Tribunal intends to consider issues such as:

- whether costs vary across different customers (such as geographical area or customer size)
- whether costs vary across gas and electricity retailers
- whether in a competitive market, it is appropriate to make allowance for the search and marketing costs incurred by other retailers in the process of attracting customers on regulated tariffs to negotiated contracts.

### 4.5 Retail margin

The net retail margin (or profit margin) is the margin on energy sales before interest and tax but after all other costs (including retail costs) have been accounted for. The net retail margin represents a return on capital employed and the risks associated with the business. Retailers must be able to earn a net retail margin if their investment in the business is to be worthwhile (an appropriate retail margin is treated as a cost of supply that must be recovered by regulated tariffs). The Tribunal currently incorporates a range of 1.5 to 2.5 per cent for electricity retailers and 2 to 3 per cent for gas.



The Tribunal will again consider whether it is appropriate that the profit margins for electricity and gas retailers be similar. Previously, it has concluded that neither electricity nor gas retailers bear significant risk, but as electricity retailers have more revenue per customer and similar retail costs to those of gas utilities it is appropriate to allow gas retailers a slightly higher net retail margin.<sup>11</sup>

The Tribunal notes that in other jurisdictions, an allowance for hedging is often included in the retail margin. In relation to electricity, the Tribunal has previously decided not to include hedging costs in the retail margin for NSW electricity retailers, as the Electricity Tariff Equalisation Fund provides a form of automatic hedging for retailers supplying customers on regulated tariffs. Gas hedging costs, on the other hand, have historically been built into the wholesale cost of gas agreed through the VPPs.

#### 4.6 Other costs

For electricity retailers, the Tribunal has previously incorporated costs associated with the National Electricity Market Management Company Limited (NEMMCO) into the wholesale cost of electricity. NEMMCO is the independent market and system operator for the wholesale national electricity market. It is responsible for administration and operation of the market in accordance with the Electricity Code. NEMMCO operates on a not-for-profit basis and receives its annual funding through fees levied on market participants (including electricity retailers, generators, network service providers, traders and market customers).

Gas retailers have recouped actual Gas Market Company (GMC) costs as a direct pass through on a retailer specific basis.<sup>12</sup> GMC is a gas industry owned company that operates the business systems used to deliver consumer choice to gas customers in NSW and the ACT. GMC's role is to develop and operate cost efficient and effective gas retail market arrangements to facilitate competition in the gas retail market. GMC operates on a not-for-profit basis and recovers its funds from its members (primarily gas retailers, large users and distribution network service providers).

The Tribunal will consider other costs incurred by retailers in supplying energy to customers such as, costs associated with compliance with licence requirements (for example the NSW Greenhouse Gas Benchmark Scheme for electricity retailers) and energy losses.

*The Tribunal seeks comment on the most appropriate treatment of the various cost components to ensure that retail charges are at, or close to, cost reflective levels for all small retail customers by 2007.*

---

<sup>11</sup> IPART, *Final Report Review of the Delivered Price of Natural Gas to Tariff Customers Served from the AGL Gas Network in NSW*, February 2001, p 33.

<sup>12</sup> Or the costs of the equivalent body in other states where appropriate.

## 5 WHAT IS THE MOST APPROPRIATE STRUCTURE FOR REGULATED TARIFFS?

Currently, the structure of default tariffs for gas and electricity varies between and within regulated retailers. In general, they include a fixed supply fee (billed irrespective of the amount of energy used) and variable usage charges (billed per unit of energy used). However, some retailers include a minimum energy charge in addition to or instead of the fixed supply fee. Some apply a single usage rate, no matter how much energy a customer uses, while others apply different rates for different 'blocks' of consumption (known as block tariff structures).<sup>13</sup> Some electricity tariffs also incorporate different usage rates in peak, shoulder and off-peak periods (where time-of-use metering is available).<sup>14</sup>

The Tribunal believes that since the costs of supplying energy to small retail customers include fixed and variable components, for default tariffs to be cost reflective, they must be structured to reflect both the fixed and variable costs. As part of its reviews, it will consider the appropriateness of inclining block structures, including whether they better reflect the costs incurred by retailers to supply regulated customers. In addition, it will consider whether retailers should have the discretion to structure regulated tariffs to provide customer choice, or whether these tariffs should be a basic option without special features ('plain vanilla').

### 5.1 Appropriateness of inclining block structures

An inclining block structure for the usage component of tariffs has recently been introduced by Energy Australia for its standard regulated retail tariff (applying from 1 July 2003). One of the aims of this structure is to manage demand for energy. The assumption is that high-consumption customers will reduce their energy consumption in response to the higher usage charges in the second block.

This kind of structure is also being introduced for network charges in both gas and electricity. In gas, AGL Gas Networks (AGLGN) has implemented an inclining block structure into its network tariffs, which flows through to some retail tariffs for customers served by the AGLGN distribution network. Electricity distribution network service providers (DNSPs) have proposed to introduce inclining block tariffs as part of the latest network review being undertaken by the Tribunal.

Energy customers and consumer advocates have expressed mixed views on inclining block structures. Some question their effectiveness in reducing demand, as only larger customers are likely to face higher charges. For example, a small customer whose consumption levels fall entirely within the first block may be charged a lower per unit price, which may encourage greater consumption. In addition, inclining block tariffs do not provide incentives to shift consumption from peak to off-peak periods, and the timing of consumption is a key cost driver.

---

<sup>13</sup> Block tariff structures include inclining block tariffs (for all energy used above a certain level the unit price is higher) or declining block tariffs (the unit price is lower for energy used beyond a certain level).

<sup>14</sup> Peak, shoulder and off-peak times are not necessarily the same for all electricity retailers.

Others question the assumption implied in inclining block structures that energy consumption beyond a certain level is discretionary, and are concerned that these structures are inequitable. For example, they could increase the energy costs of low-income households, which often consume large amounts of electricity for reasons unrelated to the use of capacity-intensive appliances. For example, they may be large households or be living in low-cost, energy-inefficient housing. To date, there has been little public information and discussion about the relationship between energy consumption and income in the context of inclining block tariffs, so it is difficult to gauge how significant the equity issue is. The Tribunal is in the process of conducting a survey of households that should, among other things, indicate how energy consumption and appliance use is related to income.

The Tribunal will consider the impact of inclining block structures on equity, and any evidence that they better reflect the costs incurred by retailers to supply regulated customers than single block usage charges.

## **5.2 Customer choice or ‘plain vanilla’?**

As noted above, the structure of default tariffs should reflect the underlying costs of supplying energy. Many of these costs are fixed costs that are best recovered via a fixed charge, while a proportion are variable costs that are best recovered via a variable usage charge. However, retailers can use different pricing arrangements as a competitive tool in the market. For example, retailers could offer to ‘bundle’ products or bear risks to provide customer choice rather than passing the network tariff structure directly through to customers.

The Tribunal’s current view is that regulated tariffs should be a basic option without special features (‘plain vanilla’) in order to best perform as a safety net for those that do not choose to enter the competitive market. Customer choice is more appropriately delivered through the contestable market.

*The Tribunal seeks comment on issues regarding the structure of regulated retail tariffs, including whether an inclining block structure is a proxy for cost reflectivity and the implications of allowing more complex price structures for the objective of rationalising the number of regulated retail tariffs.*

## 6 ON WHAT BASIS SHOULD NON-TARIFF CHARGES BE REGULATED?

Non-tariff charges (also known as regulated retail or miscellaneous charges) are fees that energy retailers charge as a result of a special request from a customer or upon the customer taking (or in some circumstances failing to take) certain actions. These charges are not a routine part of retail supply services, but arise from particular events associated with the supply of energy to customers, and have the potential to affect every retail customer. Non-tariff charges can relate to services performed either by retailers (for example, late payment fees) or by network operators (for example, charges associated with special meter readings outside the normal cycle).

The Terms of Reference for the electricity review require the Tribunal to consider and report on the basis for regulating miscellaneous charges and security deposits. In the interests of consistency, the Tribunal will also consider this issue for gas. In assessing any proposal to vary or stop regulating an existing non-tariff charge, the Tribunal is likely to be concerned about similar issues as for tariff charges—such as whether the proposed charges are cost-reflective and the potential equity implications.

The current retail regulatory arrangements for both gas and electricity list the applicable non-tariff charges. The current gas VPPs list 11 different non-tariff charges, while the current electricity determination lists only three. The key reason for the difference between the number of charges for gas and electricity is that the gas VPPs list all non-tariff charges billed by gas retailers, including both retail charges and network charges,<sup>15</sup> whereas the electricity determination lists only the charges incurred at the retail level.

### 6.1 Current non-tariff charges

The *Electricity Supply Amendment Act 2000* establishes a list of electricity non-tariff charges that the Tribunal may regulate by determining the charges, or the specific methodology for determining the charges.<sup>16</sup> These charges are limited to:

- security deposits
- late payment fees
- fees for dishonoured bank cheques.<sup>17</sup>

In its December 2000 electricity determination, the Tribunal set uniform maximum allowable charges that the standard electricity retail suppliers may choose to apply to customers supplied on a standard customer contract. Retailers may choose to charge less than the amount set by the Tribunal or not to charge them at all (for example, EnergyAustralia has only recently introduced a late payment fee for its customers). The Tribunal has also set out the specific circumstances under which these charges may be applied and also when they are prohibited. Network charges can also be passed through for electricity in addition to the three charges listed in the *Electricity Supply Amendment Act 2000*.

---

<sup>15</sup> For example, several of the gas charges applied by AGL Retail Energy – special meter read, network disconnection and meter testing charges – relate to the pass through of network costs.

<sup>16</sup> *Electricity Supply Amendment Act 2000*, s43EB(3).

<sup>17</sup> These charges are defined in the *Electricity Supply Amendment Act 2000*.

In relation to non-tariff charges for gas, the GSA provides for the Tribunal to regulate a broader range of non-tariff charges, namely:

- security deposits
- fees and charges related to:
  - late or dishonoured payments
  - establishment and maintenance of accounts
  - disconnection or reconnection of premises
- other fees, charges and payments prescribed by the regulations.<sup>18</sup>

The GSA allows the Tribunal (via a GPO) to fix the charges or the methodology by which the charges are calculated, and to prohibit the imposition of any fees, charges or payments (or class of fees, charges or payments).<sup>19</sup> Similar to tariff setting, the Tribunal has elected to fix miscellaneous gas charges through the more light-handed VPP mechanism, rather than by imposing a GPO. Generally, the VPPs require that miscellaneous charges may only be varied with the Tribunal's prior agreement.

Details of the current non-tariff charges (retail and network pass through) for electricity and gas are provided in Appendix 3.

## 6.2 Network charges

Where network operators carry out miscellaneous services on behalf of a customer, they charge the relevant retailer who then passes the charges on to the relevant customers through their regular bills. Non-tariff network charges are regulated by the Tribunal in its role as regulator of electricity and gas distribution networks and are currently set for a fixed period through the Tribunal's distribution network determinations. As they represent costs that are not controllable by retailers, the Tribunal has allowed electricity and gas retailers to pass through these charges to customers.

However, during the Tribunal's mid-term review of AGLRE's VPPs, an issue arose as to whether administrative costs incurred by retailers in billing customers for network miscellaneous charges should be recoverable in the form of a premium added to the network pass through (and if so, what might be an appropriate and cost-reflective level).<sup>20</sup> In determining whether an administration charge would be appropriate, the Tribunal will consider the cost drivers behind the charges, whether these costs are recovered through other components, such as the retail operating cost, and the likely impact of an administration charge on customers and retailers.

---

<sup>18</sup> GSA 1996, s27(1).

<sup>19</sup> GSA 1996, s27A(1).

<sup>20</sup> The Tribunal did not agree to AGLRE adding an administrative fee to network charges but committed to reconsider the issue at the next retail review.

### 6.3 Retail charges

Where similar types of retail non-tariff charges exist for gas and electricity, the levels of these charges and underlying policies that determine how they are applied are not consistent. To some extent, this is due to the wording of the different legislative provisions. Further, not all non-tariff charges are consistent across gas retailers, due to the separate agreement of each gas supplier's VPPs and the historical application of these charges. Recently, there has been pressure from consumer advocacy groups and retailers for more consistent charges across gas retailers and across energy retailers, more broadly.

The Tribunal notes the past views of consumer representatives that some non-tariff charges, such as late payment and disconnection fees, can represent a significant additional cost on top of the quarterly bill for a low-usage customer, and this poses particular problems for those in low-income groups (such as pensioners). While some retailers do impose lower charges for certain low-income customers or waive charges under specific circumstances, this is not consistently applied across retailers.

*The Tribunal seeks submissions relating to the regulation of non-tariff charges including where possible the incidence and cost of different types of charges.*

## APPENDIX 1 TERMS OF REFERENCE FOR ELECTRICITY REVIEW

**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 2004 and 30 June 2007 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 distribution area in New South Wales for the period from 1 July 2004 to 30 June 2007.

### 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 regulation 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 2004 to 30 June 2007. The Electricity Tariff Equalisation Fund (ETEF) arrangement, which complements regulated retail tariffs, will also be extended for the same period.

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.

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. Therefore, in order to promote retail competition, regulated retail

tariffs which are below the cost of supply should be moved towards full cost reflectivity, as far as practicable.

### **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 2004 to 30 June 2007 include:

- an allowance for electricity purchase costs based on an assessment of the long-run marginal cost of electricity generation, given the characteristics of the demand of customers remaining on regulated tariffs,
- appropriate retail costs;
- appropriate retail margin;
- an allowance for retailer compliance with any Commonwealth mandatory renewable energy target (MRET) requirements and the licence requirements relating to the NSW Greenhouse Gas Benchmark Scheme;
- energy losses as published by the National Electricity Market Management Company (NEMMCO);
- network charges as determined by the Tribunal and the Australian Competition and Consumer Commission;
- 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.

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 while recognising consumers' ability to adjust to new prices;
- consider options for restructuring tariffs to promote demand management.

The determination should ensure, as far as practicable, that:

- regulated retail tariffs and regulated retail charges are at cost reflective levels for all small retail customers by 30 June 2007;



- 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 with regard to the need for a smooth transition for customers; and
- alternative ways be considered to facilitate transition to full cost recovery by 2007, or by an appropriate later date, such as the setting of regulated retail tariffs at cost reflective levels for all new connections and new customers.

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 1 May 2004.

### **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 160 MWh 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*.

## APPENDIX 2 THE COSTS OF SUPPLYING ENERGY

### A2.1 Electricity purchase costs

The Terms of Reference require the Tribunal to base its estimates of wholesale electricity costs on the LRMC of electricity generation. In its previous determination, the Tribunal considered a number of factors when estimating the LRMC including:

- The Government's (then proposed) electricity tariff equalisation fund.
- A Cap Gemini Ernst and Young study commissioned by the Tribunal.
- Other studies of LRMC of electricity generation.
- Licence requirements for greenhouse energy purchases.
- NEMMCO fees and ancillary charges incurred by generators.

Further information on the Tribunal's considerations is contained in the Tribunal's determination on *Regulated Retail Prices for Electricity to 2004*, December 2000, and subsequent report called *Mid-term Review of Regulated Retail Prices for Electricity to 2004*, June 2002.

#### **What does the 'Long Run Marginal Cost of Electricity' mean?**

The marginal cost of supplying a product represents the 'opportunity cost', or sacrifice made by society to produce an extra unit of that product. It is the change in total cost that results from increasing production or output by one unit. According to economic theory, if a product's price is higher than its marginal cost, its opportunity cost is overstated, and the consumer may buy less than the optimum quantity. Conversely, if its price is less than its marginal cost, the opportunity cost is understated, the consumer may buy too much and too much of that product may be produced. This may result in a less than efficient use of resources.

It has long been recognised that the application of marginal cost pricing has some complications in industries where high infrastructure costs are a feature of expanding supply. In the electricity supply industry, infrastructure is usually constructed in large blocks—for example, in the form of generation plants with lives of up to 50 years. Thus the costs of supply will be very 'lumpy'.

Further, infrastructure is often built to provide for future demand, which can mean that there will be significant excess capacity in the system after new plant is built. While this excess capacity exists, the additional energy can be supplied at very little cost so the (short run) marginal cost is very low in the short run. If the system is close to capacity, however, the marginal cost of producing additional energy is likely to be quite high as it will include the cost of building new infrastructure.

To take these factors into account, economic theory distinguishes between short run and long run marginal costs. Short run marginal cost (SRMC) can be defined as the cost of supplying an additional unit of energy when system capacity is fixed. SRMC effectively relates to increments in operating costs. Long run marginal costs (LRMC) relate to the cost of supplying an additional unit when variations in system capacity are also taken into account.

In the Tribunal’s mid-term review of regulated electricity retail prices it decided that the appropriate range for the LRMC of electricity generation was \$39-\$59 per MWh (including NEMMCO fees and ancillary services of \$1.37 per MWh) in 2001 dollars.<sup>21</sup> Individual retailers received different cost allowances within this range as the Tribunal applied the load profile of the relevant retailer to determine the amount to be included in regulated retail tariffs. Other jurisdictional regulators in Australia have also attempted to estimate the wholesale cost of electricity to be used in setting retail tariffs for small customers although have not used the LRMC approach.

**Table A3.1 Comparison of regulatory approaches to estimating electricity costs**

Regulator	Method	Estimates
IPART Mid-term review	LRMC adjusted for retailer specific load factor	\$39 to \$59 per MWh to 2004 *
Office of the Regulator General, Victoria (now Essential Services Commission (ESC))	Retailer specific benchmarks based on Australian Financial Markets Association forward contract prices	\$65 - \$76 per MWh (across all retailers)
Essential Services Commission of South Australia (ESCOSA)	Forward contract prices (similar to the method used in Victoria)	Average of \$72 per MWh over 2003

Note: \* In 2001 dollars.

Sources

Office of the Regulator General, Victoria, *Special Investigation – Electricity retailers’ proposed price increases – Final Report*, December 2001, p 19.

Essential Services Commission of South Australia, *Electricity Retail Price Justification – Final Report*, September 2002, p 11.

IPART, *Mid-term Review of Regulated Retail Prices for Electricity to 2004*, June 2002, p 5.

## A2.2 Wholesale gas costs

The Tribunal looked at the wholesale cost of gas incurred by NSW gas retailers in some detail at the mid-term review of the VPPs for AGLRE.<sup>22</sup> In assessing the range proposed by AGLRE the Tribunal engaged Project Consultancy Services to estimate the efficient cost for AGLRE based on its load factor and likely hedging costs.

The Tribunal has not made public its decisions regarding wholesale gas costs for any NSW retailer due to the sensitive nature of the information and there is very little available data from other jurisdictions. Charles River Associates (CRA) and the Essential Services Commission of Victoria (ESC) have calculated benchmarks for Victorian gas prices in the 2003 calendar year based on observed Victorian spot market prices. The ESC indicated an appropriate range would be between \$3.03 and \$3.15 per GJ and the CRA benchmark gas cost was \$3.29 per GJ (both estimates included unaccounted for gas and hedging costs).<sup>23</sup> Although these estimates provide useful comparisons in assessing appropriate gas costs for NSW, the Tribunal recognises that there are a number of difficulties with using spot market prices in Victoria to estimate the underlying contract price of gas for a retailer in NSW.

<sup>21</sup> IPART, *Mid-term Review of Regulated Retail Prices for Electricity to 2004*, June 2002 p 5.

<sup>22</sup> IPART, *Mid-term Review of AGL Retail Energy’s Gas Retail Prices to 2004*, June 2003.

<sup>23</sup> Essential Services Commission *Special Investigation TXU’s proposed gas retail tariff amendments Final Report*, December 2002, p 20 and Charles River Associates *Electricity and Gas Standing Offers and Deemed Contracts (2003)*, December 2002, p 32.

### A2.3 Retail costs

The current regulated tariffs for gas and electricity include an estimate of the costs the Tribunal considers that efficient retailers would incur to supply energy to customers. Retail cost benchmarks typically include costs incurred by retailers to ensure their systems can cope with FRC. However, because the Tribunal and utilities were uncertain of the magnitude of costs that would be incurred as a result of the introduction of FRC when regulated tariffs for the current period were established the Tribunal's retail cost benchmarks to date have included only a small amount to represent FRC related costs.<sup>24</sup> The Tribunal seeks to establish a benchmark retail cost for electricity and gas at this review that includes ongoing FRC related expenditure.

**Table A3.2 Comparison of retail operating cost benchmarks in Australia**

		Retail costs (\$ per customer per annum) *
<b>Electricity</b>		
TAS	Office of the Tasmanian Energy Regulator (June 2003)	\$76 (ex FRC costs)
ACT	ICRC (May 2003)	\$85
SA	ESCOSA (October 2002)	\$80
NSW	IPART Mid-term review (June 2002)	\$45 - \$75
VIC	Office of the Regulator General (now ESC) (December 2001)	\$50 - \$80
NSW	IPART Determination (December 2000)	\$40 - \$60
<b>Gas</b>		
VIC	ESC (December 2002)	\$50 - \$80
NSW	IPART VPPs for Country Energy – Wagga (December 2001)	\$35 - \$55
ACT	ICRC (May 2001)	Upper end of \$40 - \$60 range
NSW	IPART VPPs for AGLRE (February 2001)	\$40 - \$60

Note: \* Benchmark retail costs include an allowance for FRC costs unless otherwise specified (although magnitude varies between jurisdictions)

Sources:

Office of the Regulator General, Victoria, *Special Investigation – Electricity retailers' proposed price increases – Final Report*, December 2001, p 30.

Essential Services Commission of South Australia, *Inquiry into Electricity Standing Contract Prices – Final Report and Determination*, October 2002, p 34.

Essential Services Commission, *Special Investigation TXU's proposed gas retail tariff amendments Final Report*, December 2002, p 31.

Independent Competition and Regulatory Commission, *Final Determination Investigation into Retail Prices for Non-contestable Electricity Customers in the ACT*, May 2003, p 22.

IPART, *Final Report: Review of the Delivered Price of Nature Gas to Tariff Customers Served from the AGL Gas Network in NSW*, February 2001, p 30.

IPART, *Final Report: Review of the Delivered Price of Nature Gas to Low-Usage Customers Served by Country Energy*, December 2001, p 27.

IPART, *Mid-term Review of Regulated Retail Prices for Electricity to 2004*, June 2002, p 5.

Office of the Tasmanian Energy Regulator, *Investigation of Prices for Electricity Distribution Services and Retail Tariffs, Draft Report, Consolidated Report*, June 2003, p 143.

Independent Competition and Regulatory Commission, *Final Determination Review of Natural Gas Prices*, May 2001, p 12.

<sup>24</sup> The Tribunal made provision for gas retailers to pass through additional prudent expenditure relating to the introduction of FRC outside the current VPPs as it was difficult to estimate the costs that would be incurred at the time the VPPs were agreed. Electricity FRC costs were considered at the mid-term review and reasonable costs were passed through in tariffs at that time.

## A2.4 Profit margins

The Tribunal has previously noted a net profit margin (that is the margin on sales before interest and tax but after all other costs including retails costs have been accounted for) of between 1.5 per cent and 2.5 per cent of sales revenue would be appropriate for electricity retailers and a slightly higher net margin of between 2 per cent and 3 per cent of sales revenue for gas retailers.

In relation to comparing the Tribunal’s benchmark profit margin for NSW electricity retailers with those of other jurisdictions, the Victorian Office of the Regulator General (now the ESC) noted that:

- NSW electricity retailers benefit substantially from reduced risks associated with energy trading as a result of the NSW Government’s Electricity Tariff Equalisation Fund (ETEF) and
- NSW electricity retailers are government-owned entities and are likely to have a lower cost of capital than the private owners of the Victorian host electricity retailers.<sup>25</sup>

**Table A3.3 Net profit margins for Gas and Electricity retailers**

		Retail Margin
<b>Electricity</b>		
TAS	Office of the Tasmanian Energy Regulator (June 2003)	2.35%
ACT	ICRC (May 2003)	3%
SA	ESCOSA (September 2002)	5%
NSW	IPART Mid-term review (June 2002)	1.5% - 2.5%
VIC	Office of the Regulator General (now ESC) (December 2001)	2.5% – 5%
NSW	IPART Determination (December 2000)	1.5% - 2.5%
<b>Gas</b>		
VIC	ESC (December 2002)	2% - 3%
ACT	ICRC (May 2001)	2% - 3%
NSW	IPART VPPs for AGLRE (February 2001)	2% - 3%

Sources:

Essential Services Commission of South Australia, *Electricity Retail Price Justification – Final Report*, September 2002, p 17.  
 IPART, *Final Report: Review of the Delivered Price of Nature Gas to Tariff Customers Served from the AGL Gas Network in NSW*, February 2001, p 32-33.  
 IPART, *Mid-term Review of Regulated Retail Prices for Electricity to 2004*, June 2002, p 5.  
 Office of the Regulator General, Victoria, *Special Investigation – Electricity retailers’ proposed price increases – Final Report*, December 2001, p 30.  
 Essential Services Commission, *Special Investigation TXU’s proposed gas retail tariff amendments Final Report*, December 2002, p 35.  
 Independent Competition and Regulatory Commission, *Final Determination Investigation into Retail Prices for Non-contestable Electricity Customers in the ACT*, May 2003, p 23.  
 Independent Competition and Regulatory Commission, *Final Determination Review of Natural Gas Prices*, May 2001, p 30.  
 Office of the Tasmanian Energy Regulator, *Investigation of Prices for Electricity Distribution Services and Retail Tariffs, Draft Report*, Consolidated Report, June 2003, p 149.

<sup>25</sup> Office of the Regulator General, Victoria, *SPECIAL INVESTIGATION – Electricity retailers’ proposed price increases – Final Report*, December 2001, pp 32-33.

### APPENDIX 3 ENERGY NON-TARIFF CHARGES (INCLUDING NETWORK CHARGES)

Name of charge (GST exclusive)	ActewAGL (gas)	AGLRE (gas)	Country Energy (gas)	Origin Energy (gas)	All standard electricity retailers
<i>Regulated?</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>No</i>	<i>Yes</i>
Late payment	\$10.00	\$10.00	\$5.00	-	\$5.00
Dishonoured payment	\$21.00	\$21.00	Twice bank fee.	\$10.00	Twice the bank fee (only applies to payment by bank cheque)
Security deposit	<ul style="list-style-type: none"> <li>Residential - \$100.00 (GST-exempt)</li> <li>Business - 2.5 x average monthly account</li> </ul> Refunded after bills paid on time for 2yr	<ul style="list-style-type: none"> <li>Residential - \$100.00 (GST-exempt)</li> <li>Business - 2.5 x average monthly account</li> </ul> Refunded after bills paid on time for 2yr <sup>26</sup>			<ul style="list-style-type: none"> <li>1.5 times the average quarterly account <b>or</b></li> <li>1.75 times the average 2-monthly account <b>or</b></li> <li>2.5 times the average monthly account</li> </ul>
Account establishment	\$20.00	\$20.00	Gas only: \$15.00 Dual fuel: \$40.00		Network pass through: \$35(b/h) or \$87.50(a/h)
Account establishment (pensioner)	\$10.00	\$10.00			
Collector call	\$30.00	\$30.00	\$30.00	\$15.00-\$20.00 (Business)	Network pass through: \$30 (disconnection visit but no disconnection)

<sup>26</sup> AGLRE also offers business customers the alternative of a paying an annual, non-refundable insurance levy (which varies depending on individual risks).

Name of charge (GST exclusive)	ActewAGL (gas)	AGLRE (gas)	Country Energy (gas)	Origin Energy (gas)	All standard electricity retailers
Disconnection/ Reconnection	\$70.00	\$70.00 (within business hours)  \$100.00 (outside business hours)	\$60.00	Reconnection due to credit issue: <ul style="list-style-type: none"> <li>• \$15.00 after disconnection</li> <li>• \$30.00 after meter removal</li> <li>• \$80.00 after street disconnection</li> </ul>	
High bill field visit	\$49.00	\$49.00			
Special meter read		\$36.36			Network pass through: \$30(b/h) or \$75(a/h)
Network disconnection fee		\$90.91			Network pass through: disconnection fee \$60, pole top/pillar box disconnection fee \$100 (max fee \$160)
Meter testing charges: - 12 cubic metres - 33 cubic metres - 85 cubic metres - 300 cubic metres - 880 cubic metres		\$42.00 \$60.00 \$80.00 \$300.00 \$800.00			Network pass through: \$50(b/h) or \$125(a/h)
Rectification of illegal connection					Network pass through: \$150(b/h) or \$475(a/h)
Provision of time of use or half hourly metering data: per half hour					Network pass through: \$25
Conveyancing inquiry					Network pass through: \$25 for desk inquiry & \$50 for field visit

