



Interim Consultation Notice

**Benchmark Retail Cost Index for
Electricity: 2011-12**

September 2010

Level 19, 12 Creek Street Brisbane Queensland 4000
GPO Box 2257 Brisbane Qld 4001
Telephone (07) 3222 0555
Facsimile (07) 3222 0599

general.enquiries@qca.org.au
www.qca.org.au

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SUBMISSIONS

Public involvement is an important element of the decision-making processes of the Queensland Competition Authority (the Authority). The Authority is releasing this Interim Consultation Notice as a first step in its review to calculate the Benchmark Retail Cost Index (BRCI) for 2011-12. Submissions are invited from interested parties concerning the Authority's proposed approach. The Authority will take account of all submissions received.

Written submissions should be sent to the address below. While the Authority does not necessarily require submissions in any particular format, it would be appreciated if two printed copies are provided together with an electronic version on disk (Microsoft Word format) or by e-mail. Submissions, comments or inquiries regarding this paper should be directed to:

Queensland Competition Authority
GPO Box 2257
Brisbane QLD 4001
Telephone: (07) 3222 0555
Fax: (07) 3222 0599
Email: electricity@qca.org.au

The **closing date** for submissions is **11 October 2010**.

For further enquiries contact Gary Henry on (07) 3222 0504.

Confidentiality

In the interests of transparency and to promote informed discussion, the Authority would prefer submissions to be made publicly available wherever this is reasonable. However, if a person making a submission does not want that submission to be public, that person should claim confidentiality in respect of the document (or any part of the document). Claims for confidentiality should be clearly noted on the front page of the submission and the relevant sections of the submission should be marked as confidential, so that the remainder of the document can be made publicly available. It would also be appreciated if two copies of each version of these submissions (i.e. the complete version and another excising confidential information) could be provided. Again, it would be appreciated if each version could be provided on disk. Where it is unclear why a submission has been marked "confidential", the status of the submission will be discussed with the person making the submission.

While the Authority will endeavour to identify and protect material claimed as confidential as well as exempt information and information disclosure of which would be contrary to the public interest (within the meaning of the *Right to Information Act 2009 (RTI)*), it cannot guarantee that submissions will not be made publicly available. As stated in s187 of the *Queensland Competition Authority Act 1997* (the QCA Act), the Authority must take all reasonable steps to ensure the information is not disclosed without the person's consent, provided the Authority is satisfied that the person's belief is justified and that the disclosure of the information would not be in the public interest. Notwithstanding this, there is a possibility that the Authority may be required to reveal confidential information as a result of a RTI request.

Public access to submissions

Subject to any confidentiality constraints, submissions will be available for public inspection at the Brisbane office of the Authority, or on its website at www.qca.org.au. If you experience any difficulty gaining access to documents please contact the Authority (07) 3222 0555.

Information about the role and current activities of the Authority, including copies of reports, papers and submissions can also be found on the Authority's website.

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1. INTRODUCTION

1.1 Background

Electricity customers in Queensland are able to choose their retailer by entering into a negotiated retail contract offered by a competitive retailer. However, customers who choose not to take up a market offer or who are not offered a market contract remain on a standard retail contract which is subject to notified (regulated) electricity prices. Customers who take up a market offer transfer from the default standard retail contract to a negotiated retail contract with their retailer of choice and are subject to the contract price they have accepted from the retailer as part of the market offer.

Small customers (those consuming less than 100 MWh per annum) who have accepted a market offer may revert to the default standard retail contract at the notified price, subject to any contractual conditions that may apply to their existing negotiated retail contract.

The *Electricity Act 1994* (the Electricity Act) specifies that the notified prices applicable to the electricity tariffs are to be adjusted annually according to changes in the cost of providing electricity as measured by changes in the Benchmark Retail Cost Index (BRCI).

1.2 The BRCI Approach

The BRCI does not involve a calculation of the efficient retail price of electricity each year. Rather, the existing electricity prices are to be escalated by the expected change in the underlying cost of supplying electricity to customers (that is, by the change in the BRCI).

The method for calculating many components of the BRCI are set out in the Electricity Act and the *Electricity Regulation 2006* (the Electricity Regulation). In broad terms, the BRCI for a particular year is calculated by dividing the total cost of electricity by the relevant load (the NEM load) for the preceding calendar year. The total cost of electricity must include the following elements:

- (a) the cost of energy;
- (b) retailers' costs (including a retail margin allowance);
- (c) network costs; and
- (d) any other costs considered relevant (for example, government fees).

The Electricity Act allows the Minister for Natural Resources, Mines and Energy and Minister for Trade (the Minister) to delegate the calculation of the BRCI to the Authority. The Authority has been delegated responsibility for determining annual adjustments to notified prices under the BRCI since 2007-08.

1.3 Context of this Interim Consultation Notice

On 21 September 2010, the Minister issued the Authority with a delegation which requires the Authority to calculate the BRCI for 2011-12, apply the annual change in the BRCI to existing notified prices and publish these prices by 31 May 2011 to come into effect from 1 July 2011. The Minister's certificate of delegation can be viewed on the Authority's website.

Section 96 of the Electricity Regulation sets out the steps that the Authority is required to follow in reaching its Final Decision on the BRCI to apply to notified prices for 2011-12.

As a first step in this process, the Authority is releasing this Interim Consultation Notice. The Authority invites comment on all aspects of the calculation of the BRCI for 2011-12. To assist stakeholders in preparing their submissions, this Interim Consultation Notice includes a discussion of each component of the BRCI and some relevant issues.

Submissions in response to this Interim Consultation Notice should be received by the Authority no later than 11 October 2010. The proposed timetable for determining the BRCI for 2011-12 is provided in Table 1.

Table 1: Timetable for BRCI calculation for 2011-12

<i>Milestones</i>	<i>Indicative Dates</i>
Interim Consultation Notice issued	23 September 2010
Submissions on Interim Consultation Notice close	11 October 2010
Release Draft Decision	mid-December 2010
Submissions on Draft Decision close	mid-February 2011
Release Final Decision and gazette notified prices for 2011-12	by 31 May 2011

Stakeholders will also have an opportunity to respond to a Draft Decision to be released by the Authority prior to the Authority making its Final Decision on any change in the BRCI for 2011-12.

1.4 Relevant Documents

In addition to the certificate of delegation issued for the 2011-12 BRCI by the Minister, the following references provide important information regarding the legislative framework that the Authority is required to consider in calculating the BRCI:

- (a) the *Electricity Act 1994* and the *Electricity Regulation 2006*, which can be accessed at the Office of the Queensland Parliamentary Counsel website at www.legislation.qld.gov.au;
- (b) the judicial review judgment on the Authority's 2008-09 BRCI Final Decision, which the Authority must have regard to in interpreting some of the BRCI legislative provisions. The judgment, cited as *AGL Energy Ltd v Queensland Competition Authority & Anor; Origin Energy Retail Ltd v Queensland Competition Authority & Anor* [2009] QSC 90, is available from the Queensland Supreme Court website at www.courts.qld.gov.au; and
- (c) the Authority's Final Decision on the BRCI for 2010-11, which can be obtained from the Authority's website at www.qca.org.au.

2. BRCI CALCULATION

The Authority proposes to adopt the same methodology for calculating the BRCI for 2011-12 as it applied in its 2010-11 BRCI Final Decision. Accordingly, interested parties are referred to the Authority's 2010-11 BRCI Final Decision for a comprehensive description of the methodological process to be followed for estimating each of the BRCI cost component for 2011-12.

2.1 Cost of Energy

For the 2011-12 BRCI, the Authority has engaged ACIL Tasman (ACIL) to provide expert advice and estimates of the cost of energy component of the BRCI. ACIL provided similar advice to the Authority for the 2010-11 BRCI and their appointment again this year will provide continuity in the calculation of energy costs between 2010-11 and 2011-12.

ACIL has been requested to provide the long run marginal cost (LRMC) and energy purchase cost estimates on the same basis that it followed to produce the 2010-11 estimates. For a full description of ACIL's approach to calculating these cost components, see ACIL's Final Report on 2010-11 BRCI which is available from the Authority's website.¹

For other energy costs components such as those associated with complying with the Queensland Gas Scheme, market fees and ancillary charges imposed on retailers by the Australian Energy Market Operator (AEMO), the Authority proposes to apply the same methodology to derive estimates for 2011-12 as it used in 2010-11. However, the Commonwealth Government has introduced significant changes to the mandatory Renewable Energy Target Scheme (RET) to come into effect from January 2011.

On 24 June 2010, the Commonwealth Government passed legislation (the *Renewable Energy (Electricity) Amendment Bill 2010*)², making significant changes to the expanded RET scheme in order to address the oversupply imbalance in Renewable Energy Certificates (RECs) which retailers are required to purchase. Under the new enhanced RET scheme the REC market will be restructured by splitting it into two schemes: the Small-scale Renewable Energy Scheme (SRES); and the Large-scale Renewable Energy Target (LRET) scheme.

Retailers will be required to purchase RECs from both the SRES and LRET market to fulfil their obligations. Under SRES, households and small businesses will receive \$40 for each REC created by small scale technologies such as solar panels and hot water systems. Retailers will have an obligation to acquire small-scale RECs based on targets which will be annually determined by the Commonwealth based on expected rates of REC creation.

Similarly, annual REC targets for retailers will also be established under the LRET scheme. However, the LRET annual target will be determined with reference to achieving an overall annual target of generating 41,000 GWh by 2020 from large-scale renewable generation sector.

Given the new enhanced RET schemes will become operational from 1 January 2011, the Authority will need to incorporate this cost component into the BRCI cost of energy calculation for 2011-12. However, there is currently no publicly available information on the cost of RECs for SRES or the LRET market to assist in modelling the costs to be incurred by retailers from the start of 2011.

¹ ACIL Tasman, *The calculation of energy costs in the BRCI for 2010 11*, Final Report to the Authority, May 2010.

² <http://www.orer.gov.au/new.html#assenttarget>

The Authority seeks comments from stakeholders on any aspects of the approach to estimating the cost of energy component for the 2011-12 BRCI that they believe need to change from that followed previously.

In particular, the Authority seeks stakeholders' views on how the cost of complying with the new enhanced RET scheme should be estimated.

2.2 Network Costs

For the 2011-12 BRCI, the Authority proposes to adopt the same approach to determining network costs as it followed in calculating the 2010-11 BRCI.

As in previous years, actual data on transmission and distribution costs will not be available for the 2011-12 BRCI Draft Decision and the Authority will need to develop estimates of these costs.

Transmission use of system (TUOS) charges Powerlink will apply to the distributors will be estimated by calculating the proportion of Powerlink's maximum allowable revenue (MAR) in the previous year (2010-11) attributable to transmission charges levied on distributors and then apply this same proportion to Powerlink's 2011-12 MAR, as calculated by the Australian Energy Regulator (AER) in its (Revised) Final Decision on Powerlink's Queensland transmission network revenue cap for 2007-08 to 2011-12.

Other transmission costs incurred by the distributors will also be estimated by escalating the 2010-11 values by the proportional change in the Powerlink TUOS charges between years.

Similarly, distribution network costs for Energex and Ergon Energy for 2011-12 will be estimated based on the AER's approved annual revenue requirement as per its Queensland Final Regulatory Determination – 2010-11 to 2014-15.

The Authority will update these estimates in preparing its Final Decision once better information is available from the distributors' 2011-12 Pricing Proposals that will be submitted to the AER.

Consistent with the Authority's previous methodology, no adjustments will be made to these costs to account for any previous annual under- or over-recovery of TUOS charges or distribution revenue by Energex and Ergon Energy.

The Authority seeks comments from stakeholders on any aspects of the approach to estimating network costs for the 2011-12 BRCI that they believe need to be changed from that followed previously.

2.3 Retail Costs

For the 2011-12 BRCI, the Authority proposes to adopt the same approach to determining retail costs as it followed in calculating the 2010-11 BRCI.

Retail costs have been estimated first by estimating the retail operating costs and then combining this with an estimate of customer acquisition and retention costs. The retail margin has been held constant throughout the years at 5%.

Retail operating costs have been estimated in previous years by escalating a benchmarked retail operating cost of \$75 per customer established in 2006-07 to account for inflation over the intervening period. The Authority uses a 60/40 weighted average of the Wage Price Index and Consumer Price Index to account for the impact of wages growth and price inflation on the benchmarked retail operating cost. The per customer escalated retail operating cost estimate is

multiplied by the total number of customers on the Energex and Ergon Energy distribution networks.

Customer acquisition and retention costs have previously been estimated by escalating benchmark costs established in 2007-08 for a customer switching retailer (\$171.43) and a customer transferring to a market contract with the same retailer (\$100.00) to arrive at cost estimates for the relevant tariff year. These cost estimates are then multiplied by forecasts of the number of customers switching and transferring in the market to arrive at an overall customer acquisition and retention cost estimate for the year.

In its 2010-11 BRCI Final Decision, the Authority estimated the number of customer switches and transfers based on market data from AEMO's MSATS system to forecast the number of customers switching between retailers and on its own collected data reported by retailers to forecast the number of customers transferring to market contracts with the same retailer. This was a change from the South Australian market data the Authority had relied on in the early years of competition in the Queensland market.

The Authority seeks comments from stakeholders on any aspects of the approach to estimating retail costs for the 2011-12 BRCI that they believe need to change from that followed previously.

2.4 NEM Load

The Electricity Act requires that the BRCI for 2011-12 be determined by dividing the total benchmark retail cost for 2011-12 by the National Electricity Market (NEM) load for the previous calendar year (2010) in order to determine the unit cost of supplying electricity, expressed in c/kWh.

The Electricity Act defines the NEM load as the total of the loads for the State supplied at each transmission connection point to a supply network. The NEM load therefore excludes any customer loads supplied directly from the transmission network (directly connected customers), the loads of customers connected to isolated distribution systems not participating in the NEM (such as the Mt Isa network) and the loads of small non-registered generators embedded in the distribution networks of Energex and Ergon Energy that do not participate in the NEM.

In calculating the 2011-12 BRCI, the Authority proposes to adopt the same approach to determining NEM load as it adopted in calculating the 2010-11 BRCI. The Authority will obtain half-hourly load data for each transmission network identifier from AEMO and remove those loads supplied to directly connected customers and to customers connected to Country Energy's distribution network.

As NEM load data for the full 2010 calendar year will not be available from AEMO until early in 2011, the Authority will need to base its 2011-12 BRCI Draft Decision on an estimate of the 2010 NEM load. As for the 2010-11 BRCI Draft Decision, it is likely that the Authority will only be able to obtain actual load data for the first three quarters of 2010 and have to rely on a forecast of the December quarter 2010 load. For the purposes of its Draft Decision, the Authority will again obtain a forecast load for the December quarter 2010 from ACIL. This estimate will be replaced with actual data for the 2011-12 BRCI Final Decision.

The Authority seeks comments from stakeholders on any aspects of the approach to estimating the NEM load for the 2011-12 BRCI that they believe need to change from that followed previously.