

Queensland Competition Authority

Interim consultation paper

Regulated retail electricity prices for 2017–18

November 2016

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SUBMISSIONS

Closing date for submissions: 7 December 2016

Public involvement is an important element of the decision-making processes of the Queensland Competition Authority (QCA). Therefore submissions are invited from interested parties concerning its assessment of 2017-18 regulated retail electricity prices. The QCA will take account of all submissions received.

Submissions, comments or inquiries regarding this paper should be directed to:

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www.qca.org.au/submissions

Confidentiality

In the interests of transparency and to promote informed discussion, the QCA 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. 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 QCA 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.

Public access to submissions

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

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THE ROLE OF THE QCA—TASK, TIMING AND CONTACTS

The Queensland Competition Authority (QCA) is an independent statutory authority that promotes competition as the basis for enhancing efficiency and growth in the Queensland economy.

The QCA's primary role is to ensure that monopoly businesses operating in Queensland, particularly in the provision of key infrastructure, do not abuse their market power through unfair pricing or restrictive access arrangements.

The QCA's primary role with respect to electricity pricing is to set regulated retail electricity prices in accordance with the *Electricity Act 1994* (the Electricity Act) and the requirements of the delegation from the Minister for Energy, Biofuels and Water Supply (Appendix A).

Key dates

Release of interim consultation paper	16 November 2016
Submissions due on interim consultation paper	7 December 2016
Release of public consultation timetable	December 2016
Release of draft determination	February 2017
Workshops on draft determination	March 2017
Submissions due on draft determination	April 2017
Release of final determination	31 May 2017

Registration of interest

www.qca.org.au/Submissions

Contacts

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1 INTRODUCTION AND LEGISLATIVE FRAMEWORK

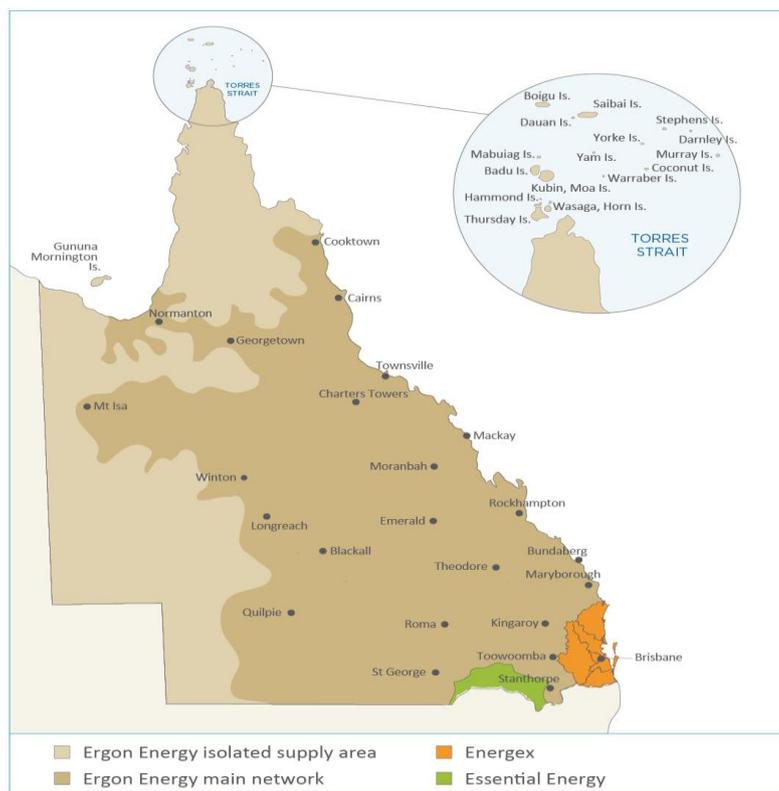
The QCA has received a delegation under the Electricity Act from the Queensland Minister for Energy, Biofuels and Water Supply (the Minister) to determine regulated retail electricity prices (notified prices) that will apply to non-market customers¹ from 1 July 2017 to 30 June 2018.²

This paper is the first stage of our 2017–18 price determination process. Submissions are invited in response to the paper and are due no later than 7 December 2016. While we have set out key issues on which we are seeking comments, stakeholders should take this opportunity to comment on any matters that they consider are relevant to our review and provide detailed arguments and evidence to support their views, where possible. Details on how to make a submission are provided at page i. An indicative timetable for the determination process is provided at page iii.

1.1 Access to notified prices

Retail price regulation in the Energex distribution area was removed on 1 July 2016. Consequently, notified prices only apply to 'non-market customers' in Ergon Energy Corporation Limited's (Ergon Distribution's) distribution area.³

Figure 1 Queensland electricity distribution areas



¹ Non-market customers are customers on a standard retail contract with terms and conditions specified by the National Energy Retail Rules.

² See Appendix A for a copy of the delegation.

³ Customers in Essential Energy's distribution area in southern Queensland do not have access to notified prices, but Origin Energy receives a subsidy to ensure that non-market customers in that distribution area pay no more than similar customers that have access to notified prices.

1.2 Legislative framework—the Electricity Act

We must determine notified prices in accordance with our obligations under the Electricity Act. While that Act does not specify criteria or principles to be applied in making a price determination, it directs us to have regard to the following matters:

- (a) the actual costs of making, producing or supplying the goods or services
- (b) the effect of the price determination on competition in the Queensland retail electricity market
- (c) any matter we are required by delegation to consider
- (d) any other matter we consider relevant.⁴

We must also have regard to the objects of the Electricity Act, which are to:

- (a) set a framework for all electricity industry participants that promotes efficient, economical and environmentally sound supply and use
- (b) regulate the electricity industry and electricity use
- (c) establish a competitive electricity market in line with the national electricity industry reform process
- (d) ensure that the interests of customers are protected
- (e) take into account national competition policy requirements.⁵

1.3 Matters we are required by delegation to consider in setting notified prices

The matters we are required by delegation to consider when determining notified prices for 2017–18 are outlined below.

The Uniform Tariff Policy

According to the delegation, the Queensland Government's Uniform Tariff Policy (UTP) 'provides that, wherever possible, small standard retail contract customers and large non-market customers of the same class should pay no more for their electricity, regardless of their geographic location'.⁶ The covering letter to the delegation further specifies that, for the purposes of the delegation, prices for small customers in regional Queensland should continue to broadly reflect the expected prices for customers on standing offers in south east Queensland.⁷

In previous price determinations, the application of the UTP resulted in most notified prices being based on the costs of supply for standing offer customers in south east Queensland (i.e. the Energex distribution area). This benefitted customers in regional Queensland, who would otherwise have faced higher prices reflecting the higher costs of supplying electricity in regional areas. The difference between the costs of supply in south east Queensland and regional Queensland is largely due to the higher network costs associated with supplying electricity over long distances to a low-density customer base. These additional costs are significant, with the

⁴ Section 90(5) of the Electricity Act.

⁵ Section 3 of the Electricity Act.

⁶ Clause 5(b) of the delegation (Appendix A).

⁷ A copy of the Minister's covering letter is provided in Appendix A.

Queensland Government expecting to pay a subsidy of \$561.2 million in 2016–17 to give effect to the UTP.⁸

'Network plus retail' cost build-up methodology

Consistent with the approach in previous price determinations, we must consider using the network (N) plus retail (R) cost build-up methodology when determining notified prices for 2017–18. Under this methodology, the N costs are generally treated as a pass-through and the R costs (energy and retail costs) are determined by us.

The network cost component

When calculating the N component for each regulated retail tariff, we must consider continuing with the same general approach we have applied in previous price determinations. This means using Energex's network charges and tariff structures when we determine flat rate retail tariffs⁹ for residential and small business customers (tariffs 11, 20, 31, 33, 41 and 91¹⁰). Adopting this approach would mean that the N components would be below cost, as they would be based on network costs in south east Queensland, rather than regional Queensland.

When we determine time-of-use and time-of-use demand retail tariffs¹¹ for residential and small business customers (tariffs 12A, 14, 22A and 24), we must consider basing the N components on the price level of network charges to be levied by Energex and the network tariff structures of Ergon Distribution. Adopting this approach would mean that the N components would be below cost, but the use of Ergon Distribution's network tariff structures would improve price signals and encourage customers to reduce consumption during peak periods in Ergon Distribution's distribution area.

For large business customers, we must consider using Ergon Distribution's network charges and tariff structures. This is the approach we have adopted in previous price determinations.

Transitional arrangements

We are required to consider maintaining the transitional arrangements for tariffs classed as transitional or obsolete (e.g. farming and irrigation tariffs). We are also required to consider allowing all customers in Ergon Distribution's distribution area to access tariffs designated as transitional in 2013-14.

1.4 Queensland Productivity Commission's inquiry into electricity pricing

The Queensland Government is considering the Queensland Productivity Commission's final report on electricity pricing and will respond in due course. In the event that the Queensland Government's response results in changes to the 2017–18 price determination framework, the QCA will adjust its approach accordingly.

⁸ Queensland Government, State Budget 2016–17—Budget Strategy and Outlook, Budget Paper No. 2, June 2016, p. 215.

⁹ Retail tariffs with usage charges that do not vary with the time and/or level of consumption.

¹⁰ Tariff 91 applies to unmetered supplies (except street lighting).

¹¹ Retail tariffs with usage and other charge rates that vary with the time and/or level of consumption.

2 POTENTIAL PRICING APPROACHES

The objects of the Electricity Act and the matters we are required to consider under the Electricity Act indicate that cost-reflective prices and the promotion of retail competition are important guiding principles in making a price determination. Accordingly, in the 2016–17 price determination we considered cost-reflectivity to be important for efficiency and equity reasons. The 2016–17 price determination was also designed to support retail competition in the large business customer segment in regional Queensland.

Under the Minister's delegation, we are also required to consider the UTP. As noted in Section 1.3, the application of the UTP in previous price determinations has resulted in most notified prices being based on costs of supply which are below the actual costs of supply.

Under the Electricity Act, we can also have regard to any other matter that we consider relevant. We consider that the impact on customers is certainly a relevant factor.

Given that there is a degree of conflict between the matters we are required to consider under the Electricity Act and those we are required to consider under the Minister's delegation, we have considered a broad range of possible pricing approaches for 2017–18, particularly for residential and small business customers.

2.1 Residential and small business customers

One possible pricing approach would be to maintain the approach we took in the 2016–17 price determination. This approach involves setting notified prices based on the costs of supply in south east Queensland (i.e. Energex costs), rather than regional Queensland (i.e. Ergon Distribution costs).

As the costs of supply in south east Queensland are generally lower than those in regional Queensland, adopting this approach would result in customers continuing to pay prices which do not reflect the actual costs of supply, potentially encouraging inefficient investment and consumption. It also requires the ongoing subsidisation of electricity prices by taxpayers (as noted in Section 1.3, the cost of this subsidy is expected to be \$561.2 million in 2016–17). However, this approach may be considered reasonable, as it would be consistent with the Queensland Government's definition of the UTP for 2017–18.

Another possibility would be to adopt the approach we have taken since 2012 in setting notified prices for large business customers. When retail price regulation for large business customers in south east Queensland was discontinued, we decided to base notified prices for large business customers outside south east Queensland on the lowest costs of supply for those customers still eligible for notified prices. Consequently, the benchmark we used to set notified prices for large business customers was Ergon Distribution's east pricing zone, transmission region one.¹² This approach has been continued in subsequent price determinations.

Adopting this approach for residential and small business customers would improve cost reflectivity (relative to setting prices based on the costs of supply in south east Queensland) and reduce the amount paid by taxpayers to subsidise electricity prices in regional Queensland. However, it would be inconsistent with the Queensland Government's definition of the UTP for

¹² Queensland Competition Authority, *Regulated Retail Electricity Prices 2012–13*, final determination, May 2012.

2017–18 and result in substantial price increases, as the costs of supplying residential and small business customers in Ergon Distribution's east pricing zone, transmission region one are 21 per cent higher than the costs of supplying comparable customers in south east Queensland.¹³

A third approach would be to move gradually from prices that reflect the costs of supply in south east Queensland to prices that reflect the actual costs of supply. This approach would promote retail competition and remove the need to subsidise regional electricity prices. However, it would be inconsistent with the UTP as some small standard retail contract customers would, based on their geographic location, pay more for their electricity than small standard retail contract customers of the same class in other areas of Queensland. Any shift to cost-reflective prices would also result in substantial price increases, particularly for customers in western Queensland and those supplied by isolated systems.

On balance, the QCA considers that the most appropriate approach for 2017–18 is to continue to base notified prices for residential and small business customers on the costs of supply in south east Queensland.

2.2 Large business customers

As noted above, in previous price determinations we have set notified prices for large business customers based on the costs of supply in the lowest cost area of regional Queensland. This approach has the benefit of being more cost-reflective and requiring a lower taxpayer subsidy than an approach based on the costs of supply in south east Queensland. It is also consistent with the Queensland Government's definition of the UTP for 2017–18 and the requirement in the delegation for the QCA to consider basing the network cost components for large business customer retail tariffs on Ergon Distribution's network charges.

Another option would be to move to cost-reflective notified prices. However, we consider that this approach would be inconsistent with the UTP.

On balance, the QCA considers that the most appropriate approach for 2017–18 is to continue to base notified prices for large business customers on the costs of supply in Ergon Distribution's east pricing zone, transmission region one.

2.3 Consultation questions

- **For residential and small business customers, should we maintain the 2016–17 approach of basing notified prices on the costs of supply in south east Queensland? Why?**
- **For large business customers, should we maintain the 2016–17 approach of basing notified prices on the costs of supply in Ergon Distribution's east pricing zone, transmission region one? Why?**

¹³ This is the estimated impact in 2016-17 on a typical tariff 11 customer in the east pricing zone, transmission region 1.

3 NETWORK COSTS

A retailer incurs network costs when electricity is supplied to its customers. These costs are associated with transporting electricity through the transmission and distribution networks and account for around 50 per cent of the final cost of electricity for small customers.¹⁴

Powerlink, Energex and Ergon Distribution, as regulated monopoly businesses, earn regulated revenues that are determined by the Australian Energy Regulator (AER). In addition to recovering their own distribution network costs, Energex and Ergon Distribution also pass Powerlink's transmission network costs through to customers in network charges that are approved by the AER.

Under the 'network plus retail' (N+R) cost build-up approach that we have used to set notified prices in previous price determinations, the N costs are treated as a pass-through. However, to determine the network cost component to be passed through to retail customers, we need to decide:

- the level at which network charges should be set (Energex levels or Ergon Distribution levels)
- the network tariff structure on which the network cost component should be based (Energex network tariff structures or Ergon Distribution tariff structures).

Network tariff structures can include, for example, combinations of fixed charges, demand charges and usage charges.

For the 2016–17 price determination, we based network costs on the prices that Energex and Ergon Distribution submitted to the AER. We expect to take a similar approach in the 2017–18 price determination.

3.1 Residential, small business and unmetered supply (excluding street lighting) customers

For the 2017–18 price determination, the Minister's delegation requires that we consider:

- for residential and small business retail tariffs (except tariffs 12A, 14, 22A and 24), basing the network cost component on Energex network charges and tariff structures
- for residential and small business time-of-use retail tariffs (tariffs 12A and 22A) and time-of-use demand retail tariffs (tariffs 14 and 24), basing the network cost component on Energex network charges, but using the relevant Ergon Distribution network tariff structures.

Energex or Ergon Distribution network charges

In determining the network cost components of regulated retail tariffs, the first issue we must consider is the level at which network charges should be set to be consistent with the UTP (Energex levels or Ergon Distribution levels). As discussed in Chapter 2, our preference for 2017–18 is to base notified prices for residential and small business customers on the costs of supply in south east Queensland. This would mean setting network charges at Energex cost levels. As a result, residential, small business and unmetered supply (excluding street lighting) customers in

¹⁴ In 2016–17, around 50 per cent of the annual bill of a typical customer on tariff 11, 20 or 22A was attributed to network costs.

regional Queensland would generally pay the same for network services as customers in south east Queensland.

Energex or Ergon network tariff structures

The second issue we must consider is whether to use the network tariff structures of Energex or Ergon Distribution. Key differences between the two include:

- the proportion of costs recovered through fixed charges
- the approach to usage charge rates (e.g. flat usage rates versus three-part inclining block tariffs)
- the applicable time-of-use and demand charging periods (e.g. different peak and off-peak periods)
- the methodology for calculating demand charges.¹⁵

For the 2016–17 price determination, we used Energex's network tariff structures as the basis for setting flat rate retail tariffs for residential, small business and unmetered supply (excluding street lighting) customers, as those structures reflected the costs of supply in south east Queensland. We used Ergon Distribution's network tariff structures as the basis for setting time-of-use and time-of-use demand retail tariffs for residential and small business customers, but adjusted them to reflect Energex cost levels to maintain consistency with the UTP.

We consider that we could adopt one of three possible approaches for 2017–18:

- (1) Use Energex's network tariff structures as the basis for all retail tariffs.
- (2) Use a mix of Energex's and Ergon Distribution's network tariff structures as the basis for retail tariffs.
- (3) Use Ergon Distribution's network tariff structures for all retail tariffs.

Energex's network tariff structures as the basis for all retail tariffs

Using Energex's network tariff structures as the basis for all retail tariffs would be inconsistent with our approach in the 2016–17 price determination. It would also result in customers facing price signals that do not reflect the impact of their consumption on Ergon Distribution's network. Consequently, this approach may provide incentives for customers to make inefficient consumption and investment decisions.

Mix of Energex's and Ergon Distribution's network tariff structures as the basis for retail tariffs

We could use Energex's network tariff structures as the basis for some retail tariffs and Ergon Distribution's network tariff structures as the basis for other retail tariffs. This approach would potentially be consistent with the proposed approach in the Minister's delegation and with our approach in the 2016–17 price determination. It would also better align the tariff structures of some retail tariffs with their underlying network tariff structures, thereby encouraging customers to reduce consumption during peak periods on Ergon Distribution's network.

As with the 2016–17 price determination, the adoption of this approach would require us to consider the incentives for customers to move between flat rate and time-of-use retail tariffs, if

¹⁵ More information on the difference between Energex's and Ergon Distribution's network tariff structures is provided in Appendix B.

Energex's network tariff structures were used as the basis for the former and Ergon Distribution's network tariff structures were used for the latter.

Ergon Distribution's network tariff structures for all retail tariffs.

Using Ergon's network tariff structures as the basis for all retail tariffs would be a further step towards improving cost reflectivity. However, it would be inconsistent with our approach in the 2016–17 price determination and would result in a change of network tariff structure for flat rate retail tariffs and controlled load tariffs. As noted in the 2016–17 price determination, this change would affect nearly all regional customers and would have significant distributional impacts.

3.2 Large business and street lighting customers

For the 2017–18 price determination, the Minister's delegation requires that we consider basing the network cost component of retail tariffs for large business customers and street lighting customers on Ergon Distribution's network charges and tariff structures. This requirement is consistent with our approach in the 2016–17 price determination, where we based the network cost components of those retail tariffs on the network charges for Ergon Distribution's east pricing zone, transmission region one. We adopted this approach on the basis that this part of Ergon Distribution's network has the highest number of large business customers and the lowest costs for large business and street lighting customers in regional Queensland.

3.3 Obsolete and transitional retail tariffs

For the 2017–18 price determination, the Minister's delegation requires that we consider maintaining transitional arrangements for retail tariffs classed as transitional or obsolete. As these tariffs are not based on actual costs, there is no need to determine network charges for these tariffs. Obsolete and transitional tariffs are discussed further in Chapter 6.

3.4 High voltage retail tariffs

Ergon Distribution has indicated that it intends to phase out its Standard Asset Customer (SAC) Large Demand High Voltage network tariff in 2017–18. This means we will not be able to use this network tariff as the basis for the network cost components for the high voltage retail tariffs (retail tariffs 47 and 48). This issue is discussed further in Section 6.5.

3.5 Consultation questions

- **Should we use Energex's network tariff structures as the basis for all retail tariffs for residential, small business and unmetered supply (excluding street lighting) customers?**
- **Alternatively, should we use Ergon Distribution's network tariff structures as the basis for some or all retail tariffs for residential, small business and unmetered supply (excluding street lighting) customers? If so, how should Ergon Distribution's network tariff structures be adjusted to reflect the UTP?**
- **Should we use Ergon Distribution's network tariff structures as the basis for retail tariffs for large business customers and street lighting customers?**
- **Are there any other issues that we should consider?**

4 ENERGY COSTS

In setting the R component of notified prices we must include an allowance for energy costs. Retailers incur energy costs when purchasing electricity to supply to their customers. Energy costs can be split into three general categories:

- (1) wholesale energy costs
- (2) other energy costs
- (3) energy losses.

In the 2016–17 price determination, our estimate of energy costs was based on advice from ACIL Allen. For the 2017–18 price determination, we have again engaged ACIL Allen to provide advice on energy costs.¹⁶

We have instructed ACIL Allen to provide cost estimates for both south east Queensland and regional Queensland. In previous price determinations, we used the south east Queensland estimates to set notified prices for residential and small business customers. The regional Queensland estimates were used to set notified prices for large business customers and street lighting customers.

A brief explanation of each cost component and how it was calculated in the 2016–17 price determination is provided below.¹⁷

4.1 Wholesale energy costs

Retailers incur wholesale energy costs when purchasing electricity from the National Electricity Market (NEM) to meet the electricity demand of their customers.

The NEM is a volatile market where prices are settled every half hour and can range from –\$1,000 per MWh to \$14,000 per megawatt hour (MWh).¹⁸ Retailers can, and do, adopt a range of strategies to reduce their exposure to these volatile prices, including:

- pursuing a 'hedging strategy' by purchasing financial derivatives such as swaps and options
- entering long-term power purchase agreements with generators
- investing in their own electricity generators.

In previous price determinations, we considered two main approaches for determining wholesale energy costs—a hedging-based approach and a long-run marginal cost approach (LRMC) which attempts to estimate the long-run costs of generation.¹⁹ In the 2016–17 price determination we used a hedging-based approach as we considered it was transparent and best reflected the actual costs retailers incur when purchasing electricity from the NEM in a given

¹⁶ The terms of reference for ACIL Allen's appointment are available on the QCA's website.

¹⁷ A detailed explanation of how each cost component was calculated in 2016–17 is provided in the 2016–17 price determination and ACIL Allen's reports, which are available on the QCA's website, www.qca.org.au.

¹⁸ The minimum spot price is defined in clause 3.9.6(b) of the National Electricity Rules. The Market Price Cap is published by the Australian Energy Market Commission (AEMC) every February. For more information, see www.aemc.gov.au.

¹⁹ In previous price determinations, we also considered a statistical model that estimated the price a retailer might be willing to pay to enter hedging contracts (the price distribution approach).

year. Hedging-based approaches have also been adopted by other Australian regulators and have been endorsed by the Australian Energy Market Commission (AEMC) in its final report on best practice retail regulation, produced for the Standing Council on Energy and Resources.²⁰

4.2 Other energy costs

In addition to wholesale energy costs, we must account for other energy costs that retailers incur when purchasing electricity from the NEM, which are:

- Renewable Energy Target (RET) costs
- NEM participation fees and ancillary services charges
- prudential capital costs.

RET costs

The RET scheme, comprised of the Large-scale Renewable Energy Target (LRET) and Small-scale Renewable Energy Scheme (SRES), provides incentives for the electricity sector to increase generation from renewable sources and reduce greenhouse gas emissions. The costs of these incentives are paid by retailers through the purchase of Large-scale Generation Certificates (LGCs) and Small-scale Technology Certificates (STCs).

In the 2016–17 price determination, ACIL Allen estimated:

- LRET costs using a market-based approach. This approach based LGC prices on forward prices for certificates published by the Australian Financial Markets Association (AFMA).
- SRES costs using the final 2016 small-scale technology percentage (STP) target for the first half of the pricing period, and the latest available non-binding 2017 STP target for the second half of the pricing period. STC prices were based on the clearing house price.²¹

NEM participation fees and ancillary services charges

Retailers purchasing electricity from the NEM are required to pay NEM participation fees and ancillary services charges to the Australian Energy Market Operator (AEMO). NEM participation fees are levied by AEMO to cover the costs of operating the NEM and funding Energy Consumers Australia. Ancillary services charges cover the costs of the services used by AEMO to manage power system safety, security and reliability.

In the 2016–17 price determination, ACIL Allen used AEMO budget and fee projections to estimate NEM participation fees. Its estimate of ancillary services charges was based on the average historical costs observed over the preceding 52 weeks.²²

Prudential capital costs

Prudential capital costs are the costs that a retailer incurs to provide financial guarantees to AEMO and to lodge initial margins with hedge providers for futures contracts. In the 2016–17

²⁰ AEMC, *Advice on best practice retail price methodology*, final report, 27 September 2013.

²¹ A detailed explanation of how each cost component was calculated in 2016–17 is provided in the 2016–17 price determination and ACIL Allen's reports, which are available on the QCA's website, www.qca.org.au.

²² *Ibid.*

price determination, ACIL Allen estimated prudential capital costs in line with the latest published AEMO requirements and margin requirements for trading in the futures market.²³

4.3 Energy losses

Some electricity is lost when it is transported over transmission and distribution networks to customers. As a result, retailers must purchase additional electricity to allow for these losses when supplying customers.

In the 2016–17 price determination, ACIL Allen accounted for these losses by applying transmission and distribution loss factors published by AEMO, in a manner that aligned with AEMO's settlement process.

4.4 Consultation questions

- **Is there any new information available to suggest alternative approaches to those used in the 2016–17 price determination might be more appropriate?**
- **What improvements could be made to the current approaches?**
- **Are there any other issues we should consider when estimating energy costs?**

²³ A detailed explanation of how each cost component was calculated in 2016–17 is provided in the 2016–17 price determination and ACIL Allen's reports, which are available on the QCA's website, www.qca.org.au.

5 RETAIL COSTS

In setting the R component of notified prices, we must also include an allowance for retail costs. Retail costs are the costs associated with services provided by a retailer to its customers, which typically include customer administration, call centres, corporate overheads, billing and revenue collection, IT systems, regulatory compliance, customer acquisition and retention costs, depreciation, interest payments and tax expenses. Retail costs also include a return to investors for retailers' exposure to systematic risks associated with providing retail electricity services.

As part of the 2016–17 price determination process, we conducted a comprehensive review of the retail cost components of retail tariffs. As part of that review, we engaged ACIL Allen to provide advice on efficient retail costs. ACIL Allen used a combination of bottom-up and benchmarking methods to estimate retail costs for residential and small business customers, informed by analysis of publicly available data, observed market offers, and detailed confidential information provided by retailers. For large and very large business customers²⁴, ACIL Allen advised that there was no compelling evidence that the retail costs varied materially from the QCA's previous allowances.

Consequently, we established separate retail cost allowances for residential and small business customers, based on the averages of ACIL Allen's benchmarking observations. For large and very large business customers, we based the retail cost allowances on our 2015–16 allowances, with the fixed components escalated by forecast inflation to maintain them in real terms.

A detailed explanation of how the retail cost components were calculated in 2016–17 is provided in the 2016–17 price determination and ACIL Allen's reports, which are available on the QCA's website, www.qca.org.au.

We consider that the retail cost allowances used for setting notified prices for 2016–17 are an appropriate starting point for setting notified prices for 2017–18. However, we will consider whether suggestions in submissions warrant a change of approach and whether there are any significant changes since the 2016–17 determination which would require adjustments to be made (e.g. significant changes in current costs or the emergence of new costs).

Indexation

In the 2015–16 price determination, we escalated the benchmark retail cost allowances for all customers by the forecast change in the consumer price index (CPI). This was drawn from the Reserve Bank of Australia's Statement on Monetary Policy (May 2015). As we estimated new retail cost allowances for residential and small business customer tariffs in the 2016–17 price determination, those allowances were not adjusted. However, the retail cost allowances for large and very large business customer tariffs were adjusted by the forecast change in CPI.

²⁴ A large business customer is a business that is classified as a Standard Asset Customer (greater than 100 MWh per annum). A very large business customer is a business that is classified either as a Connection Asset Customer or an Individually Calculated Customer.

5.1 Consultation questions

- **Is there any new information available to suggest that the approach used in the 2016–17 price determination is no longer appropriate?**
- **Is there any evidence that would suggest that retail costs have changed materially since the 2016–17 price determination?**
- **Should the retail cost allowances be indexed? If so, how should they be indexed (e.g. by CPI)?**
- **Are there any other issues we should consider when estimating retail costs?**

6 OTHER ISSUES

This chapter discusses other issues relevant to the 2017–18 price determination, including:

- the standing offer differential
- competition and headroom
- a cost pass-through mechanism
- transitional arrangements for tariffs classed as transitional or obsolete
- the possible removal of tariffs 47 and 48.

6.1 Standing offer differential—residential and small business customers

The QCA uses the N+R cost build-up methodology to derive the estimated efficient costs of supplying small customers in south east Queensland, which serve as a basis to set notified prices. In broad terms, this produces price levels that we would expect to reflect efficient market offer prices.

The Queensland Government's definition of the UTP requires us to set 2017–18 notified prices for residential and small business customers that broadly reflect the expected level of standing offer prices in south east Queensland (see Section 1.3). Consequently, it is necessary to add an amount that represents a reasonable expectation of the difference between the expected efficient market offer prices and the expected standing offer prices (the standing offer differential).

In the 2016–17 price determination, the use of the N+R methodology and the application of the UTP also resulted in us adding a standing offer differential. Retail electricity prices of small customers observed in south east Queensland generally reveal that most retailers' standing offer prices²⁵ are higher than their best market offers, albeit by varying amounts. While we could not estimate the expected price differential for 2016–17 with any certainty, we considered it would be reasonable to assume that it would remain at a level similar to the differential observed in 2015–16. Consequently, we decided that an amount of five per cent of total costs was a reasonable estimate of the amount required to deliver average price differentials that are similar to those observed in 2015–16.²⁶

For the 2017–18 price determination, we propose to consider the following matters to form a view on the expected price differential between market offers and standing offers:

- the experience in other deregulated jurisdictions; and
- the observed price differentials in the newly deregulated south east Queensland retail market.

²⁵ In 2015–16, prior to pricing deregulation, standing offer prices were notified prices. Since 1 July 2016, retail electricity prices have been deregulated in south east Queensland and retailers can set standing offer prices at levels of their own choosing.

²⁶ A detailed explanation of how each cost component was calculated in 2016–17 is provided in the 2016–17 price determination, which is available on the QCA's website, www.qca.org.au.

Consultation questions

- **Is there any new information available to suggest an alternative approach to that used in the 2016–17 price determination to estimate the standing offer differential might be more appropriate?**
- **Are there any other issues we should consider when estimating the standing offer differential costs?**

6.2 Competition and headroom—large business customers

Under section 90(5)(a) of the Electricity Act, we are required to have regard to the effect of our price determination on competition in the Queensland retail electricity market. We must also have regard to the objects of the Electricity Act, which include:

- establishing a competitive electricity market in line with the national electricity industry reform process
- taking into account national competition policy requirements.

Where it is effective, we consider that competition provides the best means of delivering the goods and services that customers demand at prices that reflect efficient costs. While there is very limited competition in the small customer market in regional Queensland, competition in the large customer segment shows greater promise of developing further, particularly in areas where notified prices more closely reflect the actual costs of supply.

As at 30 June 2015, around 28 per cent of large regional customers in regional Queensland were supplied under a market contract. However, in the Ergon Distribution east pricing zone, transmission region one—where notified prices are based on the estimated efficient costs of supply—the proportion of large customers on market contracts is higher and has been increasing. In 2012–13, around 44 per cent of large customers in this area were on market contracts; that number has increased to 47 per cent as of June 2015.²⁷

In previous price determinations, we have included an allowance for 'headroom' to facilitate the development of retail competition in regional Queensland for large business customers. The headroom allowance is an amount, in addition to the estimated efficient cost of providing customer retail services, included in notified prices for the purpose of encouraging customers to engage in the market and seek out more attractive market offers. Since the 2012–13 determination, we have set this allowance at five per cent of total estimated efficient costs.

Consultation questions

- **Should headroom continue to be included in notified prices for large business customers? If so, at what level? If not, why not?**
- **What other issues should we consider in relation to competition and headroom?**

6.3 Cost pass-through mechanism

Cost pass-through mechanisms are used by regulators to mitigate the risk that costs allowed for in regulated prices are higher or lower than actual efficient costs. Cost pass-through mechanisms are usually restricted to events that are outside the control of the regulated entity.

²⁷ Queensland Competition Authority, *Regulated Retail Electricity Prices 2016–17*, final determination, May 2012, p. 49.

We applied a cost pass-through mechanism for the first time in the 2014–15 price determination to pass through an under-recovery of costs in 2013–14 associated with the SRES. We also decided that the mechanism could be used to account for material differences in network charges, in the event that the charges billed to retailers (usually the AER-approved charges) differed from those used to set notified prices. However, this application of the mechanism has not been needed to date. In the 2016–17 price determination, we applied a cost pass-through mechanism to require the negative pass-through of a small over-recovery of costs incurred during 2015–16 associated with SRES.

The Minister's delegation is for the determination of notified prices for 2017–18. This means that while we may consider applying a cost pass-through mechanism to pass through an under- or over-recovery of costs incurred during 2016–17, we cannot commit to the continued availability of a cost pass-through mechanism beyond the 2017–18 price determination.

Consultation questions

- **Should we allow for any pass-through of SRES under- or over-recoveries incurred during 2016–17 into 2017–18 notified prices?**

6.4 Transitional arrangements

Since 2012–13 we have set notified prices using the N+R cost build-up methodology. The introduction of this methodology meant that a number of existing retail tariffs, including farming and irrigation tariffs, did not align with a network tariff.

In previous price determinations, we decided that most of these tariffs should continue to be available for several years because some customers would face significant financial impacts if they were moved to alternative tariffs.

Under the Minister's delegation, we are required to consider maintaining transitional arrangements for tariffs classed as transitional or obsolete.

We propose to maintain transitional arrangements for these tariffs.

Transitional period

We established transitional periods in the 2013–14 price determination, which have been maintained in subsequent price determinations. Tariffs 20 (Large), 21, 22 (Small and Large), 37, 62, 65 and 66 were made available to 2020.

We consider that maintaining these transitional periods will provide certainty to customers. Therefore, consistent with our approach in the 2016–17 price determination, we do not propose to make any changes to transitional time periods, unless an analysis of customer impacts indicates that a tariff could be removed earlier without causing significant detriment to customers.

Access to transitional tariffs

The Minister's delegation requires that we consider continuing to allow access to tariffs designated as transitional tariffs in 2013-14 for all customers in regional Queensland.

In the 2013–14 price determination, we decided that all customers should have access to transitional tariffs, subject to individual tariff terms and conditions.²⁸ This decision was made to

²⁸ New customers cannot access tariffs that have been classed as obsolete.

ensure equitable access for all customers. In subsequent price determinations, we noted that we would consider closing access to transitional tariffs to new customers if there was a significant increase in the number of customers accessing transitional tariffs, and thereby an increase in the subsidy paid by taxpayers. In the 2016–17 price determination, we did not find that there had been a significant increase and we continued to allow new customers to access to these tariffs. We propose to undertake a similar assessment as part of the 2017–18 price determination.

Escalating transitional and obsolete tariffs

Transitional and obsolete tariff charges, unlike other retail tariffs, are not determined using the N+R methodology. In previous price determinations, our general approach to setting charges for each transitional or obsolete tariff was to escalate the charges based on the percentage increase in the charges in the standard business tariff that customers would otherwise pay. We then applied an additional escalation factor to the increase to limit the charges for the transitional or obsolete tariff falling further below cost in real terms.²⁹ We propose to set transitional and obsolete tariffs for 2017–18 in accordance with that general approach.

Consultation questions

- **Is there any new information that suggests the overall approach we propose to take for transitional and obsolete tariffs is no longer appropriate?**
- **What other issues should we consider? Please provide supporting evidence where possible.**

6.5 High voltage retail tariffs

Ergon Distribution has begun adjusting its network tariffs in order to comply with the AEMC's revised network pricing rules.³⁰ While this process is separate to the QCA's price determination process and is regulated by the AER, it will have implications for some notified prices as Ergon Distribution intends to phase out its Standard Asset Customer (SAC) Large Demand High Voltage network tariff in 2017–18. This network tariff underpins the notified prices for high voltage customers (retail tariffs 47 and 48).³¹

In setting 2016–17 notified prices, we considered a request from Ergon Distribution to restrict access to retail tariff 47 to existing customers and to use different network tariff(s) as the basis for retail tariff 48. However, we decided to leave retail tariffs 47 and 48 unchanged as the changes were not canvassed in the interim consultation paper. We also considered that any changes to retail tariff 48 should be subject to more extensive consultation, given the potentially significant adverse impacts on some customers.

²⁹ As any given percentage increase in a higher bill will be greater in dollar terms than the same percentage increase in a smaller bill. For example, if a bill of \$1,000 (Bill A) and a bill of \$2,000 (Bill B) both increase by 10 per cent to \$1,100 and \$2,200 respectively, the dollar difference between Bill A and Bill B increases by \$100 from \$1,000 to \$1,100.

³⁰ More information on Ergon Distribution's proposed network tariff reforms is available on its website, <https://www.ergon.com.au/network/network-management>.

³¹ Business - High Voltage General Supply (Demand) (tariff 47) and Business - General Supply (>4 Gigawatt Hours) (Demand) (tariff 48).

In setting 2017-18 notified prices, we will need to consider the basis on which we set notified prices for high voltage customers as the SAC Large Demand High Voltage network tariff will be phased out in 2017-18.

At this stage, Ergon Distribution has proposed that high voltage customers classified as Connection Asset Customers (CACs) would be assigned to the relevant any time demand network tariff (the default option for existing customers), or the relevant seasonal time-of-use demand tariff, based on their connection voltage. Consistent with our approach to SAC retail tariffs, we consider it would be appropriate to introduce new CAC retail tariffs, underpinned by the relevant CAC network tariffs, for new customers.

Given the potentially substantial bill impacts for some existing customers on retail tariffs 47 and 48, we will consider implementing transitional arrangements for these tariffs and closing them to new customers.

Consultation questions

- **Should we introduce new retail tariffs underpinned by the CAC network tariffs?**
- **Should retail tariffs 47 and 48 be closed to new customers?**
- **Should transitional arrangements be implemented for existing customers on retail tariffs 47 and 48?**
- **Are there any other issues that we should consider in relation to retail tariffs 47 and 48?**

ACRONYMS

A

AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
AFMA	Australian Financial Markets Association

C

CAC	Connection Asset Customer
CPI	Consumer price index
c/day	Cents per day
c/kWh	Cents per kilowatt hour

E

Ergon Distribution	Ergon Energy Corporation Limited
Ergon Retail	Ergon Energy Queensland Limited
Electricity Act	Electricity Act 1994 (Qld)

I

ICC	Individually Calculated Customer
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K

kVa	Kilovolt ampere
kWh	Kilowatt hour

L

LGC	Large-scale Generation Certificate
LRET	Large-scale Renewable Energy Target
LRMC	Long-run marginal cost

M

MWh	Megawatt hour
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N

N	Network
N+R	Network plus retail cost build-up methodology
NEM	National Electricity Market
Notified prices	Regulated retail electricity prices

Q

QCA	Queensland Competition Authority
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R

R	Retail
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RET Renewable Energy Target

S

SAC Standard Asset Customer

SRES Small-scale Renewable Energy Scheme

STC Small-scale Technology Certificate

STOUD Seasonal time-of-use demand

STP Small-scale technology percentage

U

UTP Uniform Tariff Policy

APPENDIX A: MINISTERIAL DELEGATION



The Honourable Mark Bailey MP
Minister for Main Roads, Road Safety and Ports
Minister for Energy, Biofuels and Water Supply

Our Reference: CLLO-CIC-16063

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Website www.dews.qld.gov.au

10 NOV 2016

Professor Roy Green
Chair
Queensland Competition Authority
Level 27, 145 Ann Street
BRISBANE OLD 4000

Dear Professor ^{Roy,} Green

Re: Determination of Regulated Retail Electricity Prices for 2017–18

I write to you to issue a Delegation and Terms of Reference to the Queensland Competition Authority (QCA) for the determination of regulated retail electricity prices in regional Queensland for 2017–18 under section 90AA(1) of the *Electricity Act 1994*.

The attached Delegation and Terms of Reference for 2017–18 are consistent with the approach taken in my Delegation and Terms of Reference for 2016–17. The Government's Uniform Tariff Policy and promoting greater levels of retail competition remain important considerations when setting regulated retail electricity prices in regional Queensland.

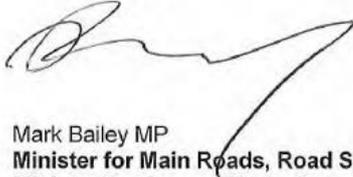
The Government remains committed to ensuring regional customers have access to reliable electricity supply at affordable prices. We are also proactively working with the business and agricultural sectors to help identify ways to assist small and large businesses to manage their electricity consumption and costs.

The deregulation of retail electricity prices for small customers in South East Queensland (SEQ) on 1 July 2016 removed a reference point for the determination of prices in regional Queensland. To maintain consistency with the regulation of prices in previous years, the Government considers that regulated prices for small customers in regional Queensland should continue to broadly reflect the expected prices for small customers on standing offers in SEQ.

Public consultation is a vital part of the QCA's process for determining retail electricity prices. As such, the Terms of Reference requires the Draft Determination to be issued in February 2017.

I trust this provides sufficient time to undertake the necessary consultation to support the Draft Determination and to allow for delivery of the Final Determination by 31 May 2017.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Mark Bailey', written over a horizontal line.

Mark Bailey MP
**Minister for Main Roads, Road Safety and Ports and
Minister for Energy, Biofuels and Water Supply**

Att: Delegation and Terms of Reference – Determination of Regulated Retail Electricity Prices for 2017-18

ELECTRICITY ACT 1994
Section 90AA(1)

DELEGATION

I, Mark Bailey, the Minister for Energy, Biofuels and Water Supply, in accordance with the power of delegation in section 90AA(1) of the *Electricity Act 1994* (the Act), delegate to the Queensland Competition Authority (QCA) the function under section 90(1) of the Act of deciding the prices that a retail entity may charge its standard contract customers for customer retail services in the Ergon Energy Corporation Limited (EECL) distribution area for the tariff year 1 July 2017 to 30 June 2018.

The following are the Terms of Reference of the price determination:

Terms of Reference

1. These Terms of Reference apply for the tariff year 1 July 2017 to 30 June 2018.
2. The QCA is to calculate the notified prices and publish an annual price determination, in the form of a tariff schedule, in accordance with these Terms of Reference.
3. In accordance with section 90(5)(a) of the Act, in making a price determination for each tariff year QCA must have regard to the matters set out in paragraph 5 of these Terms of Reference.
4. In accordance with section 90(5)(b) of the Act, QCA may have regard to any other matter that QCA considers relevant.
5. The matters that QCA is required by this delegation to consider are:
 - (a) On 1 July 2016, price regulation in the Energex distribution area was removed for small customers. This means that notified prices only apply to customers in the EECL distribution area;
 - (b) Uniform Tariff Policy - QCA must consider the Government's Uniform Tariff Policy, which provides that, wherever possible, small standard retail contract customers and large non-market customers of the same class should pay no more for their electricity, regardless of their geographic location;
 - (c) Framework - QCA must use the Network (N) plus Retail (R) cost build-up methodology when working out the notified prices and making the price determination, where N (network cost) is treated as a pass-through and R (energy and retail cost) is determined by QCA;

DELEGATION TO QCA

- (d) When determining the N components for each regulated retail tariff, QCA must consider the following:
 - (i) For residential and small business customer tariffs (with the exception of Tariffs 12A, 14, 22A and 24) - basing the network cost component on the network charges to be levied by Energex and the relevant Energex tariff structures;
 - (ii) For Tariff 12A (residential time-of-use), Tariff 14 (residential seasonal time-of-use), Tariff 22A (small business time-of-use) and Tariff 24 (business seasonal time-of-use demand) - basing the network cost component on the price level of network charges to be levied by Energex, but utilising the relevant EECL tariff structures, in order to strengthen or enhance the underlying network price signals and encourage customers to switch to time-of-use and demand tariffs and reduce their energy consumption during peak times; and
 - (iii) For large business customers in who consume 100MWh or more per annum - basing the network cost component on the network charges to be levied by EECL.
- (e) Transitional Arrangements - QCA must consider:
 - (i) maintaining transitional arrangements for tariffs classed as transitional or obsolete (i.e. farming, irrigation, declining block, non-domestic heating and large business customer tariffs), and
 - (ii) continuing to allow all EECL customers access to tariffs designated as transitional in 2013–14.

Interim Consultation Paper

6. QCA must publish an interim consultation paper identifying key issues to be considered when calculating the N and R components of each regulated retail electricity tariff and transitioning relevant retail tariffs.
7. QCA must publish a written notice inviting submissions about the interim consultation paper. The notice must state a period during which anyone can make written submissions to QCA about issues relevant to the price determination.
8. QCA must consider any submissions received within the consultation period and make them available to the public, subject to normal confidentiality considerations.

DELEGATION TO QCA

Consultation Timetable

9. QCA must publish an annual consultation timetable within two weeks after submissions on the interim consultation paper are due, which can be revised at the discretion of QCA, detailing any proposed additional public papers and workshops that QCA considers would assist the consultation process.

Workshops and additional consultation

10. As part of the interim consultation paper and in consideration of submissions in response to the interim consultation paper the QCA must consider the merits of additional public consultation (workshops and papers) on identified key issues.

Draft Price Determination

11. QCA must investigate and publish its draft price determination on regulated retail electricity tariffs, with each tariff to be presented as a bundled price.
12. QCA must publish a written notice inviting submissions about the draft price determination. The notice must state a period during which anyone can make written submissions to QCA about issues relevant to the draft price determination.
13. QCA must consider any submissions received within the consultation period and make them available to the public, subject to normal confidentiality considerations.

Final Price Determination

14. QCA must investigate and publish its final price determination on regulated retail electricity tariffs, with each tariff to be presented as a bundled price, and gazette the bundled retail tariffs.

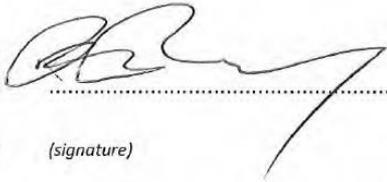
Timing

15. QCA must make its reports available to the public and, at a minimum, publicly release the papers and price determinations listed in paragraphs 6 to 14.
16. QCA must publish the interim consultation paper for the 2017–18 tariff year no later than one month after the date of this Delegation.
17. QCA must publish the draft price determination on regulated retail electricity tariffs in February 2017.
18. QCA must publish the final price determination on regulated retail electricity tariffs for the 2017–18 tariff year, and have the bundled retail tariffs gazetted, no later than 31 May 2017.

DELEGATION TO QCA

DATED this 16th day of November 2016.

SIGNED by the Honourable
Mark Bailey,
Minister for Energy, Biofuels and
Water Supply

) 
)
) (signature)

APPENDIX B: COMPARISON OF NETWORK TARIFF STRUCTURES

Table 1 Energex and Ergon Distribution residential and small business customer time-of-use and demand tariffs

<i>Distributor</i>		<i>Peak</i>	<i>Shoulder</i>	<i>Off-peak</i>
Residential (time-of-use)				
Energex	Usage	4 pm–8 pm weekdays (weekdays include government specified public holidays)	7 am–4 pm, 8 pm–10 pm weekdays (weekdays include government specified public holidays) 7 am–10 pm weekends	10 pm–7 am every day
Ergon Distribution (retail tariff 12A)	Usage	3 pm–9:30 pm any day of the week, summer ^a only		All other times
Residential (time-of-use and demand)				
Energex (introduced on 1 July 2016)	Usage	Flat usage charge		
	Demand	4 pm–8 pm workdays (workdays are weekdays but exclude government specified public holidays)		
Ergon Distribution (retail tariff 14)	Usage	Flat usage charge		
	Demand	3pm–9:30 pm any day of the week, summer ^a months only		3 pm–9:30 pm any day of the week, non-summer ^a months
Small business (time-of-use)				
Energex	Usage	7 am–9 pm, weekdays (weekdays include government specified public holidays)		All other times
Ergon Distribution (retail tariff 22A)	Usage	10 am–8 pm on summer ^a weekdays		All other times
Small business (time-of-use and demand)				
Energex (to be introduced on 1 July 2017)	Usage	Flat usage charge		
	Demand	9 am–9 pm workdays (workdays are weekdays but exclude government specified public holidays)		
Ergon Distribution (retail tariff 24)	Usage	Flat usage charge		
	Demand	10am- 8pm on summer ^a weekdays		10 am- 8 pm weekdays in non-summer ^a months

^a Summer months are December, January and February.

Table 2 Energen and Ergon Distribution non time-of-use tariffs

<i>Type</i>	<i>Distributor</i>	<i>Fixed</i>	<i>Usage</i>		
Residential (tariff 11)	Energen	c/day	Flat rate c/kWh		
	Ergon Distribution	c/day	c/kWh 1st 1,000 kWh/year	c/kWh next 5,000 kWh/year	c/kWh >6,000 kWh/year
Small business (tariff 20)	Energen	c/day	Flat rate c/kWh		
	Ergon Distribution	c/day	c/kWh 1st 1,000 kWh/year	c/kWh next 19,000 kWh/year	c/kWh >20,000 kWh/year
Small business demand (tariff 41)	Energen	c/day	Flat rate c/kWh	\$/kVa/month	
	Ergon Distribution	No network tariff			
Night controlled load (tariff 31)	Energen	n/a	Flat rate c/kWh		
	Ergon Distribution	c/day	Flat rate c/kWh		
Controlled load (tariff 33)	Energen	n/a	Flat rate c/kWh		
	Ergon Distribution	c/day	Flat rate c/kWh		
Unmetered (tariff 91)	Energen	n/a	Flat rate c/kWh		
	Ergon Distribution	c/day	Flat rate c/kWh		