

19 October 2012



Mr Gary Henry
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Queensland Competition Authority
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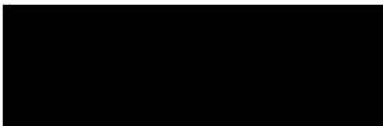
Dear Mr Henry,

Interim Consultation Paper – Regulated Retail Electricity Prices 2013-14

Energex is pleased to provide its response to the Authority's Interim Consultation Paper for Regulated Retail Electricity Prices 2013-14 issued on 19 September 2012.

Energex looks forward to ongoing participation in the consultation process and would be pleased to discuss the matter further. Should you have any enquiries, please contact Roger Dunstan on (07) 3664 4531.

Yours Sincerely,



Kevin Kehl
Executive General Manager
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Attachment

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Regulated Retail Electricity Prices 2013/14

**Response to Queensland Competition Authority
– Interim Consultation Paper**

19 October 2012



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1 Introduction

Energex Limited (Energex) welcomes the opportunity provided by the Queensland Competition Authority (the Authority) to submit comments in response to its *Interim Consultation Paper on Regulated Retail Electricity Prices 2013/14* (Interim Paper).

Energex fully supports a robust and consultative approach to electricity pricing reform and looks forward to participating in the Authority's Public Consultation Process. Obtaining the understanding and support of consumers in our distribution area is a major consideration for Energex when reviewing tariffs and implementing reforms.

Energex's submission focuses on informing the Authority of matters considered to be relevant to the Authority's task of setting regulated retail electricity prices for 2013/14 and beyond, including subsequent years of its Delegation in accordance with the provisions of its Terms of Reference (ToR). Energex's comments focus on the treatment of network costs with regard to the matters outlined in the ToR, specifically regarding Tariff 11 transitional arrangements, Time of Use (ToU) pricing and consultation timeframes. Further, there are also comments on specific and other matters raised in the ToR and some additional matters Energex wishes the Authority to consider.

2 Executive Summary

Energex is committed to delivering safe, reliable and affordable electricity to South East Queensland electricity consumers in a commercial environment that recognises the need to balance consumer outcomes with effective risk and price management.

As an electricity Distribution Network Service Provider (DNSP) operating in the National Electricity Market (NEM), the challenge for Energex is meeting peak demand while recovering its approved revenue via tariff prices. Ensuring sufficient network capacity to meet demand placed on the network during peak periods without impacting excessively on electricity prices continues to pose a significant challenge for Energex.

The Authority's ToR requires it to consider the actual costs of making, producing and supplying electricity. Demand during the peak period drives network investment and augmentation.

Due to the legacy nature of the notified tariffs, the pricing signals are not truly cost-reflective of a consumer's impact on the network; however, the Network plus Retail (N+R) cost-stack pricing approach introduced on 1 July 2012 is an improvement on the previous pricing approach. Ensuring cost-reflectivity in the calculation of the 'R' component of prices will complement the network tariffs to ensure that consumers' total electricity costs reflect the real and total cost of their service provision.

Energex network prices are approved by the Australian Energy Regulator (AER) on an annual basis and must comply with Chapter 6 (section 6.18) of the National Electricity Rules (the *Rules*). Energex's network tariff structure and prices included in Energex's Annual Pricing Proposal is available on the AER website.

Network prices generally comprise approximately 50 percent of the final retail tariff for small consumers and are calculated based on Energex's cost of supply and consumer demand in terms of capacity, security and supply reliability. These prices seek to recover the cost of distribution and transmission network services through a cost reflective, combined Network Use of System (NUoS) charge. Under the N+R approach, this NUoS charge becomes Energex's 'N'.

Energex supports continuing the use of the N+R approach for setting regulated retail electricity prices. By allowing the direct pass through of Energex's 'N' for residential and small business consumers, Energex is in a position to send a price signal that is cost-reflective and can be preserved in the final regulated tariff offering to ensure demand management benefits intended to be achieved through strong signalling can be realised.

Energex is of the view that sending cost-reflective price signals to consumers regarding their network usage will provide significant benefits by encouraging consumers to minimise demand during peak times, thereby reducing the total cost of delivering energy. Further, Energex supports the ToR's requirement for the Authority to progress the Residential Flat Rate Tariff, Tariff 11, towards cost-reflectivity and achieving this by 1 July 2015.

The Authority's ToR also requires consideration of ToU pricing with the view to encouraging consumers to switch to ToU tariffs and potentially reduce their energy consumption during peak times. With a long-term strategic goal of moving towards fully-cost reflective tariffs for all consumers, Energex supports the progression towards more widely applied ToU tariffs as a first step in this process of incremental change.

3 Response to Specific Matters raised in the ToR

Section 1.1 of the Authority's Interim Paper identified a number of specific matters specified in its Delegation and ToR that the Authority is required to consider when setting retail electricity tariffs and prices. This section provides Energex's comments in response to each of these specific matters.

3.1 N + R cost build-up approach

Energex supports continuing the use of the N+R methodology for setting regulated retail electricity prices. By allowing the direct pass through of Energex's 'N', Energex is in a position to send a price signal that is cost-reflective and can be preserved in the final regulated tariff offering. Prices signals are also used to support Energex's demand management strategy, preserving these signals ensures the intended demand management benefits can be realised.

Energex believes consumers should be provided with sufficient information to make informed decisions regarding their electricity usage, balanced with the need for simplicity and added value to the consumer. Energex supports the outcome of the 2012/13 Review of Regulated Retail Electricity Tariffs and Prices where it was determined that small consumers would not see their network tariff as a specific item on their bill. Should this outcome be revised, any costs associated with the proposal to separately identify Network and Retail costs on a consumer's bill should only be considered if the benefits of doing so can be justified.

3.2 Time of Use pricing

The Authority's ToR also requires consideration of ToU pricing with the view to encouraging consumers to switch to ToU tariffs and potentially reduce their energy consumption during peak times.

Energex supports encouraging consumers to switch to ToU tariffs to assist in minimising electricity price increases by reducing the extent of network augmentation required to ensure sufficient capacity for peak demand.

Energex supports the Authority reconsidering its approach to calculating ToU tariffs and encourages the Authority to revise its approach to calculating the 'R' component. Energex believes that an 'R' component comprising ToU Energy charges would support price signals provided by the 'N' component.

Furthermore, the current variance between the Fixed Charges for Tariff 12 and Tariff 11, resulting from the freeze on Tariff 11, has diminished the appeal of Tariff 12 by introducing a difference in the Fixed Charge.

Energex notes that the effectiveness of any approach to pricing Tariff 12, including introducing ToU Energy charges or altering Fixed Charges, will be enhanced through equivalent treatment of these two tariffs.

3.2.1 Strategic use of ToU tariffs

In addition to reducing energy demand during peak periods and, consequently, electricity prices, Energex encourages a move towards ToU tariffs (preferably capacity and/or demand-based) as a first step towards achieving its long-term strategic goal of implementing more effective price signals.

The progression towards more effective price signals is supported by introducing tariff structures comprising ToU elements (such as residential ToU or the proposed new large business ToU Demand tariff) that account for the time of a consumer's demand and the impact this has on available network capacity. During the residential peak demand period, 4pm – 8pm, capacity on the network is limited and, as a result, the value of electricity is at a premium during this time. ToU pricing reflects this premium value by charging a higher, more cost-reflective rate during the peak period.

3.3 Network cost component

Energex supports the Authority's approach to calculating the 'N' component of regulated retail electricity prices. As large consumers in the Energex network area no longer have access to notified prices (since 1 July 2012) it is reasonable that large consumer tariffs be set based on Ergon Energy's 'N' as it is only large consumers in the Ergon Energy network area that are subject to these tariffs.

3.4 Transitional arrangements

3.4.1 Tariff 11

Energex recognises and appreciates the need to transition the residential Tariff 11 from the historical structure to the appropriate N+R structure that is reflective of the cost components.

There are a range of factors contributing to Tariff increases, including the recovery of the costs of funding the Solar Bonus Scheme. Any delays to this transition, and in particular

any constraint of network prices, will result in recoveries in future years unless an alternate source of funding is utilised. Energex is forecasting the moderation of network prices beyond 2013/14 and would encourage the QCA to consider options that could offset the transitional tariff path against future tariff increases outside of the economic regulatory framework.

In accordance with the *Rules*, the network tariff will continue to be presented to the AER for approval at its real price.

3.4.2 Existing obsolete tariffs & applying transitional arrangements

As per Energex's submission to the Authority in response to the *2012/13 Draft Determination on Regulated Retail Electricity Prices*, Energex believes the transition period of 12 months for obsolescent tariffs, that was ultimately included in the Gazette, is a sufficient transition period.

Energex acknowledges that for many consumers, especially business consumers, the transition between tariffs following wide-spread reforms can be difficult to manage, especially where transitions have involved changes to peak / off-peak times or switching from consumption to demand-based tariffs. A 12 month transition period provides sufficient time and opportunity for consumers to respond and adjust to the new price signals. As such, in pursuit of progressing to cost-reflective tariffs, Energex believes no additional transition arrangements, including for large consumer tariffs, are required.

4 Response to Other Matters raised in the ToR

This section provides Energex's comments in response to various other matters included in the ToR that Energex believes are relevant to the Authority's task of determining regulated retail electricity prices for 2013/14 to 2015/16.

4.1 Period of delegation

Energex supports the Authority being delegated responsibility for setting the regulated retail electricity prices for the three year period, until 2015/16, thereby providing continuity and stability in development of tariffs during this period.

This extended Delegation will allow the Authority to take a longer-term view of price setting and implementing transitional arrangements for consumers who are subject to tariff changes. Further, this provides the Authority with the opportunity to set prices for the first year of Energex's 2015-20 AER Regulatory Determination period which will ensure any tariff changes introduced at the commencement of the period are managed in a way that is consistent with the preceding years.

4.2 Cost of service provision

The Authority's ToR requires it to consider the actual costs of making, producing and supplying electricity.

Since the 'N' component of prices is treated as a pass-through under the N+R approach, ensuring cost-reflectivity in the calculation of the 'R' component of prices will complement the cost-reflective 'N' to ensure that consumers' total electricity costs reflect the real and total cost of their service provision.

4.3 Consultation timeframes

The Authority's Delegation and ToR places a strong emphasis on stakeholder and consumer consultation. The Delegation specifies that the Authority must undertake 'extensive consultation' not limited to consultation activities specified in the ToR, which includes publishing an Interim Paper and Draft Price Determination. The ToR specifies annual timings for publishing these documents which are included in Table 1.

Table 1 Dates for publication of QCA Documents

| Document | 2013/14 dates | 2014/15 & 2015/16 dates |
|-----------------------------------|----------------------|------------------------------------|
| Interim consultation paper | 21 September 2012 | 30 August each year |
| Draft Determination | 15 February 2013 | 13 December each year |
| Final Determination | 31 May 2013 | 31 May each year |

For Energex, this proposed timing for the publication of the Draft Determination in 2014/15 and 2015/16 poses a number of risks, due to the tight timeframes within which Energex's draft prices would need to be prepared and the lack of alignment between the QCA's timing and the AER timing.

Under Chapter 6 (section 6.18) of the *Rules*, DNSPs are required to submit an annual pricing proposal to the AER at least two months prior to the commencement of the new financial year, i.e. 30 April. Final prices are not approved by the AER until 31 May.

In order to produce accurate, cost-reflective prices, Energex relies on several key inputs, for its Pricing Model, including, but not limited to:

- Designated Pricing Proposal Charges (DPPC), which are provided to Energex by Powerlink, are not available in time to be included in draft network prices. Under their contract terms, Powerlink is required to provide Energex with its Draft DPPC charges annually on 20 March;
- The Consumer Price Index (CPI) figure, which the AER requires Energex to base on the Weighted Average of Eight Capital Cities from March in year t-2 to March in year t-1. This information is made available annually around 24 April;
- Final audited information for under / over recoveries from previous years, including Distribution Use of System (DUoS) charges, DPPC, Capital Contributions and Solar PV. This information is not finalised or submitted to the AER until 15 November each year; and
- Only preliminary energy, consumer numbers and demand forecasts are available at the end of November each year.

To date, Energex has been required to submit draft prices to the Authority for inclusion in its Draft Determination at least six weeks prior to publication. Assuming this lead time continues, in order for the Draft Determination to be published on the 13 December 2012, Energex would need to submit Draft Prices to the Authority by the end of October 2012.

If Energex were to wait for all key inputs prior to issuing prices to the Authority to ensure no change was required, Energex would submit prices on 30 April 2013 for inclusion in the Authority's Final Determination; however, these prices would be subject AER Approval which doesn't occur until 31 May 2013. In future, with improved modelling capabilities, prices that are more accurate and cost-reflective may be available within a shorter timeframe.

Although Energex could estimate the various key inputs (as listed above) to produce Draft Prices only in time to meet the Authority's requirements, they would be based on many assumptions and subject to change. Once the actual values of the key inputs are known and fed into the Pricing Model, the Final Prices may vary from the Draft Prices. In Energex's view, acceptance by the stakeholders and consumers that Draft Prices and Final Prices may vary is necessary for the timings to be feasible.

5 Additional Matters for consideration

This section details additional matters Energex wishes the Authority to consider when determining regulated retail electricity prices for 2013/14 to 2015/16.

5.1 Capability of existing metering

Energex's current reliance on kW.h consumption-based charging for residential consumers is a direct consequence of existing metering capability limitations. Most small and residential consumers currently have single register kW.h accumulation metering which precludes the measurement of demand in kV.A and prevents ToU pricing.

Energex commenced the procurement of three-register ToU capable meters in 2005. Approximately 300,000 small consumers in Energex's region now have electronic meters that are both ToU and profile capable and are read as accumulation meters, with all new consumer connections receiving electronic meters.

These meters would not require a metrological change if they were reprogrammed for ToU tariffs and read manually as they are still being read as an accumulation meter. All meters currently procured by Energex are capable of being programmed with three-rate ToU data displayed and can be read as an accumulation meter.

At this stage, to support the adoption of the residential ToU tariff on 1 July 2012, where a residential consumer does not have a ToU capable meter but wishes to change to the residential ToU tariff, Energex will replace the meter at no cost to the consumer. However, there are still a large number of residential consumers who still have electro-mechanical meters with a single accumulation register.

For widespread adoption of ToU and / or demand-based tariffs for small and residential consumers, an accelerated roll-out of electronic interval meters is required. From a practical perspective, a phased roll-out would be required and Energex would consider various options such as first come basis, minimum threshold or on a geographical basis for any roll-out of three-register meters. A key consideration of the preferred option would be the availability and efficient use of resources to undertake the meter replacement program.

5.2 Consumer understanding of tariffs

In April 2012, Energex commissioned independent market research firm, Colmar Brunton, to undertake research into Queensland residential electricity consumer perceptions, issues and behaviours regarding reactions to the proposed new tariff structures (including Time of Use) outlined in the Authority's 2012/13 Draft Determination on Regulated Retail Electricity Prices. 1,972 consumers were surveyed.

Some of the key findings were:

- Only 10% of respondents claimed they know a lot about peak demand or the then available residential tariffs (Tariff 11 and controlled load tariffs 31 and 33), demonstrating a low level of knowledge and understanding of tariffs.
- Nearly half of respondents (48%) said they had never heard of or knew nothing about the then available residential tariffs.
- 53% of respondents indicated that they did not know what tariff was currently used in their household, with the lack of awareness significantly higher (79%) among residents 29 years and under.
- 67% of respondents aged 29 years or under indicated that they had never thought about their electricity tariff, with 25% of them indicated that they did not care about the tariff they were on.
- Only 39% of respondents were aware that the Queensland Government was announcing changes to the electricity tariff structure for 2012/13.
- With reference to Tariff 11, which is a flat rate, 44% of respondents thought that electricity used between 4pm and 8am was more expensive on that tariff.

Overall, the outcomes of the research indicates that, among consumers, especially those aged 29 years or under, there is a significant lack of understanding about the types of electricity tariffs and their structures. Moreover, for consumers aged 29 years or under, research indicates that there is little interest in electricity prices and, overall, a high level of disengagement. With growing public interest in electricity prices and extensive media coverage pertaining to prices, especially since June 2012, it is reasonable to expect that knowledge and understanding of tariffs will have increased among consumers.

At the time of the survey, only 13% of respondents indicated they had never heard of peak demand; this is likely to have decreased since then, but provides a good foundation for increasing awareness and understanding of Tariff 12 (residential ToU) with the view to improving the uptake in 2013/14.

Energex believes that it is reasonable to say that, among Queensland electricity consumers, more education about electricity tariffs is required to improve their knowledge and understanding. Not only will this cause consumers to be more aware of their electricity use and able to choose the right tariff for them, it will cause them to be more engaged with the process of establishing regulated retail electricity prices and drive better consultation outcomes.

In Energex's view, a consumer education and awareness campaign is critical to the success of any future tariff reform. As electricity retailers are the point of contact for consumers (i.e. their customers) in relation to electricity prices and tariffs, a successful campaign would be dependent on the support and cooperation of electricity retailers.

Energex submits that an integrated approach to a campaign, involving key stakeholders, would be the most effective way of ensuring successful implementation of future tariff reform.

6 Glossary

A list of acronyms and abbreviations used throughout this submission is provided below.

| | |
|---------------|---------------------------------------|
| A/C | Air-Conditioning |
| AER | Australian Energy Regulator |
| CPI | Consumer Price Index |
| DNSP | Distribution Network Service Provider |
| FRC | Full Retail Competition |
| kV.A | Kilovolt amperes |
| kW.h | Kilowatt hours |
| 'N' | Network charge/s |
| NEM | National Electricity Market |
| NUoS | Network Use of System |
| 'R' | Retail charge/s |
| The Authority | The Queensland Competition Authority |
| ToR | Terms of Reference |
| ToU | Time of Use |