

CHAMBER OF
COMMERCE &
INDUSTRY
QUEENSLAND

**Chamber of Commerce and Industry Queensland
Submission to the Queensland Competition Authority
Draft Report on the Review of Electricity Pricing and
Tariff Structures (Stage One)**

28 August 2009

Invigorating
Business

1.0 INTRODUCTION

The Chamber of Commerce & Industry Queensland (CCIQ) welcomes the opportunity to comment on the Queensland Competition Authority's (QCA's) draft report on the Review of Electricity Pricing and Tariff Structures (Stage One).

CCIQ is the peak business organisation in Queensland, representing the interests of 25,000 businesses and 135 chambers of commerce across the State (a more detailed overview of CCIQ's membership is provided in Appendix 1).

2.0 GENERAL COMMENTS

Energy is an essential input into nearly all goods and services and a core driver of economic growth. It is therefore a critical and unavoidable cost for many Queensland businesses.

Over the last few years, businesses have seen substantial increases in the price of electricity and a legal challenge which resulted in the revision of earlier pricing decisions. These events have created a degree of uncertainty and unpredictability around the setting of electricity prices in Queensland which is only likely to get worse with the introduction of the Carbon Pollution Reduction Scheme (CPRS). This outcome is not a satisfactory one for the State's business community as it needs a reasonable level of predictability and certainty in the pricing of this critical input in order to set budgets and assess investment opportunities.

CCIQ therefore believes there is merit in reviewing the existing pricing methodology and considering alternative methodologies which may potentially deliver more consistent and reliable pricing outcomes. The Chamber therefore welcomes the current review of pricing methodology by the QCA. CCIQ considers that the review process will enable a consideration of stakeholder concerns with the current model and hopefully facilitate the development of a more effective pricing model to guide the QCA in the future.

3.0 SPECIFIC ISSUES

3.1 *The Existing Benchmark Retail Cost Index (BCRI) Methodology*

CCIQ considers that the current BCRI methodology has failed to provide the State's businesses with a reasonable level of price predictability and certainty. Given that this outcome is a critical one for the business community, CCIQ agrees with the QCA's observation that a more fundamental overhaul of the price setting approach is warranted.

3.2 *Cost Reflectivity and Allocation of Costs Across Consumer Groups*

CCIQ acknowledges that subject to the requirements of the Uniform Tariff Policy (UTP), there needs to be some degree of cost reflectivity in the State's electricity prices in order to ensure that retailers earn an adequate return on capital and to encourage further investment in the State's electricity network and generation capacity. Better cost reflectivity may also encourage more efficient consumption thereby assisting in the management of demand and potentially reducing the need for costly new investments in generation capacity. That said, CCIQ notes that any shift to cost reflectivity will potentially result in higher prices for some consumer groups and where those cost increases are substantial CCIQ considers that there is a strong argument for gradually transitioning those customers to the higher cost-reflective price levels rather than just immediately shifting them across on the introduction of the new pricing arrangements. This will provide customers with an adequate opportunity to adjust to the new price reality and to potentially implement strategies which will minimise the impacts.

Subject to the requirements of the UTP being satisfied, CCIQ also supports in principle pricing structures which allow costs to be fairly allocated to individual homogenous customer groups and prices to be set which, within reason, reflect the costs of consumption within each of those customer groups. CCIQ considers that such an approach will help to ensure that the distribution of costs

across the various categories of consumers is fair and equitable. It will also help to reduce the likelihood of cross-subsidisation occurring across consumer groups.

This issue is a particularly pertinent one given the recent upwards trend in electricity prices is likely to continue in the future with the introduction of the Carbon Pollution Reduction Scheme and other related measures. In a high price environment all users, business or domestic, are likely to have a substantially reduced capacity to absorb additional price increases, let alone subsidise the cost of electricity for other users.

3.3 Effectiveness of Existing Tariff Structures

CCIQ agrees with the QCA's observation that the current structure of tariffs does not generally provide a good indication to consumers of the actual costs associated with consuming electricity at different times during the day. That said, CCIQ would have serious reservations about the proposal to allow retailers to completely transfer the volatility risks associated with the wholesale purchase of electricity to end consumers. Retailers have access to information, sophisticated models and financial instruments which enable them to hedge some of these risks. The average consumer (large electricity consumers will not fall into this category) does not have access to a similar suite of tools and is therefore simply not in a position to effectively manage the very volatile nature of wholesale electricity prices.

The above statement does not mean however that CCIQ considers that retailers should bear all of the risks associated with the purchase of wholesale electricity. Rather, the Chamber believes that the relevant pricing methodologies and tariff structures must strike a fair balance between retailers and consumers in terms of the allocation of risks associated with volatile wholesale electricity prices. To achieve this outcome, the pricing structure must allow retailers sufficient flexibility to allocate costs across and within consumer groups so that they can send the "right" price signals to particular types of consumers and thereby better manage their own wholesale demand profiles.

CCIQ considers that the existing tariff structure is unlikely to allow retailers sufficient flexibility to allocate their energy costs across their customer bases according to the actual costs the retailer incurs in supplying energy to particular types of customers. This in turn means it is also unlikely to provide retailers with the flexibility to better manage their own demand profiles and potentially reduce some of the risks associated with wholesale price volatility (for example, by encouraging customers to consume electricity outside of peak periods).

3.4 Options for Changing Tariff Structures

CCIQ agrees that there may be some opportunities to consolidate some existing tariffs and abolish others. CCIQ considers however that any consolidation must ensure that the energy use profiles of the consumers falling within a specific tariff category are fairly homogenous. This will enable the costs of supplying a particular type of customer to be accurately allocated to those customers, leading to more effective demand management.

CCIQ also considers that it is important that small businesses in South-East Queensland are not left without tariff 'safety net' in any restructuring of the State's tariff structures. CCIQ notes that the QCA's draft report suggests that there is some argument that this should occur as businesses are in a position to seek out a commercially sound market contract. However the usage levels of some smaller businesses may actually be more akin to domestic consumers rather than major energy users. Accordingly, there is an argument that they should have access to the same safety nets as household consumers.

CCIQ also has concerns that any move to force all businesses in South-East Queensland on to market contracts could potentially result in smaller energy users within the region's business community becoming soft targets for price increases. CCIQ acknowledges that this would not occur in a perfectly competitive market. However, the reality is that the Queensland market, even in South-East Queensland, is not perfectly competitive. There is still a degree of price regulation in

South-East Queensland and the regulated tariffs will effectively act as cap on the market contract prices which retailers can charge customers who are eligible for a given tariff.

If the regulated tariffs for these domestic and non-market customers failed to allow retailers to recover the costs of supplying these customers then retailers would, quite reasonably, need to look to other unregulated parts of their customer base to recoup these costs. Under this scenario, small business customers in South-East Queensland they would be an obvious option if they were required to be on market contracts and had no access to a tariff 'safety net' (the regulated tariff for non-market business customers in other areas of the State is unlikely to act as a cap on SEQ market prices as businesses in SEQ would not have the option of reverting to that tariff). This is because there would be no regulatory caps on the prices they could be charged and they would not have the bargaining power or knowledge of larger business users of electricity.

This scenario highlights risks of forcing small businesses in South-East Queensland to use market contracts while there are still market distortions (i.e. regulated tariff customers). It also reinforces the critical importance of ensuring that the tariff structures and pricing methodology actually allow for the accurate allocation of costs across the various types of electricity consumers. Failure to do so will likely result in other customers, particularly those on market contracts with no recourse to a regulated tariff, cross-subsidising regulated customers.

Accordingly, CCIQ believes that there is a strong argument for restructuring the existing pricing structure so that individual tariffs more accurately reflect the actual costs incurred by retailers in supplying the customers which fall under that tariff. While this approach may result in higher prices for some consumers, the reality is that a failure to recover the costs of supply from one group of consumers results in other groups of consumers paying more than their fair share.

Where particular consumer groups experience material price increases as a result of tariff consolidation or restructuring, CCIQ believes that it is important that the tariff changes are phased in rather than introduced with immediate effect. This will help to ensure that the changes do not cause undue hardship and will also allow affected consumers to adapt to the new pricing arrangements.

3.5 A New Pricing Methodology

As noted above, CCIQ considers that the current BCRI methodology has failed to provide the State's businesses with a reasonable level of price predictability and certainty. Given that this outcome is a critical one for the business community, CCIQ agrees with the QCA's observation that a more fundamental overhaul of the price setting approach is warranted.

CCIQ does not however have any firm views at this stage as to which exact methodology would be the most appropriate. That said, CCIQ considers that any new pricing methodology must provide businesses with a better degree of price predictability and certainty. CCIQ notes that the proposal to shift to a multi-year mechanism would potentially achieve this outcome. Accordingly, CCIQ considers that there is merit in the QCA exploring this proposal in more detail.

CCIQ also acknowledges that a multi-year mechanism would magnify the risk associated with the QCA incorrectly estimating the wholesale cost of electricity. CCIQ therefore agrees that some form of intra-period review process would need to be developed so that adjustments could be made if there are material changes in wholesale energy costs and/or the regulatory environment. Any such mechanism must balance fairly the rights of retailers and consumers and share the pricing/regulatory risks equitably between these two stakeholder groups.

In respect of the actual pricing methodology to be applied in Queensland, CCIQ notes the comments regarding the 'N+R' model. CCIQ agrees that this model may potentially enable the QCA to overcome some of the key problems with the BRIC approach without compromising the Queensland Government's Uniform Tariff Policy. CCIQ therefore considers that the model warrants further consideration.

As noted above, CCIQ generally supports the adoption of a pricing structure which will allow the QCA to set prices for individual consumer groups which reflect (within reason) the actual costs of electricity consumption within these groups. That said, CCIQ notes that the level of competition in the retail electricity market is not, and is unlikely to ever be, uniform across the State. Consumers and businesses in many areas of Queensland simply do not have access to a competitive supply and therefore have no option but to access supply at the notified price. CCIQ considers that these non-market customers should not be penalised for the lack of competition in their region. That is, the applicable regulated tariffs should be reasonably comparable to the price that market customers in other areas of the State pay under their contracts.

CCIQ also agrees that retailers across Queensland need to be able to send price signals to their customer base if they are to effectively manage demand. CCIQ notes that this objective is difficult to achieve without breaching the Uniform Tariff Policy and therefore while the Chamber therefore doubt the overall effectiveness of identifying the network charges and Community Service Obligation payment separately on Ergon bills, it acknowledges that this is perhaps the only way for Ergon to send some form of price signal to its customers.

While the issue is perhaps not directly related to the current review of pricing, CCIQ notes that the 'N+R' pricing methodology would separate the network cost component from the retail cost component and perhaps allow for a degree of price competition to occur outside of South-East Queensland if other retailers were eligible for the Community Service Obligation payment which is currently only paid to Ergon. CCIQ considers that this approach may potentially provide consumers in other areas of Queensland with greater choice and accordingly believes that this issue warrants further consideration.

4.0 CLOSING COMMENTS

CCIQ trusts that this information is of assistance. Please do not hesitate to contact Nick Behrens (General Manager – Policy; 3842 2279) or Sarah Kearney (Senior Policy Advisor; 3842 2253) if you wish to discuss any aspect of this submission in more detail

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> Chamber of Commerce & Industry Queensland Profile



CHAMBER OF
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Chamber of Commerce & Industry Queensland is the state's peak industry body, representing the interests of 25,000 businesses, across all industry sectors and in all regions. We champion business to gear up for the future today with the right set of solutions for success in tomorrow's world.

Chamber of Commerce & Industry Queensland is a non-government organisation that seeks to work with Government and other groups to shape Queensland's economic and social environments in a way that promotes business growth and community prosperity.

Chamber of Commerce & Industry Queensland is called upon by thousands of enterprises to deliver a broad range of business services including business representation, business compliance, business skills, business safety, business sustainability, business connections and business globally. We are commercially-minded and expertly-qualified.

Chamber of Commerce & Industry Queensland is a founding member and influential partner of the Australian Chamber of Commerce and Industry (ACCI) and part of the worldwide network of Chambers of Commerce and affiliated business service organisations.

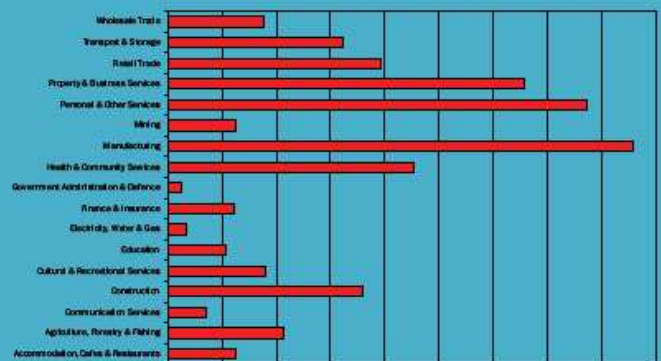
Chamber of Commerce & Industry Queensland has in excess of 3,700 members across 8 regional offices and represents over 135 local chambers of commerce and 60 trade and professional associations.

Our vision is to invigorate business success in Queensland.

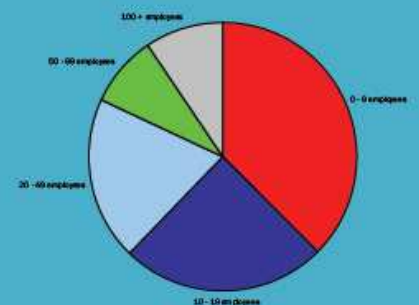


The diversification of Chamber of Commerce & Industry Queensland's membership is illustrated in the following charts:

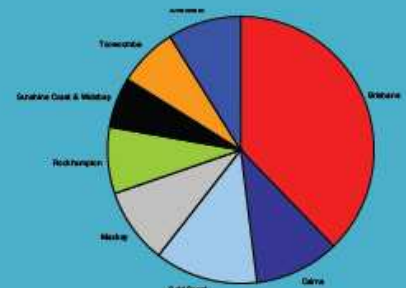
Commerce Queensland members by Industry



Commerce Queensland members by Employment Size



Commerce Queensland members by Region



CCIQ – Solutions for Business Success

Chamber of Commerce & Industry Queensland (CCIQ) represents over 25,000 businesses in Queensland. We are committed to ensuring our customers have the right tools to achieve real results in their business.

At CCIQ we harness the results of our research, lobbying and policy achievements to offer the best possible business support solutions to invigorate growth statewide, nationally and globally. By joining CCIQ you support the organisation that supports the Queensland business community.

Membership also ensures you are an integral part of an organisation dedicated to providing first class services to assist Queensland industry with relevant and practical business solutions. Not only is membership your connection to information, industry best practice, training and consultancy services, it also allows you to take advantage of the many benefits CCIQ offers.



Our success is success for all Queensland businesses.

Chamber of Commerce & Industry Queensland members are informed and connected business people. Whether you run a small business or form part of a large industry sector, call us today to take advantage of the opportunity to associate yourself with the CCIQ brand.

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