2011-2014 ELECTRICITY STANDING CONTRACT PRICE DETERMINATION

VARIATION PRICE DETERMINATION

12 June 2012

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1 ELECTRICITY STANDING CONTRACT PRICE DETERMINATION VARIATION

1.1 Authority

1.1.1 This Variation Price Determination (**VPD**) is made by the Essential Services Commission of South Australia (**Commission**) pursuant to the powers of the Commission under section 36AA of the *Essential Services Commission Act 2002* and section 35A of the *Electricity Act 1996*.

1.2 Purpose

1.2.1 For the purposes of section 36AA(4a)(f) of the *Electricity Act 1996* and section 26(8) of the *Essential Services Commission Act 2002*, this VPD varies the 2011-2014 Electricity Standing Contract Price Determination made by the Commission on 14 December 2010, as varied by the Commission on 15 June 2011; (**ESCPD**).

1.3 Commencement

1.3.1 This VPD has effect on 1 July 2012 and will be taken to vary the provisions of the ESCPD as set out in clause 1.6 on and from that date.

1.4 Electricity Standing Contract Price Determination

1.4.1 The ESCPD was made by the Commission on 14 December 2010 under Part 3 of the Essential Services Commission Act 2002 (**ESC Act**), as authorised by the provisions of sections 36AA and 35A of the Electricity Act 1996 (**Electricity Act**), in respect of the electricity standing contract prices to apply from 1 January 2011 to 30 June 2014.

1.4.2 Under section 36AA of the Electricity Act, once made, an ESCPD must continue for a minimum three-year period and cannot be varied or revoked unless the Commission has determined that special circumstances exist.

1.4.3 A key feature of the ESCPD was that it adopted a new price setting methodology, the Relative Price Movement (**RPM**) methodology, to provide greater price flexibility and alleviate many of the difficulties in relying on long-term cost forecasts.

1.4.4 The Statement of Reasons for the ESCPD described the operation of the RPM in the following terms:

> *Prices to apply at the commencement of the regulatory period will be determined by examining costs over the first year through the usual building block approach. This will ensure that the starting price is cost reflective.*
>
> *Annual movements in standing contract prices during the regulatory period will then be determined with reference to movements in market contract prices in SA. The Commission will calculate a price index (RPM index), measuring the*

change in weighted average market contract prices. This percentage change will then determine the allowed change in standing contract prices.

Changes in the standing contract price resulting from the RPM index calculation will be bound by a floor and ceiling, to provide some certainty over the extent to which prices will move over the regulatory period. Should the RPM index calculation breach the boundaries of the tolerance band, prices will be fixed at the floor or ceiling (whichever is applicable). If there are sufficient grounds to allow standing contract prices to move beyond the floor or ceiling, the Commission may undertake a "special circumstances" review to consider whether or not such a move is justified[1].

1.4.5 Section 36AA(4a)(f) of the Electricity Act provides an exception to that general rule. That section provides that the Commission may make a subsequent price determination under the ESC Act, with the effect of varying an existing ESCPD, when it determines that special circumstances exist:

> *(f) if the Commission has determined that special circumstances exist—the Commission may make a determination that takes effect as a variation of the existing determination (with effect for the balance of the term of the existing determination (unless another variation is subsequently made))*

Special Circumstances

1.4.6 In addition, section 36AA(4a)(d) of the Electricity Act provides a further exception to the general rule, whereby the Commission may, in cases where it has determined special circumstances to exist, revoke an existing ESCPD in its entirety and replace it with a new ESCPD (which itself must be of at least three years' duration).

1.4.7 The Electricity Act does not define the term special circumstances. Therefore, the existence, or otherwise, of special circumstances in any given case is a matter for the Commission to determine, having regard to its primary statutory objective of protecting the long-term interests of consumers with respect to the price, quality and reliability of essential services'[2], as well as other relevant statutory criteria arising under the ESC Act and the Electricity Act.

Clean Energy Act

1.4.8 On 13 February 2012, the Commission received an application from AGL South Australia Pty Ltd (**AGL SA**) to re-open the 2011-2014 ESCPD, to adjust the tolerance band as a result of the commencement of the Clean Energy Act 2011 (Cth) (**Clean Energy Act**). AGL SA stated in its application that it considers this to be a "special circumstances" event.

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[1] 2010-2014 Electricity Standing Contract Price Determination, Part A – Statement of Reasons, section 2.3, page A-36. Refer http://www.escosa.sa.gov.au/library/101208-ElectricityStandingContractPrice-FinalPriceDetermination-PartA.pdf

[2] ESC Act, Section 6.

1.4.9 The Clean Energy Act will come into operation on and from 1 July 2012. Among other things, that Act prices the carbon emissions of certain liable entities. In the fixed price stage, that runs from 1 July 2012 to 30 June 2015, the carbon price will start at $23 per tonne of carbon emissions in 2012/13 and will increase to $24.15 per tonne in 2013/14 and $25.40 per tonne in 2014/15. Thereafter, a market-based carbon price will apply.

1.4.10 Table 1 details AGL SA's proposed carbon cost allowance. In summary, AGL SA's proposes that the carbon cost allowance in the cap under the RPM comprises of the following:

i) Wholesale Carbon Cost;

ii) Allowance for an increase in cost for distribution losses;

iii) Adjustment for the variation in standing offer prices from 1 August 2012, whereas the carbon pricing mechanism commences on 1 July 2012; and

iv) An adjustment to the cap to maintain the percentage margin in the Standing Contract Price.

Table 1: AGL SA's Proposed Carbon Cost Allowance – 2012/13 and 2013/14

	$/MWh ($July12)	
	1 Aug 2012 – 31 Jul 2013	1 Aug 2013 – 30 Jun 2014
Wholesale Carbon Cost	$21.16	$21.69
Distribution losses	$1.72	$1.77
Adjustment for 1 August price variation	$2.00	-
Carbon cost allowance	*$24.88*	*$23.46*
Adjustment for retail margin allowance	$2.49	$2.34
Increase in Cap	$27.37	$25.80

ETSA Utilities' Network Charges

1.4.11 ETSA Utilities' distribution determination, made by Australian Energy Regulator (**AER**) on 6 May 2010, incorporated an annual allowance for feed-in-tariff (**FiT**) payments associated with the South Australian FiT scheme averaging around $10m per annum over the five year regulatory period (1 July 2010 to 30 June 2015). The determination provided for pass-through of overspends and underspends around the allowance, as these payments were outside the control of ETSA Utilities.

1.4.12 On 12 December 2011, AER approved ETSA Utilities' application to pass-through an overspend of around $9m associated with FiT payments in 2010/11. Consistent

with the approach contained in AER's 2010 determination the decision indicates that the pass-through amount was to be included in ETSA Utilities' 2012/13 distribution charges.

1.4.13 Subsequent to AER's 2010 distribution determination, a new rule (which was proposed by ETSA Utilities) was made by the Australian Energy Market Commission (**AEMC**); and commenced on 1 July 2010. This new rule permitted electricity distributors to recover the costs associated with approved jurisdictional schemes, such as the SA FiT scheme, on a forecast basis through the annual pricing process (with an 'unders and overs' arrangement), rather than through distribution determinations.

1.4.14 On 23 December 2011, ETSA Utilities wrote to AER advising of its intention to elect to recover FiT payments through its annual pricing proposal under this new rule provision. As part of this, any FiT payment allowances were required to be removed from the distribution determination. On 17 February 2012, AER revoked and substituted ETSA Utilities' distribution determination to remove FiT allowances.[3] On 16 March 2012, AER accepted ETSA Utilities's election to adopt the jurisdictional cost recovery scheme in respect of FiT payments, as it found the requirements of the National Electricity Rules (NER), namely that the FiT scheme met the definition of a jurisdictional scheme under the rules, had been met.

1.4.15 Estimated payments under the South Australian Government's FiT scheme for 2011/12 are around seven times higher than originally forecast for that year due to the high take-up of solar installations. Further, as a result of the transition to the new cost recovery arrangements, ETSA Utilities' 2012/13 pricing proposal includes the approved pass through amount for 2010/11 of $8.8m, an estimate of payments for 2011/12 of $71.3m and a forecast of payments for 2012/13 of around $79.8m. In total, FiT payments to be recovered in 2012/13 amount to $159m. The inclusion of FiT payments will increase ETSA Utilities' distribution tariffs, which in turn will affect the total standing contract price which can be charged by AGL SA.

1.4.16 Under the legislative framework established by the South Australian Government, the AER has responsibility for approving electricity network charges. For the purposes of establishing electricity standing contract prices, the Commission must treat ETSA Utilities' distribution network charges as being costs which are outside of the control of electricity retailers and therefore passed through directly to the standing contract price without further regulatory intervention by the Commission.[4]

[3] Refer http://www.aer.gov.au/content/item.phtml?itemId=752563&nodeId=779312709230665fa13fe709aac2953a&fn=Determination%20-%20ETSA%20Utilities%20-%20revocation%20and%20substitution.pdf

[4] 2010-2014 Electricity Standing Contract Price Determination – Variation Price Determination, section 1.4.6 to 1.4.8, page 2 to 3. Refer http://www.escosa.sa.gov.au/library/110704-2011_2014ElectricityStandingContractPrice-VariationPriceDetermination.pdf

1.5 Statement of Reasons

Commission's Decisions

1.5.1 To ensure that the standing contract price remains reflective of efficient costs, it is necessary to adjust the predetermined floor and cap thresholds for standing contract price movements, to accommodate the increase in costs due to the carbon price and network charges.

1.5.2 In considering whether or not special circumstances exist as a result of the commencement of the Clean Energy Act, the Commission considered the legislative context for standing contracts, established under the Electricity Act and the ESC Act, the provisions of the Clean Energy Act, AGL SA's application, and the submissions it has received on that application.

1.5.3 A Statement of Regulatory Intent[5] (**SORI**) was issued by the Commission on 16 April 2012, which set out the Commission's position that:

(a) The commencement of the Clean Energy Act from 1 July 2012; and

(b) the Australian Energy Regulator's approval (pursuant to the provisions of the National Electricity (South Australia) Act 1996 and the National Electricity Law and Rules) of the introduction of a new cost recovery scheme, comprising a year to year assessment of quantum, for the recovery of costs incurred by ETSA Utilities as a result of the South Australian feed-in mechanisms scheme, as established under Part 3, Division 3AB of the Electricity Act;

constitute special circumstances for the purposes of the section 36AA(4a)(f) for the following reasons:

(c) the price of carbon to be set under the Clean Energy Act was not taken in account directly in making the ESCPD, and is not explicitly incorporated within either the initial prices set, or the tolerance band limits set;

(d) to the extent that those costs arise, they will impact on a material component of the standing contract price;

(e) the assessment of FiT costs on a year-on-year basis was not contemplated at the time of making the ESCPD. The ESCPD, and particularly the setting of the tolerance band limits, assumed the amounts that were previously incorporated by AER in approved distribution network charges as established under the electricity distribution determination made by AER in respect of ETSA Utilities in 2010; and

(f) the extent of the FiT costs will impact on a material component of the standing contract price and, therefore, investigation of this matter is warranted.

[5] Review of 2011-2014 Electricity Standing Contract Price Determination - Statement of Regulatory Intent, http://www.escosa.sa.gov.au/projects/171/2012-agl-application-for-special-circumstances-review.aspx

1.5.4 As the Commission has determined that special circumstances exist, it is empowered, but not compelled, under section 36AA(4a)(f) of the Electricity Act, to vary the existing ESCPD or, under section 36AA (40)(d), to revoke and replace the existing ESCPD.

1.5.5 If the Commission forms the view that there is merit in making a variation price determination, it can vary any element of the existing determination in the manner it considers necessary to address the special circumstances; it does not have to vary the price, it might choose to vary some other operative element of the existing determination.

1.5.6 The Commission commenced a process to determine whether or not the impacts of the identified special circumstances are such as to require a variation to the ESCPD.

1.5.7 The Commission has determined that the impacts warrant a variation to the ESCPD, and has issued this VPD in accordance with the provisions of Part 3 of the ESC Act.

Matters Considered by the Commission

Consultation on AGL SA's Application

1.5.8 The Commission received five submissions in response to AGL SA's application[6]. These are summarised below:

(a) Alinta Energy is supportive of AGL SA's methodology and states it represents a reasonable approach.

(b) Jand Kaycee Automation state that, if AGL SA is allowed to just pass this additional cost onto the consumer, then there is no real impetus on AGL SA to reduce its carbon emissions, or find alternative non-carbon emitting sources, which is the principle reason for the legislation that has brought about this new "tax".

(c) South Australian Council Of Social Service (**SACOSS**) considers that:

- the AGL SA methodology substantially overstates the likely impact on retailer's costs;
- that consumers would be best served by waiting until the impacts on market prices are observed; and
- if the cap is likely to be reached, implementing a change only then.

(d) SA Department of Manufacturing, Innovation, Trade, Resources and Energy (**DMITRE**) submits that AGL SA's proposal to use a National Electricity Market (**NEM**) wide carbon intensity factor is inconsistent with the methodology used in

[6] http://www.escosa.sa.gov.au/projects/171/2012-agl-application-for-special-circumstances-review.aspx#stage-list=1

the price determination, and would be likely to overstate the carbon price impact in South Australia, given the lower carbon intensity of electricity supply in this state.

(e) Origin Energy is generally supportive of AGL SA's methodology for estimating the impact of carbon and believes the use of the average carbon intensity of the NEM is the correct approach. Origin Energy also noted that AGL SA had not included transmission losses in its application, and stated its support for its inclusion.

1.5.9 On 29 May 2012, the Commission received a late submission from the Conservation Council of South Australia (**CCSA**), which is a member of the Commission's Consumer Advisory Committee (**CAC**). In summary, CCSA:

(a) noted that there is no regulatory requirement for carbon costs to be forecast as part of the determination of electricity standing contract prices, but, should the Commission choose to consider including these costs, that there is a strong need for full transparency of the carbon cost component;

(b) supports the use of a national greenhouse accounting framework, such as the National Greenhouse and Energy Reporting (**NGER**) framework, rather than the use of the carbon dioxide equivalent intensity index (**CDEII**) [7] published by AEMO. However, CCSA recognises that consideration of a national reporting framework is beyond the role of the Commission for the purpose of this determination, and therefore accepts the use of the Australian Energy Market Operator (**AEMO**) Average Carbon Intensity (**ACI**) factor in this context;

(c) does not support AGL SA recovering a retail margin; and

(d) is concerned that the use of national or state-based emission factors by retailers does not reflect their individual carbon emission profile. In order to ensure transparency and fairness for electricity customers, CCSA suggests that a new method of allocating emissions to electricity end users is required, although it acknowledges that this is not a role for the Commission.

1.5.10 The Commission also undertook additional consultation on AGL SA's application with CAC, the Energy Division of DMITRE, and with AGL SA[8]. Relevant points raised in that consultation process, and the Commission's consideration of those points, are discussed in subsequent sections of this determination.

1.5.11 In making its determination, the Commission has considered all submissions and relevant points received through the consultation process.

1.5.12 While the Commission acknowledge the submission from Jand Kaycee Automation's that argued against AGL SA recovering carbon costs from customers, it is important for the Commission to ensure that electricity standing contract prices

[7] Refer to http://www.aemo.com.au/en/Electricity/Settlements/Carbon-Dioxide-Equivalent-Intensity-Index

[8] Refer to http://www.escosa.sa.gov.au/projects/171/2012-agl-application-for-special-circumstances-review.aspx

continue to reflect the efficient costs of electricity retailing and does not agree with this position.

Carbon Intensity Factors

1.5.13 For the ESCPD, the wholesale electricity cost was calculated using a Long Run Margin Cost (**LRMC**) approach. The LRMC was derived on the following basis:

(a) The LRMC was based on serving the Net System Load Profile (**NSLP**), which represents the load (demand) profile of small customers (<160MWh p.a.) in South Australia. AGL SA has established a load forecast for the NSLP by determining the load for an "average" weather scenario.

(b) The LRMC was based on a "greenfield" approach, which derives a portfolio of generators necessary to serve the NSLP (i.e. assuming no existing generators). This approach was intended to measure the cost of building an optimised mix of plant that minimises the total cost of generation.

(c) Importantly, the approach did not assume the presence of any existing generation plant in South Australia. It was based on current available technologies and current costs, thereby forming a proxy of the long-term cost of investing in new generation assets. It explicitly excluded any impacts of carbon pricing, on the basis that there was, at the time, uncertainty as to whether or not a carbon pricing regime would exist.

(d) The generation portfolio was developed purely to serve small customer load. It did not take into account interconnection between South Australia and other regions, nor does it take into account large customer load in South Australia. This approach is consistent with that used by the Electricity Supply Industry Planning Council (now AEMO) in previous standing contract price determination LRMC reviews for the Commission[9]. The stand-alone approach is also consistent with the approach taken by the Commission under the contract price methodology employed in previous reviews, where a portfolio of hedging contracts was derived to serve the regulated small customer load on a stand-alone basis[10].

1.5.14 The introduction of a carbon price is likely to affect the derivation of the LRMC for small customers in South Australia. However, the Commission has decided not to recalculate the LRMC to include carbon price impacts for this special circumstances review as it is only reviewing the impact of a carbon price for the purposes of the cap (which represents a high cost scenario). This is consistent with AGL's proposed methodology.

State versus National Intensity Factors

[9] Refer http://www.escosa.sa.gov.au/projects/92/2004-electricity-standing-contract-price-path-inquiry.aspx, and http://www.escosa.sa.gov.au/projects/7/2007-electricity-standing-contract-price-path-inquiry.aspx#stage-list=4

[10] Refer http://www.escosa.sa.gov.au/projects/92/2004-electricity-standing-contract-price-path-inquiry.aspx, and http://www.escosa.sa.gov.au/projects/7/2007-electricity-standing-contract-price-path-inquiry.aspx#stage-list=4

1.5.15 Whilst the Commission accepts that AGL SA's methodology is a suitable alternative to re-opening the price determination to re-calculate the LRMC for the purposes of this special circumstances review, the Commission disputes that a NEM wide ACI is the most appropriate input in calculating the increase in the cap, and considers this overstates the carbon price impact for standing contract customers in South Australia. In this regard, the Commission agrees with DMITRE's submission.

1.5.16 As noted above, the Commission has historically set the standing contract price to reflect the standalone costs of supplying South Australian standing contract customers. AGL SA has strongly supported that approach in all previous reviews. In its most recent determination, the derivation of the LRMC in the price determination assumes a South Australian generation portfolio developed purely to serve small customers, that is free of interconnection to other NEM regions.

1.5.17 The NEM-wide ACI used in AGL SA's proposal effectively allocates the cost of carbon emissions to South Australian electricity consumers based on the national intensity factor, which is much higher than the South Australian intensity factor, due to the greater presence of cleaner generation technologies in this state (e.g. gas and wind). AGL SA has argued that the Australian Financial Markets Association (**AFMA**) addendum to over the counter (**OTC**) contracts requires the carbon intensity factor to be calculated on a NEM-wide basis, and that the NEM-wide ACI represents a 'simple and transparent' approach to calculate the carbon cost exposure that retailers are exposed to across the OTC markets.

1.5.18 The Commission acknowledges that the AFMA addendum is based on a NEM-wide intensity factor, although it is also aware of bilateral contracts between retailers and generators where carbon costs are based on generator-specific carbon emissions. While the Commission believes that the cost of carbon emissions borne by an energy retailer will depend on the specific financial contracts that it has in place, this is ultimately a matter that is not of particular relevance to this special circumstances review. A more relevant question for this review is whether or not a retailer should allocate its carbon costs to customers in a particular jurisdiction on a NEM-wide basis, or on a jurisdiction-specific basis.

1.5.19 In order to be consistent with the standalone basis used to set the standing contract price, the Commission has decided to utilise an ACI that is based on South Australia's carbon intensity factor, rather than the NEM-wide ACI. It would be logically inconsistent to set the underlying wholesale cost on a stand-alone basis, and a carbon cost on a national basis.

1.5.20 The Commission notes that there are two state-based ACIs that could be adopted when calculating the impact of carbon on the standing contract price or tolerance cap. AEMO publishes generator dispatch information and carbon intensity information which allows the calculation of a South Australian ACI. In addition the National Greenhouse Accounts (**NGA**) calculates state-based ACI's that are "designed for use by companies and individuals to estimate greenhouse gas emissions."

1.5.21 The NGA factors calculate indirect emission factors for the consumption of purchased electricity. The *National Greenhouse Accounts Factors—July 2011*[11] report notes that:

> *"state emissions factors are used because electricity flows between states are constrained by the capacity of the inter-state interconnectors and in some cases there are no interconnections. The factors estimate emissions of CO2, CH4 and N2O expressed together as carbon dioxide equivalent (CO2-e)."*

1.5.22 Given that the NGA factors include electricity purchases from interstate (to the extent that interconnection is unconstrained), it is not consistent with the stand-alone cost approach for setting wholesale costs. It is more appropriate to use the SA-specific ACI, calculated using AEMO data, which is 0.55, based on almost 12 months of data between June 2011 and May 2012[12]. This approach was supported by the CAC and the Energy Division of DMITRE.

1.5.23 AGL SA has argued that, if the Commission were to use the AEMO data, it should have regard to the volatility of the South Australian ACI figure. It has suggested that the figure of 0.54[13] is not representative of a "normal" intensity factor, and that its use in this context may underestimate the exposure of retailers to additional wholesale energy costs resulting from the introduction of a carbon price. It has proposed an alternative method for dealing with this variation[14]. The Commission is not persuaded by AGL SA's argument, and is satisfied that the use of the AEMO ACI mean, which has been calculated using daily data for a period of almost one year, effectively removes this variability over time.

1.5.24 In its criticism of the use of the South Australian AEMO ACI figure, AGL SA has referred to the Commission's treatment of the Commonwealth Government's Large-scale Renewable Energy Target (**LRET**). AGL has stated that LRET was not considered by the Commission on a stand-alone basis, but based on the national cost. The Commission notes that LRET costs included in the 2010 determination were based on a mix of REC market prices and the LRMC of renewable (wind) energy. There is no reason for those costs (on a $/MWh basis) to be significantly different between jurisdictions, therefore the cost allocation question does not arise.

Retail Margin

1.5.25 The Commission considered whether or not it is appropriate for AGL SA to include an additional adjustment for a retail margin allowance for the carbon price, which is fixed for the remainder of the ESCPD period.

1.5.26 The Commission considered the issue of applying a retail margin to carbon costs from a first principles perspective, rather than from the perspective of considering how carbon costs would fit within the Commission's current methodology for

[11] http://www.climatechange.gov.au/~/media/publications/greenhouse-acctg/national-greenhouse-accounts-factors-july-2011.pdf - Page 19.

[12] Data current as at 5 June 2012. This includes 343 days of data.

[13] Current at the time of AGL providing its response.

[14] Note methodology provided on page 4 of AGL SA's supplementary submission to the Commission's preliminary views (refer to http://www.escosa.sa.gov.au/projects/171/2012-agl-application-for-special-circumstances-review.aspx)

determining the retail margin. It is not possible to apply that latter perspective in the current context, as the Commission's determination of the retail margin, made as part of the ESCPD, examines the margin from a whole-of-cost perspective. The approach acknowledges the difficulty in determining the cost components of the retail margin (e.g. return on capital, depreciation, amortisation and taxes) and instead relies largely on a benchmark approach to estimating the margin, having regard to other relevant regulatory decisions. This "top-down" approach is not useful for the purposes of examining whether or not a margin should be applied to one particular cost component, in this case, carbon costs. Rather, the Commission must consider the question of applying a retail margin to the carbon cost based on the inherent characteristics of that cost. The relevant question for the Commission is, therefore, whether or not the introduction of the carbon price would increase any of the underlying costs that are intended to be recovered through the retail margin.

1.5.27 The Commission also notes that the Commonwealth Government will be providing increased payments to electricity customers as compensation for any increased costs due to carbon pricing. This should alleviate the impact (if any) of additional bad debts that may arise from the introduction of the carbon price.

1.5.28 Consistency with other jurisdictional regulators is a matter that the Commission must have regard to, pursuant to section 6 of the ESC Act, but it is not required to ensure consistency at all times. If the Commission believes that there are good arguments for taking a regulatory approach that is different to other regulators, because it believes that it is in the long-term interests of South Australian energy consumers, it will do so.

1.5.29 The Commission has, in past price determinations, considered the retail margin as a percentage of controllable costs only in order to normalise jurisdictional differences between the mix of retailer and distribution charges. Where other regulators determine a retail margin as a percentage of total revenue (retail and distribution), the Commission removes the distribution component to estimate the retail margin on retailer costs only. The objective of that approach is to ensure that retailers are not able to earn an additional margin simply because of differences in network charges. The Commission's view is that the benchmarked retail margin must be determined with reference to controllable costs only and should be independent of the magnitude of non-controllable costs. It is important to recognise that the distinction between controllable and non-controllable costs is only relevant for benchmarking purposes. It is not relevant to this special circumstances review and the Commission is not considering the retail margin in aggregate. Rather, it is examining the specific impact of the introduction of carbon pricing on retailers' costs, and whether or not that event should lead to an increased retail margin.

1.5.30 Provided AGL SA is allowed to recover an appropriate carbon cost allowance, then it will continue to preserve the gross margin received per customer, per annum. Allowing AGL SA to recover an additional adjustment for retail margin allowance means that AGL SA will earn an additional profit, when no additional risk has been incurred, and without the requirement for additional investment in its business.

1.5.31 Having regard to the foregoing matters, the Commission has therefore determined that it is not appropriate for AGL SA to earn a retail margin on the carbon pass-through amount. This view was supported by the CAC and the Energy Division of DMITRE.

Transmission Losses

1.5.32 Whilst AGL SA's original application included estimates of the carbon costs associated with distribution losses, it did not include carbon costs for transmission losses. That is, the carbon costs associated with the electricity losses between the generator gate and the regional reference node (**RRN**) were omitted.

1.5.33 On 23 May 2012, AGL SA provided the Commission with a suggested approach that could be applied to calculate an adjustment factor to account for losses from the generator gate to the RRN. The methodology includes:

(a) Multiplying the sent-out energy of each South Australian generator by its corresponding transmission loss factor (**TLF**), which is published by AEMO. Individual generator data is then aggregated to provide the total energy at the RRN level.

(b) Dividing CO2-e emissions published by AEMO at the generator level, provided as part of the AEMO Carbon Dioxide Equivalent (**CO2-e**) Intensity Index (CDEII) dataset, by the total energy at the RRN level to provide a weighted average CO2-e intensity at the RRN level.

(c) The percentage difference in the intensities is treated as an adjustment factor to account for losses (1.81% in this instance).

1.5.34 the Commission has reviewed AGL SA's methodology and is satisfied that it is appropriate for the purpose proposed. The Commission has therefore decided to allow AGL SA's proposed transmission loss factor as a part of this special circumstances review on this basis.

Other Matters

1.5.35 The CCSA submission stated the need for the carbon cost component (including disclosure of relevant carbon emissions, the cost rate, and total costs) to be displayed on customers' bills.

1.5.36 Whilst the Commission supports full cost transparency for consumers of electricity retail services, the billing and disclosure matters raised by the CCSA are beyond the scope of the Commission for the purpose of this special circumstances review. The Commission notes that these matters are best addressed by national regulators and relevant government agencies.

Unbundling the Retail Component of the Tolerance Band

1.5.37 The ESCPD defines the floor and ceiling of the tolerance band as a bundled figure (inclusive of a forecast retail and network component). Given that the quantum of

FiT payments cannot be accurately determined in advance, the Commission has decided that it must re-calculate the tolerance band each year once ETSA Utilities' distribution tariffs have been approved by AER.

1.5.38 The Commission has decided to unbundle the retail component of the tolerance band from the distribution component of the tolerance band. A bundled figure will not be specified in the ESCPD for each year as is currently the case. Instead, the figure will be determined annually, once ETSA Utilities' distribution tariffs are known (around early/mid June each year).

1.5.39 Going forward, the ESCPD will specify the retail component (based on the $/MWh retailer costs determined by the Commission in the ESCPD for the floor and ceiling), with the network component to be left as a variable to be determined each year. The calculation of the RPM index (to apply to the standing contract price) and the revised cap and floor will occur simultaneously.

1.5.40 This amendment to the methodology used under the ESCPD removes the risk associated with forecasting ETSA Utilities distribution tariff in advance. This change is appropriate given the uncertainly around the amount to be recovered from the solar FiT scheme each year. This will ensure that ETSA Utilities' network charges are passed through directly to the standing contract price without further regulatory intervention by the Commission.

1.6 Variations to the ESCPD

1.6.1 Having established that special circumstances exist, the Commission considered whether to make a new determination (under section 36AA(4a)(d)) or to vary the existing ESCPD (under section 36AA(4a)(f) and section 26(8) of the *Essential Services Commission Act 2002*).

1.6.2 The Commission has not considered whether there has been material changes in any other input costs relevant to the ESCPD as a part of this process. The Commission has determined that it is appropriate to proceed to vary the existing ESCPD, rather than make a new standing contract price determination, with the variation to be limited to a recalculation of the levels of the ceiling and the floor of the tolerance band, as established under Schedule 2 of the ESCPD.

1.6.3 The specific provisions of the ESCPD that are to be varied on and from the commencement date are set out in item 1.6.4. below.

1.6.4 The ESCPD is varied as follows:

(a) In clause 2.A(d) of Schedule 2, replace the formulae:

$$\mathbf{C_{12}} = \frac{292.54 \times CPI_{12}}{242.02};$$

With

$$\mathbf{C_{12}} = \frac{319.40 \times CPI_{12}}{242.02};$$

and

$$\mathbf{F_{12}} = \frac{268.66 \times CPI_{12}}{242.02};$$

With

$$\mathbf{F_{12}} = \frac{295.52 \times CPI_{12}}{242.02};$$

(b) In clause 2.A(e) of Schedule 2, replace the formulae:

$$\mathbf{C_{13}} = \frac{303.84 \times CPI_{13}}{242.02};$$

With

$$\mathbf{C_{13}} = \frac{(163.17 + N_{13} + C_{13}) \times CPI_{13}}{242.02};$$

and

$$\mathbf{F_{13}} = \frac{275.73 \times CPI_{13}}{242.02};$$

with

$$\mathbf{F_{13}} = \frac{(135.16 + N_{13} + C_{13}) \times CPI_{13}}{242.02}$$

Where

N_{13} is the 2013/14 average electricity distribution revenue to be recovered by ETSA Utilities from electricity network tariffs that are applicable to electricity standing contract customers, as approved by the Australian Energy Regulator (expressed in $Dec10); and

C_{13} is the carbon cost allowance (expressed in $Dec10), to be calculated by the Commission as part of the 2013/14 electricity standing contract price adjustment in the same manner as that used to calculate the carbon cost allowance incorporated in C_{12} under this determination, with the exception that the Average Carbon Intensity factor published by the Australian Energy Market Operator (the Carbon Dioxide Intensity Index) is to be updated to incorporate the most recent intensity data available.