



Government of **Western Australia**
Office of **Energy**

ELECTRICITY RETAIL MARKET REVIEW

Final Recommendations Report **Review of Electricity Tariff Arrangements**



Office of Energy Report to the Minister for Energy

January 2009

ELECTRICITY RETAIL MARKET REVIEW

REVIEW OF ELECTRICITY TARIFFS

KEY MESSAGES

- Current retail electricity tariffs are not cost-reflective.
- 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).
- 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 Carbon Pollution Reduction 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, and with cost pressure on Western Power in particular.
- 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.

Cover Photo courtesy of Dougal West.

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 customers cost-reflective from 2009/10.

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.

These forecasts have taken account of the Western Power Access Arrangement submission to the Economic Regulation Authority in regard to network tariffs applicable from 2009/10.

The network component of the tariff for 2009/10 onwards will be determined by the Economic Regulation Authority before 1 July 2009. The cost impacts of the Carbon Pollution Reduction Scheme will be a function of the arrangements determined by the Commonwealth Government, which is expected to commence in 2010/11.

1. In order for tariffs for residential and small business 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	2009/10	2010/11	2011/12
A1/A2	52%	26%	13%
B1	132%	32%	19%
L1/L2	29%	26%	14%
R1	37%	27%	10%
K1/K2	50%	26%	14%

- These tariff increases are forecasts only, and are based on the impact that network tariffs would have from 2009/10 onwards if the Economic Regulation Authority approves Western Power's Access Arrangement as per its application, and the impacts of an assumed Carbon Pollution Reduction Scheme commencing in 2010/11.
- These tariff increases assume that the Tariff Equalisation Fund will be funded via a direct Community Service Obligation rather than through network charges, in accordance with Recommendation 6.
- Government should select a glide path for the residential and small business customer tariffs to reach the forecast cost-reflective levels; and should fund any difference between cost-reflective tariffs and the glide path it chooses through Community Service Obligation payments. Details of the amount of the Community Service Obligation payment should be shown on electricity bills.

2. Regarding the tariff structure for small use customer tariffs (A1/A2, B1, L1/L2, R1, K1/K2):

- the small use customer tariffs should retain their current tariff structure in the short-term for the retail component, with the exception of the new costs associated with the Carbon Pollution Reduction Scheme, which should be completely assigned to the variable component of the tariffs. The network component of the retail tariff should reflect the structure of the fixed and variable components of the relevant network tariffs as per Western Power's approved Access Arrangement;
- a new L3/L4 Tariff should be created for contestable customers on the current L1/L2 Tariff, if a glide path is implemented for the non-contestable customers currently on the L1/L2 Tariff;
- future consideration should be given to changing the A1/A2, L1/L2 and K1/K2 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, L1/L2 and K1/K2 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 from 2009/10, with assistance instead provided by direct Community Service Obligation payments.

5. Regarding tariffs for large consumers:

In order for tariffs for large businesses (contestable customers) in the South West Interconnected System to be cost-reflective in 2009/10, it is forecast that the tariffs need to increase in accordance with the following table (details of the tariff classes are in Attachment 1).

Tariff	2009/10	2010/11	2011/12
L3/L4	39%	20%	13%
R3	42%	19%	11%
S1	27%	19%	10%
T1	35%	19%	9%

M1/M2	51%	20%	13%
N2	-	-	-
P2	39%	20%	13%
W1/W2	142%	20%	10%
Z	63%	31%	23%

- The tariff increases from 2009/10 forward are forecasts only, and are based on the impact that network tariffs would have from 2009/10 onwards if the Economic Regulation Authority approves Western Power's Access Arrangement as per its application, and the impacts of an assumed Carbon Pollution Reduction Scheme commencing in 2010/11.
 - These tariff increases assume that the Tariff Equalisation Fund will be funded via a direct Community Service obligation rather than through network charges, in accordance with Recommendation 6.
 - The above tariffs should retain their current tariff structure in the short-term for the retail component, except that the new cost associated with the Carbon Pollution Reduction Scheme will be completely assigned to the variable component of the tariffs. The network component of the retail tariffs should reflect the structure of the fixed and variable components of the relevant network tariffs.
6. Community Service Obligation payments should replace the Tariff Equalisation Fund to fund the Uniform Tariff Policy in Horizon Power's supply areas from 2009/10 onwards.
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 small-use customers from 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 regulated 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 regulated retail electricity tariffs and should be separately itemised on retail bills where costs are based on a specific allowance.

BACKGROUND

The Office of 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 the following consultation was undertaken:

- an Issues Paper was circulated to key stakeholders for comment in August 2007 for a four-week consultation period;
- a revised Issues Paper considering the additional matters raised by key stakeholders was circulated for broader public comment in December 2007 for a four-week consultation period; and
- a Draft Recommendations Paper, and the Draft Frontier Economics Report to the Office of Energy regarding the review of electricity tariff arrangements, was distributed for public consultation in April 2008 for an eight-week comment period.

The roll-out of smart meters and the introduction of full retail contestability are 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 draft and final Recommendations Papers.

This report details the Office of Energy’s final recommendations for the tariffs component of the Review, and is based on Frontier Economics’ final recommendations paper titled “Electricity Retail Market Review – Electricity Tariffs”.

This Recommendations Paper is limited to addressing electricity tariff arrangements. It is noted that stakeholder submissions to the Draft Recommendations Papers expressed broad support for the findings and recommendations outlined, along with the economic modelling methodology utilised by Frontier Economics for this component of the Review.¹

¹ The submissions to the Draft Recommendations Paper are available on the Office of Energy website: <http://www.energy.wa.gov.au/>, in the “Electricity” section under “Electricity Retail Market Review”.

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 real price reduction to 2009/10 of about 30%.²

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 2006/07.³ Small business tariffs have not increased since 1991/92, which is an estimated real price reduction of about 38% to 2009/10.

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

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 these other jurisdictions.

The following graph shows that, whilst Western Australian residential electricity tariffs have remained static in nominal terms over the past decade, these tariffs have increased in the other jurisdictions of Australia.⁴ Over the period 1997/98 to 2007/08 these jurisdictions have experienced significant increases in residential electricity prices ranging from 23% to 69%, while Western Australian retail tariffs have experienced no increase.

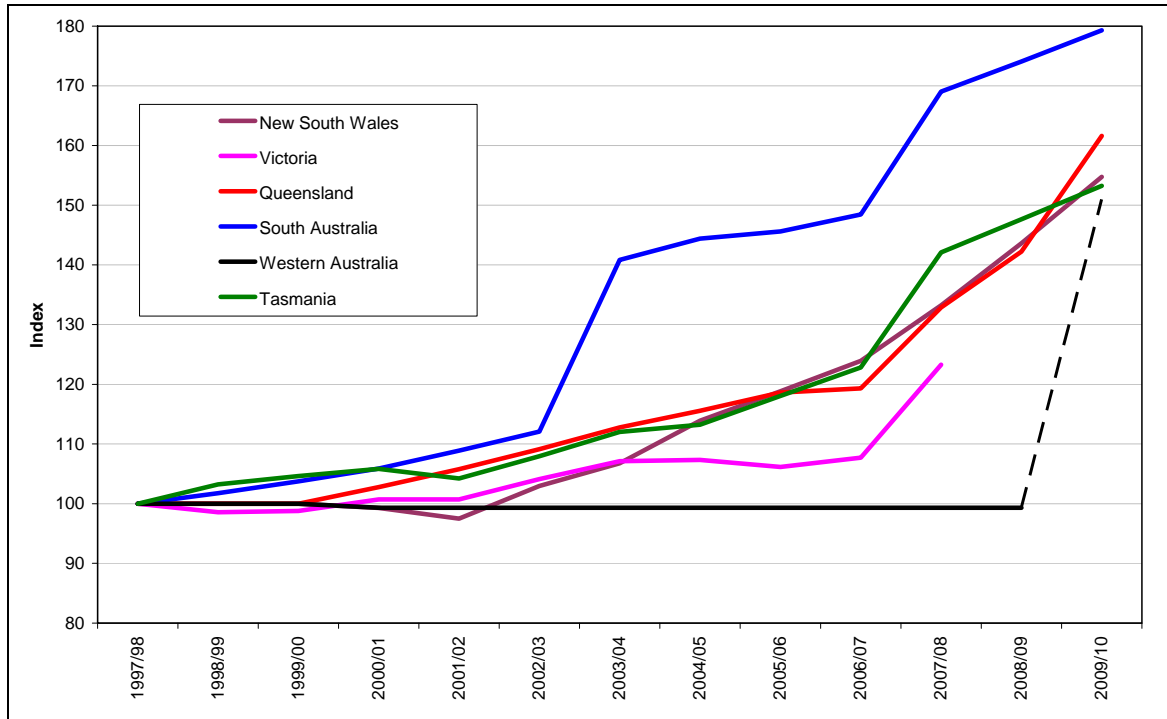
Looking forward over the period 1997/98 to 2009/10, Tasmania, Queensland, New South Wales and South Australia are to experience increases ranging from 53% to 79% during this timeframe. Victoria has moved to remove retail price caps from 2009. This means that there will no longer be fallback tariffs for any consumers in Victoria from 2009, including residential consumers, and all consumers will move to market contracts from the beginning of 2009. The Australian Energy Market Commission has also completed a review recommending that retail

² Estimate based on electricity tariff data collected by the Office of Energy and ABS CPI data, excluding the introduction of GST in 2000/01.

³ The previous Government increased tariffs for medium to large business customers (those consuming more than 50 MWh per annum) on the R3, S1 and T1 Tariffs, as of 1 July 2007 and again from 1 July 2008.

⁴ This graph was compiled by the Office of Energy based on Electricity Supply Association of Australia publications "Electricity Prices in Australia 2002/03", Table A1, and "Electricity Prices in Australia 2003/04, Table 1.2, and regulatory determinations from 2004/05 onwards.

price caps should be removed in South Australia, and that the existing framework for regulating retail energy prices should be replaced by a regulatory oversight framework allowing the competitive market to determine cost-reflective prices, accompanied by a transparent price monitoring and reporting regime.



The graph also shows that if the residential electricity tariff in Western Australia was to move to the cost reflective level in 2009/10 (dotted black line), then the percentage increase would be in line with the percentage increase in other jurisdictions over the period 1997/98 (the last time the Western Australian tariff was increased) to 2009/10.

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 recovery of the long-run marginal cost of supply.

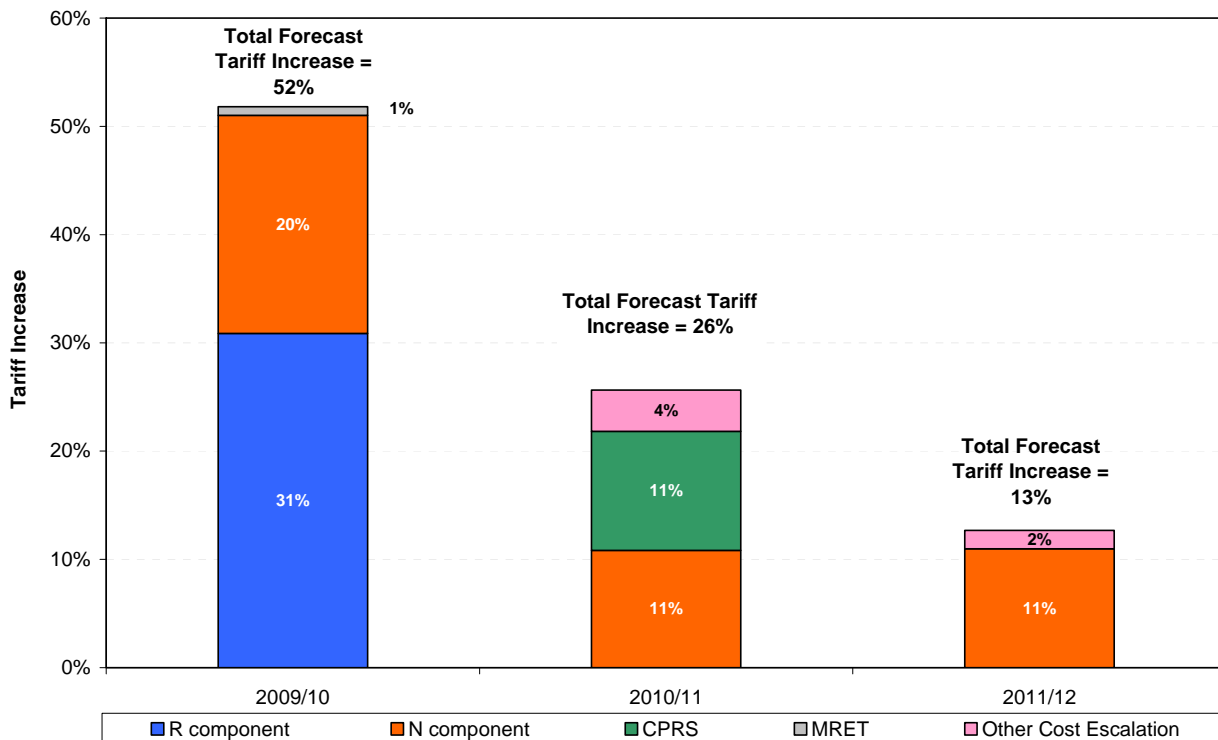
Cost-reflective pricing will eliminate potential cross-subsidies between different tariffs, which would act to prevent competition in the marketplace and would be inequitable. Cross-subsidies lead to some prices being too high relative to their costs and others being too low. Importantly, under cost-reflective 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 52% in 2009/10 to achieve cost-reflectivity. This Review has determined that the required increase in the level of the retail component of the tariff accounts for 31 percentage points of the 52% increase in 2009/10. The retail component consists of the wholesale costs, retail operating costs and net retail margin.

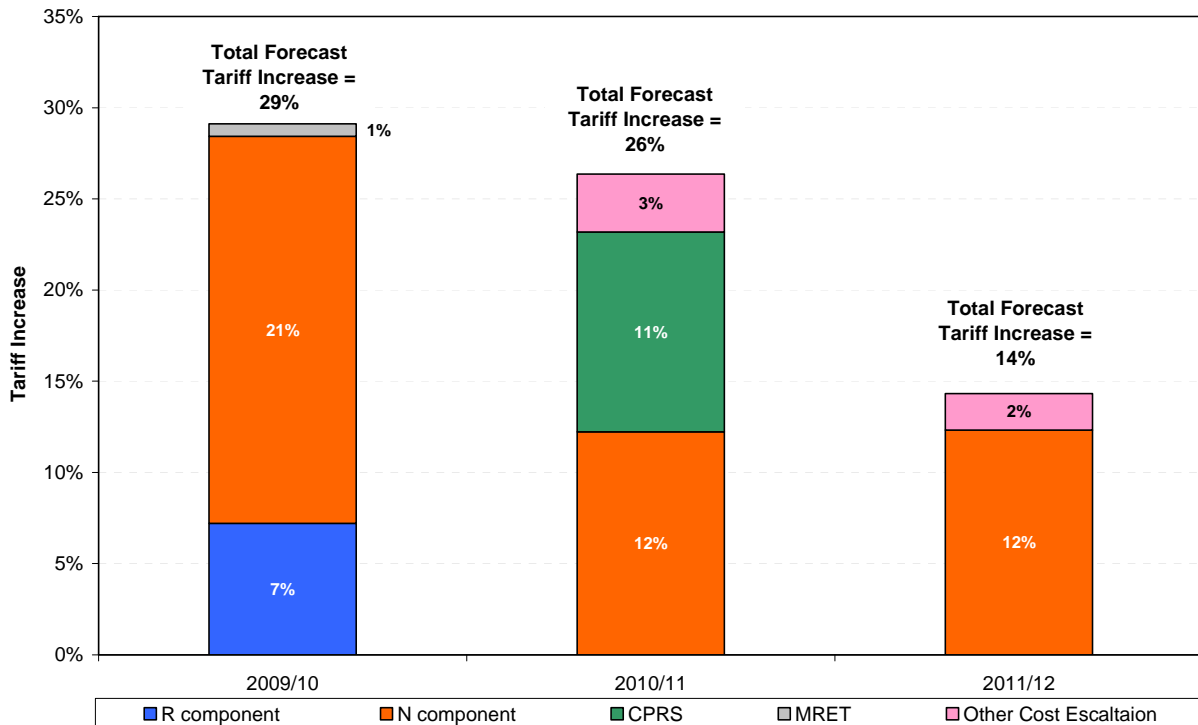
The network component of the tariff is estimated to account for 20 percentage points of the 52% increase in 2009/10, although network tariffs for 2009/10 are yet to be determined by the Economic Regulation Authority. The Economic Regulation Authority has commenced consideration of the required network tariff increase for 2009/10.

The expanded national Mandatory Renewable Energy Target has been introduced during this period and accounts for less than 1 percentage point of the 52% increase in 2009/10.

It is forecasted that the A1/A2 Residential Tariff will require a further increase of 26% in 2010/11. The majority of this increase relates to increases to network tariffs in 2010/11 and the introduction of the Carbon Pollution Reduction Scheme. The network tariff increases accounts for 11 percentage points of the total 26% increase, while another 11 percentage point of the 26% increase is an estimate for the cost increase associated with the introduction of the Carbon Pollution Reduction Scheme. The magnitude of the required increase due to the Carbon Pollution Reduction Scheme will be determined by the decisions of the Commonwealth Government in regard to scheme design and greenhouse gas reduction targets. The 26% increase for 2010/11 also includes an estimated 4 percentage point increase to 2009/10 costs relating to retail component and the Mandatory Renewable Energy Target.

A further increase of 13% is required to the A1/A2 Tariff in 2011/12 mainly due to the projected increase in network costs, which accounts for 11 percentage points of the total 13% increase.

ESTIMATES FOR L1/L2 – SMALL BUSINESS TARIFF



It is estimated that the L1/L2 Small Business Tariff needs to increase by 29% in 2009/10 to achieve cost-reflectivity. This Review has determined that the required increase in level of the retail component of the tariff accounts for 7 percentage points of the 29% increase in 2009/10. The retail component consists of wholesale costs, retail operating costs, and net retail margin.

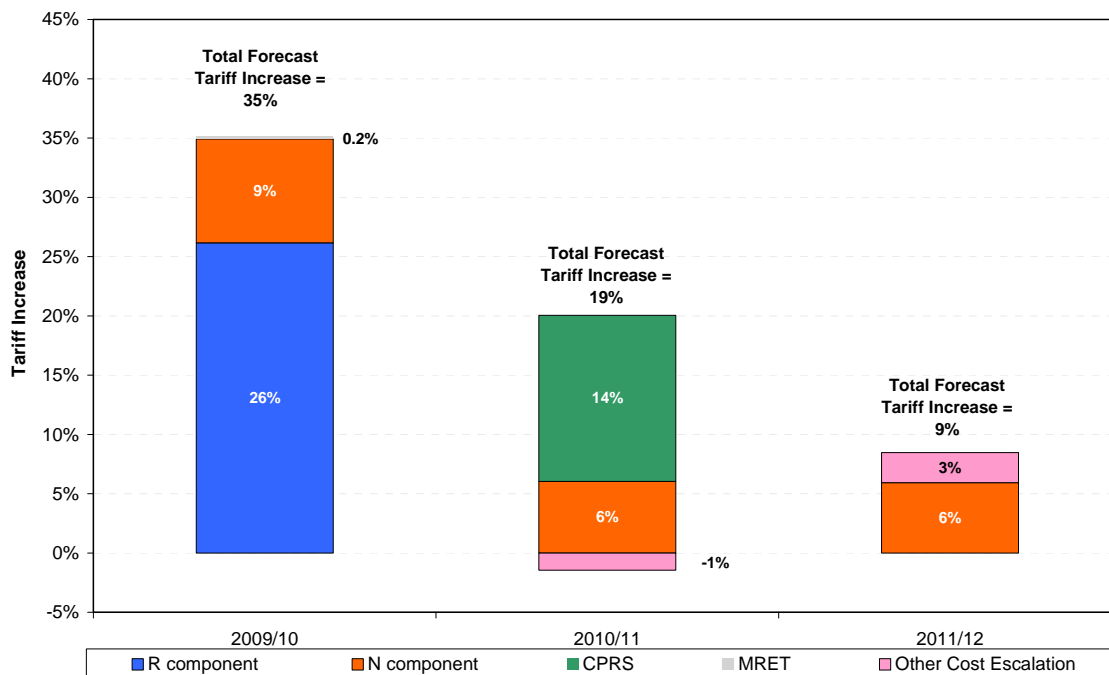
The network component of the tariff is estimated to account for 21 percentage points of the 29% increase in 2009/10, based on Western Power's Access Arrangement submission to the Economic Regulation Authority. The Economic Regulation Authority is still to approve network tariff increases for the period 2009/10 to 2011/12.

The expanded national Mandatory Renewable Energy Target has been introduced during this period and accounts for less than 1 percentage point of the required 29% increase in 2009/10.

The forecasted L1/L2 Tariff for 2010/11 indicates a further increase of 26%. The majority of this increase relates to network tariffs and the introduction of the Carbon Pollution Reduction Scheme. Network cost increases account for 12 percentage points of the 29% increase for 2010/11, while a further 11 percentage points is an estimate for the cost increase associated with the introduction of the Carbon Pollution Reduction Scheme. The magnitude of the required increase due to the Carbon Pollution Reduction Scheme will be determined by the decisions of the Commonwealth Government in regard to scheme design and greenhouse gas reduction targets. This 29% increase for 2010/11 also includes an estimated 4 percentage point increases from 2009/10 costs relating to the retail component and Mandatory Renewable Energy Target.

A further increase of 14% is required to the L1/L2 Tariff in 2011/12 mainly due to the projected increase in network costs, which accounts for 12 percentage points of the total 14% increase.

ESTIMATES FOR T1 – LARGE BUSINESS TARIFF



It is estimated that the T1 Large Business Tariff needs to increase by 35% in 2009/10 to achieve cost-reflectivity. This Review has determined that the required increase in level of the retail component of the tariff accounts for 26 percentage points of the 35% increase in 2009/10. The retail component consists of wholesale costs, retail operating costs and net retail margin.

The network component of the tariff is estimated to account for 9 percentage points of the 35% increase in 2009/10.

The forecasted T1 Tariff for 2010/11 indicates a further increase of 19% is required. This increase is mainly associated with increases to the network tariffs and the introduction of the Carbon Pollution Reduction Scheme. The magnitude of the required increase due to the network tariff increases is 6 percentage points of the total 19% increase, while a further 14 percentage points is due to the Carbon Pollution Reduction Scheme. The Carbon Pollution Reduction Scheme will be determined by the decisions of the Commonwealth Government in regard to scheme design and greenhouse gas reduction targets. It should also be noted that other cost relating to the retail component and the Mandatory Renewable Energy Target are projected to decrease in total by 1% compared to 2009/10.

A further increase of 9% is required to the T1 Tariff in 2011/12 mainly due to the projected increase in network costs, which accounts for 6 percentage points of the total 9% increase.

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 components (wholesale electricity costs, retail operating costs, and retail profit margin);
- the network charges;
- the Tariff Equalisation Fund;
- Carbon Pollution Reduction Scheme; and
- national Mandatory Renewable Energy Target costs.

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

Estimates have also been made for new costs which are expected to commence from 2010/11 for the Carbon Pollution Reduction 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 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 considered unlikely that these measures will be implemented during the Review period.

Key Assumptions

Wholesale Electricity Costs for Tariffs for Contestable Consumers

Wholesale electricity costs for tariffs for contestable customers were based on the forecast long-run marginal cost of wholesale electricity. The fuel cost estimates used in determining the long-run marginal costs were as follows:

- 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 were derived from consideration of publicly available information, with an assumed price of \$8.00 per GJ delivered.

Wholesale Electricity Costs for Tariffs for Non-Contestable Consumers

The wholesale supply costs for tariffs for non-contestable customers were based on a weighted average of the Verve Energy Sustainable Price and forecasts of the long-run marginal cost of wholesale electricity supply prepared by Frontier Economics. The weightings for these cost allocations were based on the share of the non-contestable load to be supplied to Synergy by Verve Energy under the Vesting Contract. For example, if 70% of the non-contestable load is covered by the Vesting Contract, and 30% by other wholesale supply contracts, then the wholesale supply cost was determined on the basis of a 70% contribution from the Verve Energy Sustainable Price and a 30% contribution from the forecast long-run marginal cost of wholesale electricity supply.

The Verve Energy Sustainable Price was set at a level to allow Verve Energy to recover its operating costs plus a margin set at a level to provide the Corporation, with an appropriate return on capital and tax payable (excluding any costs and revenues associated with activities other than the generation and trading of electricity). This is consistent with the methodology used to determine the Tariff Equalisation Fund, and also utilised by the Economic Regulation Authority to review the allowable revenue under the Western Power Access Arrangement.

It should be noted that the majority of the electricity requirements for non-contestable customers will be supplied by Verve Energy under the Vesting Contract over the period to 2011/12. This means that under the arrangements outlined above, non-contestable consumers receive the majority of the benefits associated with Verve Energy's existing coal and gas contract arrangements, and depreciated capital, over this period.

The wholesale price used for setting the A1 Residential Tariff is shown in Table 1, compared to the long run marginal cost of wholesale electricity supply (i.e. the wholesale costs that would have been used in the tariff without recognition of Verve Energy existing supply arrangements). These figures are reproduced from the Frontier Economics Report.

Table 1: Wholesale Cost Comparison for A1 Tariff (\$/MWh, real 2007/08 dollars, excluding line losses)			
	2009/10	2010/11	2011/12
Wholesale Cost used to set the non-contestable tariffs	90.42	91.47	88.94
Long Run Marginal Cost	106.16	99.14	97.77
% Difference	17.4%	8.4%	9.9%

This methodology for determining the wholesale cost for non-contestable customers described above was developed in recognition that the majority of the non-contestable load will be supplied by Verve Energy under the Vesting Contract over the Review Period, and that this segment of the retail market is not currently open to retail competition.

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, based on Western Power's proposed revisions to the Access Arrangement submitted to the Economic Regulation Authority. For 2008/09 the network costs used were as per Western Power's current price list.

The increases to the network costs assumed for 2009/10 to 2011/12 are the same in real terms as in Western Power's submitted Access Arrangements. CPI assumptions differ between Office of Energy and Western Power (Office of Energy CPI assumption are detailed in section below titled "[CPI Assumptions](#)") and therefore the nominal network tariff increases differ slightly between Office of Energy and Western Power. However, given that network tariffs are generally expressed as CPI+X, it is appropriate for the Office of Energy to utilise its own CPI assumptions. The nominal network tariff increases assumed for the retail tariff modelling are shown in Table 2.

Table 2: Nominal Network Cost Increase Assumptions			
	2009/10	2010/11	2011/12
Percentage increase	44.1%	28.5%	28.3%

The Economic Regulation Authority is yet to conclude its consideration of network tariffs for 2009/10 and onwards. If actual network costs deviate from the modelled estimates, this will change the increase required to achieve cost-reflective retail tariffs in 2009/10. It should also be noted that it is recommended that network costs should be treated as a pass through item, as per Recommendation 8. Further details on this matter are in the section "[Electricity Tariffs Pass-Through Charges](#)".

Carbon Pollution Reduction Scheme Costs

The Carbon Pollution Reduction Scheme⁵ is still under development, and given the uncertainty surrounding the form and targets for the scheme, the cost estimate in this analysis is inherently unreliable.

⁵ Formerly called the "National Emissions Trading Scheme", by the previous Commonwealth Liberal Government.

Costs for a Carbon Pollution Reduction Scheme have been estimated based on the arrangements as formed 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 Carbon Pollution Reduction Scheme commences operation on 1 July 2010.

Based on this, the estimated nominal carbon credit prices are as shown in Table 3.

Table 3: Nominal Carbon Credit Price Assumptions				
	2008/09	2009/10	2010/11	2011/12
Carbon Credits (\$/credit)	0.00	0.00	27.51	30.41

It should be noted that Carbon Pollution Reduction Scheme has not yet been fully developed, and there is a wide variety of estimates of the likely carbon credit price. The Commonwealth Government is currently developing details of this scheme.

It has also been assumed that retailers will bear the cost of the Carbon Pollution Reduction 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 Carbon Pollution Reduction Scheme compared to that which has been modelled will change the results of the forecast tariff levels for 2010/11 onwards. 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. The assumed nominal prices for Renewable Energy Certificates are as shown in Table 4.

Table 4: Nominal Renewable Energy Certificate (“RECs”) Prices			
	2009/10	2010/11	2011/12
RECs Price (\$/REC)	27.92	30.86	34.03

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”](#).

Cost Stacks

Residential Electricity Tariff Cost Stack

Table 5a provides a sample cost stack for the Residential A1 Tariff for 2009/10 to 2011/12, in both ¢/kWh and percentage of total tariff terms. The unit prices are in nominal terms with the CPI assumption being shown in Table 6.

Table 5a: A1 Nominal Cost Stack						
Cost Component	2009/10		2010/11		2011/12	
	¢/kWh	%	¢/kWh	%	¢/kWh	%
Black Energy Costs	10.97	51%	11.43	42%	11.42	37%
Carbon Pollution Reduction Scheme	0.00	0%	2.48	9%	2.73	9%
Mandatory Renewable Energy Target	0.12	1%	0.18	1%	0.25	1%
Ancillary Services	0.14	1%	0.14	1%	0.15	0%
Market Fees	0.06	0%	0.06	0%	0.06	0%
Retail Operating Costs	1.55	7%	1.59	6%	1.64	5%
Net Retail Margin	0.63	3%	0.79	3%	0.89	3%
Network Costs	8.24	38%	10.59	10.59	13.58	44%
Total⁶	21.71	100%	27.27	100%	30.72	100%

Small Business Cost Stack

Table 5b provides a sample cost stack for the Small Business L1 Tariff for 2009/10 to 2011/12, in both ¢/kWh and percentage of total tariff terms. The unit prices are in nominal terms with the CPI assumption being shown in Table 6.

Table 5b: L1 Nominal Cost Stack						
Cost Component	2009/10		2010/11		2011/12	
	c/kWh	%	c/kWh	%	c/kWh	%
Black Energy Cost	10.58	48%	11.01	40%	10.94	35%
Carbon Pollution Reduction Scheme	0.00	0%	2.40	9%	2.64	8%
Mandatory Renewable Energy Target	0.11	1%	0.17	1%	0.24	1%
Ancillary Services	0.13	1%	0.14	1%	0.14	0%
Market Fees	0.05	0%	0.06	0%	0.06	0%
Retail Operating Costs	0.97	4%	1.00	4%	1.02	3%
Net Retail Margin	0.64	3%	0.80	3%	0.92	3%
Network Costs	9.38	43%	12.05	44%	15.46	49%
Total⁶	21.86	100%	27.63	100%	31.42	100%

⁶ Note that the total may not add up to the sum of the components in this table due to rounding errors.

Large Business Cost Stack

Table 5c provides a sample cost stack for the Large Business T1 Tariff for 2009/10 to 2011/12, in both ¢/kWh and percentage of total tariff terms. The unit prices are in nominal terms with the CPI assumption being shown in Table 6.

Table 5c: T1 Nominal Cost Stack						
Cost Component	2009/10		2010/11		2011/12	
	c/kWh	%	c/kWh	%	c/kWh	%
Black Energy Costs	11.94	72%	11.48	58%	11.64	54%
Carbon Pollution Reduction Scheme	0.00	0%	2.33	12%	2.56	12%
Mandatory Renewable Energy Target	0.11	1%	0.17	1%	0.23	1%
Ancillary Services	0.13	1%	0.13	1%	0.14	1%
Market Fees	0.05	0%	0.05	0%	0.06	0%
Retail Operating Costs	0.05	0%	0.06	0%	0.06	0%
Net Retail Margin	0.79	5%	0.94	5%	1.02	5%
Network Costs	3.52	21%	4.52	23%	5.80	27%
Total⁶	16.59	100%	19.68	100%	21.50	100%

CPI Assumptions

Frontier Economics has presented its findings using numbers in real terms (2007/08 dollars). For clarity, the Office of Energy has presented the outcomes of the tariff review in this report in nominal terms, by applying a CPI increase to Frontier Economics' results. The CPI assumptions utilised by the Office of Energy are based on the methodology that will be used to apply the CPI in the annual tariff increases. This methodology will use the annual Perth CPI increases for the March quarter which will apply for the following financial year. This method applies a CPI number for the previous year to the following year. In line with this, the Office of Energy CPI assumptions for this report were based on:

- the actual annual Perth CPI for March 2008 for 2008/09; and
- the Department of Treasury and Finance CPI assumption utilised one year later, given that the tariff increases utilise the CPI for the previous year to the following year.

The CPI assumptions utilised by the Office of Energy in this report are as shown in Table 6.

Table 6: Office of Energy CPI assumptions				
	2008/09	2009/10	2010/11	2011/12
Increase in CPI assumption	4.30%	3.25%	3.00%	2.75%

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

1. In order for tariffs for residential and small business 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	2009/10	2010/11	2011/12
Residential Tariffs			
A1/A2	52%	26%	13%
B1	132%	32%	19%
Other Small-Use Customers			
L1/L2	29%	26%	14%
R1	37%	27%	10%
K1/K2	50%	26%	14%

- These tariff increases are forecasts only, and are based on the impact that network tariffs would have from 2009/10 onwards if the Economic Regulation Authority approves Western Power's Access Arrangement as per its application, and the impacts of an assumed Carbon Pollution Reduction Scheme commencing in 2010/11.
- These tariff increases assume that the Tariff Equalisation Fund will be funded via a direct Community Service Obligation rather than through network charges, in accordance with Recommendation 6.
- Government should select a glide path for the residential and small business customer tariffs to reach the forecast cost-reflective levels; and should fund any difference between cost-reflective tariffs and the glide path it chooses through Community Service Obligation payments. Details of the amount of the Community Service Obligation payment should be shown on electricity bills.

Submissions to the Draft Recommendations Report generally supported the move to cost reflectivity, although some noted that it may be appropriate for a glide path arrangement to be implemented (supported by a Community Service Obligation arrangement), to allow existing tariffs to reach cost reflectivity, as discussed below.

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, B1 Residential Tariff, L1/L2 Small Business Tariff, R1 Business Tariff and, the K1/K2 combined residential and business tariff.

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.

It should be noted that 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 cover the difference between the cost-reflective tariff (i.e. the actual cost of producing and supplying electricity) and the glide path for residential and small business customers. Further discussion is provided below in "[Community Service Obligation Arrangements](#)".

Whilst it is considered appropriate that decisions on glide path and associated Community Service Obligation arrangements should remain the discretion of Government, suggested principles for consideration in making such a decision are outlined in this report.

Glide Path Arrangements

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.

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 retail electricity market. This is because the introduction of full retail contestability must be accompanied with an assurance that retailers will be able to price contracts at a level that covers their costs of supplying consumers, otherwise there will be no entry of retailers into the retail market and therefore no point to introducing full retail contestability.

Either cost-reflective tariffs or a glide path accompanied with a Community Service Obligation paid to all retailers servicing small use customers will have to be implemented to introduce full retail contestability. If a glide path is adopted without the provision of Community Service Obligation payments to all retailers, full retail contestability will be delayed until cost reflectivity is reached. If a glide path is adopted with associated Community Service Obligation payments to all retailers this could still reduce the effectiveness of full retail contestability, depending on the method for paying the Community Service Obligation.

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

Almost all submissions to the Draft Recommendation Paper supported the implementation of a glide path arrangement for non-contestable customers, together with a Community Service Obligation payment for the difference between the glide path and the cost-reflective level.

The Energy Retailers' Association of Australia and Alinta expressed preference for a short glide path, while the City of Cockburn suggested a glide path that increases tariffs of around 7% per year would be preferable. The Western Australian Council on Social Service ("WACOSS") expressed support for a longer glide path to provide electricity consumers with increased opportunities to adapt to change.

Alinta indicated concern that a longer glide path may lead to potential inefficiencies in the development of generation options within the South West Interconnected System and the broader Western Australian market. Alinta also noted that while regulated electricity tariffs remain below cost-reflective levels, customers will continue to make inefficient consumption decisions, which in turn will lead to an inefficient allocation of resources within the broader Western Australian economy.

The Energy Retailers' Association of Australia noted that there was a customer backlash against a significant increase in tariffs (of around 24% in 2003) in South Australia. To avoid a similar outcome, the Energy Retailers' Association of Australia suggested that the forecast tariff changes should be re-weighted so that they are more graduated, given the significant increases required to the tariffs in Western Australia to bring them to cost-reflective levels. On this matter it should be noted that the purpose of the Review has been to determine the level of the tariff increases required to move to cost-reflective levels, with any decisions on a glide path tariff arrangement remaining with Government, as outlined above.

Careful consideration needs to be given to the interaction of any glide path and the Carbon Pollution Reduction 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 interfere with the intent of the Carbon Pollution Reduction Scheme.

As the Carbon Pollution Reduction Scheme is a Commonwealth programme, it should be up to the Commonwealth Government to determine if residential customers are to be protected from the full impact of the scheme, and if so, to implement and fund the compensation mechanism.

Community Service Obligation Arrangements

The Community Service Obligation would be paid to Synergy and Horizon Power as they are the only retailers servicing residential and small business customers.

Synergy would use the Community Service Obligation revenue to assist in payments for the costs of servicing the residential and small business consumers. These costs include network costs, internal operating costs, wholesale supply costs,⁷ renewable energy target requirements, and other regulatory and market fees.

Horizon Power customers will be charged at the same rate as the equivalent customer in the South West Interconnected System, as per the Uniform Tariff Policy. Therefore if there is a glide path arrangement for residential and small use customers in the South West

⁷ Synergy purchases electricity from Verve Energy and private generators for residential and small business customers in the South West Interconnected System.

Interconnected System, this will also apply to residential and small use customers outside the South West Interconnected System. As such, it is also appropriate for Horizon Power to receive a Community Service Obligation for the difference between the glide path and the cost-reflective tariff in the South West Interconnected System.

In addition, it should be noted, that the cost-reflective tariffs in the South West Interconnected System will not fully cover Horizon Power's costs (as costs relating to production and supply of electricity outside the South West Interconnected System are generally higher than those in the South West Interconnected System). As is the current arrangement, Horizon Power will receive funding from the Tariff Equalisation Fund for the difference between the cost-reflective tariff in the South West Interconnected System and its actual costs. The Tariff Equalisation Fund is determined by the Treasurer in consultation with the Economic Regulation Authority (if necessary). Further details on the Uniform Tariff Policy and the Tariff Equalisation Fund are in section "[Funding the Uniform Tariff Policy](#)".

There are a number of options to determine the mechanism for the Community Service Obligation payment:

- The Community Service Obligation payment could be set at a level to recover the difference between the glide path tariff selected by Government and the cost-reflective tariff. This would mean that all consumers subject to the glide path tariff would face the same percentage increases in their bill, and therefore there would be no discrimination between large and small consumers of electricity within a tariff class.
- The Community Service Obligation payment could be based on a flat payment regardless of the amount of electricity consumed. For example every consumer subject to the glide path tariff arrangement could receive a \$100 discount to the cost-reflective tariff amount per year, with the size of the discount changing annually. This means that larger electricity consumers would be faced with a larger percentage increase in their bills than lower electricity consumers. It could also be possible to have a different flat payment for different blocks of energy consumption. This approach would effectively mean that the electricity costs faced by consumers would appear as an inclining block tariff.
- The Community Service Obligation payment could be paid only up to a certain level of consumption based on the difference between the cost-reflective tariff and the glide path, with the cost-reflective tariff being for consumption above a certain threshold.

The above options would have to be considered in terms of the future implementation of full retail contestability, incentives for energy efficiency, and social issues relating to energy affordability considerations.

The Chamber of Commerce and Industry submission noted that it is important that the Community Service Obligation arrangement does not stifle competition and allow Synergy to offer electricity into the market at a lower price than other retailers through cross-subsidisation. Landfill Gas and Power also emphasised the importance of ensuring that Community Service Obligation payments are utilised appropriately and not used to cross-subsidise pricing to commercial customers. On this matter it is noted that this Report only considers the adoption of glide path arrangements in relation to tariffs for non-contestable customers. It is also recognised that structuring of the Community Service Obligation payment arrangements should be developed in a manner that reduces the opportunities for cross-subsidisation.

It is also recommended that the details of the amount of any Community Service Obligation payment to give effect to the glide path should be shown on electricity bills, to ensure customer awareness of the magnitude of these payments and the real cost of energy.

Synergy commented on this aspect of the recommendation, noting that whilst it supported the objective of making details of these payments transparent, it also considered that the presentation mechanism should not be tightly defined to the inclusion of individualized information on customer accounts. It considered that such an approach would allow scope for alternatives such as Government publication of Community Service Obligation information on an annual basis in newspapers, Government websites (with links from the Synergy website) and inclusion of these details in Annual Reports or Statements of Corporate Intent publications. Alinta and the Chamber of Commerce and Industry supported itemisation of the Community Service Obligation amount on energy bills, on the basis that it shows the extent to which the Government provides subsidisation towards the energy costs faced by individual electricity customers.

The Office of Energy recognises that imposition of a mandatory requirement on Synergy and Horizon Power to provide details of the amount of the Community Service Obligation for individual customers on electricity bills will require changes to billing systems. However it is also important that these Corporations work towards the accommodation of these requirements in the longer term planning for changes to these billing systems.

Impact on the Residential Electricity Bills

Table 7 shows the impact on average residential bills, based on a number of different glide paths, on an incremental basis and on a cumulative basis over 2009/10 to 2011/12, assuming that the costs associated with the Carbon Pollution Reduction Scheme are passed through to the consumer (i.e. the customer will face the glide path increase plus costs associated with the Carbon Pollution Reduction Scheme). Note that this analysis is based on the average consumption in Western Australia of 6,004 kWh per annum. The current residential annual bill, based on this consumption, is \$930.02 per annum.

Table 7: Increase in Average Annual Residential Bill				
Scenario	Annual Increase			Cumulative Increase
	2009/10	2010/11	2011/12	
Cost-Reflective	\$482.39	\$362.02	\$224.66	\$1,069.07
4 Year Glide Path	\$257.17	\$256.89	\$256.89	\$770.96
7 Year Glide Path	\$217.75	\$217.47	\$217.47	\$652.70
10 Year Glide Path	\$219.64	\$219.37	\$219.37	\$658.38
Glide Path based on 10% increase per year plus Carbon Pollution Reduction Scheme costs	\$93.31	\$251.08	\$127.53	\$471.91

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 Residential (A1) 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 incentives 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 tariffs on those that consume less (assuming these are lower income customers).⁸

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

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. Carbon Reduction Pollution Scheme.

Price signals will soon be attached to greenhouse gas emissions with the establishment of the Carbon Pollution Reduction Scheme. The costs of the 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 a "time-of-use tariff" arrangement, which has 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). 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/A2, L1/L2 and K1/K2 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/A2, L1/L2 and K1/K2 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 small use customer tariffs (A1/A2, B1, L1/L2, R1, K1/K2):

- **the small use customer tariffs should retain their current tariff structure in the short-term for the retail component, with the exception of the new costs associated with the Carbon Pollution Reduction Scheme, which should be completely assigned to the variable component of the tariffs. The network component of the retail tariff should reflect the structure of the fixed and variable components of the relevant network tariffs as per Western Power's approved Access Arrangement;**

- a new L3/L4 Tariff should be created for contestable customers on the current L1/L2 Tariff, if a glide path is implemented for the non-contestable customers currently on the L1/L2 Tariff;
- future consideration should be given to changing the A1/A2, L1/L2 and K1/K2 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, L1/L2 and K1/K2 Tariffs to a time-of-use tariff structure.

Fixed and Variable Structure of the Small Use Tariffs

The above recommendation recognises the new cost associated with the Carbon Pollution Reduction Scheme and recommends that this cost be completely assigned to the variable component of the tariff. This is because the overwhelming majority of the carbon costs are expected to be related to the amount of electricity consumed by the customer, given that the amount of greenhouse gas emissions will depend on the generation amount.

Also note that Western Power determines the structure of the network component (the network cost component), subject to approval from the Economic Regulation Authority. The network component has been recommended to be passed through in the section [“Electricity Tariffs Pass Through Charges”](#).

As such, the overall ratio of the fixed to variable charge is likely to change compared to the current arrangement due to the inclusion of Carbon Pollution Reduction Scheme costs and network cost pass through. However, the recommended structure should represent the fixed and variable costs of supplying electricity to a particular consumer group better than the current structure.

Tariffs in a Glide Path Arrangement Situation

It has been recommended that a new L3/L4 Tariff be created if the non-contestable customers on the current L1/L2 Tariff are subject to a glide path arrangement. Currently, the L1/L2 Tariff consists of customers that are contestable and non-contestable. The creation of the new tariff ensures that only the non-contestable customers are subject to any glide path, if the Government chooses to apply a glide path for non-contestable customers. In this situation, the L1 Tariff would be for non-contestable customers only, whilst the L3/L4 Tariff would be for contestable customers previously on the L1/L2 Tariff.

It is also recognised that the M1 Tariff contains a mix of contestable and non-contestable customers. In the case of a glide path arrangement for non-contestable customers, the non-contestable customers will be allowed to move to the L1 Tariff, whilst the M1 Tariff will only be for contestable customers. A new tariff is not warranted due to the small number of non-contestable customers currently on the M1 Tariff.

Comments from Responses to the Draft Recommendations Report

Comments on the tariff structure from responses to the Draft Recommendations Report are as follows.

Alinta suggested that, as far as possible, the structure of regulated electricity tariffs should reflect the marginal cost of electricity supply, including energy and capacity, to ensure that competition in the retail market is not distorted. Alinta also noted that, going forward, there will be a need to revisit the structure of tariffs to ensure that they are able to remain at cost-reflective levels should the underlying cost components change.

The Chamber of Commerce and Industry noted that time-of-use pricing signals will only be fully effective when tariffs are at cost-reflective levels. This comment was also supported by the Energy Retailers' Association of Australia, which noted the important relationship between time-of-use pricing and cost-reflective tariffs.

Synergy agreed with the view that inclining block tariffs cannot easily provide a cost-reflective tariff arrangement, and could therefore create distortionary cross-subsidies, which potentially could be mitigated through the use of seasonal inclining block structures reflecting different costs of supply at different points in time. Synergy forwarded the view that in the longer term tariffs should move towards time-of-use pricing to enable accurate signals to be provided to customers and provide incentive for appropriate energy consumption behaviour.

Landfill Gas and Power supported the retention of the current A1 and L1 Tariff structures, noting that time-of-use R Tariffs would be available to customers on the L1 Tariff (subject to installation of a suitable meter). Landfill Gas and Power also suggested that consideration should be given to development of a non-SmartPower time-of-use equivalent to the A1 Tariff. It is considered that the intent behind this recommendation would be to ensure that all residential customers have access to a regulated time-of-use tariff product. This view was also supported by WACOSS, which advocated for the development of a regulated time-of-use tariff product for residential customers. As noted above, it is considered appropriate that such a proposal be further considered as part of any decision to roll-out smart meters within Western Australia.

WACOSS also suggested that the principles for setting tariffs should consider the concept of a "lifeline" or "essential services" block in the residential tariff. This is effectively an inclining block arrangement, where the "lifeline" block would be the lowest price block. WACOSS suggested that the "lifeline" block should be set at a level that equates to minimum household usage to provide hot water, space heating/cooling, refrigeration and minimum lighting.

A submission from a member of the public suggested that residential tariffs should be adjusted to an inclining block arrangement, with a higher charge for consumption in excess of a fixed number of units/day (e.g. 20 units/day), to allow a return sufficient to supply renewable 'green' power by the retailers. This proposal was intended to ensure that large users do not receive a subsidy on their high usage and provide an incentive for the installation of solar hot water systems to minimise electricity demand. It was also considered that such an approach would provide a secure load for renewable suppliers to justify expansion of generating capacity.

Western Power noted in its submission that the network tariff structure does not currently support an inclining block retail tariff. There would need to be consistency in both network and

retail tariff arrangements in order for an inclining block structure to be effective. However, as discussed under [Recommendation 1 \(“Community Service Obligation Arrangements”\)](#) it would be possible to implement an inclining block tariff via the mechanism of the Community Service Obligation payment, without the need for Western Power to amend the structure of network tariffs.

Synergy also requested that the range of fees and charges currently regulated under the *Energy Operators (Electricity Retail Corporation) (Charges) By-laws 2006* (“The Synergy Tariff By-laws”) should be removed from these By-Laws from 1 July 2009. These charges include items such as late payment fees, account establishment fees, etc. Synergy claimed that these charges should be removed because it is administratively cumbersome and resource intensive to legislate minor fee changes, comparable gas fees are not legislated, and a number of the fees are network related (such as metering) making it difficult to reconcile network charges (which are not prescribed) with the Synergy Tariff By-laws. Synergy also noted that not all of its fees and charges are regulated, such as payment dishonour and merchant service fees. These matters are to be considered outside of this Review process.

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 230,000 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 that 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 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.

Carbon Pollution Reduction Scheme

A clear understanding is required of any compensation or re-balancing that the Commonwealth Government may undertake through the Carbon Pollution Reduction Scheme.

The Commonwealth Government has made a number of specific commitments to households with regard to cost increases due to the Carbon Pollution Reduction Scheme. The Commonwealth Government's Green Paper on the Scheme states the following:⁹

"...[the Commonwealth] Government has committed to:

- Cut fuel taxes on a cent for cent basis to offset the initial price impact on fuel associated with the introduction of the Carbon Pollution Reduction Scheme. The Government will periodically assess the adequacy of this for three years and adjust this offset accordingly. At the end of this three year period, the Government will review this adjustment mechanism.
- Increase payments, above automatic indexation, to people in receipt of pensioner, carer, senior and allowance benefits. Other assistance measures to meet the overall increase in the cost of living flowing from the scheme will also be provided to this group.
- Increase assistance to other low-income households through the tax and payment system to meet the overall increase in the cost of living flowing from the scheme.
- Provide assistance to middle-income households to help them meet any overall increase in the cost of living flowing from the scheme.

⁹ Fact Sheet 7, Carbon Pollution Reduction Scheme Green Paper Fact Sheet, July 2008, <http://www.climatechange.gov.au/greenpaper/factsheets/fs7.html>

- Review annually, in the Budget context, the adequacy of payments to beneficiaries and recipients of family assistance to assist households with the overall impacts of the scheme.
- Provide additional support through the introduction of energy efficiency measures and consumer information to help households take practical action to reduce energy use and save on energy bills.

The Commonwealth Government has also indicated in the terms of reference for the review into Australia's Future Tax System that it is to consider the interrelationships between the tax and payment systems and the Carbon Pollution Reduction Scheme.”

Any decision on increasing rebates to account for carbon emissions should be deferred until the arrangements for the Carbon Pollution Reduction Scheme are concluded.

It is also noted that any move by the Commonwealth Government to offset the costs of the Carbon Pollution Reduction Scheme for residential customers could reduce the size of the necessary retail tariff increases (particularly in 2010/11).

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. It is likely that these figures are conservative estimates given the difficulties currently being experienced in the broader Western Australian economy. In addition, those facing hardship may increase depending on any glide path arrangements chosen by the Government. It is likely that a steeper glide path would increase those households in utility hardship.

Recognising the prevalence of utility hardship, the Government Utilities Essential Service Hardship Inter-Agency Working Group has been formed 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 this review of electricity tariffs in its deliberations.

In expressing support for the above recommendation, Alinta noted that Government currently provides a wide range of concessions in the form of rebates, discounts and waivers to improve the affordability of essential services and other important services that improve the quality of life for eligible recipients. Alinta suggested that when financial assistance is provided in relation to services that are, or may be, provided in a contestable market, it is preferable that such assistance be provided through direct payments to ensure that the financial assistance is appropriately and effectively targeted, and that it does not distort competition in the provision of these services.

The Chamber of Commerce and Industry expressed similar views, noting that the amount of the energy rebates should be increased in proportion to any government approved tariff increases. The Energy Retailers' Association of Australia also suggested that price regulation should not be used as a means to protect vulnerable customers, as it may have unintended consequences through the introduction of cross-subsidies, which have a negative impact on market development, product innovation, investment in supply and demand management initiatives, and efforts to encourage greater energy efficiency. The Chamber of Commerce and Industry also noted that energy affordability should best be managed through comprehensive government funded direct support programs, and that such measures should be transparent and simple to administer in order not to impact on market competition.

Synergy also supported the proposed energy rebate arrangements outlined above, subject to being recompensed for all establishment and administration costs associated with any expansion of rebate applicability. Synergy also forwarded the view that retailers should be recompensed for all establishment and administration costs associated with any new hardship arrangements.

WACOSS also expressed support for the recommendation, adding that it considered that there should be an overall increase in the level of assistance provided by such rebates. WACOSS also noted that because of the fixed nature of the rebates, their relative value as a proportion of overall energy costs is lower for individuals or households with higher levels of energy consumption. Accordingly it suggested that with any move to an inclining block tariff regime, the rebates should be calculated as a proportion of the first "lifeline" block of consumption, with increases in the amount of the rebate available for those individuals with higher levels of household occupancy.

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.

The C1 Tariff is currently based on a mixture of the A1 and L1 Tariffs. The C1 Tariff has three consumption blocks, with the energy consumption in the first block charged at the A1 Tariff variable rate, and the next two blocks set on an equivalent basis to the L1 Tariff variable rates.

The fixed charge is based on the A1 Tariff, which is lower than that for the L1 Tariff. As such, this tariff presents a discount in the first consumption block and the fixed charge component compared to the L1 Tariff, which is the likely tariff that these consumers would face in the absence of the special C1 Tariff.

The D1 Tariff is currently based on the A1 Residential Tariff, with the fixed charge for additional dwellings being lower than that for the equivalent A1 Tariff charge. As such, the discount this tariff currently receives is on the fixed component compared to the A1 Tariff.

This means that the subsidies received by charitable organisations are linked to a combination of fixed and variable charges.

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).

In line with the policy that tariffs should be set at cost-reflective levels and that subsidies should be provided through direct financial assistance, rather than through tariff arrangements, it is 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/R3 Tariff). A subsidy would then be provided to the retailer servicing these customers based on the differential between the previous C1/C2 or the D1/D2 Tariff rate escalated at the glide path and the corresponding tariff that these customers have moved to for that year, passed on via a reduction in the electricity bill. This subsidy would continue until the escalated C1/C2 or D1/D2 Tariff rate reaches the level of tariff that these customers have moved to.

The subsidy would be to ensure that the community and charitable organisations face the same percentage increase in electricity tariffs as would be the case if these tariffs were not removed, with this subsidy being maintained until the tariff rates paid by the customer reach the levels of the alternative tariff as described above.

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. It should be noted that these arrangements are only to apply to existing customers on the C1/C2 and D1/2 Tariffs before the tariffs are removed.

It would also be possible for customers that have consumption of more than 50 MWh per year to move to a contract arrangement. Particularly, the proposed removal of the C1/C2 and D1/D2 Tariffs 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.

It is proposed that these arrangements be implemented from 2009/10 to allow time for development of the proposed Community Service Obligation payment arrangements as outlined above.

Recommendation:

4. The Community and Charitable Organisation Tariffs (C1/C2 and D1/D2 Tariffs) should be removed from 2009/10, with assistance instead provided by direct Community Service Obligation payments.

Most submissions to the Review supported the recommendation for removal of the C1/C2 and D1/D2 Tariffs for community and charitable organisations.

Whilst the Energy Retailers' Association of Australia supported removing these specialised tariffs, it did not support use of a direct subsidy administered via retailers, on the basis that it would be administratively difficult and result in additional costs being borne by these retailers. Synergy also advocated that retailers should be compensated for any additional costs required to administer the rebate.

WACOSS noted that the benefit that community and charitable organisations receive from the current tariff arrangement is in proportion to their level of consumption and it expressed concern that the direct subsidy should not continue the linkage between the consumption and the amount of subsidy. WACOSS also noted that any change in the way in which the electricity tariff subsidy to these consumers is delivered could have an impact on the administrative costs for these organisations which are already under financial pressure.

As discussed above, the current subsidy arrangements represent a concession on both the fixed and variable charges for energy consumption. It is also noted that it is proposed that this assistance should only be continued during the period required to transition these customers to cost-reflective tariffs, with the existing electricity charges for these customers being escalated at a rate similar to any glide path arrangements as determined by Government. Continuation of the subsidy over this period will therefore be paid via a reduction in the electricity bills for community and charitable organisations.

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 further increase of 5% was implemented on 1 July 2008, with a price path for these regulated tariffs proposing further increases of 5% per annum until 2011/12. The Frontier Economics analysis shows that the tariffs for large business customers require additional increases to achieve cost-reflective levels. As the M1 Tariff was not previously adjusted in 2007/08, it also requires an adjustment of 51% to achieve cost reflectivity in 2009/10.

Given that these business tariffs are charged to contestable customers (i.e. using at least 50 MWh of electricity per annum), it is considered that the tariffs should be moved directly to cost-reflective levels so as not to hamper the development of competition in this market segment.

Business customers that consume more than 50MWh per annum are likely to be 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. Regarding tariffs for large consumers:

In order for tariffs for large businesses (contestable customers) in the South West Interconnected System to be cost-reflective in 2009/10, it is forecast that the tariffs need to increase in accordance with the following table (details of the tariff classes are in Attachment 1).

Tariff	2009/10	2010/11	2011/12
L3/L4	39%	20%	13%
R3	42%	19%	11%
S1	27%	19%	10%
T1	35%	19%	9%
M1/M2	51%	20%	13%
N2	-	-	-
P2	39%	20%	13%
W1/W2	142%	20%	10%
Z	63%	31%	23%

- **The tariff increases from 2009/10 forward are forecasts only, and are based on the impact that network tariffs would have from 2009/10 onwards if the Economic Regulation Authority approves Western Power’s Access Arrangement as per its application, and the impacts of an assumed Carbon Pollution Reduction Scheme commencing in 2010/11.**
- **These tariff increases assume that the Tariff Equalisation Fund will be funded via a direct Community Service obligation rather than through network charges, in accordance with Recommendation 6.**
- **The above tariffs should retain their current tariff structure in the short-term for the retail component, except that the new cost associated with the Carbon Pollution Reduction Scheme will be completely assigned to the variable component of the tariffs. The network component of the retail tariffs should reflect the structure of the fixed and variable components of the relevant network tariffs.**

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 the new L3/L4 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 L3/L4 Tariff.

Submissions on the above recommendation generally supported the move to cost reflectivity for these tariffs, but there were differing views on the path to cost reflectivity.

Alinta noted that it is essential to move these large use tariffs to cost reflectivity to place the Western Australian electricity industry on a sound commercial and economic footing, which in turn is necessary to support ongoing investment in the industry. Alinta also noted that cost reflectivity for these tariffs will support entry of other retailers into the market, adding that it considered that in the longer term it is this competition that will assist in providing the most effective means to protect consumer interests. Landfill Gas and Power noted that it has experienced first hand the adverse impact of tariffs acting as a price floor on the development of its business interests.

Landfill Gas and Power also noted that there was a mixture of non-contestable and contestable consumers on the M1 and L1 Tariff, and as such, these tariffs should be split into two tariffs: one for non-contestable consumers and one for contestable consumers. The Office of Energy supports this recommendation to split the L1 Tariff into an L1 Tariff for non-contestable consumers, and an L3 Tariff for contestable consumers if the Government chooses a glide path arrangement for non-contestable customers. As discussed previously, in this situation it is also considered appropriate that the non-contestable M1 customers (i.e. their annual consumption has not exceeded 50 MWh per annum) should be allowed to revert to the L1 Tariff, leaving the M1 Tariff to be available only to contestable customers.

The Western Australian Local Government Association ("WALGA") and the City of Cockburn noted that the proposed increases for contestable tariffs would have a significant financial impact on local authorities and community groups. Both of these organisations advocated that contestable tariffs, and in particular the streetlight tariffs (the Z Tariffs), should be subject to a glide path towards cost reflectivity. WALGA also noted that, under current arrangements, the supply of electricity for street-lighting purposes is not contestable, and therefore it would be inappropriate to set these tariffs at cost-reflective levels.

These matters are to be further considered in the Review component relating to the implementation of electricity full retail contestability.

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 is reflective of the fact 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.

The Energy Retailers' Association of Australia and the Chamber of Commerce and Industry advocated the immediate removal of the large business tariffs, given the presence of competitive arrangements for supply to these customers meaning that unnecessary costs are incurred by both government and industry in the determination and comment on price determinations for these tariffs. Synergy indicated that it considered that large business tariffs should be removed from 2009/10. Alinta and Landfill Gas and Power supported the consideration of a review relating to the possible removal of these tariffs during the next tariff reset process.

TARIFFS FOR REGIONAL ELECTRICITY CUSTOMERS

The review of electricity tariff arrangements is being conducted on the basis of retention of the 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. Currently 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 currently 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.

In the event of a glide path arrangement, the Tariff Equalisation Fund will be defined as being the difference between the cost-reflective tariff in the South West Interconnected System and the electricity generation and supply costs incurred by Horizon Power, as discussed in the

section on “[Community Service Obligation Arrangements](#)”. As Horizon Power will receive tariff revenues consistent with any glide path arrangement rather than the cost-reflective tariff rate in the South West Interconnected System, the difference between the glide path and the cost-reflective rate will be covered by a direct Community Service Obligation payment to Horizon Power.

In summary, 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, with the amount of this funding projected to increase as indicated in the Frontier Economics Report. The Tariff Equalisation Fund provides financial support to Horizon Power to cover the difference between tariff revenue generated by Tariffs that are cost-reflective for the South West Interconnected System and the cost to produce electricity in the regional 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 the 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. The impact of converting the Tariff Equalisation Fund to a Community Service Obligation has been accounted for in the forecasted tariff increases provided in Recommendations 1 and 5.

If the Tariff Equalisation Fund is not converted to a Community Service Obligation, then Network Tariffs will be higher and the required cost-reflective retail tariff increases would be as indicated in Table 8.

Table 8: Necessary Retail Tariff Increases including the Tariff Equalisation Fund			
Tariff	2009/10	2010/11	2011/12
Residential Tariffs			
A1/A2	59%	23%	11%
B1	145%	28%	17%

Other Small Use Customers			
L1/L2	35%	24%	12%
R1	42%	25%	10%
K1/K2	57%	24%	12%
Large Customer Tariffs			
L3/L4	45%	18%	12%
R3	46%	17%	10%
S1	31%	17%	9%
T1	40%	17%	8%
M1	58%	18%	12%
N2	-	-	-
P2	45%	18%	12%
W1/W2	159%	16%	8%
Z	68%	29%	22%

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 from 2009/10 onwards.**

All submissions that commented on this recommendation expressed support for replacing the Tariff Equalisation Fund with Community Service Obligation payments.

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 noted in the Draft Recommendations Paper, 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 being 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; and/or
- 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.

It is also recommended that in resetting these electricity tariffs, the Economic Regulation Authority should maintain the principles for the setting of the wholesale electricity supply cost component of tariffs for non-contestable customers as outlined in this Report, utilising a blend of a Verve Energy Sustainable Price and Long Run Marginal Cost.

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 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 and Horizon Power 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 small-use customers from 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.**

Support was expressed for this recommendation by almost all submissions that commented on this recommendation.

Alinta noted that section 32 of the *Economic Regulation Authority Act 2003* already provides for the Minister responsible for this Act to request that the Authority undertake an inquiry into any matter relating to a regulated industry. Alinta notes that the Economic Regulation Authority provides independent advice to Government via standing references and advocated that a similar reference be provided to the Economic Regulation Authority for electricity tariff adjustments in the interim step towards a more formal price setting regime.

In addition to supporting the move to regular resets by the Economic Regulation Authority, WACOSS also supported the proposal that the Government retain the authority to specify glide paths with an associated Community Service Obligation, and also indicated that it supports the Minister retaining authority to set glide paths as dictated by the overarching needs of the community in certain circumstances. WACOSS also suggested that a distinction between consumer groups (for example small residential consumers versus large residential consumers) should be considered in making such pricing determinations.

Unions WA expressed the view that any adjustments to electricity tariffs should always be limited to CPI movements given that electricity is an essential service.

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 and are subject to a significant level of uncertainty, particularly at Western Power's Access Arrangement resets.

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 retail 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.

Submissions to this recommendation generally supported network tariff pass through.

Synergy did not support itemising network costs on small use customer bills, noting that it would be a significant administrative burden, may not be achievable, and would not be cost effective. Western Power noted that its current billing process supports the itemisation of network tariffs on retail bills. Landfill Gas and Power, and Alinta supported separate itemisation of network costs on bills. Alinta noted that this would enable customers to compare retail offers more easily.

As noted previously, it is recognised that the requirement to show details of network tariffs on retail bills will require additional effort from retailers, but it is considered important that such requirements are considered in any further changes to IT systems in order to improve transparency of pricing arrangements.

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 Carbon Pollution Reduction 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 scheme 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 gas 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.

However, the pass through of greenhouse gas emission trading may have to be based on some incentive mechanism, such as the long run marginal cost of greenhouse gas emissions credits, to ensure that retailers face efficient greenhouse gas emissions costs, particularly in the absence of retail competition. This is in line with the treatment for setting the black wholesale cost component and Mandatory Renewable Energy Target cost component in the recommended tariffs.

In the interests of improved price transparency, it is also appropriate that the costs of greenhouse gas mitigation measures be itemised on all retail bills, where these costs are based on some form of incentive mechanism or specific allowance.

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 where costs are based on a specific allowance.**

WACOSS suggested that additional costs associated with the Mandatory Renewable Energy Target and Carbon Pollution Reduction Scheme should be factored into any glide path tariff arrangements, with such pass through costs being spread over multiple years and other cost increases being deferred until full pass through of these costs is achieved. It also considered that such pass through costs should not be passed on to all customers, with the residential tariffs providing for a “lifeline” or “essential services” component to cover only the minimum costs of electricity production in servicing these customers.

In consideration of this proposal, it is noted that such an approach would eradicate the intended impact of pass through of these costs to ensure that all customers experience the direct impact of greenhouse gas reduction measures. In addition, it has been recommended that the costs associated with a Carbon Pollution Reduction Scheme are part of the variable component of the tariffs. As such, the lower a person’s consumption the lower the costs they face with respect to the Carbon Pollution Reduction Scheme costs. Furthermore, the Commonwealth Government has committed to reducing the impact of the Scheme for low and middle income households as discussed in the section on “[Financially Disadvantaged Customers](#)”, and it would be a misallocation of resources to double up on subsidies for the Carbon Pollution Reduction Scheme impacts.

As with the comments on network tariffs, it is recognised that the requirement to show details of greenhouse gas costs on retail bills will require additional effort from retailers. However it is considered important that such requirements are considered in any further changes to IT systems in order to improve pricing transparency.

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 tariff 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 tariff 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.

Recent Retail Pricing Determinations

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.
- In December 2008 the Queensland Competition Authority released its draft decision on increases to retail electricity tariffs for 2009/10. The draft decision is that retail electricity tariffs will increase by 13.63% at the beginning of 2009/10.

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.