



AGL Submission to the Queensland Competition Authority

Review of Electricity Pricing and Tariff Structures - Stage 2 Draft
Paper

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Executive Summary

AGL welcomes the release by the Queensland Competition Authority (QCA) of its Draft Paper on Stage 2 of its Review of Electricity Pricing and Tariff Structures. It is disappointing that the Government has yet to provide a response to the QCA's Final Report on Stage 1 of its Review. The ensuing regulatory uncertainty is difficult for retailers who are now required to undergo a further price review process using the Benchmark Retail Cost Index (BRCI) framework, which has been recognised by the QCA and other stakeholders as fundamentally flawed methodology. However, the allowance of an additional year to allow for a proper and robust process to develop an alternative pricing methodology and tariff structures is very welcome and will provide the opportunity for better consultation with stakeholders and the necessary education of customers about any new tariffs and structures.

AGL was pleased that the QCA consulted retailers in undertaking the Stage 2 Review and appreciates the opportunity to provide further input in relation to the Draft Paper.

Key Issues

AGL agrees with the key issues identified by the QCA as impacting on:

- The fixed and variable components of existing regulated tariffs often fail to reflect fixed and variable costs of supply, inhibiting the development of a sustainable competitive market; and
- The misalignment of regulated retail tariffs and network tariffs mutes price signals to customers and limits the capacity of distributors to effectively engage in demand management initiatives that could lead to lower costs for all consumers.

AGL agrees strongly with the QCA's view that, as a general rule, competition will be best served by tariff structures and notified prices which allow costs to be allocated in a way that reflects the costs of supplying electricity to customers. AGL also supports the QCA's recommendation to rationalise tariff schedules to remove obsolete tariffs, consolidate a number of tariffs, reset the fixed and variable components of notified prices for each remaining tariff to better match the true costs of supply, and replace minimum monthly payments with fixed charges.

Assessment Criteria

In assessing existing tariffs and alternative tariff options the QCA's view is that relevant assessment criteria can be reduced to two, namely:

- Cost reflectivity of tariffs; and
- Simplicity and ease with which tariffs are understood.

Whilst AGL agrees that cost reflectivity of regulated retail tariffs across all customer classes is critical, a need for simplicity and the ease with which retail tariffs can be understood is secondary to the need to ensure communication of network price signals to end customers is not stifled. Unless regulated retail tariffs are aligned with network tariffs it will be difficult for distributors to communicate price signals to end customers and to therefore encourage more efficient use of electricity.

AGL considers it of paramount importance that regulated retail tariffs are truly cost reflective across all customer classes and tariffs to ensure that competition is promoted for all customers and appropriate signals are sent to customers to manage their consumption.



Vulnerable Customers

AGL notes and agrees with the QCA's view that issues associated with vulnerable customers are better addressed via specific support arrangements than by creating distortions in the electricity tariff structures or pricing regime.

Alternative Tariff Structures

Whilst AGL agrees simpler tariffs are preferable, AGL is of the view that inclining block (IBT) and time of use (TOU) tariffs are not overly complex and have been in place for some time in South Australia, New South Wales and Victoria. With appropriate education and information Queensland electricity customers should not find it any more difficult than customers in those jurisdictions to understand such tariff structures.

At a minimum with any tariff restructure, regulated retail tariffs should align with the underlying network tariffs. If the network introduces IBT or TOU tariffs then it would be appropriate to introduce a similar regulated retail tariff.

Transition - BRCI 2010/11

In previous submissions AGL has stated that the policy objectives articulated in the Direction will be most effectively achieved over a longer timeframe, with the 2010-11 year being treated as a 'transitional year', with a view to establishing a 3 year price path commencing on 1 July 2011. The QCA would then have the time necessary to properly consider:

- The appropriate methodology for determining the WEC in circumstances where the details of the CPRS will be known and can be more comprehensively dealt with;
- A comprehensive restructure of the tariffs, considered in light of the network tariff structures (which will not be known until 30 May 2010); and
- The most appropriate means of managing the customer impacts resulting from the move to cost reflectivity and demand management price signals. This part of the process will need to be the subject of intensive consultation between the QCA, industry, consumer groups and the government.

In the absence of alternate direction from the Government, the QCA has commenced the price review process for 2010-11 utilising Benchmark Retail Cost Index (BRCI) methodology contained in existing legislation. AGL understands that given the time constraints, and the absence of any further indication from the government as to an alternate remit, the QCA is required to commence this consultation on the 2010-11 BRCI. AGL acknowledges the significant challenge this process will present for all stakeholders in such a truncated timeframe.

Whilst AGL is of the view that a 'transitional year' to implement a new methodology is warranted, AGL is of the view that the Government must amend the BRCI methodology for 2010-11 year to allow, *at a minimum*, the pass through of the actual network costs faced by retailers. To continue with the BRCI without making any adjustments in relation to network costs will come at a significant cost to both retailers in Queensland and effective competition in Queensland over the 2010-11 year.

AGL is also of the view that all retail regulated tariffs should be transitioned to fully cost reflective levels for all customers across all consumption bands as quickly as possible. As noted previously, AGL is of the view that any vulnerable customers that are adversely impacted should be assisted directly by Government through the payment of (transparent) subsidies rather than a distortion of the electricity pricing framework or tariff structures.

Assessment of Existing Tariff Structures

AGL notes the distinction between cost recovery and cost reflectivity and agrees that even where costs may be fully recovered the tariff may not necessarily be cost reflective. As existing Notified Prices established using the BRCI methodology do not recover actual costs faced by retailers Notified Prices are not likely to be cost reflective.

Assessment Criteria

As noted above, the QCA has identified two key criteria for assessing both existing tariff structures and alternative options, namely:

- Cost reflectivity of tariffs; and
- Simplicity and ease of understanding.

AGL agrees that fully cost reflective prices achieve several objectives of tariff reform, including cost recovery, promoting competition within customer classes and sending appropriate price signals for customers to manage their consumption. However, in the event that a more complex network tariff (e.g., time of use or inclining block tariff) is implemented in the future the regulated retail tariffs should reflect the underlying network charges. AGL considers that the need to communicate the network price signal is of greater importance than the need to retain simple tariffs.

Cross Subsidies

The Draft paper states there are two reasons why cross subsidies exist, namely

- The weighting of regulated retail tariffs to higher variable charges and very small fixed charges; and
- The use of the Net System Load Profile (NSLP) means that all customers with accumulation meters are assumed to have the same load profile regardless of their actual consumption, resulting in averaging of costs across all customers.

The key cause of cross subsidies that should be addressed in tariff reform is the allocation of charges between the fixed and variable components. The use of the NSLP for small customers consuming less than 100MWh a year does not of itself create major issues as retailers also settle their energy purchase costs using the NSLP. However, the inclusion of large customers of Tier 1 retailers (that consume more than 100MWh a year) on accumulation meters in the NSLP creates additional cross subsidy. This is not unique to Queensland. The inclusion of large customers in the NSLP has the effect of flattening the load profile and the related energy purchase cost for all customers on the NSLP.

AGL strongly supports the QCA's recommendation¹ for the removal of price regulation for customers consuming more than 100MWh a year. Since full retail competition was introduced it has been the experience in the Queensland electricity market that those customers with higher consumption are more profitable and have been subject to 'cherry picking' by new entrant retailers, leaving incumbent retailers with a higher proportion of lower consumption and less profitable (possibly unprofitable) customers without the benefit of the higher consumption and higher margin customers.

AGL supports the QCA's view that:

- Current regulated tariffs are not structured to reflect the major costs of supplying electricity to customers due to misalignment of retail and network tariffs.

¹ in QCA's Final Report - Stage 1 Review of Electricity Pricing and Tariff Structures



- A particular flaw in a number of tariffs is that the fixed and variable costs are not appropriately reflected in the fixed and variable components of the Notified Prices.
- Some existing tariffs provide perverse pricing signals.
- As a starting point for reform fixed and variable components of tariffs should reflect the structure of the costs faced by retailers.
- Monthly minimum payments on Tariffs 21, 31 and 33 should be replaced by fixed charges to better reflect the costs faced by retailers.
- Small consumption customers may be adversely affected as they will face potentially higher fixed charges. These issues should be addressed through specific and direct support for vulnerable customers rather than distort tariff structures and the pricing regime.
- All customers will be best served by a well functioning competitive electricity market and that the key to achieving this in a sustainable way is to ensure that prices reflect cost and the manner in which those costs are incurred.

Alternative Tariff Structures

AGL agrees that flat tariffs provide little or no information to customers regarding the total costs of consumption and are not cost reflective.

Whilst AGL agrees simpler tariffs are preferable, AGL is of the view that inclining block (IBT) and time of use (TOU) tariffs are not overly complex and have been in place for some time in South Australia, New South Wales and Victoria. With appropriate education and information Queensland electricity customers should not find it any more difficult than customers in those jurisdictions to understand such tariff types.

AGL also notes the QCA's statement that TOU tariffs must be able to access real time information about prevailing spot prices for wholesale cost of energy and network capacity. This is not true as a customer simply needs to know the price they will pay for consumption of energy in each period of the day. It is the retailer's job to manage the risks associated with the wholesale energy market. Education is key to ensuring customers are well informed about the cost of the energy they consume. A simple example could be something along the lines of a fridge magnet that highlights the price and the time periods so customers are reminded on a daily basis of when energy is cheapest to consume.

AGL also notes the QCA's view that there is little merit in introducing seasonal tariffs as there is no corresponding seasonal network tariff structure. The fundamental principle of tariff design should be that the regulated retail tariffs will follow and align with the applicable network tariffs. If the network introduces IBT, seasonal or TOU tariffs then it would be appropriate to introduce a similar regulated retail tariff.

AGL also agrees that retailers should not be adversely impacted by the use of interruptible or direct load control devices, either from a systems, process or financial perspective. And that network businesses should take the responsibility for providing incentives for customers to trial direct load control devices.



Potential for Improving Existing Tariffs

AGL agrees that existing tariffs could be improved by:

- Removal of obsolete tariffs 37, 63 and 64;
- Removal of Tariff 21 and transferring of customers on Tariff 21 to Tariff 20;
- Combining or aggregating tariffs for customers with similar consumption patterns and/or underlying costs (e.g. farm and irrigation tariffs);
- Encouraging large customers to move to market contracts by removing access to regulated pricing; and
- Ensuring that the fixed and variable components of the retail tariffs reflect the structure of costs faced by retailers.

The QCA proposes (at p.23) to consolidate Tariffs 62, 64, 65, and 66 into a single TOU tariff either by moving customers to Tariff 20 or a special purpose tariff. AGL suggests that as a TOU tariff, Tariff 22 would be more appropriate than Tariff 20. In addition, as pointed out in AGL's submission, the differences in pricing periods should be considered when consolidating tariffs. Where the pricing periods cannot be altered for whatever reason, an option will be to move customers to the general supply tariff i.e. Tariff 20.

Proposal for a New Set of Tariffs

AGL is supportive of the QCA's preferred course of action being a new set of regulated retail tariffs that are aligned with the network tariffs, are as cost reflective as possible given the prevalence of accumulation meters, accommodate voluntary access to TOU tariffs for small customers with TOU meters, and are as simple as possible to understand.

AGL is also supportive of an opt-in TOU tariff (if backed by a similar network tariff) and notes that development of a regulated retail TOU tariff needs to occur through a very robust consultation process with all stakeholders. A comprehensive communication and education campaign for customers would also be necessary to ensure customers who opt in to a TOU tariff do so on a fully informed basis.

AGL notes the QCA's statement that it does not foresee any need for obscure or complex pricing structures in any new retail tariff schedule. AGL reiterates its earlier point that IBT and TOU are well understood in other jurisdictions and at a minimum, the retail pricing structures should be underpinned by the corresponding network tariff structures.

MMA Report

The Report to Queensland Competition Authority, Review of Queensland Notified Electricity Retail Prices dated 29 October 2009 by McLennan Maganasik Associates (MMA) presents a view of existing electricity tariffs and possible alternative tariff options. AGL notes that in order to undertake this analysis MMA has attempted to estimate a retailer's costs to form an assessment of profitability of individual tariffs across customer classes and consumption bands. AGL notes that MMA has not yet had the opportunity to consult with stakeholders, and AGL accepts the analysis as indicative only as there has been insufficient time to conduct a detailed review. Given that it would currently appear that



the opportunity for legislative reform is likely to be delayed, AGL will revert in due course with comments regarding the MMA analysis.