

ELECTRICITY RETAIL MARKET REVIEW

Draft Recommendations Report Review of Electricity Tariff Arrangements



Office of Energy Report to the Minister for Energy

April 2008

ELECTRICITY RETAIL MARKET REVIEW

REVIEW OF ELECTRICITY TARIFFS

KEY MESSAGES

- Retail electricity tariffs need to reflect the costs of supply to ensure the continued security of supply and the financial viability of all electricity industry participants (both private and Government owned). Current retail tariffs are not cost-reflective.
- Tariffs need to increase into the future to move to cost-reflective levels. Increases are required in 2009/10 to address pressures in the existing costs of electricity supply. New costs are expected in 2010/11, with commencement of a National Emissions Trading Scheme.
- Concessions should be increased in line with Government approved tariff increases to mitigate some of the impacts of the tariff increases on low income and disadvantaged consumers.
- Household electricity prices have remained fixed since 1997, but costs to supply electricity have increased significantly over the past decade, particularly in recent years with the strong economic conditions in Western Australia.
- In many instances, electricity users have the opportunity to reduce their use. Increased energy efficiency will become increasingly important and can be achieved by applying simple energy saving techniques.

RECOMMENDATIONS

This Review forecasts the required increase in the retail component of electricity tariffs (wholesale electricity costs, retail operating costs, and retail profit margin) necessary to make tariffs for residential and small business (small-use) customers cost-reflective from 2009/10, and has taken account of prior decisions by the Economic Regulation Authority in regard to network tariffs.

The Review also forecasts the required increase in the retail component of electricity tariffs necessary to make tariffs for contestable customers (large businesses) cost-reflective from 2008/09, and has taken account of prior decisions by the Economic Regulation Authority in regard to network tariffs.

The network component of the tariff for 2009/10 will be determined by the Economic Regulation Authority in due course. The cost impacts of the National Emissions Trading Scheme will be a function of the arrangements determined by the Commonwealth Government, and is expected to commence in 2010/11.

- 1. In order for tariffs for residential and other small-use customers in the South West Interconnected System to be cost-reflective from 2009/10, the tariffs are forecast to need to increase as per the estimates in the following table (details of the tariff classes are in Attachment 1).**

Tariff	2008/09	2009/10	2010/11	2011/12
Residential Tariffs				
A1/A2/B1	-	47%	15%	2%
Other Small-Use Customers				
L1/L2	-	21%	16%	2%
R1	-	32%	19%	2%
K1/K2	-	44%	15%	2%

These tariff increases are forecasts only, and include estimates of the impact of decisions by the Economic Regulation Authority in 2009/10 and the National Emissions Trading Scheme in 2010/11.

Government could select a glide path for the residential and other small-use customer tariffs to reach the forecast cost-reflective levels. However, Government should fund any difference between cost-reflective tariffs and the glide path it chooses through Community Service Obligation payments. If a glide path is chosen by Government, details of the amount of Community Service Obligation payment should be shown on electricity bills.

- 2. Regarding the tariff structure for the A1/A2 and L1/L2 Tariffs (for residential and small business customers):**
 - the A1/A2 and L1/L2 Tariffs should retain their current tariff structure in the short-term;**

- future consideration should be given to changing the A1/A2 and L1/L2 Tariffs to an inclining block tariff structure once these tariffs reach cost-reflective levels; and
 - if, and when smart meters are implemented in Western Australia, consideration should be given to changing the A1/A2 and L1/L2 Tariffs to a time-of-use tariff structure.
3. Regarding energy rebates for financially disadvantaged residential customers:
- all rebates should be increased in proportion to any Government approved electricity tariff increases;
 - the Seniors' Air Conditioning Rebate should be renamed the "Air Conditioning Rebate" and should be expanded to apply to those eligible for the Dependent Child Rebate; and
 - the Supply Charge Rebate should continue to be administered via electricity bills, but should be re-titled to the "Energy Rebate", and should not be linked to the value of the electricity supply charge.
4. The Community and Charitable Organisation Tariffs (C1/C2 and D1/D2 Tariffs) should be removed and assistance provided by direct Community Service Obligation payments.
5. In order for tariffs for large businesses (contestable customers) in the South West Interconnected System to be cost-reflective in 2008/09, the tariffs need to increase in accordance with the following table (details of the tariff classes are in Attachment 1).

Tariff	2008/09	2009/10	2010/11	2011/12
Large Customer Tariffs				
R3	31%	8%	13%	3%
S1	19%	10%	11%	3%
T1	28%	9%	12%	3%
M1	32%	11%	10%	4%
N2	-	-	-	-
P2	10%	10%	16%	2%
W1/W2	118%	13%	9%	3%
Z	25%	11%	10%	2%

The tariff increases from 2009/10 forward are forecasts only, and include estimates of the impact of decisions by the Economic Regulation Authority in 2009/10 and the National Emissions Trading Scheme in 2010/11.

6. Community Service Obligation payments should replace the Tariff Equalisation Fund to fund the Uniform Tariff Policy in Horizon Power's supply areas.

7. Regarding future tariff reset processes:

- **regulated electricity tariff resets should be undertaken by the Economic Regulation Authority;**
 - **the first retail tariff determination by the Economic Regulation Authority should take effect from 1 July 2012, and timing for subsequent retail tariff determinations should coincide with the timing of the network Access Arrangement resets to the greatest extent possible;**
 - **retail electricity tariffs should be subject to annual adjustments between the resets; and**
 - **Government can retain the discretion to continue glide path arrangements for residential and other small-use customers following the first tariff determination by the Economic Regulation Authority, with Community Service Obligation payments made for the difference between the glide path tariff and tariff determinations.**
- 8. Network tariffs should be automatically passed through for all classes of retail electricity tariffs and should be separately itemised on retail bills.**
- 9. Costs from greenhouse gas emissions mitigation measures should be automatically passed through for all classes of electricity tariffs and should be separately itemised on retail bills.**

BACKGROUND

The Minister for Energy is conducting the Electricity Retail Market Review (the “Review”), comprising a review of:

- electricity retail tariff arrangements;
- the introduction of full retail contestability in electricity, and
- the roll out of smart meters.

As part of the Review process, an Issues Paper was circulated to key stakeholders for comment in August 2007. A revised Issues Paper considering the additional matters raised by key stakeholders was circulated for broader public comment in December 2007.

This Recommendations Paper is limited to addressing the electricity tariff arrangements. The roll out of smart meters and the introduction of full retail contestability will be the subject of a separate draft recommendations paper and consultation process.

The Office of Energy is responsible for completing the Review and preparing recommendations for the Minister for Energy’s consideration.

The Office of Energy has commissioned Frontier Economics to assist in the economic modelling for the Review, and for the development of the draft and final Recommendations Papers.

This Overview Report details the Office of Energy’s recommendations relating to the tariffs component of the Review, and is based on Frontier Economics’ draft recommendations paper titled “Electricity Retail Market Review – Electricity Tariffs”. This Overview Report and the Frontier Economics draft recommendations paper will be open for an eight-week public comment period, ending 30 May 2008.

GOVERNMENT ENERGY POLICY OBJECTIVES

The Government's energy policy objectives are to:

- encourage and facilitate provision of secure, reliable and sustainable energy services at competitive prices;
- implement appropriate market and regulatory arrangements to achieve a competitive, dynamic and sustainable energy sector;
- ensure the Government-owned Electricity Corporations participate in the energy industry in a competitively neutral manner, whilst they endeavour to make a profit, consistent with maximising their long-term value to the State; and
- raise awareness and provide information and tools by which consumers can make informed choices about the level, source, and cost of their energy consumption.

COST-REFLECTIVE ELECTRICITY TARIFFS

Regulated retail tariffs in Western Australia have been frozen for some time. Residential tariffs have not increased since 1997/98, which is an estimated a real price reduction to 2009/10 of about 30%.¹

Until July 2007, large business tariffs had not increased in nominal terms since 1991/92, which is about a 34% reduction in real electricity prices to 2006/07.² Small business tariffs have not increased since 1991/92, which is expected to be a real price reduction of about 38% to 2009/10.

Cost-reflective retail tariffs are essential for development of a competitive electricity retail market. If tariffs do not reflect the cost of supplying electricity, including an appropriate margin, then retailing electricity will not be a profitable business activity. New entrants will be unlikely to enter the market, and existing retailers may exit (or suffer substantial losses if it is Government-owned and required to continue to supply).

Even in the absence of reform and competition, tariffs that are below efficient costs will continue to have significant negative impacts on the financial viability of the Government-owned Electricity Corporations. Existing private electricity suppliers will also be impacted through an inability to compete with the regulated tariff prices, as tariffs would act as a price floor rather than a price ceiling.

Cost-reflective pricing is appropriate and is necessary for other essential services, such as water. The Government has recently agreed to phase in cost-reflective water tariffs to metropolitan residential customers by 2013/14.³

¹ Estimate based on electricity tariff data collected by the Office of Energy and ABS CPI data, excluding the introduction of GST in 2000/01.

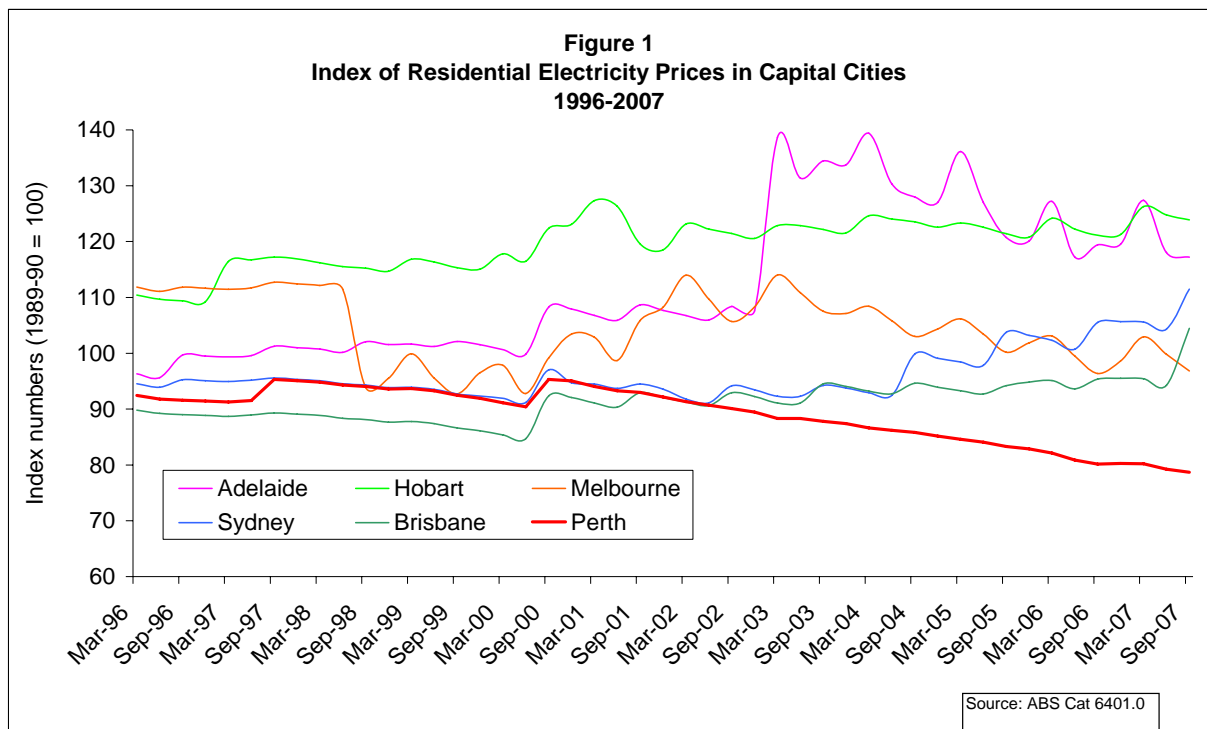
² Government increased tariffs for medium to large business customers (those consuming more than 50MWh per annum) on the R3, S1 and T1 Tariffs, as of 1 July 2007.

³ The Economic Regulation Authority has determined that water prices will have increasing charges for three inclining blocks of consumption. The first two blocks of consumption will be priced at the lower and higher estimates

Given that electricity tariffs in Western Australia have significantly decreased in real terms over the last decade, and that there have been recent substantial increases in the cost of producing and supplying electricity, the current tariffs are not cost-reflective and require adjustment.

Similar pressures have also been experienced in other parts of Australia, resulting in increases to regulated tariffs in the other jurisdictions.

The following graph shows that whilst Western Australian electricity tariffs have remained relatively static in nominal terms and declined in real terms over the past decade, tariffs have increased in the other jurisdictions of Australia.⁴



In addition, the following table shows the recently announced retail electricity tariff increases for residential and small business customers in the other Australian jurisdictions.⁵ This table shows that the other Australian jurisdictions are continuing to see sustained residential and small business tariff increases. The other jurisdictions will all see tariff increase over 15% for the period from 2006/07 to 2011/12. These increases may appear small relative to the increases forecast in this Review, but tariffs in the other jurisdiction have been steadily increasing over the last decade, whilst the Western Australian tariffs have been reducing in real terms over this period.

of long-run marginal cost, and the price of the third block will be priced at the existing top rate for residential consumption. The fixed component of the water charges is to reflect the efficient cost to serve consumers.

⁴ This graph was compiled by Frontier Economics for the Office of Energy based on data from ABS (ABS Cat 6401.1).

⁵ Sources for this table are listed in Attachment 2 to this Report.

State	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12
New South Wales	5.0 to 5.8%	7.0 to 8.0%	7.0 to 8.0%	7.0 to 8.0%		
Victoria	1.6%	12.0 to 17.0% for residential customers Cease coverage for small businesses				
Queensland		11.32%				
South Australia	2.5%	12.34%	CPI	CPI		
Tasmania	4.0%	15.7% for residential customers 16.4% for small business customers	4.0%	3.8%		
Northern Territory		4.4%	CPI	CPI	CPI	CPI

The affordability and accessibility of electricity for residential consumers is an important consideration in assessing tariff arrangements. However, it is not desirable to require electricity to be supplied at a price where the short-term and long-term reliability of supply is unsustainable. Electricity prices need to provide an appropriate return on efficient investments in the supply of electricity to ensure new supplies are delivered into the market. In economic terms, tariffs need to provide for the long-run marginal cost of supply.

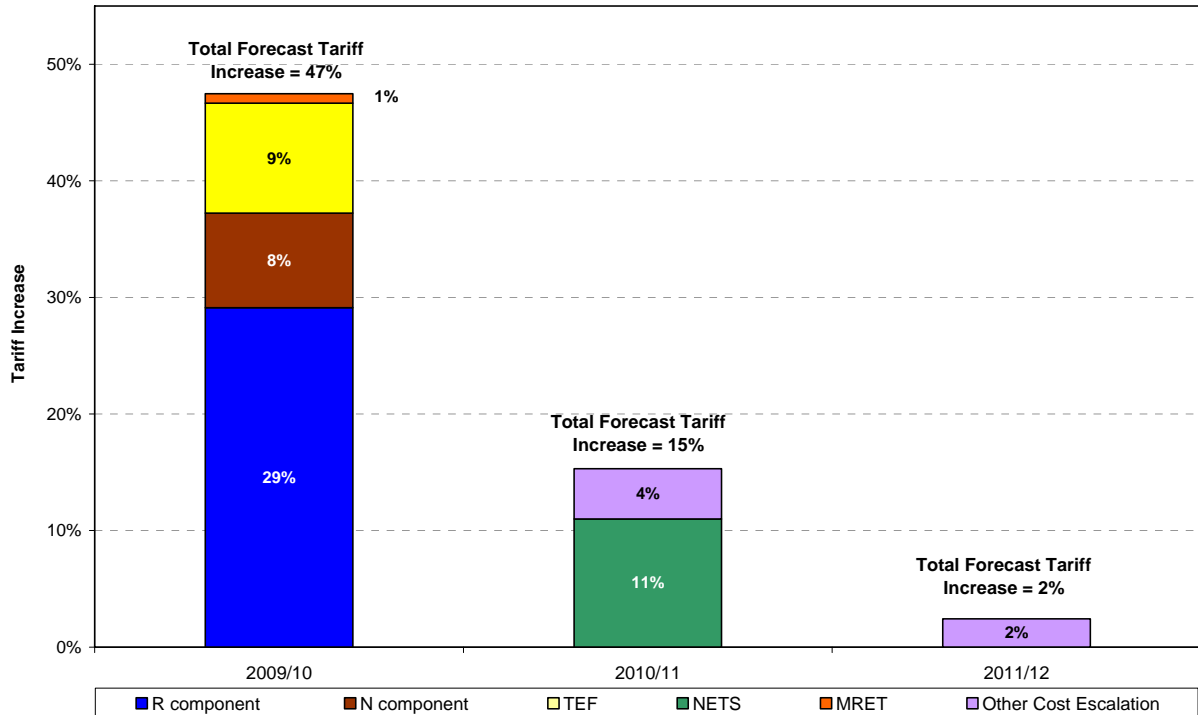
Cost-reflective pricing will eliminate potential cross-subsidies between different tariffs, which would act to prevent competition in the marketplace and would be inequitable. Cross-subsidies lead to some prices being too high relative to their costs and others will be too low. Importantly under cost-reflective pricing arrangements, the needs of disadvantaged customers or groups of consumers can and should be addressed by direct subsidies outside of the tariff arrangements, not via cross-subsidies.

CLIMATE CHANGE AND ENERGY CONSERVATION

The State Government recognises the threat that climate change poses to Western Australia and is working with the Commonwealth Government on a number of initiatives aimed at reducing Australia's carbon emissions. The community has become increasingly aware of the importance of these issues and the requirement to take action to achieve climate change mitigation objectives. This awareness includes increasing recognition of the importance of efficiency in the use of the State's natural resources and minimisation of the negative impacts associated with these activities.

Cost-reflective pricing will assist in driving increases in energy efficiency by placing an appropriate value on energy consumption, and therefore driving customer behaviour. Increased tariffs will also make renewable energy sources more cost competitive.

ESTIMATES FOR A1/A2 – RESIDENTIAL TARIFF



It is forecasted that the A1/A2 Residential Tariff needs to increase by 47% in 2009/10 to achieve cost-reflectivity. This Review has determined that the required increase in the level of the retail (R) component of the tariff accounts for 29 percentage points of the 47% increase in 2009/10.

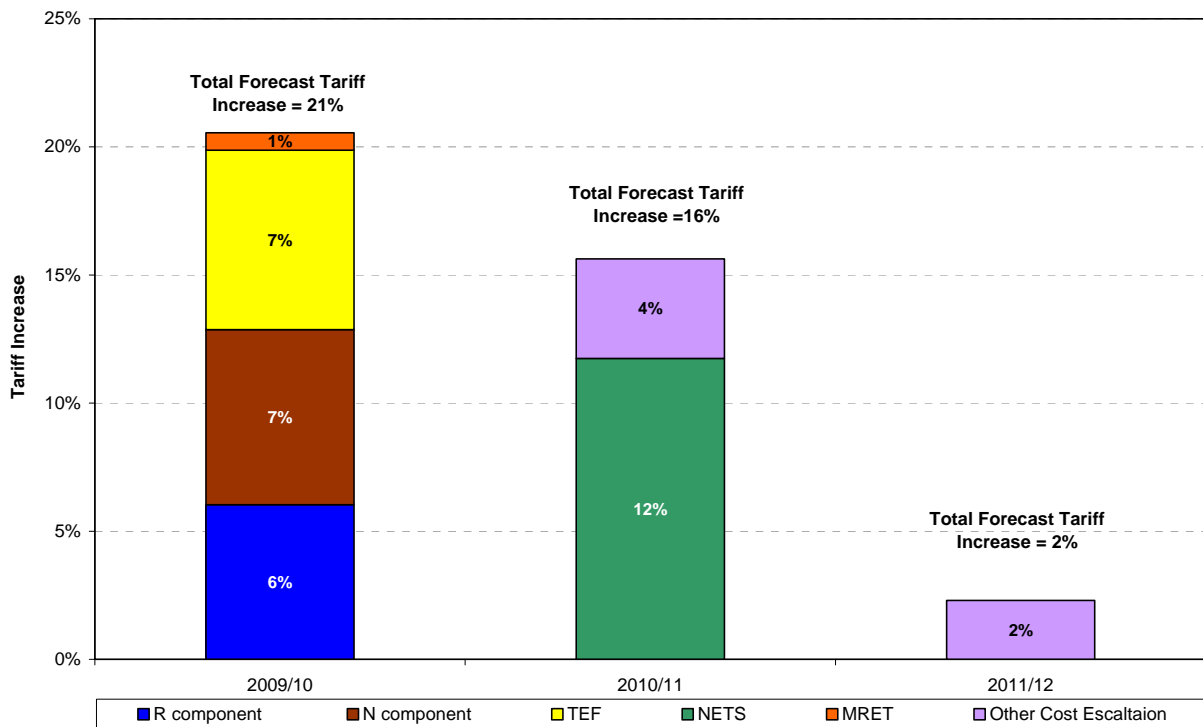
The network (N) component of the tariff is estimated to account for 8 percentage points of the 47% increase in 2009/10, although network tariffs for 2009/10 are yet to be determined by the Economic Regulation Authority. The Economic Regulation Authority will commence considering the required network tariff increase for 2009/10 later this year.

Since tariffs were last increased, the Tariff Equalisation Fund has been introduced to subsidise the supply of electricity to regional areas by Horizon Power. The Tariff Equalisation Fund is estimated to account for 9 percentage points of the required 47% increase in 2009/10. The Tariff Equalisation Fund is determined by the Treasurer on advice from the Economic Regulation Authority (if required), and the forecasted Tariff Equalisation Fund component is based on Horizon Power's estimate and is yet to be formally set by the Treasurer. Similarly, the expanded national Mandatory Renewable Energy Target has been introduced during this period and accounts for less than 1 percentage point of the 47% increase in 2009/10.

It is forecasted that the A1/A2 Residential Tariff will require a further increase of 15% in 2010/11. The majority of the 15% increase in 2010/11, 11 percentage points, is an indicative estimate for the cost increase associated with the introduction of the National Emissions Trading Scheme. The magnitude of the required increase due to the National Emissions Trading Scheme will be determined by the decisions of the Commonwealth Government in

regard to scheme design and greenhouse gas reduction targets. The 15% increase for 2010/11 also includes an estimated 4 percentage point increase in 2009/10 costs.

ESTIMATES FOR L1/L2 – SMALL BUSINESS TARIFF



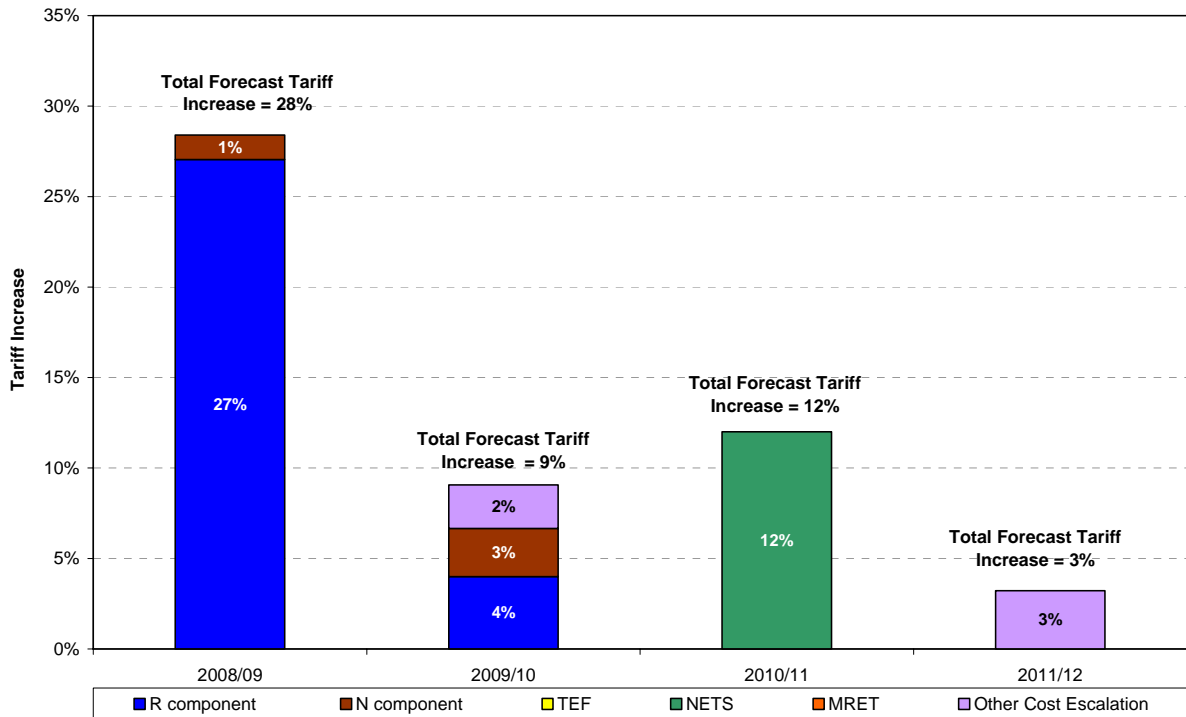
It is estimated that the L1/L2 Small Business Tariff needs to increase by 21% in 2009/10 to achieve cost-reflectivity. This Review has determined that the required increase in level of the retail (R) component of the tariff accounts for 6 percentage points of the 21% increase in 2009/10.

The network (N) component of the tariff is estimated to account for 7 percentage points of the 21% increase in 2009/10, although network tariffs for 2009/10 are yet to be determined by the Economic Regulation Authority. The Economic Regulation Authority will commence considering the required network tariff increase for 2009/10 later this year.

Since tariffs were last increased, the Tariff Equalisation Fund has been introduced to subsidise the supply of electricity to regional areas by Horizon Power. The Tariff Equalisation Fund is estimated to account for 8 percentage points of the 21% increase in 2009/10. The Tariff Equalisation Fund is determined by the Treasurer on advice from the Economic Regulation Authority (if required), and the forecasted Tariff Equalisation Fund component is based on Horizon Power's estimate and is yet to be formally set by the Treasurer. Similarly, the expanded national Mandatory Renewable Energy Target has been introduced during this period and accounts for less than 1 percentage point of the required 21% increase in 2009/10.

The forecasted L1/L2 Tariff for 2010/11 indicates a further increase of 16%. The majority of the 16% increase for 2010/11, 12 percentage points, is an indicative estimate for the cost increase associated with the introduction of the National Emissions Trading Scheme. The magnitude of the required increase due to the National Emissions Trading Scheme will be determined by the decisions of the Commonwealth Government in regard to scheme design and greenhouse gas reduction targets. This 16% increase for 2010/11 also includes an estimated 4 percentage point increases in 2009/10 costs.

ESTIMATES FOR T1 – LARGE BUSINESS TARIFF



It is estimated that the T1 Large Business Tariff needs to increase by 28% in 2008/09 to achieve cost-reflectivity. This Review has determined that the required increase in level of the retail (R) component of the tariff accounts for 27 percentage points of the 28% increase in 2008/09. The network (N) component of the tariff is estimated to account for 1 percentage point of the 28% increase in 2008/09.

It is estimated that the T1 Tariff needs to increase by 9% in 2009/10 to maintain cost-reflectivity. This Review has determined that the required increase in level of the retail (R) component of the tariff accounts for 4 percentage points of the 9% increase in 2009/10. The network (N) component of the tariff is estimated to account for 3 percentage points of the 9% increase in 2009/10, although network tariffs for 2009/10 are yet to be determined by the Economic Regulation Authority. The Economic Regulation Authority will commence considering the required network tariff increase for 2009/10 later this year. Similarly, the expanded national Mandatory Renewable Energy Target has been introduced during this period and accounts for 2 percentage points of the required 9% increase in 2009/10.

The forecasted T1 Tariff for 2010/11 indicates a further increase of 12%, almost all of which is associated with the introduction of the National Emissions Trading Scheme. The magnitude of the required increase due to the National Emissions Trading Scheme will be determined by the decisions of the Commonwealth Government in regard to scheme design and greenhouse gas reduction targets.

A NOTE ON MODELLING THE TARIFF COMPONENTS

Frontier Economics used a building block approach to forecast cost-reflective tariffs based on the following existing costs:

- the retail (R) components (wholesale electricity costs, retail operating costs, and retail profit margin);
- the network (N) charges;
- the Tariff Equalisation Fund; and
- existing national Mandatory Renewable Energy Target costs.

Frontier Economics has undertaken economic modelling to determine the retail (R) component required to make tariffs cost-reflective. Frontier Economics has also made estimates of the required increase in the total tariff to achieve cost-reflectivity.

Estimates have also been made for new costs which are expected to commence from 2010/11 for the National Emissions Trading Scheme and expansion of the Mandatory Renewable Energy Target.

The Frontier Economics Report provides a detailed description of its modelling methodology.

This economic modelling has forecast the cost-reflective level of tariffs within the South West Interconnected System. Where applicable and regulated, these tariffs will apply to eligible customers in regional Western Australia (outside the South West Interconnected System) that are served by Horizon Power in accordance with the Government's Uniform Tariff Policy.

It should be noted that the modelling outcomes do not include costs associated with full retail contestability and smart meters. This is because it is not certain that these measures will be implemented during the Review period (2008/09 to 2011/12). Modelling outcomes may need to be adjusted in the final report to account for the outcomes of these components of the Review, should the Government determine that these matters are to be progressed in Western Australia within this timeframe.

Key Assumptions

Wholesale Electricity Costs

In developing wholesale cost estimates, coal price assumptions were derived from responses to the Office of Energy's data request. A cap on these coal prices was also determined as the maximum price that, given assumed gas prices, is consistent with investment in, and dispatch of, coal-fired generation plant. Gas price assumptions are derived from consideration of publicly available information, with an assumed price of \$8.00 per GJ delivered.

Wholesale Prices have been determined on the following basis:

- for non-contestable customers, a blend of a forecast of Verve Energy's sustainable price and the long-run marginal cost of wholesale supply in the South West Interconnected System; and

- for contestable customers, the forecast long-run marginal cost of wholesale supply in the South West Interconnected System.

Network Costs

The network access arrangement for the South West Interconnected System has not yet been determined for the period 2009/10 to 2011/12, and therefore the network cost component of the tariff building blocks is an estimate only.

If actual network costs deviate from the modelled estimates, this will change the increase required to achieve cost reflective tariffs in 2009/10. Given the Economic Regulation Authority is yet commence its consideration of network tariffs for 2009/10, network costs should be treated as a pass through item, as per Recommendation 8. Further details are in the section [“Electricity Tariffs Pass-Through Charges”](#).

National Greenhouse Gas Emissions Trading Scheme Costs

The National Emission Trading Scheme is still under development, and given the uncertainty surrounding the form and targets for the scheme, this cost estimate is inherently unreliable.

Costs for a national greenhouse gas emissions trading scheme have been estimated based on the arrangements for such a scheme, as released by the National Emissions Trading Taskforce in August 2006.

The forecast prices for carbon credits were derived from activities within the National Electricity Market, which is the largest electricity market in Australia. It has been assumed that Western Australian energy market participants will be price takers for carbon credits, and that the National Emissions Trading Scheme commences operation on 1 July 2010.

Based on this, the nominal carbon credit prices have been estimated to be:

	2008/09	2009/10	2010/11	2011/12
Carbon Credits (\$/credit)	0.00	0.00	26.36	28.98

It should be noted that National Emissions Trading Scheme has not yet been fully developed, so there is a wide variety of estimates of the likely carbon credit price. The National Emissions Trading Taskforce is currently undertaking further modelling of the National Emissions Trading Scheme. However this modelling has not yet been completed and is not yet available publicly and therefore could not be used for the purposes of the Review. The Commonwealth Government is also developing cost estimates.

It has also been assumed that retailers will bear the cost of the National Emissions Trading Scheme based on the average emissions intensity in the South West Interconnected System and their portfolio share of electricity consumption. Changes to the cost impacts of National Emissions Trading Scheme compared to that which has been modelled will change the results of the forecast tariff levels for 2010/11. Further details are in the section [“Electricity Tariffs Pass-Through Charges”](#).

Mandatory Renewable Energy Target

The expanded Mandatory Renewable Energy Target arrangements have not been fully developed, so assumptions have been made to arrive at estimated costs for this scheme.

The Mandatory Renewable Energy Target was modelled such that the pathway for the renewable energy target is assumed to be a straight line from the 2010 target of 9,500 GWh per annum to the 2020 target of 45,000 GWh per annum.

The forecast prices for Renewable Energy Certificates were derived from activities in the National Electricity Market, which is the largest electricity market in Australia. Western Australian energy market participants were assumed to be price takers for Renewable Energy Certificates.

Changes to the Mandatory Renewable Energy Target scheme compared to that which has been modelled will change the results of the forecast retail tariff levels. Further details are in the section "[Electricity Tariffs Pass-Through Charges](#)".

Tariff Equalisation Fund

The Tariff Equalisation Fund was introduced to fund the subsidy of electricity supply to the regional customers outside the South West Interconnected System that Horizon Power is obliged to supply. The value of the Tariff Equalisation Fund is determined by the Treasurer in consultation with the Economic Regulation Authority (if necessary), and is collected through distribution network charges.

The funding requirement for the Tariff Equalisation Fund depends on the size of the approved tariff increases. Therefore, the current Tariff Equalisation Fund values for the Review are estimates only and will be determined by the Treasurer prior to the Economic Regulation Authority's determination of network tariffs from 1 July 2009.

Electricity Tariff Cost Stack

The following table provides a sample cost stack for the A1 Residential Tariff for 2009/10 to 2011/12, in both ¢/kWh and percentage of total tariff terms.

Cost Component	2009/10		2010/11		2011/12	
	¢/kWh	%	¢/kWh	%	¢/kWh	%
Black Energy Costs	10.81	51.3%	11.21	46.1%	11.06	44.4%
National Emissions Trading Scheme	0.00	0.0%	2.43	10.0%	2.67	10.7%
Mandatory Renewable Energy Target	0.12	0.5%	0.18	0.7%	0.24	1.0%
Ancillary Services	0.14	0.7%	0.14	0.6%	0.14	0.6%
Market Fees	0.06	0.3%	0.06	0.2%	0.06	0.2%
Retail Operating Costs	1.52	7.2%	1.56	6.4%	1.60	6.4%
Retail Margin	0.57	2.7%	0.67	2.8%	0.69	2.8%
Network Costs	6.52	30.9%	6.89	28.3%	7.18	28.8%
Tariff Equalisation Fund	1.35	6.4%	1.18	4.9%	1.27	5.1%
Total	21.08	100%	24.31	100%	24.90	100%

THE LEVEL OF TARIFF INCREASES AND GLIDE PATHS FOR RESIDENTIAL AND OTHER SMALL-USE CUSTOMERS

1. In order for tariffs for residential and other small-use customers in the South West Interconnected System to be cost-reflective from 2009/10, the tariffs are forecast to need to increase as per the estimates in the following table (details of the tariff classes are in Attachment 1).

Tariff	2008/09	2009/10	2010/11	2011/12
Residential Tariffs				
A1/A2/B1	-	47%	15%	2%
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R1	-	32%	19%	2%
K1/K2	-	44%	15%	2%

These tariff increases are forecasts only, and include estimates of the impact of decisions by the Economic Regulation Authority in 2009/10 and the National Emissions Trading Scheme in 2010/11.

Government could select a glide path for the residential and other small-use customer tariffs to reach the forecast cost-reflective levels. However, Government should fund any difference between cost-reflective tariffs and the glide path it chooses through Community Service Obligation payments. If a glide path is chosen by Government, details of the amount of Community Service Obligation payment should be shown on electricity bills.

A 47% escalation of the A1 Tariff would increase the average annual residential bill by \$384.08 (from \$817.20 to \$1,201.28) if the tariff change was fully applied at 2009/10.⁶ This would result in an increase in electricity bills of a little over one dollar per day for the average consumer within the South West Interconnected System.

Glide Path Issues

A number of options exist for phasing in the increases to the current “franchise tariffs” to manage the impact on households and small businesses. Franchise customers are those that consume less than 50 MWh per annum. Franchise customers are not contestable and can currently only be supplied by Synergy in the South West Interconnected System, and Horizon Power outside of the South West Interconnected System. Franchise customers include customers on the A1/A2 Residential Tariff, L1/L2 Small Business Tariff, and the R1 Business Tariff.

⁶ Based on the average residential consumption in the South West Interconnected System of 5,200 kWh/annum.

Large electricity tariff increases may have a financial impact on electricity consumers, some of whom may require time to adjust their behaviour to accommodate the impact of these increases. Accordingly, a key advantage of a longer glide path is that it will gradually introduce the tariff increases, allowing consumers to make plans to adjust their consumption and/or accommodate the increased energy costs.

However, introducing a glide path for tariffs to reach cost-reflective levels over time is essentially a subsidy. Therefore, it is appropriate that Government make a Community Service Obligation payment to Synergy to pay for any glide path.

The Community Service Obligation payments should be made to Synergy for serving small-use customers within the South West Interconnected System. Synergy would then use the Community Service Obligation revenue to pay Verve Energy and private-sector generators that contract with Synergy to serve households and small business customers.⁷

Details of the amount of any such Community Service Obligation payment should be shown on electricity bills to ensure customer awareness of the magnitude of these payments and the real cost of energy.

A key advantage of a shorter glide path is that it will take less time to reach cost-reflective tariffs, thereby minimising the size of the Community Service Obligation payments to Synergy.

It is inherently more difficult to make cost forecasts over a longer glide path, which means that there is greater potential for additional tariff increases over and above this Review's forecasts. The uncertainty over future emissions trading cost impacts is an important example of this risk.

Longer glide paths will delay the benefits associated with increased competitive pressure in the electricity market, through a delay to the potential introduction of electricity full retail contestability. Prices must be fully cost reflective in a full retail contestability environment to provide an appropriate incentive for new entrant retailers to enter the residential and small business market. Alternatively, Community Service Obligation payments would need to be made available to private sector retailers.

A longer glide path will also delay the point in time where customers will face appropriate price signals, and will therefore affect when customers will begin taking steps to drive better economic efficiency and energy efficiency outcomes.

Careful consideration needs to be given to the interaction of any glide path and the National Emissions Trading Scheme. The policy intent of emissions trading is to account for the cost of carbon emissions and to pass this cost on to consumers. A glide path that reduces the pass-through of carbon emissions costs to customers would likely muffle the intent of the National Emissions Trading Scheme.

⁷ The Vesting Contract would require amendment to recognise Community Service Obligation payments in a similar manner to tariff revenue, to allow Verve Energy and Synergy to receive appropriate shares of these payments. The Vesting Contract is a contract for the wholesale supply of electricity and Capacity Credits from Verve Energy to Synergy, and took effect upon the disaggregation of Western Power Corporation on 1 April 2006. Details of the Vesting Contract arrangements are available on the Office of Energy website (www.energy.wa.gov.au).

Any glide path for residential and other small-use customer tariffs will apply to Horizon Power's residential and other small-use customers outside of the South West Interconnected System, as per the Uniform Tariff Policy. The Uniform Tariff Policy is currently funded by the Tariff Equalisation Fund, and Recommendation 6 proposes that the Uniform Tariff Policy be funded via a Community Service Obligation rather than via the Tariff Equalisation Fund (further details on the Uniform Tariff Policy and the Tariff Equalisation Fund are in section "[Funding the Uniform Tariff Policy](#)").

The tariff changes listed in Recommendation 1 assume that the Uniform Tariff Policy continues to be funded by the Tariff Equalisation Fund. However, if Recommendation 6 is approved, then:

- the Uniform Tariff Policy will be funded by Community Service Obligation payments rather than the Tariff Equalisation Fund, which would lower the magnitude of the necessary tariff increases (further details on the magnitude of this impact is provided in section "[Funding the Uniform Tariff Policy](#)"); and
- the glide path for residential and other small-use customer tariffs outside the South West Interconnected System will be funded via Community Service Obligation payments, which is consistent with arrangements in the provision of other utility services.

If Recommendation 6 is not approved, then consideration should be given to providing glide path Community Service Obligation payments to Horizon Power, and setting the Tariff Equalisation Fund to fund the difference between Horizon Power's actual costs and the cost-reflective tariff in the South West Interconnected System.

TARIFF STRUCTURES FOR RESIDENTIAL AND OTHER SMALL-USE CUSTOMERS

Determining an appropriate tariff structure requires a balance between:

- ensuring that customers face cost-reflective tariffs;
- maintaining a relatively simple set of regulated tariffs; and
- the achievement of any other desired policy objectives, such as adopting measures to facilitate greater electricity demand management and increased energy efficiency.

Tariff structure considerations also relate to the relative importance placed on the fixed and variable portions of the tariff arrangements.

Currently the A1 Residential Tariff is a flat tariff arrangement with a fixed charge (a ¢/day supply charge), and a unit charge (¢/kWh) applied based on the number of units consumed. In general, flat tariffs are simple to understand and administer and can be reasonably well matched to the cost structure of the supply of electricity. This means that flat tariffs can be made relatively cost-reflective and structured to minimise distortionary cross-subsidies.

An alternative tariff structure is a declining block tariff, which has a fixed charge (a ¢/day supply charge), and a unit charge that is larger for the first block of consumption than for later blocks (e.g. 17.47¢/unit for the first 1,650 units/day and 15.76¢/unit for units in excess of 1,650 units/day). Declining block tariffs are traditionally considered to be more economically efficient, as they allow for efficient recovery of the fixed cost components of electricity supply. This

means that declining block tariffs can easily be made cost-reflective, so that they do not have distortionary cross-subsidies.

Another alternative tariff structure is an inclining block tariff, which has a fixed charge (a ¢/day supply charge), and a unit charge that is lower for the first block of consumption than for later blocks (e.g. 15.76¢/unit for the first 1,650 units/day and 17.47¢/unit for units in excess of 1,650 units/day). Inclining block tariffs have traditionally not been considered to be economically efficient, as they cannot easily accommodate the high fixed cost nature of electricity supply. As a result, inclining block tariffs cannot easily provide a cost reflective tariff arrangement and could create distortionary cross-subsidies.

There are other matters that may be considered when designing the tariff structure, including:

1. Social/Environmental policy objectives:

Declining block tariffs generally do not meet social/environmental policy objectives from the perspective of imposing higher tariffs on those that consume less (i.e. lower income customers) and do not create additional incentive for energy efficiency. On the other hand, inclining block tariffs generally assist in meeting the environmental policy objective of putting an incentive on energy efficiency, and the social equity objective of imposing lower tariff increases on those that consume less (assuming these are lower income customers).⁸

2. The Reserve Capacity Mechanism under the Wholesale Electricity Market.

The Reserve Capacity Mechanism exists to ensure there is sufficient capacity to meet demand at critical peak times. The Reserve Capacity Mechanism requires retailers to purchase Capacity Credits in proportion to their share of system peak demand, which means that greater electricity consumption by a retailer's customers during peak periods will make that retailer liable for increased capacity costs.

The Reserve Capacity Mechanism may make it easier to design a cost-reflective inclining block tariff in Western Australia, if it can be shown that customers with high annual electricity consumption consume more during peak times than customers with low annual electricity consumption. However, data is not currently available with sufficient granularity to be able to determine whether such a correlation exists.

3. The National Emissions Trading Scheme.

Price signals will soon be attached to greenhouse gas emissions with the establishment of the National Emission Trading Scheme. The costs of the National Emissions Trading Scheme could be more easily aligned and appropriately recovered using an inclining block tariff structure if it can be shown that customers with high electricity consumption are responsible for the emission of more greenhouse gases than customers with low energy consumption. However, once again, data is not currently available with sufficient granularity to be able to determine whether such a correlation exists.

A further alternative tariff structure is time-of-use tariffs, which have a fixed charge (i.e. a ¢/day supply charge), and a unit charge (¢/kWh) that varies by the time of day (peak vs. off peak).

⁸ Data collected by the Office of Energy from Synergy's database shows that customers with a household income below \$35,000 consume less than those with household income above \$55,000.

Examples in this regard include the R1 (small business), R3 (medium business), S1 (low/medium-voltage large business), and T1 (high-voltage large business) Tariffs.

Time-of-use tariffs have significant potential benefits in providing strong price signals for energy conservation in peak times. Time-of-use tariffs for residential and small business customers (the A1 and L1 Tariffs) will be an option if smart meters are rolled out in Western Australia. Synergy currently offers a time-of-use product for residential and small business customers (SmartPower), but the prices are not regulated. Therefore, it is proposed that time-of-use charging for the A1 and L1 Tariffs should be further considered at the next tariff reset, once it is known if (and when) smart meters will be rolled out in Western Australia.

Recommendation

2. Regarding the tariff structure for the A1/A2 and L1/L2 Tariffs (for residential and small business customers):

- **the A1/A2 and L1/L2 Tariffs should retain their current tariff structure in the short-term;**
- **future consideration should be given to changing the A1/A2 and L1/L2 Tariffs to an inclining block tariff structure once these tariffs reach cost-reflective levels; and**
- **if, and when smart meters are implemented in Western Australia, consideration should be given to changing the A1/A2 and L1/L2 Tariffs to a time-of-use tariff structure.**

FINANCIALLY DISADVANTAGED CUSTOMERS

Currently, the Supply Charge Rebate paid to electricity customers is not separately means tested and applies to about 25% of customers on the A1/A2 Residential Tariff (about 190,000 customers). The Supply Charge Rebate is available to the following concession card holders:

- Centrelink Healthcare Card;
- Pensioners' Concession Card;
- Commonwealth Seniors Health Card;
- Veterans' Affairs Gold Card;
- Veterans' Affairs Pensioner Concession Card, and
- Western Australian Seniors Card.

The Supply Charge Rebate is intended to defray both electricity and gas costs, but is currently paid through the electricity bill, as this is an efficient means to administer these arrangements. The Rebate is also currently linked to the value of the electricity supply charge.

In recognition of the intent of the Supply Charge Rebate, it is recommended that the rebate should continue to be administered via electricity bills, but should be re-titled as the "Energy Rebate", and should not be linked to the value of the electricity supply charge.

It is also recommended that the current rebate schemes be adjusted to provide an increased level of assistance to financially disadvantaged electricity consumers. Increasing the amount of the rebates in the same proportion to any Government approved tariff increases for residential customers will ensure these electricity customers experience the same proportionate increase in electricity bills as the rest of the population.

As the Energy Rebate is currently set equal to the electricity supply charge, the increase to the rebate would ensure that customers covered by the rebate continue to only pay electricity consumption charges. This would preserve the status quo for consumers that receive the rebate, and would not increase costs to administer the rebate.

The other major rebate recipients are customers holding concession cards that also qualify for the Dependent Child Rebate. This additional rebate, over and above the Energy Rebate, is based on the number of children in the household (with a maximum rebate for four or more dependent children in the household). It is recommended that the Dependent Child Rebate be increased in proportion to the increases in the residential tariff, to preserve the proportion of compensation afforded by this rebate.

Since young children face similar difficulties as seniors in regulating their body temperatures, it is also recommended that the Seniors' Air Conditioning Rebate be renamed the "Air Conditioning Rebate" and Government consider expanding it to apply to those eligible for the Dependent Child Rebate, in accordance with the existing location based criteria. It is recommended that this rebate be adjusted in proportion to the any Government approved increase in the residential tariffs.

The other rebates that should also be adjusted in proportion with residential tariff movements include the Account Establishment Fee Rebate, Life Support Equipment Electricity Subsidy, and Thermoregulatory Dysfunction Energy Subsidy.

A clear understanding is required of any compensation or re-balancing that the Commonwealth Government may undertake through the National Emissions Trading Scheme. However, the recently released Garnaut Review states:⁹

"These price rises [due to a National Emissions Trading Scheme] will disproportionately affect low income households for whom the affected products make up a larger portion of expenditure and who are less able to afford investment in product with lower energy (and emissions) profiles.

As a major environmental reform, [a National Emissions Trading Scheme] is not intended incidentally to have large and arbitrary effects on the distribution of income – and in particular, not to redistribute income away from people on low incomes.

In the case of households, there is a strong environmental as well as equity rationale for returning the revenue from the rent value of the permits that is passed through to households, in an economically and environmentally efficient way.

⁹ Page 48 of the Garnaut Climate Change Review (2008), Interim Report to the Commonwealth, State and Territory Governments of Australia, February 2008

Policy instruments for returning rents collected from households could include adjustments to the social security and income tax systems, and, assistance through information or capital subsidies to support efficient household adjustment to higher energy prices.

Any decision on increasing rebates to account for carbon emissions should be deferred until the arrangements for the national emissions trading scheme are concluded.

Recommendation

3. Regarding energy rebates for financially disadvantaged residential customers:

- **all rebates should be increased in proportion to any Government approved electricity tariff increases;**
- **the Seniors' Air Conditioning Rebate should be renamed the "Air Conditioning Rebate" and should be expanded to apply to those eligible for the Dependent Child Rebate; and**
- **the Supply Charge Rebate should continue to be administered via electricity bills, but should be re-titled to the "Energy Rebate", and should not be linked to the value of the electricity supply charge.**

It is estimated that about 5,000 households in Western Australia are currently in "utility hardship", meaning that financial difficulties are impacting the ability of these households to meet electricity, gas and water payments. Considering electricity alone, it is estimated that around 3,300 households in Western Australia are facing financial difficulty in meeting their electricity payments.

Recognising the prevalence of utility hardship, the Minister for Energy has established the Government Utilities Essential Service Hardship Inter-Agency Working Group to advise on strategies to address these issues. Changes to electricity tariffs will increase pressure on financially disadvantaged and other low income households. The Government Utilities Essential Service Hardship Inter-Agency Working Group should consider the outcomes of the electricity tariffs Review in its deliberations.

TARIFFS FOR COMMUNITY AND CHARITABLE ORGANISATIONS

There are a number of particular tariff arrangements developed for supply to charitable and community organisations:

- Currently the C1 Tariff (C2 Tariff outside the South West Interconnected System) is available to small voluntary and charitable organisations, including community and not-for-profit groups.
- The D1 Tariff (D2 Tariff outside the South West Interconnected System) is available to charitable organisations providing residential accommodation.

Only Synergy and Horizon Power are required to offer these tariffs (i.e. these customers effectively do not have a choice of supplier, even if their consumption is above the contestability threshold).

The Issues Paper for the Review canvassed views on the proposal to remove these tariffs and replace the assistance with direct Community Service Obligation payments. Stakeholders generally expressed broad support for the provision of assistance to these organisations outside of the tariff arrangements.

It is therefore recommended that the tariffs for community and charitable organisations be removed from 2009/10, with future assistance provided through Community Service Obligation payments made directly to retailers servicing these customers. Under these arrangements customers on the C1/C2 and D1/D2 Tariffs would be given the option to move to an alternative tariff arrangement at their discretion (likely to be the L1/L2, or R1/R2/R3 Tariff). A subsidy would then be provided to the retailer servicing these customers and then passed on via a reduction in the electricity bill to ensure that the community and charitable organisations face the same percentage increase in electricity tariffs as the other customers on these alternative tariffs.

In addition, if the switch to an alternative tariff requires a new meter (for example, switching to the R1 Tariff will require a new meter as this is a time-of-use tariff), then the cost of the new meter should also be subsidised via a Community Service Obligation payment.

This arrangement would allow those community and charitable organisations with consumption exceeding 50 MWh/per annum to be contestable, and therefore negotiate supply from any retailer and potentially access additional cost savings. It is noted that this arrangement would require a change to government policy to allow for Community Service Obligation payments to be made to non-government organisations, as the Community Service Obligation payment would need to be paid to the retailer with whom the organisation chooses to sign a contract.

Recommendation:

4. The Community and Charitable Organisation Tariffs (C1/C2 and D1/D2 Tariffs) should be removed and assistance provided by direct Community Service Obligation payments.

TARIFFS FOR LARGE BUSINESS CUSTOMERS

Tariffs for contestable business customers (the R3, S1 and T1 Tariffs) were increased on 1 July 2007 by 9%, 15% and 18% respectively, based on estimates of required increases provided by Synergy. A price path for these regulated tariffs proposed further increases of 5% per annum until 2011/12. It was intended that these changes would move these tariffs to cost-reflective levels, to ensure that the tariffs acted as a price ceiling rather than as a price floor.

As indicated in the Frontier Economics Report, the tariffs for large business customers require additional increases to achieve cost-reflective levels. As the M1 tariff was not previously adjusted in 2006/07, it also requires an adjustment of 32% on 1 July 2008 to achieve a cost-reflective level.

As these business tariffs are charged to contestable customers (i.e. using at least 50 MWh of electricity per annum), these tariffs should be moved directly to cost reflective levels to not hamper the development of competition in this market segment. Business customers that consume more than 50MWh per annum are able to sign a market contract at a lower price with any retailer rather than remain on tariff.

Significant private investment has been made by participants in the Western Australian electricity market. Electricity retail tariffs that are not reflective of costs can impact investments that have been made or stifle future investment.

Recommendation:

5. In order for tariffs for large businesses (contestable customers) in the South West Interconnected System to be cost-reflective in 2008/09, the tariffs need to increase in accordance with the following table (details of the tariff classes are in Attachment 1).

Tariff	2008/09	2009/10	2010/11	2011/12
Large Customer Tariffs				
R3	31%	8%	13%	3%
S1	19%	10%	11%	3%
T1	28%	9%	12%	3%
M1	32%	11%	10%	4%
N2	-	-	-	-
P2	10%	10%	16%	2%
W1/W2	118%	13%	9%	3%
Z	25%	11%	10%	2%

The tariff increases from 2009/10 forward are forecasts only, and include estimates of the impact of decisions by the Economic Regulation Authority in 2009/10 and the National Emissions Trading Scheme in 2010/11.

Note that:

- the N2 Tariff (for supply to commonwealth and foreign government instrumentalities in Horizon Power's non-integrated systems) has a price escalator tied to Singapore gas prices, so it has been increasing annually and requires no further increases; and
- the P2 Tariff (for supply to commonwealth and foreign government instrumentalities in Horizon Power's North West Integrated System) is the same as an L1/L2 Tariff on a per unit basis if the average consumption for customers on the P2 Tariff is applied, and has therefore been increased in line with the L1/L2 Tariff, but from 2008/09.

OPTIONS FOR REMOVAL OF TARIFFS FOR LARGE BUSINESS CONSUMERS

Large electricity consumers are generally in a superior position to small-use customers in terms of the incentive, expertise and capacity to manage their electricity consumption, and to negotiate electricity contracts. It is also noted that Synergy and Horizon Power are only required to offer the regulated tariffs to customers using less than or equal to 160 MWh of electricity per annum (an annual bill of around \$28,000).

Western Australia is currently the only State in Australia that still regulates tariffs for large consumers. The decision by other jurisdictions to remove regulated tariffs for large customers reflects that retailers have an incentive to compete for customers that consume significant quantities of energy.

However, in considering the removal of tariffs for large business customers, it needs to be recognised that there will be less or no competition for customers in regional areas outside of the South West Interconnected System. Removal of regulated tariffs for larger customers may have more significant implications for those customers located in areas outside the South West Interconnected System.

It is also recognised that once large business tariffs are set at cost-reflective levels in the South West Interconnected System, they will act as a price cap rather than as a price floor for that market segment. This will provide an incentive for large customers in the South West Interconnected System to negotiate individual contracts, either with Synergy or with an alternative retailer. It is therefore considered appropriate to retain tariffs for large business customers over this tariff review period, with a further assessment of the continued need for these tariffs at the next reset, which is recommended to occur in 2012.

TARIFFS FOR REGIONAL ELECTRICITY CUSTOMERS

The review of electricity tariff arrangements is being conducted on the basis of retention of the Government's Uniform Tariff Policy, meaning that the tariffs are set to be cost reflective in the South West Interconnected System, and applicable regulated tariffs outside of the South West Interconnected System are the same for the same classes of customers inside the South West Interconnected System.

However, the cost to supply electricity is generally significantly higher outside the South West Interconnected System than in the South West Interconnected System. The difference between the tariff revenues and the electricity generation and supply costs incurred by Horizon Power outside of the South West Interconnected System is funded by the Tariff Equalisation Fund. The Tariff Equalisation Fund is paid by all electricity customers in the South West Interconnected System that are connected to the distribution network, as a component of network charges which is passed through the retail tariff.

Eligible customers in Horizon Power's supply areas will continue to be subsidised.

FUNDING THE UNIFORM TARIFF POLICY

Electricity customers connected to the Western Power distribution network within the South West Interconnected System currently provide a subsidy to regional customers outside of the South West Interconnected System to allow for the application of the Uniform Tariff Policy. This subsidy is currently around \$72 million and is funded via the Tariff Equalisation Fund. The Tariff Equalisation Fund provides financial support to Horizon Power to cover the difference between tariff revenue from the areas outside of the South West Interconnected System and the cost to produce electricity in these areas.

The Tariff Equalisation Fund is funded by an additional charge collected by Western Power as part of the distribution network tariffs. This means that the customers connected to the distribution system in the South West Interconnected System (residential and small business customers, but not large business customers) cross-subsidise customers outside of South West Interconnected System customers (residential, small, and large business customers).

An alternative to the Tariff Equalisation Fund is to fund the Uniform Tariff Policy through an annual Community Service Obligation payment. This would mean that the broader population of Western Australia would contribute to the subsidy of electricity outside the South West Interconnected System, rather than just residential and small business customers in the South West Interconnected System. This approach is consistent with the provision of subsidies for other essential services in Western Australia, such as water.

As noted in the Frontier Economics Report, removing the Tariff Equalisation Fund from the networks distribution tariff means that these costs are not included in the retail tariff, which decreases the size of the required retail tariff increases for residential and small business customers within the South West Interconnected System. This would reduce the forecasted tariff increases to the levels indicated in the following table.

Tariff	2008/09	2009/10	2010/11	2011/12
Residential Tariffs				
A1/A2/B1	-	38%	17%	2%
Other Small-Use Customers				
L1/L2	-	14%	18%	2%
R1	-	27%	20%	2%
K1/K2	-	35%	17%	2%
Large Customer Tariffs				
R3	28%	6%	14%	3%
S1	16%	8%	12%	3%
T1	25%	8%	13%	3%
M1	26%	9%	12%	3%
N2	-	-	-	-
P2	5%	8%	18%	2%
W1/W2	105%	10%	12%	3%
Z	21%	12%	14%	4%

Changing funding of the Uniform Tariff Policy from the Tariff Equalisation Fund to Community Service Obligation payments would impact the State Budget, as the subsidy would now come from taxpayers rather than electricity customers connected to the South West Interconnected System distribution network.

Recommendation:

6. Community Service Obligation payments should replace the Tariff Equalisation Fund to fund the Uniform Tariff Policy in Horizon Power's supply areas.

ELECTRICITY TARIFFS RESETS AND ADJUSTMENTS

As noted in the Frontier Economics Report, the lack of a regulated process for regular tariff reviews imposes significant uncertainty on both businesses and consumers. This uncertainty has implications for investment decisions by businesses, with the potential to lead to inefficient patterns of investment in both the retail and generation sectors. Uncertainty also has implications for decisions by consumers, impacting their ability to adjust to changes in electricity tariff arrangements.

A means of providing greater certainty to investors and consumers is to implement a regulated process for regular tariff reviews. As discussed in the Issues Papers, there are several options for a regular tariff review:

- The Office of Energy could be made responsible for periodically reviewing tariffs and advising the Minister for Energy as to the appropriate tariff arrangements, with the Minister to be responsible for the final determination of tariffs.
- An independent regulatory authority, such as the Economic Regulation Authority, could be given responsibility for periodically reviewing tariffs and advising the Minister for Energy as to the appropriate tariff arrangements, with the Minister responsible for the final determination of tariffs.
- An independent regulatory authority, such as the Economic Regulation Authority, could be given responsibility for periodically reviewing and setting tariffs.
- A mechanical arrangement could be implemented to annually adjust tariff levels, with regular review of the tariff adjustment mechanism by the Minister for Energy or an independent authority.

It is recommended that electricity tariffs should be regularly reviewed and reset by the Economic Regulation Authority. This will empower an independent regulatory body to set tariffs based on economic criteria specified in legislation, and will ensure that tariffs remain cost-reflective over time. As discussed in the Frontier Economics Report, it is proposed that the tariffs should be reviewed at least on a triennial basis, with timing aligned as far as possible with Western Power's network Access Arrangements. Allowing the Economic Regulation Authority to align the timing for network and retail tariff resets would make the process easier for the Economic Regulation Authority to manage, and will provide increased certainty to the market and to consumers.

The Economic Regulation Authority would be required to annually adjust retail tariffs based on parameters that it determines at each periodic tariff reset. This will provide maximum flexibility to ensure that tariffs remain as cost reflective as possible between resets, but will still provide maximum price transparency and stability.

As noted in Recommendation 1, the Government may consider it appropriate that a glide tariff path be introduced to allow tariffs for residential and other small-use customers to reach cost reflective levels over time. Accordingly, there may be a need for Government to retain the capacity to specify glide path arrangements for residential and other small use customers against cost-reflective electricity tariffs determined by the Economic Regulation Authority.

As per Recommendation 1, a Community Service Obligation payment should be made to Synergy to pay for any such subsidy. There may also be a need to allow for these Community Service Obligation payments to be made to alternate retailers should full retail contestability be introduced in electricity before tariffs are fully cost reflective. This would effectively allow alternate retailers to compete against cost-reflective tariffs rather than any glide path tariff arrangement.

Recommendation:

7. Regarding future tariff reset processes:

- **regulated electricity tariff resets should be undertaken by the Economic Regulation Authority;**
- **the first retail tariff determination by the Economic Regulation Authority should take effect from 1 July 2012, and timing for subsequent retail tariff determinations should coincide with the timing of the network Access Arrangement resets to the greatest extent possible;**
- **retail electricity tariffs should be subject to annual adjustments between the resets; and**
- **Government can retain the discretion to continue glide path arrangements for residential and other small-use customers following the first tariff determination by the Economic Regulation Authority, with Community Service Obligation payments made for the difference between the glide path tariff and tariff determinations.**

ELECTRICITY TARIFFS PASS THROUGH CHARGES

Network Tariffs

Western Power is making significant investments focussed on improving the safety and reliability of the South West Interconnected System; and developing the network infrastructure required to support the State's fast growing economy, growth in new residential development, and asset replacement. Cost increases associated with these network expenditures will be passed on to retailers via network tariffs, which are expected to trend upwards in future years.

Network tariffs represent a significant portion of total electricity supply costs (around 30%) and are subject to a significant level of uncertainty, particularly at Western Power's Access Arrangement resets. Annual network tariff adjustments are limited in the interim period between each network tariff reset, typically to a factor of CPI+5% each year.

Given the difficulty in forecasting network tariffs into the future, it is appropriate to separately itemise network tariffs as a pass-through charge for all electricity retail tariffs. Under this arrangement, retail tariffs would be structured to cover all other costs involved in supplying electricity (the R components), with network charges being specified as a separate component and adjusted each year to reflect changes in the relevant network tariff.

This arrangement will provide the flexibility to ensure that tariffs remain as cost-reflective as possible each year, and also provide maximum price transparency and stability. In the interests of improved price transparency, it is appropriate that these network charges be itemised on all retail bills.

Recommendation:

8. Network tariffs should be automatically passed through for all classes of retail electricity tariffs and should be separately itemised on retail bills.

Emissions Trading and Renewable Target Costs

As noted by Frontier Economics, greenhouse gas emissions mitigation schemes will affect the cost of retailing electricity, and have therefore been taken into account in this Review. However, the structures for the National Emission Trading Scheme and the new Mandatory Renewable Energy Target have not yet been fully developed, so it is difficult to determine a robust cost impact for these measures until the schemes structures are determined.

Accordingly, greenhouse gas emissions mitigation costs have been modelled based on assumptions about how these policies would work, as outlined in the Frontier Economics Report. These cost estimates were developed to provide an indication of these future greenhouse mitigation costs only.

Consistent with the approach for network tariffs, it is appropriate to separately itemise greenhouse gas emissions mitigation costs as a pass-through charge for all electricity retail tariffs. This will provide sufficient flexibility to ensure that the costs of these policies are passed on to consumers. This will provide:

- a clear incentive for consumers to reduce their greenhouse gas emissions through increased energy efficiency;
- maximum flexibility to ensure that tariffs remain as cost-reflective as possible each year; and
- maximum price transparency and stability.

In the interests of improved price transparency, it is appropriate that the costs of greenhouse gas mitigation measures be itemised on all retail bills.

Recommendation:

9. Costs from greenhouse gas emissions mitigation measures should be automatically passed through for all classes of electricity tariffs and should be separately itemised on retail bills.

ATTACHMENT 1

The following table provides definitions of the Synergy and Horizon Power tariff classes, and examples of the customers on each tariff class.

Tariff	Definition	Examples of Customers
A1/A2	<ul style="list-style-type: none"> The A1 Tariff is Synergy's standard residential tariff for private dwellings, and is used solely for residential purposes. The A2 Tariff is a Horizon Power tariff equivalent to the A1 Tariff. 	<ul style="list-style-type: none"> Residential households.
B1	<ul style="list-style-type: none"> The B1 Tariff is a Synergy tariff for off-peak residential water heating in the six-hour period between 11pm and 6am. 	<ul style="list-style-type: none"> Residential households.
C1/C2	<ul style="list-style-type: none"> The C1 Tariff is a Synergy tariff for small voluntary and charitable organisations. The C2 Tariff is a Horizon Power tariff equivalent to the C1 Tariff. 	<ul style="list-style-type: none"> Community clubs. Youth groups. Non-profit groups. Fire/rescue groups.
D1/D2	<ul style="list-style-type: none"> The D1 Tariff is a Synergy tariff available to charitable organisations providing residential accommodation. The D2 Tariff is a Horizon Power tariff equivalent to the D1 Tariff. 	<ul style="list-style-type: none"> Hostels and homes for the aged. Emergency accommodation.
K1/K2	<ul style="list-style-type: none"> The K1 Tariff is a Synergy tariff for locations where part of the electricity use is for residential purposes, and part is for business purposes. The K2 Tariff is a Horizon Power tariff equivalent to the K1 Tariff. 	<ul style="list-style-type: none"> Farming properties. Commercial properties with a caretaker's residence attached.
L1/L2	<ul style="list-style-type: none"> The L1 Tariff is Synergy's tariff for small businesses that use low/medium voltage electricity (240/415 volts). The L2 Tariff is a Horizon Power tariff equivalent to the L1 Tariff. 	<ul style="list-style-type: none"> Schools and churches. Hospitals. Shops and factories. Hotels and motels. Sporting complexes.
M1/M2	<ul style="list-style-type: none"> The M1 Tariff is a Synergy tariff for business customers with high electricity usage and high voltage. The M2 Tariff is a Horizon Power tariff equivalent to the M1 Tariff. 	<ul style="list-style-type: none"> Port authorities. Heavy machinery producers. Mining companies. Government departments.

Tariff	Definition	Examples of Customers
N2	<ul style="list-style-type: none"> The N2 Tariff is a Horizon Power tariff for supply to commonwealth and foreign government instrumentalities in Horizon Power's non-integrated systems. 	<ul style="list-style-type: none"> US Naval Base (Exmouth) Commonwealth Departments (Defence Agriculture, etc.) Centrelink Bureau of Meteorology.
P2	<ul style="list-style-type: none"> The P2 Tariff is a Horizon Power tariff for supply to commonwealth and foreign government instrumentalities in Horizon Power's North West Integrated System. 	<ul style="list-style-type: none"> Centrelink Commonwealth Departments (Defence Agriculture, etc.) Bureau of Meteorology.
R1	<ul style="list-style-type: none"> The R1 Tariff is a Synergy available to non-contestable business customers that consume between 80 and 137 kWh per day, and use more than 20% of their power in off-peak periods. The R1 Tariff is a time-of-use tariff. 	<ul style="list-style-type: none"> Retail. Accommodation. Agriculture. Government. Manufacturing.
R3	<ul style="list-style-type: none"> The R3 Tariff is a Synergy available to contestable business customers that consume more than 137 kWh per day, and use more than 30% of their power in off-peak periods. The R3 Tariff is a time-of-use tariff 	<ul style="list-style-type: none"> Retail. Accommodation. Agriculture. Government. Manufacturing.
S1	<ul style="list-style-type: none"> This S1 Tariff is a Synergy tariff for business customers with energy supplied at low/medium voltage (240/415 volts), combined with a moderate to high load factor and higher energy use (6.6kV, 11kV, 22kV or 33kV). 	<ul style="list-style-type: none"> Transport and storage. Business. Manufacturing. Government. Retail.
T1	<ul style="list-style-type: none"> The T1 Tariff is a Synergy tariff for business customers who use a lot of high voltage energy (6.6kV, 11kV, 22kV or 33kV), combined with a moderate to high load factor. 	<ul style="list-style-type: none"> Government. Transport and storage. Manufacturing. Retail. Business.
W1/W2	<ul style="list-style-type: none"> The W1 Tariff is a Synergy tariff for traffic lights. The W2 Tariff is a Horizon Power tariff equivalent to the W1 Tariff. 	<ul style="list-style-type: none"> Main Roads.
Z	<ul style="list-style-type: none"> Both Synergy and Horizon Power have a series of Z tariffs for streetlights. 	<ul style="list-style-type: none"> Local Councils.

ATTACHMENT 2

Sources for the table showing the recently announced retail electricity tariff increases for residential and small business customers in the other Australian jurisdictions (page 9)

New South Wales

- The Independent Pricing and Regulatory Tribunal of New South Wales (IPART) issued a determination on 14 June 2007 that regulated electricity prices for residential and small business customers should be allowed to rise by an average of 7% to 8% per year for the three years 2007/08, 2008/09 and 2009/10.

Victoria

- The Victorian Department of Primary Industries has provided for average price increases of 12% to 17% for household customers for the 2008 calendar year. Small business customers were excluded from access to the regulated tariff arrangements from 1 January 2008.

Queensland

- On 19 June 2007 the Queensland Competition Authority released its annual price determination with an 11.37% increase in the maximum electricity prices that may be charged to non-contestable (residential and small business) customers remaining on the regulated tariff rates. These rates are applicable for the period 1 July 2007 to 30 June 2008.

South Australia

- The Essential Services Commission of South Australia (ESCOA) released a final determination on 30 November 2007 indicating that the electricity prices paid by standing contract customers (residential and small business customers that have not moved to market contracts) should increase by 12.34% on 1 January 2008, with further annual increases on each 1 July for 2008 to 2010 based on CPI movements.

Tasmania

- Tasmania's Independent Energy Regulator released a final determination in September 2007 indicating that electricity prices for residential customers should increase by 15.7% from 1 January 2008, with increases for business customers of 16.4%.
- Further increases for these residential and business customers of 4% from 1 July 2008 and 3.8% from 1 July 2009 are included in this determination.

Northern Territory

- On 24 April 2007 the Northern Territory Treasurer announced an increase of 4.4% in the electricity prices paid by residential and small business customers effective from 1 July 2007. These electricity prices are to increase in accordance with CPI movements for the period 2008/09 to 2012/13.