



Review of Electricity Pricing and Tariff Structures

Further AGL Submission to the Queensland Competition Authority
Date: 04 August 2009





Further to AGL's submission dated 17 July 2009, AGL is providing this submission with a view to suggesting a legislative and regulatory framework that will:

- outline a clear direction for regulatory pricing processes and principles over the next few years;
- provide a sufficient degree of latitude to the government, QCA and industry to permit the pricing process to become more innovative and flexible in order to deal with the various structural and regulatory changes imminent, such as the Carbon Pollution and Reduction Scheme (*CPRS*);
- support a transition process such as AGL (and other stakeholders have suggested); and
- encourage competition for small customers, facilitate a move toward a light-handed regulatory approach, with the eventual aim being a level of competition such that retail prices can be de-regulated in contestable areas.

AGL understands that continuing amendments to the framework may not be considered desirable. AGL is advocating a 'transition approach', and notes that 'final' framework would need to be capable of permitting adjustment, innovation and flexibility, while still providing the industry and consumers with sufficient certainty as to the principles against which all decisions will be assessed. These principles should be enshrined in legislation, with further detail stipulating methodological approaches provided in regulatory provisions.

AGL is therefore suggesting a legislative approach which will:

- provide in legislation the key principles which must underpin the regulation of the retail price of electricity for small non-market customers;
- permit the making of regulations which will further specify the process and regulatory principles – thereby providing greater direction through regulation while allowing greater innovation and flexibility in the future;
- permit flexibility around the commencement of the 3 year price path so as to cater for the option of a 'transitional year' approach, whereby elements of the BRCI would be used for a 'transitional year';
- establish a robust review process in line with that provided in other jurisdictions.

Stated objectives in Ministerial Direction

AGL understands that the policy objectives as stated by the government in its Terms of Reference for the review are:

- better reflect the costs of supplying electricity, including network costs and 'all state and Commonwealth Government environmental obligations', and
- assess in the long term management of peak electricity demand and provide an incentive for customers to use electricity more efficiently.

The Ministerial Direction also requires the QCA to ensure that the existing headroom is maintained at a relatively stable level, and to maintain the maximum uniform tariff policy.

As noted by AGL in its previous submission, there are some tensions between the policy objectives articulated by the government in the Ministerial Direction. The most obvious of these is the requirement to maintain the maximum uniform tariff policy while establishing cost reflective tariffs.

As noted in AGL's first submission, AGL suggests that the only means of achieving this is to:



- base the uniform tariff on the costs incurred by retailers supplying regulated customers in the Energex patch; and
- direct and transparent rebates to be paid to the Ergon retail business to account for the shortfall.

Legislative framework

The legislation should specify:

1. The **principles for price determination** in respect of:
 - a) the determination of the estimate of costs which must be undertaken every 3 years while explicitly allowing for:
 - flexibility as to the date the first 3 year price path is to commence, thereby permitting a one year 'transition' period;
 - the cessation of a regulated pricing regime with the finding of effective competition.
 - b) the nature of the annual indexation across the period of the price path.
2. the **power to make regulations** to specify the methodology to be used;
3. **the processes for the making of the determinations**;
4. the framework for **merits review** of the determination.

Principles guiding the determination

The legislation should specify that the QCA's determination in regulating the price at which small non-market customers are supplied must be guided by, and give effect to, the following objectives:

- To ensure that all of the costs incurred by retailers operating in the Energex patch in supplying small non-market customers are fully recovered, including:
 - the full and direct pass through of the Energex network costs;
 - the full and direct pass through of any costs incurred by retailers due to any legislated or regulatory scheme which could reasonably be assumed to impose additional costs on new entrant retailers operating in Queensland. For the avoidance of doubt, this will include, but is not limited to:
 - the 13% Gas Scheme (or any amended version of such);
 - the scheme under the Renewable Energy (Electricity) Act; and
 - any emissions trading scheme
 - a return on investment and funds employed commensurate with the regulatory and commercial risks involved;
- To facilitate the development of effective retail competition for small retail customers. This is best achieved by ensuring:
 - the costs of supplying regulated customers is assessed with reference to an efficient benchmark new entrant retailer of significant size operating in the Energex patch; and



- the tariffs are set so as to maintain a stable retailer margin. This should be referable to the margin that was available to the Energex retail business at the time of the sale in 2006/07.
- To allow for the further rationalisation of regulated retail tariffs;
- To promote economic efficiency and facilitate maintenance of the financial viability of the industry and the incentive for long term investment; and
- To protect the interests of consumers of electricity.

Process

The legislation should provide that the QCA must engage in a comprehensive consultation process. Specifically, the legislation should provide:

- There must be minimum periods available for consultation between the release of consultation papers (eg issues papers, draft determinations) and information and the due date for submissions from stakeholders;
- The QCA must be obliged to release all data used in calculations and all outputs of modelling exercises, unless there are justifiable grounds on which confidentiality of the information can be asserted;
- Iterative workshops must form a meaningful part of the consultation process.

Price path periods and commencement dates

As noted in its previous submissions, AGL is very supportive of a move to a 3 year price path. However, AGL remains of the view that there needs to be some flexibility permitted as to the date on which the first 3 year price path commences. This could be the subject of an Order-in-Council.

Merits review process

AGL proposes a draft framework for a Review and Appeals process in **Annexure 1**, which is based on South Australian regulated pricing regime.

Regulatory provisions

The legislation should permit the making of regulations which provide more specific direction as to the determination of the regulated price. The benefit of having these directions in regulations rather than in legislation is that it would then permit a greater degree of flexibility within the framework, so as to permit/encourage more innovative approaches to regulatory pricing regimes.

AGL suggests that the regulatory provisions that should apply in the determination of the three year price path (ie after the transitional period) would implement a framework whereby:

- Retail tariffs should fully reflect all costs of supplying electricity, with a return on investment and funds employed commensurate with the regulatory and commercial risks involved. The costs should be assessed with reference to the detail articulated below;



- The margin/headroom available to retailers operating in the Energex patch remains at a relatively stable level.

Wholesale energy costs

Wholesale energy costs should be assessed with reference to:

- LRMC of the Energex NSLP as the 'floor' of the wholesale energy costs;
- Actual energy purchase costs incurred by retailers operating supplying the regulated load in the Energex patch, which is to be assessed with reference to reliable and robust market data;
- The level of risk faced by retailers in supplying the regulated load in the Energex patch, with specific reference to:
 - volume risk, that is a retailer under or over hedges its load due to incorrect load forecasts and has to either buy or sell hedge contracts at the relevant market price. Load forecasts can prove to be incorrect due to churn being higher or lower than predicated;
 - liquidity risk, that is the WEC model assumes that a retailer is able to purchase its hedge cover in equal portions starting 2 years prior to the relevant period. However, it is possible that there will be insufficient liquidity in the market and the retailer can not purchase the load at the price assumed in the WEC model; and
 - extreme weather events. That is a retailer is left under hedged at times of extreme demand which usually equates to extreme pool and contract prices.

Retail operating costs

- Retail operating costs should be benchmarked against the efficient costs faced by a new market entrant retailer

Headroom

- Headroom should be set *at a minimum* to the level established in 2007 in undertakings by the Government when the retail entities were sold and should reflect all risks of supplying regulated customers in the Energex patch of the retail electricity market;

Indexation and tariff adjustment

- Re-balancing of individual retail tariffs should be allowed within set '*side constraints*' that limit the overall tariff increases across the particular region.

Re-opening mechanisms

AGL concurs with the finding of the AEMC in its recent 2nd Interim Report on 'Review of Energy market Frameworks in light of Climate Change Policies':

The CPRS will significantly increase the wholesale electricity purchase costs and volatility incurred by retailers. The increases in costs will be hard to forecast and initially difficult for retailers to manage with financial hedging. These factors will make it very difficult for pricing regulatory to accurately forecast and allow for costs in retail prices.

The legislative and regulatory framework will therefore need to allow a significant degree of flexibility.



Annexure 1 Merits review process

The provisions proposed below are based on the review process established in the analogous South Australian legislation and regulatory provisions.

Reviews and appeals

1—Review by Commission

- (1) An application may be made to the Commission—
 - (a) by the QCA or by a regulated entity to which the determination applies, for a review of a price determination; or
 - (b) by a person of whom a requirement has been made by written notice under Part 5 for a review of the decision of the QCA to make that requirement; or
 - (c) by a person who has been given written notice under Part 5 of the proposed disclosure of information that the person claimed to be confidential information for a review of the decision of the Commission to disclose the information.
- (2) An application for a review must—
 - (a) be in writing; and
 - (b) set out the price determination or part of the price determination, or the decision, to which the application relates; and
 - (c) set out in detail the grounds on which the applicant seeks review and the decision sought on the review; and
 - (d) be accompanied by any information that the applicant considers should be taken into account by the Commission on the review; and
 - (e) be lodged with the Commission within 20 working days after the price determination is published or after receipt of the written notice referred to in subsection (1) (as the case requires).
- (3) If an application is made for a review of a price determination—
 - (a) the Commission must give a copy of the application to each other person who could also have applied for review of the determination; and
 - (b) invite each such person to join as a party to the review and make submissions on the matter the subject of the review in a manner and within a period specified by the Commission.
- (4) The price determination or decision to which the application relates operates until the review under this part is completed.
- (5) A review must be decided within 20 working days of the application being lodged with the Commission.
- (6) If a review is not decided within that period, the Commission is to be taken to have confirmed the price determination or decision.



- (7) After considering the application, the Commission may confirm, vary or substitute the price determination or decision.
- (8) The Commission must give the applicant and any other person who joins as a party to the review written notice of the Commission's decision, and comprehensive reasons for the decision, on the review.
- (9) If the Commission decides on a review of a price determination to vary or substitute the determination, the Commission must vary or substitute the determination by a further determination in accordance with Part 3 but that further determination may not be made the subject of an application for a review under this section.

2—Appeal

- (1) The applicant for a review under this Part, or any other party to the review who made submissions on the review, who is dissatisfied with the price determination or decision as confirmed, varied or substituted by the Commission on the review may appeal to the Commercial List Supreme Court Judge (the Court) against the determination or decision.
- (2) The Court must sit with experts selected in accordance with Schedule 1.
- (3) An appeal must be made—
 - (a) within 20 working days after receipt of the written notice of the decision on the review; or
 - (b) if the Commission failed to make a decision on the review within the allowed period, within 10 working days after the end of that period,which period can only be extended where the Court is of the view that such an extension is warranted in the circumstances.
- (4) If an appeal is made under this section, any other party to the review who made submissions on the review must be given notice of the appeal and may, on application, be joined as a party to the appeal.
- (5) If an appeal is made under this section, the price determination to which the appeal relates operates until the appeal is determined
- (6) On an appeal the Court may consider information
 - a) on which the Commission based the price determination or decision that was the subject of the review and any information put before the Commission on the review
 - b) and any additional information.
- (7) The Court may, on an appeal—
 - (a) affirm the decision appealed against; or
 - (b) remit the matter to the Commission for consideration or further consideration in accordance with any directions of the Court.
 - (c) substitute the QCA decision with its own decision
- (8) An appeal will lie against a decision of the Court under this section on a question of law and on questions of fact and reasoning.



Schedule 1—Appointment and selection of experts for Court

- (1) The Minister must establish a panel of experts who may sit as assessors with the Court consisting of persons with knowledge of, or experience in, a regulated industry or in the fields of commerce or economics.
- (2) A member of a panel is to be appointed by the Minister for a term of office not exceeding 3 years and on conditions determined by the Minister and specified in the instrument of appointment.
- (3) A member of a panel is, on the expiration of a term of office, eligible for reappointment.
- (4) Subject to subclause (5) and except in the case of an appeal limited to a question of law, a judicial officer of the Court must select 2 members from the panel to sit with the Court on an appeal. The panel must consist of:
 - a) one panel member experienced in economics or commerce; and
 - b) one panel member experienced in the electricity industry
- (5) A member of a panel who has a direct or indirect pecuniary or other interest in a matter before the Court is disqualified from participating in the hearing of the matter.
- (6) Subclause (5) does not apply if the interest is as a result of the supply of goods or services that are available to members of the public on the same terms and conditions.
- (7) If a member of a panel sitting with the Court dies or is for any reason unable to continue with any proceedings, the Court constituted of the judicial officer who is presiding at the proceedings and the other member of the panel sitting with the Court may, if the judicial officer so determines, continue and complete the proceedings.
- (8) If proceedings are reheard, the Court may have regard to any record of proceedings made in the earlier proceedings (including a record of evidence taken in those proceedings).
