The Allen Consulting Group

South Australian Gas Standing Contract Prices — Price Path Review and Inquiry

Benchmarking analysis

March 2008

Report to the Essential Services Commission of South Australia

The Allen Consulting Group

The Allen Consulting Group Pty Ltd

ACN 007 061 930, ABN 52 007 061 930

Melbourne

Level 9, 60 Collins St

Melbourne VIC 3000

Telephone: (61-3) 8650 6000

Facsimile: (61-3) 9654 6363

Sydney

Level 12, 210 George St

Sydney NSW 2000

Telephone: (61-2) 8272 5100

Facsimile: (61-2) 9247 2455

Canberra

Empire Chambers, Level 2, 1-13 University Ave

Canberra ACT 2600

GPO Box 418, Canberra ACT 2601

Telephone: (61-2) 6204 6500

Facsimile: (61-2) 6230 0149

Perth

Level 21, 44 St George's Tce

Perth WA 6000

Telephone: (61-8) 6211 0900

Facsimile: (61-8) 9221 9922

Brisbane

Level 9, 379 Queen St

Brisbane QLD 4000

PO Box 7034 Riverside Centre, Brisbane QLD 4001

Telephone: (61-7) 3016 3500

Facsimile: (61-7) 3221 7255

Online

Email: info@allenconsult.com.au

Website: www.allenconsult.com.au

Disclaimer:

While The Allen Consulting Group endeavours to provide reliable analysis and believes the material it presents is accurate, it will not be liable for any claim by any party acting on such information.

© The Allen Consulting Group 2008

Contents

Chapter 1 1
Overview *1*

Chapter 2 3
Electricity retail operating costs and margins *3*
- 2.1 New South Wales (Regulated electricity retail tariffs and charges for small customers 2007 to 2010) 3
- 2.2 New South Wales (Regulated electricity retail tariffs and charges for small customers 2004 to 2007) 5
- 2.3 Queensland (Electricity Benchmark Retail Cost Index (BRCI) for 2008-09) - Draft 6
- 2.4 Queensland (Electricity Benchmark Retail Cost Index (BRCI) for 2007-08) 7
- 2.5 South Australia (2008-10 Retail Electricity Price Path) 9
- 2.6 South Australia (2005-07 Retail Electricity Price Path) 10
- 2.7 Victoria (Electricity and Gas Standing Offers and Deemed Contracts 2004-07) / CRA Report to the Australian Energy Market Commission 2007 12
- 2.8 Victoria (Electricity and Gas Standing Offers and Deemed Contracts 2003) 13
- 2.9 Australian Capital Territory (2007-08 Electricity Price Determination) 14
- 2.10 Australian Capital Territory (2003-06 Electricity Price Determination) 16
- 2.11 Tasmania (2008-10 electricity price determination) 17
- 2.12 Tasmania (2004-07 electricity price determination) 18

Chapter 3 19
Gas retail operating costs and margins *19*
- 3.1 South Australia (2005-06 – 2007-08 gas price determination) 19
- 3.2 New South Wales (2007-2010) 20
- 3.3 New South Wales 2004-2007 21
- 3.4 New South Wales 2001-2003 22
- 3.5 Victoria 23
- 3.6 CRA Report to the Australian Energy Market Commission 2007 23
- 3.7 CRA report to the Victorian Government on Electricity and Gas Standing Offers and Deemed Contracts (2003) 24
- 3.8 Other States 26

Chapter 4 27
Summary of decisions *27*

Bibliography 31

Chapter 1

Overview

The purpose of this note is to describe the decisions that other economic regulators or relevant consultants' reports have made in relation to energy retail operating costs and energy retail margins. This information is intended to assist the Commission to determine an appropriate allowance for retail operating costs and margin when determining Origin Energy's standing contract prices for its South Australian gas customers.

Comparing the respective decisions, the following broad observations can be made.

- There have been few decisions on regulated retail prices for gas customers. However, it has been common (for example, by NERA (2004) in a report to IPART and CRA (2007) in a report to the AEMC) to assume that the retail operating cost (on a per customer basis) for a gas retailer are the same as for an electricity retailer.
- There is little new information contained in many regulatory decisions, as it has been common for one regulator simply to apply the decision of preceding decisions, and adjustments to other regulatory decisions that have been made in some regulatory decisions – such as for the relative scale of the retailer – have not (at least to our knowledge) been justified by empirical information.
  - The regulators that have made decisions based largely on an examination of the costs incurred by a retailer are ESCOSA and IPART, with the latter decision being subsequently followed by other regulators.
  - IPART's most recent decision a range of between $60-$80 per customer in 2006/07 (and a preferred value for a new entrant of $75 per customer), or between $55-$75 (and a preferred value of $70 per customer) if customer acquisition activities are excluded.
- There is some disagreement between regulators (and their advisers) about how retail operating costs would be expected to increase over time (putting aside the effects of scale – discussed separately below).
  - IPART has assumed that retail operating costs increase with the CPI and that any tendency for input prices (such as wages) to increase at a faster rate will be offset by productivity gains.
  - QCA (and CRA) have assumed that labour-related retail operating costs will rise by wages growth and other costs will increase with CPI.
- The appropriate treatment of customer acquisition costs has been a central feature of recent regulatory decisions.
  - In its most recent decision, IPART was required to determine prices with respect to the cost of a new entrant, which IPART assumed would have to acquire all of its customers. It estimated the total acquisition cost as $200 per customer, and provided an annualised allowance (assuming customer lives of 6 and 8 years for commercial and industrial customers) of $35 per customer per annum.

- The QCA in its recent draft decision provided an allowance for the cost that a retailer would incur to maintain scale. It commenced with IPART's estimate of the total acquisition cost, and multiplied the upfront cost by the assumed churn rate to derive the amount that would need to be spent annually to acquire sufficient customers to maintain scale.
- In the QCA's previous decision, it attempted to provide an allowance to compensate the retailer for the increase in expenses expected to arise from the loss of customers if it undertakes no acquisition. It quantified this loss at $2 per customer based on ESCOSA's decision (although its subsequent draft decision accepts that this allowance was too low).

- The retail margin provided in the more recent regulatory decisions has converged on 5 per cent (measured as EBITDA as a proportion of revenue). However, there is some disagreement as to what is covered by that margin.
  - In IPART's most recent review, the margin is not intended to provide a return on intangible assets (i.e. acquired customers). If the allowance for the cost of acquiring customers was included in the margin, then the margin would rise to almost 9 per cent.
  - In contrast, ESCOSA's bottom-up calculation of the retail margin in its recent electricity review is understood to have assigned a value to all customers, but nevertheless was equal to a 5 per cent margin (EBITDA/revenue).

Chapter 2

Electricity retail operating costs and margins

2.1 New South Wales (Regulated electricity retail tariffs and charges for small customers 2007 to 2010)

The relevant legislation required IPART to develop allowances for retail operating costs and retail margins based on the hypothetical retail operating costs and retail margin of a mass market new entrant rather than a standard retailer who supplies regulated customers. As a mass market new entrant by definition has no customers, the allowance was required to include the cost of acquiring new customers.

IPART's final findings on allowances for retail costs and retail margin are provided in Table 2.1.

Table 2.1

NSW RETAIL COSTS AND RETAIL MARGINS – 2007-08 – 2009-10

Description	Allowance
All retailers	
Retail operating costs ($2006-07 $/customer)	$75
Customer acquisition costs ($2006-07 $/customer)	$35
Adjustment for double counting ($2006-07 $/customer)	-$5
Retail cost allowance ($2006-07 $/customer)	**$105**
Escalation over the regulatory period	CPI
Retail Margin (EBITDA)	**5%**

Source: IPART 2007a

Retail operating costs

Base allowance

IPART decision about retail operating costs was developed using cost information provided by the Standard Retailers as a proxy for mass market new entrant costs and benchmarking against regulatory decisions in other jurisdictions. This gave a range of $60-$80 per customer. IPART decided that the retail operating cost of a mass market retailer without access to the economies of scale and scope from a combined retail/distribution business would be towards the top end of this range, which it decided was $75 per customer. IPART noted that the final allowance of $75 per customer was lower than that used in a number of other regulatory decisions, but also noted the limited data in the public domain against which the Standard Retailers' costs could be compared (IPART 2007a, 95-96).

IPART decided that there would be 'double-counting' of $5 per customer if the retail allowance discussed above and the separate allowance for customer acquisition costs discussed below were applied simultaneously. IPART's decision was as follows:

> Having reviewed the reported costs for each category at a disaggregated level and the other information available to it, the Tribunal has decided to reduce the retail cost allowance by $5 to account for costs that have been included in both the retail operating cost and customer acquisition cost allowances. (IPART 2007a, 107)

If it is assumed that IPART's estimate of the cost of acquiring new customers includes the full cost of these activities (which is implied by IPART's discussion), then IPART's adjustment can be interpreted as implying that the standard retailers' reported operating expenses included approximately $5 per customer for customer acquisition costs, and that the appropriate allowance for operating costs excluding all customer acquisition costs required the removal of this $5 per customer, leaving its preferred allowance of $70 per customer (from a range of $55-$75).

Escalation

IPART decided that the allowance should be constant in real terms over the determination period. IPART decided that the pressure for cost reductions arising from technological change and productivity improvements would be expected to offset the effects of rising real wages over the period (IPART 2007a, 99).

Customer acquisition costs

IPART included a significant allowance for customer acquisition costs on the basis that a mass market new entrant by definition does not have any customers and must incur costs to acquire them. Frontier Economics in its report to IPART, estimated the cost of acquiring customers to be around $200 per customer ($2006/07). Around 1/3 of costs are relate to direct acquisition and around 2/3 to customer transfer. A summary of cost categories is provided in Box 2.1.

Box 2.1

CUSTOMER ACQUISITION COSTS

- Door to door/ commission/ agent cost per sale
- Sales overheads;
- Credit checking;
- Communications/ stationery/ information booklets/ confirmation packs;
- Data processing/ customer transfers/ registration
- Postage
- Telecommunication costs (1300 numbers, etc) per sale – inbound/ outbound telesales.

Source: IPART 2007, 101

IPART decided to compensate for the cost of customer acquisition by converting the upfront cost into an annualised allowance, assuming that residential customers would stay with a retailer for 8 years and business customers for 6 years. The average allowance over all customers was $35 per customer per annum.

Retail margin

IPART determined that a MMNE retail margin (defined as EBITDA) of 5 per cent of sales should be used to set regulated tariffs. This is the mid point of the range recommended by Frontier Economics based on its expected returns analysis and bottom up methodologies in its report to IPART. Consistent with the discussion above, this margin did not include any allowance for customer acquisition (or, equivalently, any return on the stock of customers). If the allowance for acquisition costs was included instead in the margin, then the margin would have been approximately 8.7 per cent (i.e. almost 4 percentage points higher).

2.2 New South Wales (Regulated electricity retail tariffs and charges for small customers 2004 to 2007)

Table 2.2

NSW RETAIL COSTS AND RETAIL MARGINS 2004-05 – 2006-07

Description	Allowance
All retailers	
Retail operating costs ($2004-05, $/customer)	$70
Customer acquisition costs ($2004-05, $/customer)	-
Total retail operating cost ($2004-05, $/customer)	**$70**
Escalation	CPI
Retail Margin (EBITDA)	**5%**

Source: IPART 2004

Retail operating costs

Base allowance

In its determination for the period 2004-2007, IPART adopted a starting benchmark retail operating cost of $70 per customer for all retailers. This figure was based on an analysis of retailers' actual operating costs and benchmarks from other jurisdictions.

Escalation

The allowance implicitly was escalated for CPI over the regulatory period.

Customer acquisition costs

No allowance was made for customer acquisition costs.

Retail margin

IPART allowed a retail net profit margin of 2 per cent (EBIT). This was lower than the margin allowed in other states. IPART justified this on the basis that the Electricity Tariff Equalisation Fund (ETEF), allows retailers to purchase electricity for regulated customers at a fixed price, thereby eliminating most of the energy purchase price risk, does not operate in other states (IPART, 2004, 42-44).

2.3 Queensland (Electricity Benchmark Retail Cost Index (BRCI) for 2008-09) - Draft

The QCA's determination of retail operating costs reflects the likely cost of providing customer retail services to Queensland customers connected to the national grid, based on an efficient retailer carrying on an electricity retail business. It is assumed that the retailer is operating separate from any other business (that is, the business is a standalone Queensland retailer); has a significant market share of the State's electricity retail business; provides customer retail services to a cross-section of customers throughout the State; and earns a reasonable retail margin (QCA, 2007, 19-20).

Table 2.3

QUEENSLAND RETAIL COSTS AND RETAIL MARGINS 2008-09

Description	Allowance
All retailers	
Retail operating costs ($2008-09, $/customer)	$80.57
Customer acquisition costs ($2008-09, $/customer)	$18
Total retail operating cost ($2008-09, $/customer)	**$98.57**
Escalation	Wage inflation applied to 60% of cost base and CPI applied to 40% of cost base (3.65 per cent)
Retail Margin (EBITDA)	**5%**

Source: QCA 2008

Retail operating costs

Base allowance

QCA's draft determination proposes to set the retail operating cost allowance at $80.57 per customer (excluding customer acquisition costs). This allowance was calculated by commencing with IPART's estimate of $75 per customer for 2006/07 and escalating for wages growth and CPI inflation as discussed below.

QCA's consultants, CRA, noted that the IPART decision drew upon actual cost information. In discussing the other benchmarks, they argued that little weight should be placed on the cost benchmarks that were established early in the period of energy retail regulation given that they were based on very little information (CRA 2008, 54).

Escalation

The QCA decided that operating costs per customer would grow in line with the growth input prices. Labour costs (accounting for 60 per cent of the cost base) were forecast to grow in line with forecasts of wages growth (4.25 per cent) and the remainder was forecast to grow in line with CPI forecasts (2.75 per cent).

Customer acquisition costs

The QCA interpreted IPART as making an annualised allowance for customer acquisition costs of $30 per customer (the $35 annual cost less the $5 'double counting' adjustment). It then concluded that this meant that the implied up-front cost of customer acquisition is $171 per customer ($200*30/35) in $2006/07.[1] It decided that it was appropriate to make an allowance that reflected the cost of acquiring (or retaining) the customers forecast to be lost through switching. It calculated that an allowance of $18.00 per customer would be required in 2008/09 (and that $28.47 per customer should have been allowed in 2007/08). It concluded that if a retailer merely permitted customers to churn and did not attempt to attract them that the retailer would quickly lose scale and costs would rise substantially – which is not a realistic assumption.

It noted that the allowance for customer acquisition and retention may overstate the cost for an incumbent retailer, as it is less costly for it to target its existing customers, and transfers of existing customers have little in the way of administrative costs.

It is noted that the QCA's draft decision incorporated two changes of approach since its previous decision, which are:

- to include a substantially higher estimate of effect of loss of scale on per customer operating expenses, and as a result compensating for the cost of customer acquisition rather than for the loss of scale; and
- to compensate for the full upfront cost of customer acquisition in the relevant year rather than to include an allowance for the annualised cost of customer acquisition.

Retail margin

Adopted a margin of 5 per cent (EBITDA as a proportion of revenue), following the decisions of IPART and ESCOSA.

2.4 Queensland (Electricity Benchmark Retail Cost Index (BRCI) for 2007-08)

The QCA's determination of retail operating costs reflects the likely cost of providing customer retail services to Queensland customers connected to the national grid, based on an efficient retailer carrying on an electricity retail business. It is assumed that the retailer is operating separate from any other business (that is, the business is a standalone Queensland retailer); has a significant market share of the State's electricity retail business; provides customer retail services to a cross-section of customers throughout the State; and earns a reasonable retail margin (QCA, 2007, 19-20).

The retail operating costs and margins adopted by the QCA are provided in Table 2.4

[1] We do not consider that this is the most sensible interpretation and application of the IPART results. The preferred method would have been to start with a base operating expenditure allowance of $70 per annum (i.e. exclusive of acquisition costs) and then used the full $200 per customer as the full cost of acquiring customers. This method would have resulted in a lower all-up allowance for operating expenses.

Table 2.4

QUEENSLAND RETAIL OPERATING COSTS AND RETAIL MARGINS 2007-08

Description	Allowance
Operating costs ($2007-08, $/ customer)	$77.90
Customer acquisition costs ($2007-08, $/ customer)	$2
Total retail operating cost ($2006-07, $/ customer)	**$79.90**
Escalation	Wage inflation applied to 60% of cost base and CPI applied to 40% of cost base (3.9 per cent)
Retail margin (EBITDA)	**5 per cent**

Source: QCA 2007, Final decision – Advice to the Minister for mines and Energy: Benchmark Retail Cost Index for Electricity: 2006/07-2007-08; QCA 2007, Draft decision – Benchmark Retail Cost Index for Electricity: 2006/07-2007-08.

Retail operating costs

Base allowance

On the basis of analysis of retail costs in other states it was decided that $75 (excluding customer acquisition costs but including an allowance of $10 for full retail contestability costs) was a reasonable estimate of retail costs for a well established and efficient retail business in 2006-07. This gave a figure of $77.90 for 2007-08 (QCA 2007, 21-22).

Customer acquisition costs

QCA also assumed that with full retail contestability, an efficient business would incur customer acquisition and retention costs across its entire customer base. CRA, in its report to QCA considered 2 approaches to dealing with this issue:

- the operating expenditure forecast could include an allowance for the cost that retailer would incur to retain its existing customer base and, therefore, its scale of operation; or
- the forecast of operating costs could reflect the potential cost to the retailer of 'doing nothing' and, as a result, losing customers and its scale of operations.

The cost to a retailer of retaining customers was estimated to be around $3.50 per customer, which reflected:

- IPART's (2007a) estimate of the annualised cost of acquiring a customer of $35 per annum; and
- the assumption that 10 per cent of customers would be expected to churn in any given year, leaving an acquisition cost of $3.50 per customer.

With respect to the loss of scale, it was estimated that the alternative cost to the retailer would be around $2 per customer in 2007-08 based upon ESCOSA's estimate for AGL.

QCA decided to adopt the second approach described above and so included an allowance of $2 per customer to account for the loss of scale associated with customer churn (QCA 2007, 23).

Escalation

QCA assumed that retail costs would grow by 3.9 per cent between 2006-07 and 2007-08, which reflected a combination of its forecast of wages growth (applied to 60 per cent of the cost base) and CPI (applied to the remainder of the cost base).

Retail margins

QCA determined that the appropriate retail margin for a well established and efficient retail business was 5 per cent. As the QCA used IPART's operating expenditure allowance as a starting point (which excluded depreciation and amortisation), this can be interpreted as an EBITDA margin.

Five per cent was seen to be appropriate for Queensland in light of the benchmark margins used in other jurisdictions and the lower risks faced by Queensland retailers due to QCA's proposal to recognise some short run variations in its approach to determining the cost of energy.

2.5 South Australia (2008-10 Retail Electricity Price Path)

ESCOSA is required to develop allowances for retail operating costs and margins for an efficient retailer that is required to provide electricity to a small customer under a standing contract. The final retail operating cost and retail margin allowances are provided in Table 2.5.

Table 2.5

SOUTH AUSTRALIAN RETAIL OPERATING COSTS AND RETAIL MARGINS 2008 – 2010

Description	Allowance
Operating costs ($2008 March, $/ customer)	$93.77 (average 2008-09)
Customer acquisition costs ($2008 March, $/customer)	-
Total retail operating cost ($2008 March, $ per customer)	**$93.77**
Escalation	declining by 4.1 per cent / year over the determination period
Retail margin (EBITDA)	**5 per cent**

Source: ESCOSA 2007, Final Inquiry Report and Price Determination, 2007 Review of Retail Electricity Price Path.

Retail operating costs

Base allowance

ESCOSA set a retail operating cost allowance of $97.27 per customer at the commencement of the price path period. The starting point was arrived at by escalating the allowance set under the previous determination to Q1 of 2008, analysis of actual cost information provided by AGL SA and benchmarking against other regulatory decisions. ESCOSA set quarterly reductions in retail operating costs over the course of the determination period (see escalation). In order to ensure comparability with other decisions we have calculated the base allowance as the average of the quarterly allowances in the first year. Accordingly, the base allowance for the 2008-09 financial year is $93.77.

Escalation

The allowance reduces by 4.1 per cent per year because AGL SA is implementing initiatives which are expected to achieve cost savings and increase productivity. ESCOSA believes that it is appropriate for AGL to share the productivity gains with its customers on a 50:50 basis.

Customer acquisition costs

No special allowance is made for customer acquisition and retention costs. However, as ESCOSA drew heavily on AGL's reported expenditure – which would have included the cost of its customer acquisition activities – some allowance for customer acquisition costs was included (ESCOSA, 2007, A-58-A-59).[2]

Retail Margin

ESCOSA has determined that a margin of 5% of sales revenue (EBITDA) is appropriate. This decision is informed by comparable retail margins allowed by other jurisdictional regulators and analysis of a bottom-up retail margins based on data provided by AGL SA for the 2005-06 financial year.

2.6 South Australia (2005-07 Retail Electricity Price Path)

In its 2005 determination, ESCOSA examined the retail operating cost that would be incurred by a prudent retailer in delivering the range and standard of services required under a standing contract and the actual operating cost that AGL SA incurred in delivering these services.

[2] It is noted that ESCOSA's estimate of the bottom-up margin included a 'return on' and 'return of' the cost of acquiring customers. Hence, to the extent that ESCOSA relied upon its bottom-up calculation, there would have been some double-counting of the allowance for customer acquisition.

Table 2.6

SOUTH AUSTRALIAN RETAIL OPERATING COSTS AND RETAIL MARGINS 2005 – 2007

Description	Allowance
Operating costs ($ December 2004, $/ customer)	$84
Customer acquisition costs ($ December 2004, $/ customer)	-
Total retail operating cost ($ December 2004, $/ customer)	**$84**
Escalation	CPI+2 per cent
Retail margin (EBITDA)	**5 per cent**

Source: ESCOSA 2005, Final Report: Inquiry into Retail Electricity Price Path.

Retail operating cost

Base allowance

The analysis of actual data provided cost estimates that were similar to the benchmarks that had been used in previous determinations. Accordingly, it maintained its benchmark approach. The retail operating cost allowance was set at around $84 per customer (December 2004 dollars).

Escalation

The allowance was allowed to escalate at a rate of CPI + 2 per cent over the determination period to allow for increasing average operating costs per customer remaining with AGL as a result of customer churn (ESCOSA, 2005a, 52-53).

Customer acquisition costs

ESCOSA was careful to remove customer acquisition costs when examining AGL's actual costs. When looking at the benchmarks applied by other regulators at the time, it is important to note that only Victoria and South Australia had introduced full retail contestability at that time. ESCOSA included an allowance for customer acquisition costs in its bottom-up calculation of the retail margin discussed below.

Retail Margin

ESCOSA undertook a return on investment analysis to estimate the necessary retail margin for electricity retailers. ESCOSA attempted to identify the capital in the business, the weighted average cost of capital (WACC), appropriate depreciation/ amortisation allowances. This calculation included a return on, and return of, the value of an acquired customer. That value was set with reference to the cost of purchasing customers.

This provided a retail margin of 5 per cent of sales (EBITDA) or 10 per cent of retail operating costs + WACC (ESCOSA, 2005a, 55-57).

2.7 Victoria (Electricity and Gas Standing Offers and Deemed Contracts 2004-07) / CRA Report to the Australian Energy Market Commission 2007

The CRA analysis for the electricity and gas standing offers and deemed contracts for 2004-2007 is not publicly available and therefore cannot be reviewed. However, CRA's 2007 study for the Australian Energy Market Commission of the impact of prices and profit margins on energy retail competition in Victoria provided an estimate of retail operating costs and margins.

Table 2.7
VICTORIAN RETAIL OPERATING COSTS AND RETAIL MARGINES 2004 - 2007

Description	Allowance
Operating costs ($2006-07, $/ customer)	$75
Customer acquisition costs ($2006-07, $/ customer)	$49
Total retail operating cost (2006-07, $/ customer)	**$124**
Escalation	-
Retail margin (EBITDA)	**1-13 per cent**

Source: CRA 2007, Impact of prices and profit margins on energy retail competition in Victoria, report to the Australian Energy Market Commission, 8 November 2007. Note: the margin is the actual margin, not CRA's view of the appropriate margin.

Retail operating costs

Base allowance

CRA derived estimates of retail operating costs in Victoria by benchmarking against other jurisdictions and considering which of the estimates was likely to be most applicable in the Victorian context. It concluded that IPART's 2007 determination of $75 per customer per year (excluding customer acquisition costs) was applicable to Victoria because:

- the retailer considered by IPART is one that has achieved scale (around 900 000 customers) in a jurisdiction outside NSW. That Jurisdiction is likely to be Victoria, thus the characteristics of the retailer considered by IPART are likely to be similar to those of the Victorian market; and
- the MMNE retailer considered by IPART is not one that is affiliated with a distribution business, which matches the Victorian retailers' position.

Escalation

CRA was not explicit about the rate of escalation it adopted for retail operating costs, although its views are reflected in the QCA decisions summarised above.

Customer acquisition costs

Customer acquisition costs were assessed by applying (approximately) the methodology developed by IPART.[3] Customer acquisition cost estimates provided by retailers were amortised on a straight-line basis across the expected life for residential and small business customers based on NEMCO's churn statistics of 3 and 4 years respectively. This gave a weighted average of $49 per customer per year.

Retail margin

CRA calculated the actual net margins for Victorian electricity retailers at between 1 and 13 per cent in the 2004-07 period. It did not offer any advice on what an appropriate margin should be.

2.8 Victoria (Electricity and Gas Standing Offers and Deemed Contracts 2003)

There is no public information about the retail margin set by the Victorian Government for either its 2003, 2004 or 2007 regulated tariff determinations. CRA provided a report to the Victorian Government as an input to the 2003 and 2004 decisions, but the decisions themselves remain confidential (ESCOSA, 2007, A-64).

Table 2.8

VICTORIAN RETAIL OPERATING COSTS AND RETAIL MARGINS 2003

Description	Allowance
Operating costs ($2003, $/ customer)	$67 ($90 actually used)
Customer acquisition costs ($2003, $/ customer)	-
Total retail operating cost (2006-07, $/ customer)	**$67 ($90 actually used)**
Escalation	CPI
Retail margin (EBITDA)	**5-8 per cent**

Source: CRA 2002, Electricity and Gas Standing Offers and Deemed Contracts (2003), Report to the Victorian Department of Natural Resources and Environment, December 2002.

Retail operating costs

Base allowance

CRA in its 2002 report to the Victorian Department of Natural Resources and Environment, *Electricity and Gas Standing Offers and Deemed Contracts (2003)* applied a figure of $90 per customer. The rationale for using this figure is somewhat complex.

[3] It is noted that IPART set a constant (real) annual allowance for customer acquisition costs, whereas CRA assumed straight line depreciation.

The ORG's mean benchmark for operating costs for 2002 of $65 per customer (the mid-point of $50 and $80 gives a basis on which to estimate retail operating costs for 2003. This benchmark includes an allowance for the reasonable costs that are likely to be incurred by retailers as a result of FRC. For 2003, a figure of $67 per customer could then be used – a rise of 3.1% o allow for inflation.

However, the ORG's investigation of retail pricing in December 2001 reported that several retailers were claiming that their operating costs were significantly higher than the benchmark, and no satisfactory explanation for this discrepancy was apparent. In the absence of a more robust benchmarking calculation, there may be too much risk to adopt the figure of $67 that does not have industry support. Therefore, this analysis is using a figure of $90 per customer; on the basis that this is a much closer approximation to the retailers' views of what their retailer operating costs are and that should be recovered from standing offer customers. This figure is being used in the absence of any recent research concerning retail operating costs in Victoria, an readers of this report should not take this to constitute a new benchmark figure (CRA 2003, 25).

Escalation

The base allowance represented a CPI based increase on the previous year.

Customer acquisition costs

There was no discussion of customer acquisition costs.

Retail Margin

CRA recommended allowing a retail net margin of between 5 and 8 percent in 2003 in order to promote more effective competition and allow more customers to experience the benefits of competition. This was consistent with the Victorian Essential Services Commission's view that broadening the reach of competitive activity could be achieved in future by relaxing the standing offer tariff arrangements to provide more 'headroom' for competition to determining market prices below the safety net price cap' (CRA 2002, 27).

2.9 Australian Capital Territory (2007-08 Electricity Price Determination)

The ACT Government decision on retail electricity prices is based on an estimate of the economically efficient cost base of an incumbent electricity retailer providing retail electricity supply services to a regulated customer segment. Table 2.9 provides a summary of the ICRC determination on retail operating costs and retail margins for 2007-08.

Table 2.9

ACT RETAIL OPERATING COSTS AND RETAIL MARGINS 2007-08

Description	Allowance
Operating costs ($2007-08, $/ customer)	$94.91
Customer acquisition costs ($2007-08, $/ customer)	-
Total retail operating cost	**$94.91**
Escalation	CPI
Retail margin	**4 per cent**

Source: ICRC 2007, Final Decision and Price Direction: Retail Prices for Non-contestable Electricity Customers, June 2007.

Retail operating cost

Base allowance

ICRC decided on a retail operating cost allowance of $94.91 per customer for the 2007–08 financial year. This figure was developed by through the application of a CPI inflation adjustment to the $85.00 per customer allowance developed in 2003-04 combined with benchmarking against regulatory decisions in other states (ICRC 2007, 38).

Escalation

Costs from prior years were assumed to increase with CPI inflation.

Customer acquisition costs

ICRC decided not to allow any explicit recovery of customer acquisition and retention costs into its benchmark cost base because this would have a negative social impact in terms of the additional cost passed on to customers. It believes that this social imperative outweighs the need for further reduction of barriers to entry. ICRC also determined that such costs are likely to be low on a per customer basis anyway and could be argued to be covered by the CPI allowance for retail operating costs (ICRC 2007 39).

Retail Margin

ICRC has set the retail margin for 2007-08 at 4 per cent. This is an increase of 1 per cent on previous years. ICRC believes this figure sufficient in the context of its other decisions on electricity purchase and other costs, and when these costs are compared to those in other jurisdictions on a like-for-like basis. ICRC explained its decision as follows:

> … the retail margin provides a return to the regulated retail entity, among other things to compensate it for the risks it bears in aggregating an uncertain retail load and purchasing this load in a wholesale electricity pool (albeit using hedging strategies to mitigate such risks to the greatest extent possible). The Commission believes that the wholesale electricity market is displaying a change in price volatility which reflects into the price and availability of hedging contracts that would justify a re-rating of the risks experienced by retailers and hence an increase in the retail margin allowed. The increased volatility also increases the costs to the retailer as it must secure additional working capital (which comes at a financing cost) to finance variations away from its contracted position. This is described in the Frontier Economics report prepared for IPART. Unlike the approach adopted by IPART in its draft determination, the Commission prefers to increase the retail margin rather than to add a volatility premium to the electricity purchase cost.

2.10 Australian Capital Territory (2003-06 Electricity Price Determination)

Table 2.10

ACT RETAIL OPERATING COSTS AND RETAIL MARGINS 2003-04 - 2005-06

Description	Allowance
Operating costs ($2003, $/ customer)	$85
Customer acquisition costs ($2003, $/ customer)	-
Total retail operating cost ($2003, $/ customer)	**$85**
Escalation	Escalation at CPI is implicit in the quotation of base year prices
Retail margin	**3 per cent**

Source: ICRC 2003, Final Determination: Investigation into Retail Prices for Non-Contestable Electricity Customers in the ACT, May 2003.

Retail operating cost

Base allowance

The ICRC set a retail operating cost allowance of $85 per customer (including full retail contestability costs) for 2003-06. This figure was derived by benchmarking against comparable decisions in NSW, Victoria and South Australia and adjusting for local conditions. The allowance was higher than that set in other jurisdictions to account for diseconomies of scale in the ACT (ICRC 2003, 21-22).[4]

Escalation

Future escalation at CPI is implicit in the use of a CPI-based price cap.

Customer acquisition costs

No explicit allowance was made for customer acquisition costs.

Retail margin

The retail margin in the ACT was set at 3 per cent of sales. This figure was lower than that in comparable markets due to lower risks facing standard retailers in the ACT relative to other jurisdictions (ICRC 2003, 23).

[4] It is noted that no empirical work to substantiate its view that its retailer was below the minimum efficient scale, nor of the relationship between long term per customer cost and size, was considered

2.11 Tasmania (2008-10 electricity price determination)

The Office of the Tasmanian Energy Regulator (OTTER) adopted a benchmarking approach to setting retail operating costs and retail margins. A summary is provided in Table 2.11

Table 2.11
TASMANIAN RETAIL OPERATING COSTS AND RETAIL MARGINS JAN 2008 – JUNE 2012

Description	Allowance
Operating costs ($ June 2006, $/ customer, June 2006 Dollars)	$85
Customer acquisition costs ($ June 2006, $/customer)	-
Total retail operating cost (June 2006, $/ customer (excl depreciation)	**$85**
Escalation	CPI
Retail margin	**3 per cent**

Source: Office of the Tasmanian Energy Regulator (OTTER) 2007, 2007 Electricity Pricing Investigation – Final report.

Retail operating cost

Base allowance

OTTER set a retail operating cost allowance of $85 (June 2006 dollars) per customer per annum (excluding depreciation) for the period 2008-2010. This figure is consistent with the allowance set by the ICRC in the ACT, which most closely reflects the conditions in the Tasmanian market (OTTER 2007, 285).

Escalation

The retail operating cost was assumed to escalate at the rate of the CPI.

Customer acquisition costs

No explicit allowance was made for customer acquisition costs (although it is noted that full retail contestability has not commenced in Tasmania as yet).

Retail Margin

The Tasmanian retail margin net EBITDA has been set at 3 per cent of sales. This figure was developed using a combination of a simple return on investment analysis and benchmarking against other states. It is lower than the net retail margins on total costs recently set in other jurisdictions, which have been between 4 and 5 per cent. OTTER argued that the context in which those margins were set is different to that in Tasmania. Regulators in other jurisdictions set margins for the purpose of developing standing offer prices for small customers in the context of full retail contestability and in the absence of a regulated energy price for small customers. Aurora is not exposed to the same risks as other retailers operating in a fully contestable market, nor is it exposed to the energy price risk faced by retailers in other jurisdictions. Consequently, OTTER decided that 3 per cent was an adequate margin (OTTER 2007, 295).

2.12 Tasmania (2004-07 electricity price determination)

Table 2.12

TASMANIAN RETAIL OPERATING COSTS AND RETAIL MARGINS 2004 – 2007

Description	Allowance
Operating costs ($ May 2003, $/ customer)	$76.67
Customer acquisition costs ($ May 2003, $/customer)	-
Total retail operating cost ($ May 2003, $/ customer (excl depreciation)	**$76.67**
Escalation	CPI
Retail margin	**3 per cent**

Source: Office of the Tasmanian Energy Regulator (OTTER) 2003, Investigation of Prices for Electricity Distribution Services and Retail Tariffs on Mainland Tasmania: Final Report and Proposed Maximum Prices, September 2003.

Retail operating costs

Base allowance

In its determination for the period 2004-2007, OTTER set an allowance for retail operating costs of $76.67 (May 2003 dollars) per customer per annum (excluding costs for full retail contestability). This was equal to the benchmark set by the ICRC in its 2003 determination (OTTER 2007, 276-277).

Escalation

Escalation occurred in line with the CPI.

Customer acquisition costs

No allowance was made for customer acquisition costs (although it is noted that full retail contestability has not commenced in Tasmania as yet).

Retail margin

The net retail margin was set at 3 per cent for 2004-2007 based on benchmarking against other jurisdictions, particularly the ACT and South Australia. The rate was set at a level below that used in the larger states because the incumbent retailer was not subject to significant contestability or energy price risks (OTTER 2007, 286-287).

Chapter 3

Gas retail operating costs and margins

There is limited information available about the establishment of retail operating cost and retail margin allowances in Australian gas markets. Moreover, there appears to be less consistency between jurisdictions than there is in electricity markets. For example, while South Australia regulates on a similar basis to electricity, NSW has voluntary agreements with retailer, while the ACT and Queensland appear not to regulate retail prices at all.

3.1 South Australia (2005-06 – 2007-08 gas price determination)

As for electricity, ESCOSA sets gas retail costs and margins on the basis of a prudent retailer servicing standard contract customers in South Australia.

Table 3.1

SOUTH AUSTRALIAN GAS RETAIL OPERATING COSTS AND RETAIL MARGINS 2005 - 2008

Description	Allowance
Operating costs ($ December 2005, $/ customer)	$79.70
Customer acquisition costs ($ December 2005, $/ customer)	-
Total retail operating cost ($ December 2005, $/ customer)	**$79.70**
Escalation	CPI+2%. FRC component only escalated at CPI.
Retail margin	**10 per cent of controllable costs**

Source: Essential Services Commission of South Australia (ESCOSA) 2005b, Gas Standing Contract Price Path: Final Inquiry Report and Final Price Determination.

Retail operating costs

Base allowance

In its 2005 review of gas ESCOSA determined that an appropriate retail cost allowance for 2005-06 of $79.70 per customer per year (including $8.30 for operational expenditure on retail contestability). This figure was derived through a benchmarking approach which considered recent regulatory decisions for gas and electricity. Greater emphasis was placed on gas retail operating cost benchmarks rather than electricity because of concerns that electricity cost were likely to be higher as a result of higher trading costs, greater incidence and size of bad debts and greater tendency for customers to use call centres. A lower weight was placed on benchmarks derived from stapled retail/ distribution businesses (ESCOSA 2005b, A-77).

Escalation

Costs were escalated at a rate of CPI + 2 per cent over the determination period to for the ROC account for customer churn away from the primary retailer (ESCOSA, 2005b, A-72, A-80). The operational expenditure component of the ROC was only escalated at the rate of CPI.

Customer acquisition costs

No explicit allowance was made for customer acquisition costs.

Table 3.2

GAS BENCHMARKS CONSIDERED

Regulator	Determination period	Retail Operating cost (nominal)
SA Government	2004-05	$62
Victorian Department of Infrastructure	2004-2007	$81.28 - $86.36
Victorian Essential Service Commission	2003	$40-$65
IPART	2001-2003	$35-55
ICRC	2001	$40-$60

Source: ESCOSA 2005, A-76

In order to ensure maintain consistency in full retail contestability allowances, Origin Energy's FRC costs were assessed separately using the 'actual cost approach' that was applied in setting the 2004/05 standing contract prices (ESCOSA 2005, A-66). This reflects the fact that full retail competition capital costs may vary materially across jurisdictions.

Retail margin

ESCOSA set a retail margin of 10 per cent of controllable costs (ESCOSA 2005b, A-94). This margin was set after consideration of relevant benchmarks. The benchmarks deemed to be relevant included ESCOSA's decision under the 2005-2008 electricity standing contract price determination and the 2004/05 Origin Energy gas retail margin set by the Minster for Energy (ESCOSA 2005b, A-87). Interstate benchmarks were deemed to be less relevant because of the need to account for differences in the operational risks of the companies considered, including differences in regulatory requirements, wholesale energy markets, public v private ownership and customer growth and churn rates (ESCOSA 2005b, A-89-A-90).

3.2 New South Wales (2007-2010)

In NSW, the IPART is responsible for regulating default retail prices gas customers consuming less than 1terajoule per year, or around $15,000 worth, where they have not chosen to enter into a negotiated customer supply contract. Although it has the ability to establish gas pricing orders to regulate tariffs, fees and other charges for small retail customers, it has instead established Voluntary Transitional Pricing Arrangements (VTPAs) with each of the standard suppliers except Sun Gas. The VTPAs apply from 1 July 2007 to 30 June 2010.

The main characteristics of the VTPAs for each standard supplier are:

- price controls in the form of a weighted average price cap (WAPC). The WAPC limits the increase in average default prices, weighted by consumption (for variable charges) and by customer numbers (for fixed charges).
- limitations on the maximum change in average default prices. The limit is defined as the change in the consumer price index (CPI) for the previous calendar year. The exception is the Murray Valley district supplied by Origin Energy in which the limit on the change in average prices is CPI+2% per annum.
- the ability for suppliers to apply to IPART to increase the average default prices in excess of the maximum defined in the VTPAs under special circumstances (IPART 2007b).

The assumptions underpinning retail operating costs and margins in VTPAs are based on decision made in 2004 and 2001.

3.3 New South Wales 2004-2007

Table 3.3

NSW GAS RETAIL OPERATING COSTS AND RETAIL MARGINS 2004-05 – 2006-07 (NERA REPORT)

Description	Allowance
Operating costs ($ 2004, $/ customer)	$45-65
Customer acquisition costs ($ 2004, $/ customer)	-
Total retail operating cost ($ 2004, $/ customer)	**$45-65**
Escalation	CPI
Retail margin	**2-3 per cent**

Source: National Economic Research Associates (NERA) 2004, New South Wales Energy Retail Costs: A Report for the Independent Pricing and Regulatory Tribunal, February 2004.

Retail operating cost

Base allowance

A report commissioned for IPART by National Economic Research Associates used retailers' data to develop appropriate costs and margins. It recommended the use of electricity retailers operating costs as a benchmark for gas retailers (NERA 2004, 12). On this basis, it estimated that the range of allowable retail costs for the gas industry is between $45 and $65 per customer (NERA 2004, 17).

Escalation

NERA used the CPI as the basis for escalating costs over the period (NERA, 2004, 6).

Customer acquisition costs

No explicit allowance was made for customer acquisition costs

Retail margin

NERA (2004, 280) recommended a retail margin of 2-3 per cent which was consistent with other jurisdictions.

3.4 New South Wales 2001-2003

The 2001 report *Review of the Delivered Price of Natural Gas to Tariff Customers Servid from the AGL Gas Network in NSW* estimated that retail operating costs and net retail profit margin (EBIT) were about 10 percent of the total cost of supply.

Table 3.4

NSW GAS RETAIL OPERATING COSTS AND RETAIL MARGINS 2001-02 – 2003-04

Description	Allowance
Operating costs ($ 2001-02, $/ customer)	$40-60
Customer acquisition costs ($ 2001-02, $/ customer)	-
Total retail operating cost ($ 2001-02, $/ customer)	**$40-60**
Escalation	-
Retail margin	**2-3 per cent**

Source: IPART 2001, Review of the Delivered Price of Natural Gas to Tariff Customers Served from the AGL Gas Network in NSW: Final Report.

Retail operating cost

Base allowance

IPART examined gas retailing in Australia and the UK and noted that there was limited information available on retail operating costs. It decided that the electricity industry provided a reasonable comparator and applied an industry benchmark in the range of $40-60 per customer (IPART 2001:30). The costs of full retail contestability were excluded from this figure. Because these costs were largely outside the control of the primary retailer and the magnitude of these costs was not clear at the time, the Tribunal decided that the recovery of retail contestability costs should fall outside the price constraints.

Escalation

It is implicit in the CPI indexation of prices that operating costs per customer were assumed to rise with the CPI.

Customer acquisition costs

No explicit allowance was made for customer acquisition costs (although full retail competition had not been introduced at the start of the period).

Retail margin

IPART decided to permit the primary retailer to earn a net profit margin of 2-3 per cent of sales revenue. This was slightly larger than that allowed for electricity because electricity retailers earn more revenue per customer but face similar retail costs per customer.

3.5 Victoria

The Victorian government requires that all gas retailers must offer supply to residential customers at "standard" tariffs. In 2003, the Victorian Government reached an agreement with gas retailers on standard tariffs for residential and small business consumers through to the end of 2007. A similar agreement has been reached for 2008, however, standard energy tariffs are no longer available for consumers on small businesses tariffs. Customers on small business tariffs will be required to accept a market-based offer for their electricity and gas supplies in 2008 (**www.dpi.vic.gov.au**). Details of how the standard price was calculated, including retail operating costs and retail margins are not publicly available on the DPI website.

3.6 CRA Report to the Australian Energy Market Commission 2007

CRA in its report to the Australian Energy Market Commission on the impact of prices and profit margins on energy retail competition in Victoria pointed out that there is limited information available about retail operating costs in the Victorian gas market. The Victorian gas market is smaller than the electricity market which it noted suggests that operating costs would be higher on a per customer basis for gas than electricity if gas retailers operated on a standalone basis. However, the actual costs may not be different from those for electricity retailers because in practice, gas retailers operate in conjunction with electricity retailers. Other factors that may influence gas retailer operating costs relative to electricity retailers include frequency of meter reads and bill preparation, working capital requirements and increasing complexity in the gas market. However, the extent of these influences is unknown.

Table 3.5

VICTORIAN GAS RETAIL OPERATING COSTS AND RETAIL MARGINS 2004-2007

Description	Allowance
Operating costs ($2006-07, $/ customer)	$75
Customer acquisition costs ($2006-07, $/ customer)	$23
Total retail operating cost ($2006-07, $/ customer)	**$98**
Escalation	-
Retail margin	**-1-2 per cent**

Source: Charles River and Associates (CRA) 2007, Impact of prices and profit margins on energy retail competition in Victoria, Final Report. Prepared for the Australian Energy Market Commission, 8 November 2007. Note: the margin is the estimated margin, not its view on the appropriate margin.

Retail operating costs

Base allowance

In the absence of better information, CRA adopted the same retail operating costs for gas as they did for electricity. That is, $75 per customer excluding customer acquisition costs. This figure was derived through a benchmarking study of other jurisdictions, which found that IPART's decision was most relevant to Victoria.

Escalation

CRA was not explicit about its assumed rate of escalation over the period, although its views are those of the QCA decisions summarised above.

Customer acquisition costs

Customer acquisition costs were estimated by amortising estimates of customer acquisition costs (provided in retailers' submissions) on a straight-line basis across the expected life for residential and small business customers, which is 3 and 4 years respectively. A weighted average of $23 per customer per year was derived (CRA 2007, 39-40).

Retail margins

CRA estimated the net retail margin for standing offers to be between 2 per cent and 5 per cent and for market contracts at between -4 per cent and -1 per cent. Market contract rates were assumed to be at a 3 per cent discount to standing offer rates. For the market as a whole, assuming 50 per cent of customers were on market contracts, the range of net margins is between -1 per cent and 2 per cent. It did not offer advice on what an appropriate margin should be.

3.7 CRA report to the Victorian Government on Electricity and Gas Standing Offers and Deemed Contracts (2003)

The Victorian Government's reasons for the standing offer price was not published, although it relied on CRA's advice, which is summarised below.

Table 3.6

VICTORIAN GAS RETAIL OPERATING COSTS AND RETAIL MARGINS 2003

Description	Allowance
Operating costs ($ 2003, $/ customer)	$60
Customer acquisition costs ($ 2003, $/ customer)	-
Total retail operating cost ($ 2003, $/ customer)	**$60**
Escalation	-
Retail margin	**4 per cent**

Source: Charles River and Associates (CRA) 2002, Electricity and Gas Standing Offers and Deemed Contracts (2003), Report to the Victorian Department of Natural Resources and Environment, December 2002.

Retail operating costs

Base allowance

CRA used IPART's estimate of the 1998-99 retail costs of AGL's unbundled gas retailing business (adjusted for CPI) as a benchmark for determining retail costs of gas businesses in Victoria. It estimated that the plausible range of retail costs was from $50-60 per customer but used $55 per customer for 2002. It adjusted this figure for 2003 to take account of reduced retailer responsibilities which gave a benchmark of $52.50 per customer (excluding full retail contestability costs). Full retail contestability costs were estimated at $7.50 per customer per year. However, as for electricity, CRA use a figure of $90 in their analysis on the basis that this is a much closer approximation to the retailers' views of their operating costs.

Escalation

CRA did not allow for escalation over the period as the determination was for a single year.

Customer acquisition costs

No explicit allowance was made for customer acquisition costs

Retail margins

With respect to retail margins, CRA recommended using a net margin of up to 4 per cent because it was within the range proposed by the Office of the Regulator General regarding electricity in 2002, provided greater equality in returns between retailers and enabled competitive activity.

3.8 Other States

Western Australia

Western Australia regulates gas prices to small business and residential customers through tariff caps. Tariff caps are set through the *Energy Co-ordination (Gas Tariffs) Regulations 2000.* No information is available about the retail operating costs and retail margins used in calculating the tariffs. Western Australia is currently reviewing retail operating costs and retail margins as part of its review of the the tariff caps *Energy Co-ordination (Gas Tariffs) Regulations 2000 (WA Office of Energy, 2007)*.

Queensland

Retail pricing for gas supply in Queensland became fully contestable from 1 July 2007. However, the Queensland Competition Authority (QCA) does not provide any information on retail price regulation on its website. The only information provided is the standard retail contract terms and prices (http://www.qca.org.au/gas-retail/contract_terms).

Australian Capital Territory

The ACT regulator, the ICRC reports that retail pricing for gas supply in the ACT is fully contestable and that regulation of gas retail prices ceased from 1 January 2002 (http://www.icrc.act.gov.au/energy/gas).

Tasmania

Tasmania is currently in the process of establishing a gas distribution network and has not made a decision on pricing regulations.

Chapter 4

Summary of decisions

The table below summarises the discussion in the previous sections, and also sets out the relevant parts of the allowance in December 2008 dollars. In deriving the allowances in December 2008 dollars, we have endeavoured to replicate the relevant regulator's views about the change (escalation) in operating costs to the extent possible. Thus, where a regulator has assumed that operating expenses increase with the CPI, we have applied this assumption, but where the regulator has assumed another rate of increase (for example, as is the case of the QCA), we have applied that other rate of escalation.

Table 4.1

SUMMARY OF CURRENT RETAIL OPERATING COST AND RETAIL MARGIN DETERMINATIONS

Regulator (state)	Period (base year)	Retail operating cost ($/customer/year)		Customer acquisition/ retention costs ($/customer/year)		Total retail operating costs		Retail margin	Escalation
		Base year prices	Dec '08 prices	Base year prices	Dec '08 prices	Base year prices	Dec '08 prices		
Electricity Determinations									
IPART (NSW)	2007-08 to 2009-10 (2006-07)	$70[d]	$73.80	$35	$36.90	$105	$110.70	5% (EBITDA)	Price escalation in line with CPI is implicit in the quotation of prices on a base year.
IPART (NSW)	2004-05 to 2006-07 (2004-05)	$70	$78.33	-	-	$70	$78.33	5%	Price escalation in line with CPI is implicit in the quotation of prices on a base year.
QCA (QLD)	2008-09 (2008-09)	$80.57	$80.57	$18	$18	$98.57	$98.57	5%	Wage inflation applied to 60% of cost base and CPI applied to 40% of cost base (3.65 per cent increase on 2007-08). No increase over determination period.
QCA (QLD)	2007-08 (2007-08)	$77.9	$80.94	$2	$2.08	$79.90	$83.02	5%	The ROC allowance will escalate at 3.9 per cent per annum over the determination period. It is not clear from the determination whether the retail margin is EBIT or EBITDA
ESCOSA (SA)	2008 to 2010 (Mar 2008)	$93.77	$95.45	Not identified / allowance in ROM	Not identified / allowance in ROM	$93.77	$95.45	5% (EBITDA)	ROC starting point was developed by escalating previous ROC allowance at CPI+2. ROC allowance will reduce by 4.1 percent per year adjusted on a quarterly basis over the determination period to account for anticipated productivity gains which ESCOSA believes should be shared 50:50 with customers. ESCOSA made a provision of $10 for initial FRC costs in its 2003 determination. These were removed in its 2005 determination and are not included in the current determination[b].
ESCOSA (SA)	2005-07 (Dec 2004)	$84	$99.75	-	-	$84.00	$99.75	5%	Allowance escalated at CPI+2% over the determination period.

Regulator (state)	Period (base year)	Retail operating cost ($/customer/year)		Customer acquisition/ retention costs ($/customer/year)		Total retail operating costs		Retail margin	Escalation
		Base year prices	**Dec '08 prices**	**Base year prices**	**Dec '08 prices**	**Base year prices**	**Dec '08 prices**		
CRA report to AEMC on Vic	2004 to -2007 (2006-07)	$75	$79.07	$49	$50.18	$124	$129.25	n/a	CRA endeavoured to calculate real ROC and retail margins in Victoria over the period 2003-2007.
CRA[c] (VIC)	2003 (2003)	$67	$75.86	-	-	$67	$75.86	5-8%	CRA ROC is based on submissions from retailers because of industry rejection of calculated ROC. CRA calculated a ROC of $67 per customer which represented a CPI based escalation of 3.1 per cent on the 2002 benchmark. Retail margins represent an escalation on the previous benchmark of 2.5-5 per cent to allow 'headroom' for competition.
ICRC (ACT)	2007-08 (2007-08)	$94.91	97.19	-	-	$94.91	$97.19	4%	ROC is a CPI based escalation of previous allowance. No escalation over period as it is a single year determination. Retail margin is a 1 per cent increase on previous determination to account for changes in price volatility.
ICRC (ACT)	2003-04 to 2006-07 (2003)	$85	$97.58	-	-	$85	$97.58	3%	Price escalation in line with CPI is implicit in the quotation of prices on a base year
OTTER (TAS)	Jan 2008 to Jun 2012 (June 2006)	$85	$90.31	-	-	$85	$90.31	3% (EBITDA)	Price escalation in line with CPI is implicit in the quotation of prices on a base year.
OTTER (TAS)	Jan 2004 to Dec 2007 (May 2003)	$76.67	$88.96	-	-	$76.67	$88.96	3% (EBITDA)	Prices escalation occurred a the rate of CPI over the determination period. FRC costs were excluded from ROC.

Regulator (state)	Period (base year)	Retail operating cost ($/customer/year)		Customer acquisition/ retention costs ($/customer/year)		Total retail operating costs		Retail margin	Escalation
		Base year prices	Dec '08 prices	Base year prices	Dec '08 prices	Base year prices	Dec '08 prices		
Gas determinations									
ESCOSA (SA)	2005-06 to 2007-08 (Dec 2005)	$79.70[e]	$91.51	-	-	$79.70	$91.51	10% of controllable costs	Based on benchmarking other electricity and gas decisions. Greater emphasis placed on gas decisions. Price escalation occurred at a rate of CPI+2% over the determination period, except for Opex component of ROC which only escalated at CPI.
NERA report to IPART on NSW	2004-05 to 2006-07 (2004)	$45-$65 ($55)	$61.55	-	-	$55	$61.55	2-3%	NERA inflated prices at the rate of the CPI
IPART (NSW)	2001-02 to 2003-04 (2001)	$40-$60 ($50)	$60.54	-	-	$40-$60 ($50)	60.54	2-3% (EBIT)	Escalation at CPI is implicit in the quotation of prices in a base year.
AEMC (CRA report on Vic)	2004 to 2007 (2006-07)	$75	$79.07	$23	$24.25	$98	$103.32	n/a	CRA endeavoured to calculate real ROC and retail margins in Victoria over the period 2003-2007.
Vic DNR (VIC)	2003 (2003)	$60.00	$68.88	-		$60	$68.88	4%	There was no escalation over the period as the determination was for a single year.

Source: [a]NERA 2004, 15; [b] ESCOSA 2005, 52; [c] Current Vic determination not available, 2003 CRA report to Victorian ESC most recent information available. [d]includes $5 reduction for double counting.

Bibliography

Charles River and Associates (CRA) 2008, Calculation of the Benchmark Retail Cost Index for 2007-08 and 2008-09, Prepared for the Queensland Competition Authority, 24 January 2008.

Charles River and Associates (CRA) 2007, Impact of prices and profit margins on energy retail competition in Victoria, Final Report. Prepared for the Australian Energy Market Commission, 8 November 2007.

Charles River and Associates (CRA) 2002, Electricity and Gas Standing Offers and Deemed Contracts (2003), Report to the Victorian Department of Natural Resources and Environment, December 2002.

Essential Services Commission of South Australia (ESCOSA) 2004, Electricity Standing Contract Price Final Report. ELECTRICITY STANDING

Essential Services Commission of South Australia (ESCOSA) 2005a, Final Report: Inquiry into Retail Electricity Price Path.

Essential Services Commission of South Australia (ESCOSA) 2005b, Gas Standing Contract Price Path: Final Inquiry Report and Final Price Determination.

Essential Services Commission of South Australia (ESCOSA) 2007, Final Inquiry Report and Price Determination: 2007 Review of Retail Electricity Price Path.

Independent Competition and Regulatory Commission (ICRC) **http://www.icrc.act.gov.au/energy/gas**.

Independent Competition and Regulatory Commission (ICRC) 2003, Final Determination: Investigation into Retail Prices for Non-Contestable Electricity Customers in the ACT, May 2003.

Independent Competition and Regulatory Commission (ICRC) 2007, Final Decision and Price Direction Retail Prices for Non-contestable Electricity Customers, Report 7 of 2007, June 2007.

IPART 2001, Review of the Delivered Price of Natural Gas to Tariff Customers Served from the AGL Gas Network in NSW: Final Report.

IPART 2004, NSW Electricity Regulated Retail Tariffs 2004/05 to 2006/07, Final Report and Determination

IPART 2007a, Promoting retail competition and investment in the NSW electricity industry: Regulated electricity retail tariffs and charges for small customers 2007 to 2010.

IPART 2007b, Review of Regulated Retail Tariffs for Gas – 1 July 2007 to 30 June 2010.

LECG 2007, SA Standing Contract Electricity Prices Price Path Review and Inquiry: confidential report on efficient and prudent retail operating costs and retail operating margin, August 2007.

National Economic Research Associates (NERA) 2004, New South Wales Energy Retail Costs: A Report for the Independent Pricing and Regulatory Tribunal, February 2004.

Office of the Tasmanian Energy Regulator (OTTER) 2007, 2007 Electricity Pricing Investigation – Final report.

Office of the Tasmanian Energy Regulator (OTTER) 2003, Investigation of Prices for Electricity Distribution Services and Retail Tariffs on Mainland Tasmania: Final Report and Proposed Maximum Prices, September 2003.

Queensland Competition Authority (QCA) http://www.qca.org.au/gas-retail/contract_terms.

WA Office of Energy 2007, Gas Tariff Regulations Review Report, Report prepared by the Minister for Energy the Hon Francis Logan MLA on the Review of the Energy Coordination (Gas Tariffs) Regulations 2000.