



ICRC

independent competition and regulatory commission

Mr Andrew Barr MLA
Treasurer
ACT Government
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Copied to: energyindustrylevy@act.gov.au

Dear Treasurer,

Re: Investigation into the Energy Industry Levy

I refer to a discussion paper provided to the Commission on the investigation into the Energy Industry Levy (EIL). The discussion paper called for comments on proposed amendments to Part 3A of the *Utilities Act 2000* (EIL provisions).

Attached to this letter is a succinct overview of the current methodology and associated issues which underpin my comments contained herein. The discussion paper outlines four options under investigation. I address each of these options below.

Option 1: Fixed Methodology –this option creates an unequal distribution of regulatory costs, where the larger utilities would pay a significantly reduced levy, and the smaller utilities would pay a significantly higher levy, resulting in a significant barrier to entry into the ACT retail electricity market for new participants. This option is not recommended.

Option 2: Variable Methodology – whilst this option is feasible, and would work within the current framework for recovering the levy, it may result in the under recovery of regulatory costs for the Territory. This option is not recommended.

Option 3: Variable Methodology (with minimum fee) – under this option the Levy Administrator is not able to account for the fee at the time the levy is determined, increasing the risk of over or under-recovery for the Territory. This option is not recommended.

Option 4: Current Methodology (with defined fixed fee) - this option addresses the barrier to entry issue that Treasury have identified. If the fixed fee is based on the minimal cost of regulating a small utility and only changed infrequently, it would have the added benefit of creating certainty for smaller and newer entrants to the market about the levy payable. This option is the preferred option as it eliminates a barrier to entry without exposing the Territory to increased risk of not recovering regulatory costs.

Commission staff have raised concerns in the past in relation to the variable 'A' (adjustment for previous year) in the current levy formula. The adjustment should be made by comparing last year's estimated costs against actual costs, not against levy paid (T). The Commission recommends that the investigation consider whether the calculation of the adjustment component of the levy formula is producing the intended effect and make appropriate amendments if it is not.

If you require any further information regarding the comments in this letter please contact Mr Ian Phillips on [redacted].

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Malcolm Gray', written in a cursive style.

Malcolm Gray
Senior Commissioner
3 February 2016

Discussion Paper on the ACT Energy Industry Levy Discussion Paper

The Discussion Paper is seeking the views of energy industry participants on four matters, viz:

- Whether the determination of the Energy Industry Levy (EIL), including the range of regulatory costs to be recovered, is well understood
- The predictability of the annual levy
- The classification of regulatory costs
- The levy's retrospective adjustment mechanism.

In addition the discussion paper sets out alternative methodologies to distribute total regulatory costs amongst energy operators and seeks feed back on these alternative methodologies.

The Commission has relevant experience with the determination of regulatory costs in the energy sector and is well placed to comment on each of the matters referred to.

Purpose of the Energy Industry Levy

The discussion paper notes (page 5) that the EIL is intended to fully recover regulatory costs. While the relevant legislation only refers to recovering 'reasonable costs' the Explanatory Statement to the *Utilities (Energy Industry Levy) Amendment Bill 2007* states that the purpose of the levy is to provide "funds to cover the ACT's financial obligations in relation to national and local regulatory activities". With full cost recovery being implicit in the operation of the methodology specified in Section 54 (C) of the Utilities Act, the statement made in the Discussion Paper is an appropriate interpretation of the legislation.

The methodology specified in the legislation is designed to recover reasonable regulatory costs through a two step process. First the net regulatory costs for the coming levy year are estimated. Second, the estimate of the previous year's net regulatory costs is reconciled against the levy paid in the previous year. The net regulatory cost for the coming levy year is then adjusted to reflect any under or over recovery in the previous levy year. The methodology ensures that the levy payments (with a one year lag) match the actual regulatory cost incurred.

The formula assumes that the levy paid in the previous year matches the estimate of net regulatory costs for the previous year. If actual net regulatory cost in year t_{-2} is not the same as forecast net regulatory cost for year t_{-2} then T in year t_{-1} will not equate with estimated regulatory costs for year t_{-1} and the over and under adjustment mechanism will not work as intended.

Determination of the Energy Industry Levy

The Commission notes that the methodology specified in Section 54 (C) of Part 3A of the Utilities Act is broadly consistent with the approach the Commission takes to setting the annual utility licence fees under Section 45 of the Utilities Act. The actual recovery process however is entirely different as the EIL is recovered by the ACT Revenue Office using the input from the levy administrator. Levy revenue collected by the Revenue Office is allocated to regulatory bodies via GPO allocations through a budget appropriation.

The two step process referred to above is applied by the Commission when setting the annual licence fee for Icon Water, EAPL and TransGrid. (EAPL and TransGrid are gas and electricity

transmission infrastructure providers.) The Commission's approach to determining the annual licence fee does not require it to separately categorise particular regulatory costs as being fixed.

The Commission has the capacity to determine a licence fee for both ActewAGL gas and electricity distribution. Were the Commission to set an annual licence fee of ActewAGL gas or electricity distribution that amount would be deducted from the regulatory costs to be recovered through the EIL in the process of determining the net regulatory cost (section 54G(2)).

When determining net regulatory costs under the EIL the levy administrator has to take account of both national and local costs. The national costs reflect the contributions the ACT makes to the operation of the AEMC and the MCE. Local costs represent the costs of ACAT, the technical regulator and the Commission.

ACAT adjudicates on matters relating to both energy supply and distribution services in both the electricity and gas sectors. The Technical Regulator incurs regulatory costs in respect of infrastructure distribution services and can segregate his costs between these two sectors.

The Commission incurs costs in respect of all four energy sectors. These regulatory costs relate to production of the Utility Licences Annual Report and the administration of the EIL on behalf of the ACT Revenue Office. The levy determination formula requires the administrator to separately identify regulatory costs which are fixed. The regime defines a fixed regulatory cost as a cost which is unrelated to market share. Fixed net regulatory costs are recovered equally from all operators in a sector. As the distribution networks are monopolists, it means that the requirement to determine fixed regulatory costs is only operative in respect of the electricity and gas supply sectors as there is more than one operator in these sectors.

The residual net regulatory cost, i.e. those costs which are not fixed, are allocated to market participants according to their market share in the previous levy year.

The definition of a fixed regulatory cost is problematic. It could be argued that most regulatory costs incurred by the Technical Regulator and the Commission are unrelated to an operators' market share. In respect of ACAT its adjudications are likely to be in response to the actions of a specific provider though that will only be known *ex-post*. These costs, however, need not be directly related to an operator's market share.

The Commission's view is that it is not necessary to separately identify fixed regulatory cost and that all regulatory costs, other than costs directly attributable to a specific operator, should be recovered from the operators in a sector on the basis of their market share.

In the energy supply sectors recovering fixed regulatory costs through a common charge on each operator is likely to act as a barrier to entry as the levy will fall disproportionately on small providers.

Predictability of the annual levy

Whether operators can predict their annual levy charge largely depends on the Levy Administrator's capacity to estimate the net regulatory costs in the upcoming levy year. If planned or budgeted for activities are not performed then levy charges will display year on year volatility. The extent to which operators can anticipate this will depend on their knowledge of the work programs of ACAT, the technical regulator and the Commission.

The predictability of the annual levy will be improved by greater transparency in the process by which the levy is established and the quality of the data on which it is based. For this reason, removing the retrospective adjustment mechanism will only superficially address concerns about volatility and predictability.

