



Retail Market Review – Reference price methodology

Consultation paper feedback session

May 2018



Welcome and introduction

James Clinch – ESC



Agenda

1. Welcome and introduction
2. Update on consultation paper submission process
3. Future consultation

Consultation paper submission feedback

Jessica Saigar – ESC



Consultation paper proposed approach



← As per AER approved tariffs

← Estimates based on the futures markets for electricity and LNG net back for gas (including losses)

← Market based analysis

← Cost based analysis

← Analysis of retail margins

← Market and licence fees, ancillary charges

Overview of submissions

- The commission received 13 public submissions to the consultation paper.
- Submissions came from a mix of small, medium and large retailers, as well as consumer groups.
- A cost-based approach was largely supported in submissions.
- A number of submissions questioned the timeframes we are required to deliver under and commented on the interaction with other policy processes that are ongoing.

Wholesale electricity costs

Approach outlined in consultation paper and technical workshop

- Set out our proposed approach using futures market, which includes electricity purchase costs (including hedging) and a volatility allowance.
- The approach requires estimations of:
 - Load profiles (MRIM data)
 - Spot prices (NEM)
 - Cost of financial hedging contracts (ASX futures market)
 - An efficient, but conservative hedging profile (portfolio optimisation model)

Wholesale electricity costs

Overall feedback

- Broadly supported a futures market approach
 - comments on specific input assumptions.
- A small number of submissions suggested:
 - alternative approach (e.g. LRMC)
 - how future policy would impact this (i.e. NEG).

Wholesale gas costs

Approach outlined in consultation paper and technical workshop

- Netback price approach, which included:
 - World Bank commodity price forecasts (LNG in Japan) – sensitivity test using oil-linked forecast
 - IMF forecasts of exchange rates
 - Shipping costs
 - SRMC of liquefaction and Wallumbilla to Gladstone pipeline
 - Pipeline costs to Victoria, including reserved capacity to meet peak demand (based on AEMO forecasts of residential load factor)

Wholesale gas costs

Overall feedback

- Netback approach was the most transparent for this process
 - may not necessarily represent the actual cost to retailers.
- The commission should gather additional data to support the estimation
 - for example, contract prices.

Environmental costs

Approach outlined in consultation paper and technical workshop

- Market based approach based on trading (or clearinghouse) and futures prices, as well as the liabilities faced by retailers.
- The consultation paper identified the national renewable energy schemes, Victorian Energy Upgrades and solar feed-in tariffs as costs for retailers.

Overall feedback

- General support for taking a market based approach.

Network costs

Approach outlined in consultation paper and technical workshop

- Directly passing through costs approved by the AER for each distribution zone – for both electricity and gas.

Overall feedback

- Broadly supported the approach, noting that a reference price would be required for each distribution zone.

Retail operating costs

Approach outlined in consultation paper and technical workshop

- Would be seeking to estimate operational costs incurred by a retailer in conducting its business (i.e. billing and IT systems, call centre, corporate overheads).
- Ideal approach would be a comprehensive bottom-up estimate of costs, but an interim approach of regulatory benchmarks and publicly available data.
- The commission also sought data from retailers to assist with a bottom-up estimate of costs.

Retail operating costs

Overall feedback

- Some reserved support for a benchmarking approach in the interim.
- Some retailers suggested to look at actual cost data.
- Some suggested that it was inappropriate to exclude all competition costs (e.g. marketing).

Retail margin

Approach outlined in consultation paper and technical workshop

- A fully comprehensive approach that included analysis using expected returns, bottom-up estimates and benchmarking of comparable firms.
- However, due to the timeframes we proposed an interim approach using estimates from regulatory benchmarks in other jurisdictions.

Overall feedback

- Reserved support for the longer term approach to a range of approaches.
- Some supported benchmarks in the interim, others stated that this approach was not appropriate.

Other costs

Approach outlined in consultation paper and technical workshop

- Estimates of a range of market, licence and other costs based on published and historical information.
- Costs are assumed to be directly passed through.

Overall feedback

- Very few submissions focused on other costs.

Future consultation

James Clinch – ESC



Consultation going forward

Competitiveness review

- Our principles will guide how we seek to engage while developing and delivering the competitiveness review.
- We will be seeking your input into how we do this in practice. Particular issues might include:
 - Frequency of engagement.
 - Style of engagement (e.g. town hall, workshop or one-on-one).
 - Anything else?