



INQUIRY INTO RETAIL ELECTRICITY PRICE PATH ISSUES PAPER

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ELECTRICITY

REQUEST FOR SUBMISSIONS

The Essential Services Commission of SA invites written submissions from interested parties in relation to the issues raised in this paper. Written comments should be provided by **30 July 2004**. It is highly desirable for an electronic copy of the submission to accompany any written submission.

It is the Commission's policy to make all submissions publicly available via its website (www.escosa.sa.gov.au), except where a submission either wholly or partly contains confidential or commercially sensitive information provided on a confidential basis and appropriate prior notice has been given.

The Commission may also exercise its discretion not to exhibit any submission based on their length or content (for example containing material that is defamatory, offensive or in breach of any law).

Responses to this paper should be directed to:

Inquiry into Electricity Price Path

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Public Information about ESCOSA's activities

Information about the role and activities of the Commission, including copies of latest reports and submissions, can be found on the ESCOSA website at www.escosa.sa.gov.au.

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1. INTRODUCTION

1.1 Background

In late March 2004, the South Australian government released a report from the Independent Pricing and Regulatory Tribunal of NSW (IPART), on a review of the methodology used by the *Essential Services Commission of South Australia* (the Commission) in examining standing contract electricity prices for South Australian small consumers to apply in 2004.

The report made a number of recommendations, which the government has indicated it will adopt, including changes to the *Electricity Act 1996* (Electricity Act). A copy of the IPART report is available on the Commission's website (www.escosa.sa.gov.au)¹.

One of the key recommendations was that the legislation should be altered to:

- ▲ move from an annual (or more frequent) price setting process to a price path approach covering multiple years;
- ▲ require the process to be initiated by a proposal from the electricity retail entity, rather than by the Commission; and
- ▲ provide for a period of at least six months for a review of the entity's proposal.

Draft legislation to achieve these outcomes has recently been introduced into the Parliament and will be debated in Parliament in the second half of 2004. In the interim, the government has indicated it intends that the Commission proceed with the necessary studies and consultation to allow a price path to be implemented from 2005, in anticipation of the legislative changes being adopted.

Accordingly, on 26 May 2004, the Minister for Energy referred to the Commission an Inquiry under Part 7 of the *Essential Services Commission Act 2002*.

1.2 Part 7 Inquiry

Section 35(2) of the *Essential Services Commission Act 2002* (ESC Act) requires the Commission to conduct an inquiry into any matter relating to a regulated industry that the industry Minister, by written notice, refers to the Commission.

Section 35(5) provides for the Minister to impose certain requirements on the Commission in its conduct of the inquiry.

¹ Under the section "What's New" of 28 May 2004.



Section 36 requires the Commission to publish notice of the inquiry, which includes details of the purpose, terms of reference, period and opportunities to input into the inquiry.

Section 37 provides guidance on the conduct of an inquiry, and specifically provides that the Commission's powers to obtain information apply and that the Commission may require any person to attend before the Commission and answer questions or produce documents or records as required by the Commission.

The Minister must cause a copy of the final report to be laid before both Houses of Parliament within 12 sitting days after receiving the report. The Commission must then ensure that copies are available for inspection or purchase by the public.

1.3 The Inquiry

The Notice of Inquiry from the Minister for Energy was received by the Commission on 26 May 2004. A copy is provided in Attachment 1.

The Notice requires the Commission to release an Issues Paper within one month of receipt of the Notice, outlining the information that the Commission requires the electricity entity to provide and advising stakeholders of the key issues it is intending to address. This Issues Paper has been prepared to comply with this requirement.

The Notice also requires the Commission to release a Discussion Paper following the release of the electricity entity's price path proposal. The proposal and the Discussion Paper are to provide the basis for a consultation process.

A draft decision is to be released by late November, and a final decision and determination is to be made by end March 2005. The draft decision should include provision for a bridging price for the period to 30 June 2005.

The Terms of Reference for the inquiry are as follows:

- ▲ The Commission is to investigate the standing contract price proposal ("the Proposal") that will apply to small customers from 1 July 2005 for a period of no less than three years.
- ▲ In assessing the proposal, the Commission's evaluation will be limited to reviewing the electricity entity's prudent controllable costs which, together with the relevant network tariffs, comprise the final standing contract prices charged to small customers. There should be no provision for specific headroom allowed in the prudent controllable costs determined by the Commission.
- ▲ On completion of the inquiry, the Commission may issue a determination under Part 3 of the Act in conjunction with the making of its final report on the inquiry.

- ▲ In determining whether the electricity entity's controllable costs are justified as the prudent costs incurred in supplying small customers, in addition to the requirements of Parts 2 and 3 of the Act, the Commission is to have regard to:
 - the electricity entity's justification for its proposed charges, presented as part of the proposal;
 - the wholesale electricity contracts and hedging strategies that would be utilised by a prudent electricity entity in providing the standing contracts to each of the residential and business customer classes in South Australia;
 - the electricity entity's actual underlying wholesale electricity contracts, hedging strategies and other arrangements for securing electricity for supply in South Australia, as well as the method for allocating these costs between large and small customers and within the small customer class;
 - the retail operating costs that would be incurred by a prudent electricity entity in delivering the range and standard of services that are required of the electricity entity in providing standing contract services to South Australian small customers;
 - the electricity entity's actual operating costs in providing standing contract services to South Australian small customers, and the method of allocating its costs between the different customer classes;
 - the electricity entity's proposed margin on standing contract sales, and its actual margin achieved in recent years, and whether these are reasonable having regard to the entity's investment in the business, the risks of standing contract retailing in South Australia, and the equivalence with standing contract retailer margins interstate without Government risk management schemes;
 - any cross-subsidies between, and within, business and residential small customer classes, and whether these cross-subsidies are justified to prevent a disproportionate price impact on any small customer group;
 - the prices charged and costs incurred in providing comparable services in other States and Territories of Australia, and whether the reasons for any differences can be justified; and
 - any other factors the Commission considers relevant.

1.4 Inquiry Process and Timetable

As part of the inquiry process, the Commission will consult with stakeholders and undertake detailed analysis. It will request AGL SA Pty Ltd (AGL) to provide specified information and to submit a price path proposal for the period to 30 June 2008.

It will release AGL's proposal to stakeholders, and will seek comments on this and on key issues relevant to the Inquiry.



It will engage consultants to assist the Commission undertake reviews of the various components of the retail cost, including consideration of AGL's actual costs wherever possible.

It will release a Discussion Paper and relevant consultant reports to facilitate stakeholder understanding of the issues and to encourage discussion. It will arrange public forums to consider the AGL proposal and additional information provided by consultants and stakeholders.

The Commission is required by its Terms of Reference to submit a draft determination by end November and a final determination by end March 2005. An indicative timetable for the inquiry is set out below. The Commission will provide updates to the timetable on its website.

Details on how to make submissions are provided on the opening page of this Issues Paper.

TIMETABLE	
ACTION	BY
Publish Inquiry Terms of Reference	31 May 2004
Release Issues Paper	25 June 2004
Send information request to AGL	25 June 2004
Receive submissions from stakeholders	30 July 2004
Receive information & submission from AGL	20 August 2004
Release AGL proposal	23 August 2004
Release Discussion Paper	6 September 2004
Receive submissions from stakeholders	22 October 2004
Hold public forum	Late October
Release draft to Minister/AGL	23 November 2004
Release draft to public	30 November 2004
Final determination for bridging price to 30/6/05	7 December 2004
Receive submissions from stakeholders	1 February 2005
Hold public forum	February 2005
Final determination	By 31 March 2005

2. IPART REPORT

Section 4 of the IPART Report reviewed the regulatory framework and the process followed by the Commission.

First, it concluded that the process set out in legislation for determining justifiable standing contract prices was not well suited to a position of static or falling costs. It recommended that legislative amendments or administrative guidance should be initiated by the Government to clarify an appropriate process irrespective of whether prices and costs were rising, static or falling.

Secondly, it concluded that the current legislative framework provided insufficient time for a “ground-up” review of price with adequate stakeholder consultation, and that annual (or more frequent) reviews are excessively costly and burdensome. It found that a medium-term price path would increase certainty for customers, AGL and competing retailers. Accordingly, it recommended a medium-term price path should be set which may provide for annual adjustments subject to compliance checks. A period of at least six months should be allowed for a review, to ensure adequate time for stakeholder input.

Thirdly, it concluded the medium-term price review process should be initiated by a proposal from the utility, and the Commission could consider submissions on the proposal from other stakeholders and act as an independent arbitrator, rather than being perceived to defend an initial position.

Section 5 of the IPART report provided an assessment of the Commission’s methodology.

First, IPART observed that the ESC Act requires the Commission to consider a range of objectives, but its primary objective is the long-term interests of the consumer. It suggested that, once a view is taken of what “the long-term interests of consumers” means, the question of how this is to be balanced against the other objectives can be considered.

IPART suggested that a practical approach might be to start from prudent long-to-medium term costs for the entity (as the Commission had done), and then to cross-check this against an evaluation of price outcomes from this analysis in terms of short-term market headroom.

Secondly, IPART concluded that the building block methodology used by the Commission should continue to be the primary approach, but supported by benchmarking against competitive prices and margins in South Australia and elsewhere where possible.

Thirdly, IPART considered different options for determining wholesale energy costs (such as actual costs, market benchmarks, prudent contract costs and long run marginal costs).



It concluded that notional prudent contract cost is an appropriate methodology to which a regulator should have regard, but other approaches should also be considered. It recommended that, despite the difficulties and uncertainties involved, future reviews should estimate actual contract costs attributable to standing contract customers.

Fourthly, IPART reviewed the specific methodology used by the Commission's consultants (IES) to determine the wholesale electricity cost, and concluded it was consistent with approaches used elsewhere. However, because of the uncertainties associated with each parameter, it suggested cross-checking against actual contract data should be undertaken early in the process. Accordingly, it recommended this methodology should continue to be applied, with earlier verification against actual contract data.

Fifthly, the retail operating cost benchmarking methodology used by the Commission was endorsed by IPART as common regulatory practice. It indicated the benchmarking could have been supported by an analysis of actual costs, but recognised the difficulties of allocating AGL's overall retailing costs to different market segments.

Finally, IPART reviewed the Commission's approach to setting a retail margin, including the issue of headroom. While observing that the approach was consistent with normal regulatory approach, it suggested the Commission could consider whether the margin should be set as a dollar rather than percentage figure, and that the Commission be more specific about the nature and magnitude of the risks of retailing in the South Australian market (not covered in the wholesale energy price). It proposed that the government should give guidance to the Commission on whether there should be allowance for headroom in the price.

In conclusion, it should be noted that the present Inquiry by the Commission is in response to the recommendations of the IPART Report, which the government has supported. In undertaking this Inquiry, therefore, the Commission seeks to implement the IPART recommendations as comprehensively as it can. Certainly, the Terms of Reference of the Inquiry provide every opportunity for the Commission to achieve this: there is a period of over six months provided for consultation; AGL will submit a price path proposal to the Commission as a basis for consultation; and the Commission is required to examine AGL's actual wholesale energy costs, operating expenses and margins.

3. OBJECTIVES OF PRICE REVIEW

The IPART Report (Section 5.1) addressed the importance of providing clarity of the objectives for price regulation of standing contracts. The full extract is provided below.

“5.1 Clarity of objectives for regulation of standing contracts

The ESC Act 2002 requires the consideration of a range of objectives but its primary objective is the long-term interests of the consumer. Efficiency, promotion of competition and prevention of misuse of market power are subsidiary. A separate section also requires it to have regard to the particular circumstances of the industry, its costs and financial impacts (see section 3.1.4 of this report – legal powers and responsibilities).

This range of objectives is similar to those specified in legislation or codes for other regulators eg IPART, the ESC of Victoria and the Gas Code. While IPART’s legislation does not give guidance to weighting, Ofgem’s legislation in the UK gives primacy to consumer interests (“to protect and advance the interests of consumers by promoting competition where possible, and through regulation only where necessary”).

While the ESC Act gives primacy to the long-term interests of the consumer, the question remains as to how this should be interpreted. ‘Long term’ suggests more than short-term static efficiency concepts, such as the new-entrant cost in this period. But is the long-term interest of the consumer best served by:

- Promoting the development of the competitive market? In this case, an approach which ensures headroom by design (eg long-term or short-term costs plus a margin) would be desirable.*
- Ensuring stable provision of default retail services at reasonable prices? In this case, the starting point may be the reasonable actual costs incurred by the supplier.*
- Ensuring efficient prices in the default service over the medium-to-long term and avoidance of shocks for consumers? In this case, prudent long-term costs built up from a theoretical contracting position may be the appropriate starting point.*
- Ensuring efficient prices in the short term? In this case consideration of a shorter contracting period becomes relevant.*

Once a view is taken of what the ‘long-term interests of consumers’ means, the question of how this is to be balanced against the other objectives can be considered.

In balancing these objectives, it would not be feasible to rely on one methodology alone for assessing the costs. This is precisely because the different perspectives offered by different methodologies are necessary to evaluate properly price outcomes against the different objectives.

For example, as noted below, the benchmark for achieving financial sustainability would be the benchmark of reasonable actual costs incurred, while the benchmark for promotion of competition would be prices in the competitive market and/or long or short-term costs plus a margin.

Hence, a practical approach may be to start from prudent long-to-medium-term costs for the incumbent, as ESCOSA has done, and cross-check this against an evaluation of price outcomes from this analysis in terms of short-term market headroom. Ideally, the framework for evaluating these outcomes should be clarified through the discussion of the regulatory objectives at the outset of the review. ESCOSA’s 2003 review arguably provided such a framework but this was assumed at the start of the 2004 review.

Headroom is a difficult and controversial issue. Different regulators have adopted different approaches. IPART has not allowed headroom. Ofgem in the UK, according to AGL’s submission to the current price

review process, allowed an average headroom of 8 per cent to encourage development of a competitive market.

Judgements on the objectives of the review can be critical for the methodology adopted by the regulator. In the case of ESCOSA's retail review, implicit differences in these judgements appear to underlie some of the differences of view on the appropriate methodology and price outcomes. As the discussion of these objectives has not been clear, especially in the initial stages of the 2004 review, the difference in the views on objectives is more implicit than explicit.

Finding:

The objectives of retail price regulation and the implications for the methodology should be clearly specified at the outset of a review and greater regard had to alternative approaches to estimating the cost components.

Recommendation:

Greater clarity should be brought to the objectives for regulation of standing contracts in future reviews and greater use made of data/estimates under alternative approaches as a cross-check of the primary analysis."

3.1 Objectives of the Commission

The Commission is a statutory body, with its powers and functions limited to those granted it by Parliament through the ESC Act.

The ESC Act sets out (in section 5) the particular functions of ESCOSA. Section 5(1)(a) specifies that one such function is "to regulate prices and perform licensing and other functions under relevant industry regulation Acts" – the Electricity Act has been declared for this purpose.

When the Commission is undertaking a function within its overall responsibilities, it must have regard to specific objectives as set out in legislation. Section 6(1) of the ESC Act sets out the core set of objectives to which the Commission must have regard:

- 6(1) *In performing the Commission's functions, the Commission must:*
- (a) *have as its primary objective protection of the long term interests of South Australian consumers with respect to the price, quality and reliability of essential services; and*
 - (b) *at the same time, have regard to the need to:*
 - (i) *promote competitive and fair market conduct; and*
 - (ii) *prevent misuse of monopoly or market power; and*
 - (iii) *facilitate entry into relevant markets; and*
 - (iv) *promote economic efficiency; and*
 - (v) *ensure consumers benefit from competition and efficiency; and*
 - (vi) *facilitate maintenance of the financial viability of regulated industries and the incentive for long term investment; and*
 - (vii) *promote consistency in regulation with other jurisdictions.*

The Commission is not, however, required only to have regard to these specified objectives; relevantly, if it is making a price determination under Part 3 of the ESC Act, it must also, under Section 25(4), have regard to:

- (a) *the particular circumstances of the regulated industry and the goods and services for which the determination is being made;*
- (b) *the costs of making, producing or supplying the goods or services;*
- (c) *the costs of complying with laws or regulatory requirements;*
- (d) *the return on assets in the regulated industry;*
- (e) *any relevant interstate and international benchmarks for prices, costs and return on assets in comparable industries;*
- (f) *the financial implications of the determination;*
- (g) *any factors specified by a relevant industry regulation Act or by regulation under the ESC Act;*
- (h) *any other factors that the Commission considers relevant.*

Section 25(5) of the ESC Act also requires the Commission to ensure that, wherever possible, the costs of regulation do not exceed the benefits, and that the decision takes into account and clearly articulates any trade-off between costs and service standards.

If the Commission is conducting an inquiry into the declared retailer's standing contract price justification statement on the referral of the Minister, it must also incorporate in its consideration process any matters specified by the Minister and any specific directions in respect of the conduct of the inquiry set out in the terms of reference.

It can be seen from the above that there are multiple factors that the Commission is required to have regard to in making a price determination. The Commission has a clear prime objective as set out in Section 6(1)(a) of the ESC Act, which is "protection of the long-term interests of South Australian consumers with respect to the price, quality and reliability of essential services", but it is required "at the same time" to have regard to a suite of other factors which must also be considered.

In relation to price determinations, Section 25(6) of the ESC Act states that the price determination provisions in Sections 25(3), (4) and (5) are subject to the provisions of the relevant industry regulation Act for that industry (in this case, the Electricity Act 1996).

Specifically, Section 25(4) states that, in making a price determination, the Commission must "in addition to having regard to the general factors specified in Part 2" have regard to a number of other factors (such as the particular circumstances of the regulated industry and the costs of supplying the goods or services).

The "general factors specified in Part 2" are, of course, the objectives set out in Section 6 of the ESC Act, including the primary objective, but these objectives are subject to the



provisions of the Electricity Act 1996. To the extent that there is any conflict, the ESC Act section 6 objectives which are general in nature and apply to all of the Commission's work and the ESC Act section 25(4) objectives which are specific to price determinations, are subject to the specific Electricity Act provisions which deal with the particular circumstances of the electricity supply industry in South Australia.

The Commission notes that the Electricity Act has a number of objects set out in section 3 which include the promotion of efficiency and competition in the electricity supply industry and the protection of the interests of consumers. It regards these objects as being broadly in line with those set out for the Commission in its own Act.

In its previous price reviews, the Commission has sought to determine what an efficient (or prudent) retailer could charge if they had the sole responsibility for standing contract supply to small customers in South Australia. By allowing the retailer to charge what an efficient retailer would charge, the Commission sought to comply with the broad range of objectives, and in particular:

- ▲ consumers' long-term interests;
- ▲ encouraging efficiency and competition;
- ▲ maintaining financial viability of the industry.

IPART has suggested that the Commission should be clearer about the particular objectives of price regulation and how it intends to make its determination relative to those objectives; it suggested these should be clearly specified at the outset of a review.

3.2 Objectives for this Inquiry

The Commission has set out above the legal obligations it must meet, the key factors it has emphasised in its previous decisions, and the range of approaches proffered by IPART.

The Commission sets out below its proposed approach for the current Inquiry, which incorporates these options.

Having regard to the legislative objectives, the Commission confirms that the key objective in the establishment of an electricity retail price path is the protection of the long-term interests of consumers.

Naturally, the Commission will have regard to all of the factors it is required to by law, and will attempt to ensure that all objectives are achieved. This includes the need to have regard to the Terms of Reference of the Inquiry set out in Attachment 1.

Objectives For Retail Electricity Price Path

In considering consumers' long-term interests, the Commission proposes to establish a price path which establishes the lowest possible price consistent with:

- ▲ the costs that an efficient retailer would be expected to incur in meeting the responsibilities of standing contract supply to small customers in SA over the period;
- ▲ encouraging the development of competition among retailers for the benefit of consumers;
- ▲ encouraging ongoing, efficient investment to meet consumers' long-term requirements; and
- ▲ providing an appropriate return for an efficient declared retailer.

The Commission seeks views from stakeholders on the objectives it has stated for establishing a retail price path. Based on the relevant legislation, are there are other factors to which it should have regard?



4. THE COMMISSION'S 2002 AND 2003 PRICING METHODOLOGY

In order to place the development of a retail electricity price path in a context, it is considered useful to set out briefly the process undertaken in the first two reviews of the electricity standing contract price.

4.1 The legislative basis

Section 36AA of the Electricity Act provides that a declared retailer is, on request, legally bound to sell electricity to small customers at a standing contract price and under standing contract terms and conditions which are set out in the Electricity Retail Code (now the Energy Retail Code) made by the Commission.

AGL SA is the only retailer so declared in South Australia and is therefore responsible for supplying every small customer who seeks supply (including those who wish to return from a market contract with any retailer).

Retailers (including the declared retailer) are able to offer market contracts to small customers, where terms and conditions (apart from a few basic terms) can be set by the retailer. There is no restriction on price for these market contracts and the Commission has no role in setting or monitoring the prices for these contracts.

At the time of the 2002 and 2003 reviews, section 36AA(6) of the Electricity Act specified that the price for standing contract supply was to be either the price fixed by the declared electricity retailer by notice published in the Gazette together with a justification for that price (which price can only take effect 3 months after the date of publication) or a price fixed by the Commission, by a price determination under section 35A(1)(a) of the Electricity Act and under Part 3 of the ESC Act, which replaced the declared retailer's price.

The declared retailer's price justification statement could also be subject to an Inquiry under Part 7 of the ESC Act and the 2002 review was conducted against the background of a formal request for Inquiry by the Minister for Energy.

The legislation placed no obligation on the declared retailer, having had a price fixed for standing contract supply, to come forward with another price for another period.

4.2 Overall Approach and Methodology

The legislative scheme for standing contract supply and pricing was established in September 2002 by amendments to the Electricity Act, three months before full retail



competition commenced on 1 January 2003. The Commission's approach to retail price setting began in mid 2002 in parallel with the Government's consideration of a proposed legislative scheme.

The Commission's underpinning philosophy was to seek to balance short term price protection to consumers under a fail-safe standing contract, with the objective of a competitive retail market developing at the earliest possible opportunity, given the initial 100% market share of AGL SA and the difficulties faced by new entrant retailers.

The approach taken by the Commission was based on the experiences of regulators in other jurisdictions – particularly those in the UK, Victoria and NSW and was also influenced by the Terms of Reference of the Inquiry, set by the Minister in September 2002, which specifically required the Commission to consider the costs of a prudent retailer undertaking the role of declared retailer (i.e. providing standing contract supply to any small customer who sought it).

Based on its review of the work of other regulators, the Commission determined there were four cost components about which it needed to form an opinion in determining whether the standing contract price could be justified and whether a cost component reflected the cost of a prudent retailer. The four components were:

- ▲ Wholesale electricity cost (including other costs associated with purchasing in the NEM, as well as network losses)
- ▲ Network charges payable to ETSA Utilities
- ▲ Retailer operating costs
- ▲ Retailer margin or profit.

The Commission's approach to each of these components can be summarized as follows:

4.2.1 Wholesale electricity cost

The Commission noted the difficulty faced by regulators in estimating a wholesale electricity price for a future period, given the nature of contract and hedging arrangements and weather driven variation in loads. The Commission therefore sought to identify a number of benchmarks or check points where the Commission could gain confidence that its estimates were credible. In particular, it sought to compare the estimate of future costs with historic cost trends adjusted for known events, and to compare overall prices (and net receipts to retailers) with interstate equivalents – particularly Victoria.

Victoria was identified as the most relevant comparison as it had largely the same market participants, it was a privatised market like South Australia, was interconnected to South Australia by two links, and did not have government

operated equalization funds as operate in NSW and Queensland. Further, AGL had electricity standing contract obligations in both the South Australian and Victorian markets, but no such obligations in other electricity markets in Australia.

Finally, the Commission used a consultant to model both prudent retailer wholesale energy purchase costs and the costs incurred by AGL SA using its actual contracts, to ensure the estimated “prudent” cost was below the estimated “actual” cost. The methodology used by the Commission’s consultant was set out in considerable detail in the reports provided to the Commission and attached to various discussion papers and reports. In brief, the model derived an estimate of wholesale energy costs (broken down into quarters of the year, for peak and off-peak) based on assumptions regarding load and load profile, contract position, contract prices, add-on costs for hedge mismatch and other risks, passthrough costs and network losses. The Commission required a number of different scenarios to be used for evaluation (covering different contracting periods or profiles, and different pricing assumptions for caps or swaps) or in some instances a single point estimate.

4.2.2 Retailer Operating Costs

As there was no satisfactory “benchmarking” study to support a decision in this area, the Commission determination of a component for retailer operating costs was based on a consideration of allowances in other jurisdictions.

4.2.3 Retailer Margin or Profit

The retailer margin was set by reference to margins allowed in other jurisdictions, having regard to the nature of the South Australian market, the responsibilities of AGL SA as both the standing contract retailer in South Australia and the only first tier retailer in South Australia. This latter responsibility means that AGL SA must pay for all electricity consumed in South Australia other than that consumed by the largest customers and that metered by second tier retailers (via interval meters or profiling of accumulated meter readings).

Regard was also had to the fact that the South Australian market is characterised by a very peaky load profile, the worst in the NEM, and a tight supply-demand balance very dependent on interstate supplies over the two interconnectors.

4.2.4 Network Charges Payable to ETSA Utilities

Network charges payable by the retailer to the network operator ETSA Utilities (which includes the TUOS payment to Electranet) are determined each year by the Commission in accordance with the Electricity Pricing Order (EPO).



In keeping with regulatory practice elsewhere, the Commission decided that 100% of network charges should be passed through in retail prices.

4.2.5 Summary

The Commission's standing contract price methodology, as outlined above, did not seek to establish the lowest possible cost of a retailer with the standing contract obligation, nor did it seek to determine the cost that a new entrant retailer with small customer numbers could achieve and offer to consumers through market contracts; rather, the price was set so as to meet the legislative objectives, the imperatives of the Terms of Reference of the 2002 Inquiry and ultimately to balance and weigh a complex range of objectives and factors.

5. KEY ISSUES: PRICE PATH ESTABLISHMENT

What the Commission is now required to do is to establish a retail electricity price path to apply for standing contract supply for a period of at least 3 years.

It should be noted that the concept of a “price path” for electricity retail prices for small consumers has never been considered previously in South Australia, and the legislation to require this will not be in place for the initial part of the Commission’s inquiry.

Price paths are not a new concept: they already exist in NSW and Victoria. However, the concept in those states is quite different to that proposed for South Australia.

In Victoria, where a price path was introduced in December 2003 for each of the five declared retailers, the Government and the retailers negotiated the path: it was not determined or reviewed by the regulator.

In NSW, the regulator does set the price path for a forward period of some years, but the price path is set for the purpose of the government’s Electricity Trading Equalisation Fund (ETEF) which transfers funds between the government owned generators and retailers on the basis of a theoretical wholesale energy price (the long run marginal cost). It is not necessary for the regulator to calculate the actual cost of electricity: with ETEF, the risks to the retailer are essentially removed.

The introduction of a regulator determined price path in South Australia is therefore a new concept, which has not been tested elsewhere in the national electricity market. It places considerable responsibility on the regulator to determine reliable costs for the retailer; so as to neither over- nor under- compensate the retailer for efficient costs of operating as the declared retailer to all small consumers.

The requirement for the Commission to introduce a price path for standing contract prices therefore raises a number of key issues on which the Commission is keen to receive stakeholder comment at an early stage of the Inquiry. In particular:

- ▲ What form of regulation should the Commission apply in relation to a 3-year price path for standing contract prices?
- ▲ What approach(es) should the Commission adopt in estimating prices over a three-year future period, given the uncertainties inherent in the estimation process?
- ▲ On what basis should the Commission set the wholesale electricity costs and retail operating costs?
- ▲ What modifications to the approach adopted by IES in estimating wholesale energy costs in the 2002 and 2003 reviews should the Commission adopt?
- ▲ What information should the Commission seek from AGL that is reasonable to support the prices proposed?

- ▲ What provision should be made to re-open the price path if underlying conditions change?
- ▲ Should standing contract prices be seen as a “fail safe” price to support the objective of moving customers onto market contracts, or should they be seen as the normal price for consumers?
- ▲ What assumptions should be made about “churn” rates, and the impact of changing consumer numbers and consumption patterns for standing contract supply?
- ▲ Is there an alternative approach to setting prices for three years ahead, which is fair to consumers and AGL?

These matters are discussed briefly below.

5.1 Form of Regulation

The Commission will need to select from among numerous design options for the retail electricity price path. In regulatory terms this is known as selecting a form of regulation.

There are several considerations in the selection of a form of regulation, the most significant of which is ensuring that the form selected complies with the relevant legislation and, in this case, accords with the Notice of Inquiry from the Minister for Energy.

More general considerations include:

- ▲ incentives effects – does the form of regulation encourage ongoing efficiencies in energy contracting, does it need to, or does it allow or invite cost increases or cost laxity?
- ▲ regulatory risk – what risks are there of the price path over or under estimating prudent prices, how are those risks allocated, to whom are they allocated, are they allocated to the party best able to manage the risks?
- ▲ administrative costs – does the form strike a sensible balance between accuracy and complexity? Some forms of regulation can involve intricate and sophisticated mechanisms designed to achieve desired effects, but end up requiring so much effort, information, and hence cost, to administer that the benefits are wiped out.
- ▲ robustness – can the form cope with unforeseen circumstances and unexpected events? Robustness can be achieved by flexible forms of regulation, or can be built in to otherwise stricter forms of regulation by way of pass through mechanisms, re-opening provisions and adjustment mechanisms. Clause 4.2 of the Terms of Reference of the Inquiry refers to such mechanisms.

The forms of regulation available for the retail electricity price path may include some of the following characteristics and elements:

- ▲ setting the maximum annual revenue that AGL can earn from standing contract customers over the period, then allowing AGL to collect that revenue from each

customer category as it sees fit (or within additional constraints specific to customer categories);

- ▲ setting the actual price that can be charged to each customer category over each year of the price path;
- ▲ setting a starting price for each customer category, then setting out a formula for annual adjustments (such as annual CPI-X adjustments, or annual adjustments based on other energy cost indicators or measures);
- ▲ allowing pass throughs for particular types of events and for uncontrollable costs (such as distribution and transmission tariffs);
- ▲ allowing re-opening of the price path in cases of severe events; or
- ▲ some combination of the above and other elements.

In determining the appropriate form of regulation, the Commission will have regard to the form selected in other jurisdictions (eg. Victoria), the views put forward by the various stakeholders (eg. the consumers and AGL), and compliance costs that will be imposed on the retailer and the administrative and monitoring costs that will be imposed on the Commission.

What form of regulation/price path formula should the Commission adopt?

What correction factors and rebalancing parameters, if required, should the Commission consider or allow?

5.2 Overall Approach

IPART has endorsed the continued use of a building block pricing methodology, supplemented by benchmarking against actual costs wherever possible.

In keeping with the Terms of Reference of its Inquiry, the Commission proposes to focus its attention on three of the four previously identified components of retail costs, namely; wholesale energy costs, retail margin and retailer operating costs. The fourth component, network charges, will be added to these components to give the standing contract price.

As the Commission has previously recognised, there is considerable uncertainty associated with estimating future wholesale energy prices even one year ahead. Estimating for a three-year period will be required to establish the price path. A key issue for the Commission is how to obtain estimates that do not place the interests of consumers or AGL at serious risk.

The Commission considers that the negotiated prices in Victoria provide sufficient margin to allow a retailer to absorb a reasonable amount of risk². In NSW, given ETEF, the regulator can set wholesale prices such that it has little implications for the retailer's profitability. However, in a privatised market like South Australia, the wholesale energy price set by the regulator is of critical importance.

What methodology should the Commission use to obtain estimates of wholesale electricity costs for a future three-year period?

What modifications to the approach adopted by IES in estimating wholesale energy costs in the 2002 and 2003 reviews should the Commission adopt?

Are there other approaches that the Commission should consider in setting a retail price path?

5.3 Actual versus Prudent Costs

In its previous price determinations, the Commission has placed great emphasis on a determination of the costs that a "prudent"³ retailer would incur in meeting the standing contract obligations (partly in response to the Terms of Reference of the initial inquiry which required it to have regard to such prudent costs).

Moreover, the Commission has supported this approach in preference to an "actual" cost methodology, as it believed the latter approach would encourage inefficiencies (in that actual costs could be passed through, no matter how inefficient).

However, the IPART Report has recommended that the Commission pay greater attention to AGL's actual costs in any future price inquiry.

It should be noted that there are difficulties in estimating both "prudent" and "actual" costs: neither is able to be determined with any greater accuracy than the other.

² This is based on the Commission's reading of the report: *Electricity and Gas Standing Offers and Deemed Contracts (2004-2007)*, prepared by Charles River Associates in December 2003. For example, page 43 of the report states "Because of this additional uncertainty, it would be reasonable to make an additional allowance for risk in the net margin, to set it above the level that would be recommended if prices were being considered only for 2004."

³ "Prudent costs" in this context are taken to be the costs incurred by an efficient retailer acting efficiently in accordance with good industry practice, to achieve the lowest sustainable cost of delivering the service, taking into account the circumstances and obligations imposed on the incumbent retailer.

The Terms of Reference for the Inquiry the Commission is now undertaking require the Commission to review AGL's "prudent controllable costs" and to determine which of these costs are justified as the prudent cost incurred in supplying small customers"⁴.

In assessing both "prudent costs" and "actual costs" the Commission will be required to assess the underlying assumptions made by AGL in deriving the price path. Hence evaluation of these costs will ultimately require the making of an informed judgement on the assumptions underpinning these costs.

In the case of wholesale energy costs, the assumptions relate to factors such as customer load profiles, future weather/temperature conditions, customer numbers and churn rates, and the allocation of hedging and other contracts between standing contract and other customers.

In the case of retail operating costs, the assumptions relate to factors such as joint cost allocation, depreciation schedule, capitalisation policy etc.

Clearly, there are uncertainties and difficulties associated with the process of determining appropriate assumptions, with a high likelihood that any assumptions will prove to be inaccurate.

Inevitably, therefore, a good deal of regulatory judgement will be required in the establishment of the price path.

How should the Commission, in setting a price path, treat actual and prudent costs?

5.4 Re-opening of Price Path

As noted in the previous section, determining the costs of standing contract electricity supply for a period of three years to June 2008 requires forecasting of a number of factors. Even if contracts are already in place for the full three year period (which is unlikely), the actual cost incurred by AGL will depend on factors such as future weather/temperature conditions, number of customers and customer churn, supply/demand balance in the National Electricity Market, and changes in consumer demand patterns – all of which are unpredictable.

In setting a price path over this extended period, there are serious risks of outcomes being significantly different to the assumptions that underpinned the forecasts. This could impact negatively on consumers or AGL.

⁴ See sections 3.2 and 3.4 of the Notice of Reference of Inquiry (Attachment 1).

Whilst it is not desirable for a re-opening of the price every time there is a minor change in an underlying cost (as this would be administratively time-consuming and defeat the purpose of providing customers with a longer term certainty about price), there must be some changes that are so different from the base assumptions that the price path will need to be revised.

The Commission has not at this time formed any views about how such a re-opening process could apply and what factors would constitute a basis for re-opening.

What factors should be taken into account by the Commission in establishing a price path re-opening mechanism?

5.5 “Fail-safe’ or “Normal” Prices?

The standing contract is established in legislation as the basic protection for all small consumers who choose not to enter (or who do not enter) into a market contract with a retailer.

The standing contract terms and conditions are set by the Commission in its Energy Retail Code, and AGL as the declared retailer is required to supply any small customer under the standing contract.

There are two alternative views as to the nature of the standing contract. The first is that it is essentially a “fail-safe” contract, and is there to ensure no consumer can have electricity supplied on any worse terms and conditions: it is there to protect them as a minimum standard.

The alternative view is that the standing contract is the norm, the standard supply arrangement for small customers.

These differing interpretations can result in different views about the standing contract price.

On the former view, the price could be set at a slightly higher level than the normal price, to encourage retailers to set market contract prices so as to attract customers. This view is partly supported by the present arrangements in the Electricity Act, where standing contract responsibilities expire on 30 June 2005. This view would argue that standing contracts were seen by Parliament as a temporary measure for the first two and a half years of competition (Jan 2003 – June 2005), and had no ongoing role thereafter.

The alternative view, that the standing contract is the normal supply arrangement for small customers, would place greater emphasis on setting a price at the “proper” or “normal” level, without any consideration of its role in encouraging the development of competition

in market contracts. This view would recognise that a large number of customers will always remain with the standing contract retailer, regardless of the development of competition and the availability of market offers.

The Commission notes that the Terms of Reference of the Inquiry have directed the Commission that it is not to include a specific component for headroom.

While the Commission used the former view, outlined above, of the standing contract price in its earlier price determinations, the Commission notes that the amendments to the Electricity Act currently before the Parliament, while envisaging the eventual expiry of the standing contract arrangements, remove the current 30 June 2005 date and provide for expiry on a date fixed by Proclamation. This may lead to a view that it would be more appropriate for the Commission to regard the standing contract price as the base or normal price and to adopt the latter view outlined above.

Should the Commission regard the standing contract price for small customers:

- ▲ ***as a “fail-safe” standard: with regard being had to the fact that market offers should be better than the standing contract price and customers seeking a better price should move to a market contract, or***
- ▲ ***as the “standard” supply arrangement: with no regard to the price having an impact on market development.***

5.6 Demand Assumptions

One of the key inputs which influences the wholesale energy price is the demand profile of small customers and the overall level of demand. In establishing a price path, regard will need to be paid to how that demand profile might change over the three years.

The small customer demand profile in South Australia is known to be extremely peaky, with high demand on a few hot days in summer and relatively low for the rest of the year. This low “capacity factor” contributes to the higher average energy cost for these consumers relative to business and interstate consumers.

However, the demand profile can only be estimated: it is not able to be precisely determined. It is derived currently by looking at previous years’ demand profiles for the total system, and removing the actual and estimated half-hourly demand of large consumers and small consumers who have moved to market contracts. This is a very inexact process, especially as large numbers of consumers are moving away from standing contracts each month.

If the profile for the remaining standing contract customers was not important, this would not be a major issue but unfortunately, it does have a significant impact on the average energy cost.

The Commission will ultimately need to determine the load and load profile for standing contract customers for each of the three years of the price path. This will need to incorporate assumptions about matters such as:

- ▲ the extent of customer churn,
- ▲ changes in load profile of remaining consumers,
- ▲ expected growth in average demand.

How could the Commission improve its ability to estimate demand parameters?

What other approaches, such as sensitivity analysis, could the Commission use to manage this uncertainty?

5.7 Information from AGL

The Commission sets out in the following Section 6 the information it requires AGL to provide in its submission and price path proposal.

What additional information should be requested from AGL SA to assist the Commission in its evaluation of the price path proposal?

5.8 Alternative Approaches

The IPART Report endorsed the building block approach previously used by the Commission, and recommended it be used in the next price path review. The Commission has indicated it agrees with this recommendation.

However, the Commission is open to suggestions from stakeholders on alternative approaches to reviewing and setting a price path for the next three years. It therefore encourages stakeholders who have views on alternative approaches to make a submission to the Commission, so that it can decide if these other approaches can complement or indeed replace the building block methodology it is proposing to use.

What approaches, other than the building block approach, could the Commission consider in reviewing and setting a price path for the next three years?

5.9 Other Issues

While the Commission has nominated the above eight key issues for stakeholder comment, it is of course keen to receive stakeholder input on other issues relevant to this Inquiry.



6. PRICE PATH PROPOSAL

Under the Terms of Reference for the Inquiry, the electricity entity (AGL SA Pty Ltd) is to provide a price path proposal to the Commission by a date specified by the Commission, and containing information requested by the Commission.

As indicated previously, an Inquiry under Part 7 of the ESC Act is covered by the information gathering powers of the Commission under Part 5 of the Act, including a requirement to produce documents and records as required.

Part 5 of the ESC Act states that the Commission may, by written notice, require a person to give the Commission, within a time and in the manner stated in the notice, information in the person's possession that the Commission reasonably requires for the performance of its functions. It also includes obligations on the Commission to preserve confidentiality of certain information that could affect the competitive position of the regulated entity or is commercially sensitive for some other reason.

Amendments to the Electricity Act to place an obligation on the declared retailer to make a submission of a price path proposal for standing contract prices is not yet in place and that obligation does not yet reside with AGL. Nevertheless, the Commission understands that AGL has agreed with the government that it will cooperate in this Inquiry and will make such a submission when requested by the Commission.

Part 5 of the ESC Act provides the Commission with some powers to require AGL to provide to it information relevant to this Inquiry, which concerns an electricity price path for at least a 3 year period from 2005.

The Commission therefore intends to proceed in this Issues Paper to outline the information it requires from AGL, and to rely on either or both of AGL's agreement with the government and the Commission's powers under Part 5 of the ESC Act. Indeed, by requesting this information under Part 5, AGL is provided with the protection afforded by the ESC Act for confidential information.

6.1 Information Required from AGL SA Pty Ltd

The Commission seeks the following information from AGL, to be provided to the Commission by Friday, 20 August 2004.

The information must be provided in two forms: a document able to be released by the Commission as the basis for public consultation, and a stand-alone document containing confidential information to assist the Commission in its assessment. The document for public release should provide sufficient detailed information to allow stakeholders to understand and evaluate the price path proposal.



The information required by the Commission in AGL's initial submission should include at least the following:

1. The demand forecasts for each year of the price path by consumer group and tariff, on which the submission has been based, together with information on historical actual demand.
2. The proposed prices and price path for AGL's controllable costs for the major small consumer tariffs.
3. The wholesale electricity costs for each year of this period, and where appropriate, broken down into tariffs, consumer groups or seasons.
4. The retail operating costs per consumer for each year of this period, and where appropriate, broken down into tariffs and consumer groups.
5. The retail margin to be applied for each year of this period, and where appropriate, broken down into tariffs and consumer groups.
6. A detailed justification and explanation of the costs and margins used in items 2 to 5 above, including reasons for shifts from historical trends, audited⁵ historical operating costs and cost estimates of wholesale electricity contracts, and the assumptions underpinning these costs (including the cost allocation methodology used)
7. An indication of total revenue and costs for each year of the price path, for each major customer category and tariff.
8. A proposed form of regulation and its compliance with that form of regulation.
9. Any other information that will assist the Commission comply with the Terms of Reference of the Inquiry and the objectives of the relevant legislation.

The Commission will provide this information request by formal notice to AGL at the time it releases this Issues Paper.

Commission staff will work with AGL to clarify any issues arising from this request, and to ensure the information provided meets the Commission's requirements.

Is there any additional information the Commission should seek from AGL, which would assist the Commission in this Inquiry?

⁵ The audit should be undertaken based on guidelines prepared by the Commission. These guidelines will be provided to AGL prior to the audit.

7. NEXT STEPS

The Commission has set out a provisional timetable for the Inquiry in Section 1.4 of this Issues Paper.

The timetable indicates that the Commission is seeking comment on the issues raised in the paper by 30 July 2004.

The Commission will also be writing to AGL to seek provision of information and a price path proposal by 20 August 2004. The Commission intends to release the AGL price path proposal for public consideration within a few days of its receipt.

In the period between June and mid August, the Commission will undertake a number of studies with the assistance of consultants to give it a more detailed understanding of the cost components of the standing contracts.

The Commission will use the information it receives from stakeholder submissions, AGL and consultants to prepare a Discussion Paper for release to stakeholders by 6 September 2004.

Submissions on the Discussion Paper will be sought by 22 October, and a public forum will be organised in late October to facilitate discussion on the submissions and key issues relating to the price path inquiry.

The Commission will issue a draft determination in late November 2004. Stakeholders will be given an opportunity to comment on the draft decision and to participate in a public forum in early 2005, prior to the final determination being released.

This Issues Paper provides the first opportunity for stakeholders to have an input into the process. The Commission encourages stakeholders to comment on the Key Issues identified in Section 5.

Submissions need to be received by the Commission by 30 July 2004 if they are to be considered in the preparation of the Discussion Paper for release in early September.



ATTACHMENT 1

Essential Services Commission Act 2002

NOTICE OF REFERENCE UNDER PART 7

Standing Contract Prices of AGL from 2005

1. BACKGROUND

- 1.1 Pursuant to Part 7 of the *Essential Services Commission Act 2002* (“**the Act**”) an industry Minister may, by written notice, refer any matter relating to a regulated industry to the Essential Services Commission (“**the Commission**”) for the Commission to conduct an inquiry into that matter.
- 1.2 By virtue of section 14D of the *Electricity Act 1996*, the electricity industry is a regulated industry for the purposes of Part 7 of the Act.
- 1.3 The Hon Patrick Conlon, Minister for Energy (“**the Minister**”) is the Minister administering the *Electricity Act 1996*.
- 1.4 Pursuant to section 36AA of the *Electricity Act 1996* the Governor may declare an electricity entity to be subject to section 36AA of the *Electricity Act 1996*.
- 1.5 By proclamation in the Gazette, edition of 12 September 2002 (p.3384), AGL South Australia Pty Ltd ACN 091 105 092 (“**the electricity entity**”) is a declared electricity entity pursuant to section 36AA of the *Electricity Act 1996*.
- 1.6 The Government has announced a legislative amendment process in response to the recommendations of the Report by the Independent Pricing and Regulatory Tribunal (IPART) of March 2004. These changes will be pursued whilst the price inquiry to which these terms of reference apply is in progress.
- 1.7 It is anticipated that the Commission’s final report and determination (should the Commission consider it appropriate) will be issued pursuant to the new legislative regime.

2. REFERENCE

I PATRICK CONLON, Minister for Energy, hereby refer to the Commission the matter described in paragraph 3.1 of the Terms of Reference for the Commission to investigate pursuant to Part 7 of the Act, in accordance with the Terms of Reference specified below.

3. TERMS OF REFERENCE

The following are the Terms of Reference for the inquiry specified pursuant to section 35 of the Act:

- 3.1 The Commission is to investigate the standing contract price proposal (“the Proposal”) that will apply to small customers from 1 July 2005 for a period of no less than three years.
- 3.2 In assessing the proposal, the Commission’s evaluation will be limited to reviewing the electricity entity’s prudent controllable costs which, together with the relevant network tariffs, comprise the final standing contract prices charged to small customers. There should be no provision for specific headroom allowed in the prudent controllable costs determined by the Commission.
- 3.3 On completion of the inquiry, the Commission may issue a determination under Part 3 of the Act in conjunction with the making of its final report on the inquiry.
- 3.4 In determining whether the electricity entity’s controllable costs are justified as the prudent costs incurred in supplying small customers, in addition to the requirements of Parts 2 and 3 of the Act, the Commission is to have regard to:
 - 3.4.1 the electricity entity’s justification for its proposed charges, presented as part of the proposal;
 - 3.4.2 The wholesale electricity contracts and hedging strategies that would be utilised by a prudent electricity entity in providing the standing contracts to each of the residential and business customer classes in South Australia;
 - 3.4.3 The electricity entity’s actual underlying wholesale electricity contracts, hedging strategies and other arrangements for securing electricity for supply in South Australia, as well as the method for allocating these costs between large and small customers and within the small customer class;

- 3.4.4 The retail operating costs that would be incurred by a prudent electricity entity in delivering the range and standard of services that are required of the electricity entity in providing standing contract services to South Australian small customers;
- 3.4.5 The electricity entity's actual operating costs in providing standing contract services to South Australian small customers, and the method of allocating its costs between the different customer classes;
- 3.4.6 The electricity entity's proposed margin on standing contract sales, and its actual margin achieved in recent years, and whether these are reasonable having regard to the entity's investment in the business, the risks of standing contract retailing in South Australia, and the equivalence with standing contract retailer margins interstate without Government risk management schemes;
- 3.4.7 Any cross-subsidies between, and within, business and residential small customer classes, and whether these cross-subsidies are justified to prevent a disproportionate price impact on any small customer group;
- 3.4.8 The prices charged and costs incurred in providing comparable services in other States and Territories of Australia, and whether the reasons for any differences can be justified; and
- 3.4.9 any other factors the Commission considers relevant.

4. CONDUCT OF INQUIRY

- 4.1. Following the receipt of these terms of reference, the Commission's inquiry process shall consist of at least the following:
 - 4.1.1 The publication of a notice of inquiry, as required pursuant to section 36 of the Act, no later than 7 days following receipt of these terms of reference;
 - 4.1.2 The release of an issues paper within 1 month of receipt of these terms of reference, in whatever form the Commission considers appropriate, setting out the information it requires the electricity entity to provide by a date specified in the Paper, and seeking comment on the key issues it should address in its investigations;



- 4.1.3 The release of a Discussion Paper following the release of the electricity entity's proposal, as the basis of a consultation process on the proposal and on other information available to the Commission on components of the electricity entity's controllable costs;
 - 4.1.4 The release of a draft decision and determination (if applicable) to the Minister and electricity entity for comment no later than one week prior to the public release of a draft decision and determination;
 - 4.1.5 The release of a draft decision and determination (if applicable) no later than 30 November 2004, including provision for a bridging price for the period to 30 June 2005; and
 - 4.1.6 The submission of a final report and price determination (if applicable) to the Minister and electricity entity no later than 31 March 2005, and to the public no later than 7 days thereafter.
- 4.2 The final price determination (if considered appropriate) should allow for an adjustment within the period for which the determination applies based on such factors and as frequently as considered appropriate by the Commission.
- 4.3 The consultation process may consist of a public hearing, public seminar or workshop but the Commission may receive and consider any written submissions as it thinks appropriate.

5. DEFINITIONS

In this notice:

- 5.1 "business customer class" means those small customers not included in the residential customer class and excluding unmetered supplies;
- 5.2 "controllable costs" refer to those costs of the electricity entity which comprise the wholesale cost of electricity, retail operating costs, retail profit margin and any other cost (other than network charges) incurred by the electricity entity in carrying out its obligations under relevant legislation;
- 5.3 "proposal" refers to the document or documents provided by the electricity entity to the Commission in response to its initial information request as set out in the Issues Paper. The documents may include confidential

components which the Commission must not publicly release and must treat in accordance with section 30 of the Act;

- 5.4 “residential customer class” means the group of small customers consuming electricity in premises wholly or principally as private residence; “small customer” has the meaning given to it in the *Electricity Act 1996*;and
- 5.5 “standing contract price” has the meaning given to it by section 36AA(6)(b) of the Electricity Act 1996

Dated May 2004

HON PATRICK CONLON MP
Minister for Infrastructure
Minister for Energy
Minister for Emergency Services