

Integral Energy

**Review of Queensland Electricity
Retail Pricing Arrangements**

Stage 2

**Submission to the
Queensland Competition Authority's
Request for Comments Paper**

2nd October 2009

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1 Background and Purpose

Integral is the holder of a non-area Retail Authority in Queensland and, whilst a relatively new entrant to the Queensland market, has provided energy services to Australian families and businesses for more than 50 years, including approximately 850,000 market and non-market customers in Queensland and New South Wales.

Integral has actively participated in the residential and small business segments since the commencement of Full Retail Competition (FRC) in Queensland, demonstrating a commitment to the Queensland market and establishing a significant market share in a relatively short period of time.

Integral supports the Queensland Government's intervention into the current status of retail tariff regulation in Queensland, and supports the nature and content of the direction provided to the Queensland Competition Authority (QCA) by Government to carry out a review of electricity retail pricing structures and methodologies (the review).

Integral has reviewed the QCA's Request for Comments Paper regarding Stage 2 of the review, and this submission discusses the matters the QCA has proposed.

2 Integral's Objectives

Integral's objectives are to:

1. See retail tariffs are set at cost reflective levels in Queensland. There are many reasons why cost reflective tariffs are beneficial for market participants, primarily related to the dispatch and receipt of economic signals which influence consumption patterns by users;
2. Operate under a transparent pricing mechanism that allows retailers operational flexibility to set their own retail tariffs in the context of effective competition. The current standard offer retail tariffs were established well before the introduction of Full Retail Competition (FRC) and in an environment of vertical distribution/retailing operations in Queensland;
3. Operate under a regulatory regime which encourages retailers to be efficient in regard to the costs that are under their direct control. Network costs, comprising distribution and transmission costs, are not within the control of retailers and they should not be expected to manage these costs. Similarly, externally imposed environmental costs are also not within the control of retailers. Whatever the final form of price control chosen by the QCA, the isolation of these factors outside of the control is critical; and
4. Move to a less regulated environment, in a transitional approach, to foster greater competition.

3 Integral's Views

Overall, Integral welcomes the outcomes of Stage 1 of the QCA's review on electricity prices and tariff structures and supports the view that electricity tariffs in Queensland need to move to a more cost reflective level. However, Integral does not support the proposed timeframes for the review and notes that there would be significant benefit in delaying the rollout of any new or modified tariffs. This will enable Retailers, Distribution Network Service Providers (DNSP) and other industry stakeholders to fully evaluate and consider retail tariff levels and structures that would be optimal for Queensland customers. It would also allow Retailers and DNSPs to fully consider the impacts on billing and operating systems which may need to be modified as a consequence of any major changes to the current tariffs.

The QCA must also coordinate with the Australian Energy Regulator (AER) and DNSP's to ensure that the network tariff options that are being considered by the QCA are capable of being delivered. If retail tariff reforms, such as time of use or demand tariffs, are not coordinated with network tariff changes, then price signalling to Queensland customers will be ineffective.

As per Integral's original submission to the QCA on stage 1 of this review, Integral would prefer to move towards pricing structures that are set by individual retailers (similar to that currently utilised in the Victorian jurisdiction). These pricing structures would allow individual retailers to fully account for individual retailer costs and further promote competition within the Queensland market.

3.1 Makeup of Individual Tariffs

Integral supports cost reflectivity for individual tariffs, rather than an average across all tariff classes. Retail tariffs need to include fixed charges to allow for the fixed costs within a retailer's operating environment. However, these fixed costs incurred by retailers will vary greatly between retailers and cannot be fairly averaged across retailers of different sizes or structures eg sole electricity retailers compared to vertically integrated retailers. It would therefore be difficult for the QCA to determine whether fixed costs in current retail tariffs reflect fixed costs of retailers.

To overcome this variance, should the QCA prefer to set the tariff itself, a benchmark fixed cost should be used when setting the fixed charge component of each individual retail tariff. It is proposed that the QCA could, when reviewing cost reflectivity, derive a common range of costs on which to set reasonable fixed baseline costs. It will be important to ensure that acquisition and retention costs are included.

3.2 The Suite of tariffs Available to Customers

Due to the time restraints of this tariff review, Integral has not been in a position to complete a "bottom up" analysis of all the current tariff classes available to Queensland customers. However tariffs 11, 20, 21 and 22 are, in Integral's experience, not cost reflective for current or new entrant retailers. As detailed in Stage 1 of this review, retail headroom has been eroding each year since the Benchmark Retail Cost Index (BRCI) was introduced.

The QCA should, when establishing the cost reflectivity of the individual tariffs, have regard for the fact that these tariffs are among the most prevalent in Queensland, and are not currently cost reflective. This cost inequity is currently a major barrier to entry with the insufficient headroom hindering retailers' ability to achieve long-term commercial risk returns.

3.3 Promoting Competition across Classes of Customers

Integral understands that there has been considerable churn in South East Queensland since the commencement of FRC in Queensland. However, Ergon Energy's area remains reasonably uncontested due to poor headroom in tariffs caused by higher distribution network charges and loss factors.

Integral remains keen to operate in this area and would support any decision or initiative of the QCA to support the opening of this market and increase headroom in Ergon Energy's area. This would allow all Queenslanders to benefit from competition.

One way of achieving increased competition in the Ergon area would be to allow competitive retailers to charge the Energex network tariff to regional Queensland customers and for Ergon to recoup the difference between Ergon and Energex network tariffs from the CSO payments that they receive from the Queensland Government (similar to the QCA proposal in stage 1 of this review). Integral would be pleased to discuss these options in further detail.

3.4 Structure of Tariffs

Demand management should be a primary objective for the QCA in order for customers to be aware of the relationship between peak electricity demand on the Queensland network and the costs of funding and maintaining the network. Integral notes however that the ability for this review to adequately account for this objective is limited because:

- (a) network pricing is not within the jurisdiction of the QCA (Queensland DNSPs are due to submit pricing proposals to the AER in early 2010), and
- (b) demand based tariffs are contingent on adequate information being captured using suitable meters.

The majority of small retail customers do not have suitable meters installed on which demand based tariffs could be calculated. Therefore, in planning for the future, these types of meters should be encouraged. Integral does support time of use tariffs where the time periods align adequately with system demand, to the extent that customers can then reduce demand and ultimately reduce long term distribution capital expenditure. A consideration for Integral is to ensure that any network pricing signals are passed through to customers. A current risk is that network costs are under-recovered. The proposed "N" + "R" model will help to address this risk.

As Integral has proposed a transitional approach, it may be possible to educate customers to promote more efficient use of electricity through marketing activities in the short term such as bill messaging or bill inserts. This may achieve some of the outcomes without the need for immediate tariff restructure.

3.5 Inclining Block Tariffs

Integral does not object to the introduction of inclining block tariffs and, in a limited way, inclining block tariffs may send appropriate “second best” pricing signals to Queensland customers in the absence of time of use tariffs. However, the QCA should have regard to the retail billing system changes that would be required in order to effect changes of this magnitude. Implementing significant changes to billing systems without adequate time for robust testing brings the risk of bill quality issues for customers.

It should also be noted that without parity in the pricing signals between network and retail tariffs, the full benefits of these price signals may be lost. Ultimately, while retail price signaling does allow customers to reduce their overall bills by altering their behaviour, the primary benefit of price signaling is to alleviate capital expenditure of the distribution system in the short term which can only be accomplished by corresponding network price signaling.

3.6 Demand Management and Time of Use Pricing

Peak demand pricing provides the most effective and transparent link between customer demand and network’s capital expenditure to service that demand. Peak pricing is a matter being considered by most, if not all, electricity distributors in order to reduce their augmentation expenditures. To this extent, peak pricing can provide better utilisation of network assets and reduce network charges in the longer term. To be effective in changing customers’ consumption patterns, however, the associated pricing signals need to be passed through to customers by the retailer in full. This will also ensure that retailers are not disadvantaged financially by not being able to pass through these network pricing signals.

Integral therefore maintains its recommended approach of an “N” (network) plus “R” (retail) structure to calculating regulated retail charges in Queensland, where network charges are passed through in full and are calculated separately from the retail “R” component. The QCA should be aware that any introduction of demand pricing to the current suite of retail tariffs available in Queensland will require a considerable amount of time and expense (by both retailers and distribution entities) to implement. Retailers’ billing systems would need to have major reconfiguration completed and meters capable of reading demand data would need to be installed.

Time of use pricing would also be an effective mechanism for sending the correct signals to customers, albeit not as effective as demand pricing. Time of use pricing would also be simpler to implement and less costly. It is Integral’s belief that there are already a relatively large percentage of customers (including residential customers) within the Energex distribution area that have a meter installed that is capable of time of use readings (although not capable of supporting demand based tariffs). Considerable time would still be needed to develop a time of use product that would meet the needs of customer, distribution entities and retailers.

Integral considers that any questions on metering requirements for the introduction of demand and/or time of use pricing should be put directly to network providers in Queensland and the outcomes should form part of the Draft Report.

3.7 Interruptible Tariffs

Integral believes that interruptible tariffs are a significant tool for the future that will allow for the reduction of maximum demand on the Queensland distribution network. It therefore considers that the current interruptible tariffs (i.e. tariff 31 and tariff 33) should be modified / added to in three ways.

- Load Shifting – Any modification to the current retail tariff schedule should be designed to encourage greater conversions to interruptible tariffs. This may include relaxing of some of the tariff requirements such as;
 - Removing the requirement for the electricity supply to be permanently connected;
 - Relaxing rules around solar heated water and heat pumps etc.
- Demand Control or Load Clipping Devices – Development of new tariffs that allow for control devices to regulate the cycling of air conditioning units. These tariffs would be controlled by the distribution entities.
- Load Curtailment Tariffs - Development of tariffs that allow retailers to defer peak wholesale pricing risk and allow the provision of a more sculpted product to customers. These tariffs would be controlled by the retail entities.

Once again, considerable time and expense would need to be incurred in order to establish appropriate tariffs (pricing plans) for Queensland customers and Integral does not believe these could be effectively completed by July 2010.

3.8 Transitional Arrangements and Future Options

Due to the complexities of modifying existing, or establishing new retail pricing structures, Integral strongly recommends a transition year between achieving cost reflectivity with the current retail tariffs and moving toward new, better designed, retail tariffs. In order to achieve the most appropriate outcomes for Queensland customers, distribution entities and retailers, considerable consultation will need to occur between all stakeholders including community consultation.