

# **Ergon Energy Corporation Limited**

**Review of Electricity Pricing and Tariff  
Structures**

**Stage 2 Draft Report  
– Submission**

**Queensland Competition Authority**

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Stage 2 Draft Report  
Submission  
Queensland Competition Authority  
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# TABLE OF CONTENTS

<b>1</b>	<b>INTRODUCTION .....</b>	<b>3</b>
<b>2</b>	<b>GENERAL COMMENTS .....</b>	<b>4</b>
<b>3</b>	<b>SPECIFIC COMMENTS .....</b>	<b>7</b>
3.1	Options for Alternative Tariff Structures with Accumulation Metering .....	7
3.1.1	Flat Tariffs .....	7
3.1.2	Inclining and Declining Block Tariffs.....	7
3.1.3	Seasonal Tariffs.....	8
3.1.4	Incentive based tariffs .....	8
3.2	Proposal for a New Set of Tariffs.....	9
3.2.1	Alignment of Network Tariffs with Retail Tariffs under N + R Pricing Methodology .....	9
3.2.2	Introduction of voluntary time-of-use for residential customers with interval meters .....	9
3.2.3	Site Specific Network Costs .....	11

# 1 INTRODUCTION

Ergon Energy welcomes the opportunity to provide comment to the Queensland Competition Authority (QCA) on its Draft Report on Stage Two of its Review of Electricity Pricing and Tariff Structures (Stage 2 Draft Report).

This submission is provided by:

- Ergon Energy Corporation Ltd (EECL) in its capacity as a Distribution Network Service Provider (DNSP) in Queensland; and
- Ergon Energy Queensland Pty Ltd (EEQ), in its capacity as a non-competing area retail entity in Queensland.

In this submission, EECL and EEQ are collectively referred to as 'Ergon Energy'.

Ergon Energy is available to discuss this submission or provide further detail regarding the issues that it has raised should the QCA require.

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## 2 GENERAL COMMENTS

Ergon Energy welcomes the collaborative approach being taken by the QCA in seeking stakeholder comment, and supports the QCA's view that the current Benchmark Retail Cost Index (BRCI) methodology has a number of flaws, and that a fundamental overhaul of the price setting approach is warranted in Queensland. Ergon Energy considers it essential that retail tariffs are significantly restructured to ensure the effective long term management of peak demand and the provision of incentives for more efficient electricity use.

Ergon Energy agrees that the proposed N + R approach and supporting price setting framework would offer significant improvements over the existing BRCI methodology, as it could provide a means to allow existing tariffs to be transitioned to cost reflective levels, as well as providing mechanisms to allow the pass through of not only network costs, but other 'expected' and 'unexpected' costs (such as those costs associated with the CPRS and expanded RET) likely to be incurred by retailers.

Ergon Energy also supports the QCA's findings that:

- Under Full Retail Competition (FRC) cost reflectivity should be considered primarily from a retailer's perspective rather than from an economic perspective;
- Network tariff structures should be the primary driver in determining the retail tariff structure; and
- Regulated retail tariff pricing must be consistent with the objectives of FRC whilst considering the impact on EEQ's customers. In this regard consideration of EEQ's customers should extend to both large and small customers, regardless of whether they are connected to the National Electricity grid or to an isolated network. That is, it should be remembered that while some of EEQ's customers effectively have no alternative to notified prices (due to the level of competition) some of our customers do not have any alternative to accessing notified prices.

Ergon Energy recognises the concerns of consumer groups that changes to the current methodology for calculating prices and associated changes to tariff structures may impact on customers facing financial hardship. Ergon Energy agrees with the QCA that hardship issues are best addressed through specific support arrangements such as government policies and effective retailer customer hardship programs. This ensures appropriate assistance is delivered to customers where it is most required without distorting retail tariff structures and the pricing regime.

Ergon Energy generally supports the QCA's findings concerning the introduction of a (initially) voluntary time-of-use tariff. Ergon Energy also supports a move to mandated time-of-use tariffs over time. However, there are associated issues which must be considered prior to a decision to proceed with the introduction of a voluntary time-of-use tariff. These include:

- Accessibility of these tariffs to customers who do not have an appropriate meter installed (meter replacement charges etc.);
- The determination and implementation of appropriate time-of-use periods (and any associated charges for reprogramming tariff times on existing meters); and
- The determination of a new time-of-use settlement profile, that may impact retailer cost reflectivity and FRC.

These issues are discussed later in the submission.

Ergon Energy recommends that consideration should also be given to ways to encourage the take up of such voluntary tariffs. For example customer education should be provided on the benefits of moving to such a tariff. An alternative approach would be to require any new connections to have a time-of-use tariff, as all new connections will have appropriate metering installed. Existing customers could still voluntarily select to go on a time-of-use tariff.

Ergon Energy considers that a seasonal “R” component should be developed for small customers as:

- It can be applied irrespective of the meter type installed at the premise (including accumulation meters);
- The network tariff need not introduce a seasonal component before a seasonal retail tariff is implemented. That is, a seasonal “N” component could lag the introduction of a seasonal “R” component;
- A seasonal summer “R” component, once hedge costs are considered, would be substantially higher than the other seasons. Therefore this would increase the price of retail tariffs in summer but reduce the average price for non-summer periods;
- A summer seasonal “R” component would send an improved cost reflective price signal to accumulation metered customers, which would be beneficial to the network businesses, electricity market and long term electricity prices given a significant driver of growth in both the network and power stations is the need to meet the increasing peak demand in summer; and
- A summer seasonal retail tariff should assist in reducing demand by ensuring a better cost reflective price signal is sent to consumers who have above average use of air-conditioners, pool pumps, refrigerators etc over the summer months.

Ergon Energy agrees with the QCA that a combination of tariff signals could provide a preferred solution. Ergon Energy considers that a (initially) voluntary time-of-use signal combined with a seasonal signal could provide a powerful cost reflective signal to assist peak demand management and energy efficiency initiatives. The benefits of this approach require further consideration.

Whilst Ergon Energy agrees that it is important to ensure retail tariffs are easily understood by consumers, simplicity should not be a goal in its own right. That is, simplicity is merely one factor and not the primary driver behind decisions to structure tariffs to achieve cost reflectivity. Ergon Energy strongly believes that the education of customers is critical in the effective long term management of peak demand and energy efficiency. A partnership between customers, retailers and distributors must be fostered to ensure positive outcomes for both customers and industry. Accordingly, where a more complicated retail tariff structure is seen as the most appropriate method of achieving the objectives of this review, a customer education strategy would need to be developed to support the tariff changes.

Ergon Energy supports the QCA’s preferred solution, being the introduction of a new set of regulated retail tariffs (as opposed to amending the existing set of tariffs). This solution allows existing network signals to be seen by customers and allows for any new signals as a result of a restructure of network tariffs (for example the introduction of capacity based pricing, kVA tariffs etc), to be easily passed through to customers. If a decision is made to amend the existing set of tariffs then Ergon Energy supports the QCA’s proposal to remove obsolete tariffs and consolidate remaining tariffs. However, regardless of which proposal is adopted, the costs associated with the transition to an alternative retail tariff needs to be considered (e.g. costs associated with meter replacement or meter reprogramming).

Ergon Energy is generally supportive of the QCA's provisional conclusions in respect to Stage 2 of the Review. However, Ergon Energy considers there are several critical issues that must be addressed and considered to ensure the most practical implementation of any alternative tariff structure. Ergon Energy has set out detailed comments on each of these issues, which it believes is relevant information the QCA must consider prior to delivering its Final Report to the Minister in respect of Stage 2 of the Review.

### 3 SPECIFIC COMMENTS

#### 3.1 Options for Alternative Tariff Structures with Accumulation Metering

##### 3.1.1 Flat Tariffs

Ergon Energy notes that page 14 of the Stage 2 Draft Report states:

*“However, where fixed costs are likely to be high, some part of the fixed costs of supply may also be recovered through the consumption charge.”*

Ergon Energy requests clarification of this statement. Ergon Energy considers that adoption of this approach would only be cost reflective where there is banding of consumption charges and the extra fixed cost is included into the lower band where all customers have to pay this amount. However, this would likely produce a declining block tariff for the variable component. For simplicity purposes, Ergon Energy considers that this approach should be avoided.

Ergon Energy agrees with the issues raised by both the QCA and their consultants, McLennan Magasanik Associates (MMA), regarding the efficiency problems associated with a flat tariff. Notwithstanding these issues, Ergon Energy agrees that the pricing of retail tariffs must consider cost reflectivity from the retailer’s perspective. Therefore, prices for retail tariffs should be calculated based on the principle objective of facilitating competition, rather than on an economic basis. For example, it needs to be recognised that the retailer is paying the customer’s network tariff not an economic alternative approach. Further, the retailer must pay for the underlying settlement profile, including the assumed peak and off-peak split, which could be different to the actual usage pattern of the customer and the customer’s peak and off-peak split.

##### 3.1.2 Inclining and Declining Block Tariffs

Page 16 of the Stage 2 Draft Report states:

*“However, on their own, neither would appear to offer much in the way of useful price signalling to customers or for demand management on networks.”*

Ergon Energy agrees with the QCA’s findings on inclining and declining block tariffs. For clarification, Ergon Energy’s submission to the Stage 2 Request for Comments Paper on this issue was on the basis of considering these mechanisms on their own, rather than in conjunction with other mechanisms.

For the reasons discussed in Ergon Energy’s submission to the Stage 2 Request for Comments Paper, it is extremely difficult to determine how to band the consumption levels for the “R” component in the N+R Approach. Further as stated by stakeholders and the QCA, the “R” component should be determined based on the underlying costs of supply. If the network businesses did consider either inclining or declining block tariffs to be appropriate<sup>1</sup> network tariff structures, then this would ultimately flow through to regulated retail tariffs under the N+R approach. Therefore, Ergon Energy believes that inclining and declining block mechanisms should not be introduced through retail tariffs directly but rather as a consequence of their adoption through the network tariff process.

<sup>1</sup> Ergon Energy agrees with the QCA’s findings that on their own, neither tariff provides useful price signalling to customers or for demand management on the network

### 3.1.3 Seasonal Tariffs

Ergon Energy considers that seasonal tariffs have a strong ability to assist with both demand management and electricity consumption reduction, because:

- There is currently a high correlation between peak demand and peak energy use in the summer period. This is evidenced by Figure 4 and the respective commentary in the QCA's Stage 2 Draft Report on page 26. Specifically, Figure 4 in the QCA's Stage 2 Draft Report shows both Energex's summer peak and winter evening peak have increased significantly over the past few years.
- It is highly likely that these two peaks will grow as will general consumption due to the increase in population and economic activity together with a greater reliance on electricity dependent products e.g. plasma TVs, computers, air-conditioners, pools, dryers etc.

Ergon Energy notes that page 39 of the MMA report indicates that a seasonal "R" component for summer is only slightly higher than the "R" component in non-summer periods. This led the QCA to indicate that there is little merit in introducing seasonal retail tariffs as there is no corresponding seasonal network tariff. However, Ergon Energy believes that MMA should have priced the cost of energy on the basis of the issues recognised by the QCA in its Final Stage 1 Report. If this analysis was undertaken, it would likely result in a conclusion that there is merit in introducing a seasonal retail tariff. This view is supported by both Energex's load profile in Figure 4 of QCA's Draft Stage 2 Report and the significantly higher wholesale cost of hedging for quarter one of a calendar year compared to that of the other quarters. Ergon Energy understands that this analysis may have been outside the scope of MMA's consultancy.

Ergon Energy supports the introduction of seasonal pricing for the "R" component, especially since the "R" component price signal should be strong enough to assist manage peak demand and electricity consumption. Ergon Energy considers that a thorough investigation into the merits of seasonal retail tariff pricing should be undertaken given it could provide a significant step in meeting the review's objectives. Ergon Energy notes that it also supports the introduction of seasonal tariffs for the "N" component.

### 3.1.4 Incentive based tariffs

Ergon Energy strongly supports the QCA's findings in relation to interruptible tariffs and direct load control devices. As noted by MMA, these are network initiatives and as such, the network tariffs should be the driver for reform or expansion of these tariffs. Ergon Energy considers it essential that regulated retail tariffs do not inhibit the take up of these tariffs. Further, when either network business introduces new incentive based tariffs, such changes should be able to be passed through retail tariffs, or new retail tariffs constructed.

Ergon Energy notes that page 19 of the Stage 2 Draft Report states:

*"It is therefore important to note that:*

- a) Retailers are not adversely impacted by the use of interruptible or direct load control devices."*

Ergon Energy considers that a retailer would not be adversely impacted by the use of an interruptible network tariff. This is provided it is passed through to customers under the proposed N + R approach, with an appropriate market based “R” component.

## **3.2 Proposal for a New Set of Tariffs**

### **3.2.1 Alignment of Network Tariffs with Retail Tariffs under N + R Pricing Methodology**

Ergon Energy supports the view that retail tariffs should complement network tariffs and that any consideration of alternative tariff structure options for retail pricing must take into account the underlying network tariff structures.

Ergon Energy agrees it is prudent for network businesses to undertake a comprehensive review of their tariff structures to ensure they reflect and achieve network priorities. However, it should be noted that Ergon Energy regularly reviews its network tariff structures and pricing to ensure they meet the business’ priorities. Further, the outcomes of these reviews are inputs into the annual pricing submission to the economic regulator. Therefore, this is considered “business as usual” for network businesses. As a result, Ergon Energy does not support the QCA’s Stage 2 Draft Report finding that Energex must undertake a fundamental review of its network tariffs “first”.

As discussed in submissions to Stage 1 of the Review, Ergon Energy would prefer to send its own signals to customers. However, we recognise the difficulties in achieving this under a Uniform Tariff Policy. Ergon Energy therefore considers retail tariffs should be based on the existing Energex network tariffs. Any changes to Energex’s network tariff structures would flow through to the retail tariff structure under the proposed N + R approach.

Ergon Energy notes that under the proposed N+R approach, Ergon Energy is reliant on Energex’s network tariff structures to send signals to customers. This is because the Queensland-wide notified prices will be based on Energex’s underlying network tariffs. Given that the majority of Ergon Energy’s customers are on notified prices, Ergon Energy will therefore be reliant on Energex’s network tariffs to send signals. Importantly, Ergon Energy believes that the introduction of capacity charges to recover fixed costs is a priority issue for consideration from our network perspective. If Energex do not share this view, and does not introduce capacity charges that would also benefit Ergon Energy, then Ergon Energy will have no ability to itself signal customers.

### **3.2.2 Introduction of voluntary time-of-use for residential customers with interval meters**

Ergon Energy supports the QCA’s views concerning the introduction of time-of-use tariffs. Further, Ergon Energy supports the introduction of time-of-use tariffs from both a network and a retail perspective. Ergon Energy also supports the list of issues detailed on page 28 and 29 of the Stage 2 Draft Report that must be addressed in developing a suitable regulated time-of-use tariff. However, Ergon Energy considers there are other issues which also need to be considered.

The Stage 2 Draft Report infers that a cost-benefit analysis is only required if an accelerated roll out of interval meters is envisioned. Ergon Energy believes that a detailed cost benefit analysis needs to be undertaken prior to any decision to allow meters to be read as Type 5 (manually read interval) meters occurs. As set out in Ergon Energy's response to the Stage 2 Request for Comments paper, there are significant costs associated with the requirement to read interval meters as Type 5 meters. These include:

- Increased site visits to customers' premises to reprogram meters to allow for interval data to be collected for time-of-use tariffs;
- Increased time (and labour costs) required to download required interval data from each meter rather than reading meter registers;
- Increased expenditure in metering equipment (such as download probes) to allow meter reads to be conducted with existing (hand-held) metering equipment. Such equipment would become obsolete, if a decision was made to roll out smart meters in Queensland; and
- Increased expenditure and investment in system and IT capabilities to cater for changes to metering and billing processes.

These costs will ultimately flow through to customers. Further, if a decision is made to roll-out smart meters (remotely read interval meters rather than manually read interval meters) in 2012, the costs discussed above will become inefficient and unnecessary as they do not support the roll-out of smart meters. Finally, there are alternative options for introducing time-of-use tariffs (rather than requiring meters to be read as interval meters) and these should be seriously considered.

In this regard, Ergon Energy notes that the new electronic meters currently being installed by distribution businesses in Queensland are capable of providing time-of-use readings without being read as an interval meter. That is, the meters are able to be programmed to accumulate the registration on different time rates into separate registers, and then the meters can be read as accumulation meters with multiple registers. While the number of such meters in service in Ergon Energy's distribution area is relatively low, it is increasing. Further, Ergon Energy considers a customer should have the ability to request a meter change (subject to payment of any applicable charges) if they wish to take up a time-of use tariff. This would be consistent with the QCA's proposed opt-in approach, without the significant costs associated with the ability to read meters as interval meters. Therefore, this approach is preferred to introducing a requirement to read meters as Type 5 interval meters.

If the associated interval meter's half-hour data is not sent to Australian Energy Market Operator (AEMO) for settlement purposes, then that customer's meter would be settled on the underlying Net System Load Profile (NSLP). This would be the NSLP for the relevant distribution area (i.e. Energex or Ergon Energy). As it is proposed that the new retail tariffs are to be based on network tariffs in south-east Queensland then the assumed settlement shape would be the Energex NSLP.

As detailed above, Ergon Energy considers that under the N+R approach Energex's current time-of-use periods would be used. This would continue until such time as Energex adjusts the time-of-use periods in its network tariffs. If this is the case, careful consideration is required concerning the ability for small customers (domestic or business) to shift load to the Energex network's off-peak periods, being 9pm to 7am Monday to Friday. A more tailored time-of-use product may be preferable which allows

more customers the ability to respond whilst also benefiting peak demand management initiatives. These issues (including any costs associated with reprogramming existing meters) should be considered as part of any time-of-use recommendation.

To provide an incentive for customers whilst ensuring cost reflectivity for a retailer, Ergon Energy supports MMA's view that a new NSLP peel-off shape is required for these customers. However, Ergon Energy believes that the determination of a shape which represents time-of-use customers would be difficult and also understands that the introduction of a new peel off shape is a substantive undertaking in its own right.

Ergon Energy has previously stated in prior submissions to this review that the eligibility for retail tariffs should primarily be based on the customer's network tariff and the sophistication of the customer's meter. Notwithstanding the above, Ergon Energy agrees with the QCA's findings that time-of-use retail tariffs should commence as an optional retail tariff (upon resolution of the identified issues), until such time as all the necessary reviews are conducted in regard to the introduction of smart meters and the impact on customers has been fully considered.

Ergon Energy recommends that consideration should also be given to ways to encourage the take up of such voluntary tariffs. For example customer education should be provided on the benefits of moving to such a tariff. An alternative approach would be to require any new connections to have a time-of-use tariff, as all new connections will have appropriate metering installed. Customers at existing installations could also still voluntarily select to go on a time-of-use tariff.

Based on the QCA's recommendations in the Stage 2 Draft Report, retail tariffs for large customers would only impact customers in Ergon Energy's distribution area. Ergon Energy supports the use of time-of-use tariffs for these customers.

### **3.2.3 Site Specific Network Costs**

The QCA has not specifically addressed the network site specific costs issues for Large Customers (i.e. those customers that have been classified by the network business as consuming over 100MWh per annum). The QCA's Stage 1 Final Report recommended that from 1 July 2010, Large Customers should not be able to access regulated retail tariffs. The QCA appears to have softened this stance on page 13 of the draft Stage 2 Report:

*"However, in both cases some further consideration would be required for those operating outside the Energex network area where competition and the availability of market contract offers may be limited even for these customers."*

Ergon Energy agrees that further consideration of this issue is required for Large Customers operating in regional Queensland. On this basis it is considered that the specific network cost issues raised by Ergon Energy in its submission on the Draft Stage 1 Report are still relevant.

Both Ergon Energy and Energex have site specific network cost components in their respective network tariffs for particular large customers classified as Individually Connected Customers (ICCs), Connection Asset Customers (CACs) and Embedded Generators (EGs). Generally these customers are large network users who have a dedicated supply system (or share a dedicated supply system), which is quite different and separate from the remainder of the supply network. Typically such customers have

either large energy consumption requirements, or place significant demand on the network. Accordingly, site specific costs are charged to these customers to send individual or direct signals of the costs associated with the actual dedicated connection assets (or share of dedicated connection assets) utilised by the customer, as well as apportioning appropriate charges for use of any shared distribution network assets utilised by the customer in taking supply from the distribution system.

To facilitate site specific charges, Ergon Energy and Energex apply individual network tariffs for each ICC, CAC and EG customer. The proposed N + R approach based on South East Queensland (Energex) costs would be a workable approach for relevant large customers on the Energex network should they have access to regulated retail tariffs, (provided that where network costs are site specific the notified price applicable for that customer specifically bundles that site specific cost). However, a policy decision must be made on the 'N' component which will be incorporated into the notified price applicable to those customers connected to Ergon Energy's network who also have site-specific network costs. Ergon Energy is cognisant that Ergon Energy and Energex are two separate distribution businesses with different network assets, cost drivers and customer characteristics. In terms of cost reflectivity, both businesses necessarily have different network tariffs for supplying such large customers.

Ergon Energy notes the approach to this issue will have implications for how many regulated retail tariffs are required if the N + R components are aggregated to derive 'bundled' notified prices in the regulated retail tariffs for large customers. That said, it is important to note site-specific network costs need not drive an increase in the complexity of tariffs in a retail schedule, provided the rules for application of site-specific network costs are made clear.

The reclassification of services under the AER has some impacts for site specific costs of new ICC, CAC and EG customers (i.e. the reclassification of design and construction of new large customer connection assets as an 'Alternative Control Service' means the connection service will be removed from the revenue cap and provided under a price-cap approach). In Ergon Energy's area, this means that new customers will pay up-front for the design and construction of any dedicated connection assets. However, the network tariffs for these customers will still be site specific. Ergon Energy considers as a matter of fairness that each distributor's site specific costs should be passed through to customers.