Mr Charles Millsteed
Queensland Competition Authority
L19 12 Creek St
Brisbane QLD 4000
SENT BY EMAIL

Dear Mr Millsteed

Re: Regulated Retail Electricity Prices 2014-15
Interim Consultation Paper

This is Qenergy Limited's (QEnergy's) response to the Queensland Competition Authority's (the Authority's) interim Consultation Paper (the Paper) for setting regulated retail electricity prices for 2014-15. QEnergy is grateful for the opportunity to respond to this paper.

QEnergy is an established national electricity retailer based in Brisbane with customers in Queensland, New South Wales, Victoria, South Australia and the Northern Territory, specialising in providing retail electricity to small businesses.

As an overarching comment, QEnergy is worried that a continuation of the methodology used in the last two Determinations will continue to suppress competition in Queensland. We continue to argue strongly that there are not incentives to encourage new entrants (or existing retailers for that matter) to compete to win new customers – in a market which is framed as one where customers are offered a discount to a regulated tariff, offering very small discounts means customers remain on their existing arrangements.

There is a common misperception amongst consumers that transferring is a difficult task even though the reality is different. Small discounts (less than 10%) expressed in percentage terms, even though sometimes large in dollar terms, have proven in our experience to be insufficient to entice customers to switch in sufficient numbers to justify the allocation of sales or marketing activity.

QEnergy welcomes the recent announcement by the Government to remove price controls in South-East Queensland by July 2015. QEnergy will be ready to once again compete for customers in South-East Queensland once the main impediment (the current regulated tariff structure) is removed. We encourage the Authority to consider the insufficient headroom allowance in particular in the context of a market which when compared to the rest of NEM, has lagged behind in a competitive sense since the 2011/12 Determination.

QEnergy addresses specific sections of the paper below in turn.

Network Costs

The Authority seeks stakeholders' views on the following

(a) the suitability of Energex's network tariffs as the basis of retail tariffs for residential and small business customers;

Until the Community Service Obligation is moved from Ergon Energy Queensland to Ergon Energy Corporation Ltd the Uniform Tariff policy closes off competition in regional Queensland. Therefore the Energex tariff structure is the only option at this point.

(b) the suitability of Ergon Energy's network tariffs as the basis of retail tariffs for large customers and, in particular;

(i) whether notified prices for large customers should be based on network Charges in Ergon Energy's East pricing zone, Transmission Region 1 and, if not, what should they be based on?

(ii) what better options, if any, are there for the network charge(s)to be used as the basis for notified prices for very large Ergon Energy customers?

QEnergy has no specific comments here.

Network tariffs

The Authority seeks stakeholders' views on how best to maintain or improve alignment between network and retail tariffs for the purposes of setting notified retail prices.

QEnergy supports the Independent Pricing And Regulatory Tribunal Rule change proposal for the Australian Energy Regulator to publish the regulated network pricing at an earlier date.

Wholesale Costs

The Authority seeks stakeholders' views on the following:

(a) What improvements might be made to ACIL Allen's hedging-based approach for 2014-15?

QEnergy reiterates our previous comments that we believes that over the long-run, Long-Run Marginal Cost (LRMC) pricing will be delivered by the Queensland electricity market since this is the rational approach to electricity generation pricing. We therefore do not support the use of a solely market-based approach to estimating energy costs.

However, if the hedging-based approach is determined upon, QEnergy once again reiterates that ACIL Allen should use Power Purchase Agreement data available from retailers as an input into calculations. The Authority has the power to ask for these data for the purposes of making Determinations, and this approach has been used in South Australia from a retail contract price perspective. In our view, this means there are no reasons not to include these costs as a part of the wholesale electricity cost base.

(b) Is there any new information available to suggest an alternative approach might be better than the hedging-based approach for 2014-15?

Again, QEnergy reiterates our previous comments that over the long-run, LRMC pricing will be delivered by the Queensland electricity market since this is the rational approach to electricity generation pricing. We therefore do not support the use of a solely market-based approach to estimating energy costs.

However, if the hedging-based approach is determined upon, QEnergy recommends that ACIL Allen adopt the 99% Probability of Exceedence (POE) forecast for costs rather than the 95% POE forecast. A review of QEnergy's approach to risk-management (and in particular our Earnings-at-Risk modelling, the key determinant of what risk is taken and what risk is not) shows that since inception, the modelling, limit setting and measurement has been outworked at a 99% POE level.

This is not an unduly conservative approach but reflects the level of experience of QEnergy's risk management oversight team (at executive and Board sub-committee level), which includes five experienced traders who have all run electricity books of greater than $1bn.

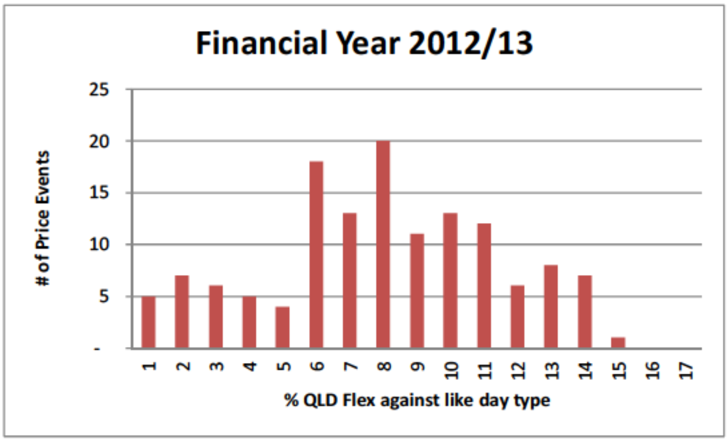
Further note that the Australian Energy Market Operator (AEMO) volatility factor for Queensland – used as an input into the prudential capital required to operate in each jurisdictional market – is now the highest in Australia, providing further evidence that the riskiness of the Queensland wholesale market should be compensated through higher risk premia.

(c) What factors should ACIL Allen take into account when determining modelling inputs such as customer load forecasts, plant outage scenarios, hedging strategies and spot price forecasts?

As noted in previous submissions, QEnergy believes that the daytype allocation methodology utilised by ACIL Allen significantly underestimates the correlation between load and price spike outcomes in the retailer dataset. Whilst the ACIL Allen price series may show an appropriate number of spikes, the coincidence of additional high prices and higher than usual load outcomes (ie the highly correlated nature of the two flex outcomes) is not reflected. This would tend to have a significant dampening effect on the load-weighted average retailer pool price (and hence overall) cost of energy.

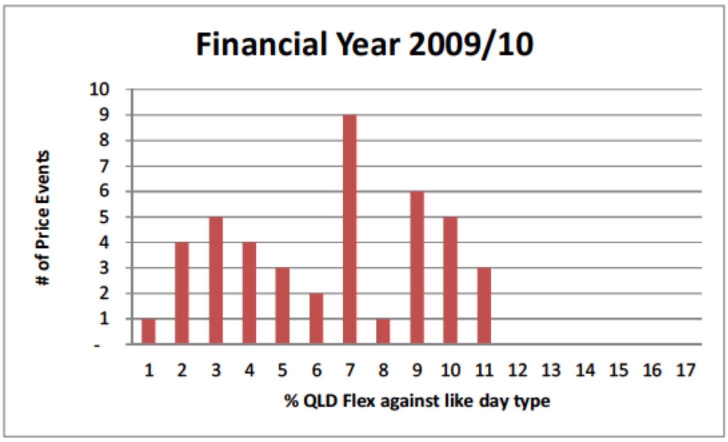
To demonstrate this, QEnergy examined actual outcomes for the 2012/13 financial year and averaged across each month the NEM regional consumption for each day of the week to form a daytype profile. Then, each day of the month was compared to this daytype profile to give some estimate of the load flex on that day.

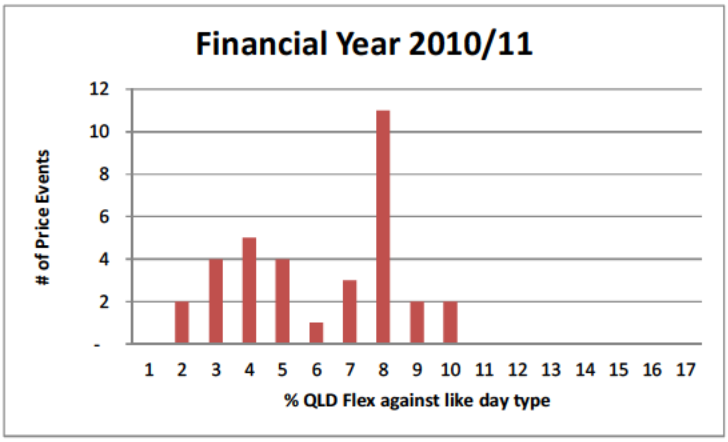
For the financial year, the number of observations of percentage flex (regardless of daytype) was then plotted against the number of price events above $300/MWh, which is charted below.

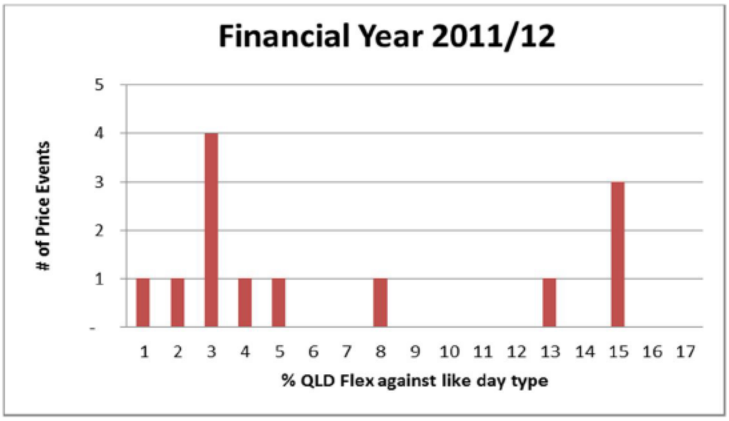


This distribution is significantly skewed to the right-hand side, demonstrating the high correlation between unusually high load-flex and high prices as well as the large number of high load-flex days.

Because of the period of the load set used by ACIL Allen, the same analysis was then done for the previous three years:







These charts show that there has been a change in the current financial year (possibly starting in the 2011/12 financial year) in the number and magnitude of high load-flex days. These were not represented in the dataset used by ACIL Allen which was significantly skewed by relatively mild weather in its earlier years.

Further, there has been a significant – and very material to retailers – increase in the correlation between the high load-flex days and high price events. This latter simply cannot be accurately reflected through a dataset derived from a methodology that does not take consecutive days temperature allocations into account (because it is consecutive days that make the difference in load flex and price) but merely allocates individual days on a NEM-wide basis.

QEnergy would be glad to discuss this further with ACIL Allen should that be of interest.

(d) How best should the Authority account for carbon price uncertainty and the resultant potential lack of contract trading data?

Given uncertainty around carbon tax the approach to allocation of energy costs needs to be conservative to factor in that risk although we acknowledge that by the time the final decision is made, any uncertainty surrounding the carbon tax may have been largely resolved.

Environmentals

The Authority seeks stakeholders' views on the following:

(a) What improvements might be made to ACIL Allen's approach to estimating SRES costs for 2014-15?

QEnergy notes that the Small-scale Technology Certificate (STC) prices are generally trending upwards and recently reached record levels (currently trading above $39 / STC). We recommend using the clearing house price in future determinations.

(b) What improvements might be made to ACIL Allen's approach to estimating LRET costs for 2014-15?

(c) Is there any new information available to suggest alternative approaches might be better at estimating SRES and LRET costs for 2014-15?

QEnergy considers as per our submission for the last Determination that there should be an allowance for the forecast risk between the forecast percentage for the second calendar year within a financial-year Determination, and the ultimate outturn. In previous years the forecasting record has been absolutely woeful, viz:

When the 2011/12 Determination was made, the SRES percentage for 2012 was published by ORER (now part of the Clean Energy Regulator) at 16.75%, which was downwardly revised by ACIL to 9% in their calculations on the basis that the scheme was changing.

Announcements as to STP are given below:

Publication Date	***31/03***	***29/07***	***16/12***	***Final***
2012 SRES Percentage	16.75	20.87	23.95	23.96

At 1.43 times the original estimate, this was a forecast error of 43% from the non-binding STP in place at the time of the final Determination, and a forecast error of 167% from the estimate used by ACIL. Extraordinarily, there was no makegood to the final figure of 23.96%.

A similar issue occurred in the 2012/13 Determination. At the time when the Determination was made, the SRES percentage for 2012 was published by ORER at 7.94%.

Announcements as to STP are given below:

Publication Date	***30/03***	***19/10***	***Final***
2012 SRES Percentage	7.94	18.76	18.76

At 2.36 times the original estimate, this was a forecast error of 136% from the non-binding STP in place at the time of the final Determination. Again, there was no makegood to the final figure of 18.76%, and in both of these years electricity retailers rather than customers paid the Federal Government for compliance with these schemes.

Once again the same thing has occurred for the 2013/14 Determination. At the time when the Determination was made, the SRES percentage for 2014 was published by ORER at 7.69%. It is now, still not in final form, set at 8.98%. Further, at the time when the Determination was made, the LRET percentage for 2014 was published at 9.00%. The draft percentage now stands at 9.46%.

Whilst QEnergy expects that the Authority will deliver a pass-through mechanism to recoup this additional cost retrospectively, it still means that retailers are required to fund the additional component rather than customers. We consequently consider that a risk margin should be added to the percentage forecast for SRES and LRET targets for 2014/15 to take account of this systematic bias in the regulator's forecast performance.

AEMO Charges

The Authority seeks stakeholders' views on the following:

(a) What improvements might be made to ACIL Allen's approach to estimating NEM fees for 2014-15?

(b) What improvements might be made to ACIL Allen's approach to estimating ancillary services charges for 2014-15?

(c) Is there any new information available to suggest alternative approaches might be better at estimating these costs for 2014-15?

QEnergy has no specific comments to make here.

Prudential Capital

The Authority seeks stakeholders' views on the following:

(a) What improvements might be made to ACIL Allen's approach to estimating prudential capital costs for 2014-15?

(b) Is there any new information available to suggest alternative approaches might be better at estimating these costs for 2014-15?

QEnergy has noted in prior year submissions that the departure from the use of LRMC from the energy cost calculations implies a standalone retailer model. Whilst the Authority last year provided some compensation in cost terms for the provision of these prudentials, the Queensland wholesale market volatility has increased over the intervening period to the extent that retailers must hold additional prudential margin with AEMO in order to avoid being called to provide additional support overnight in the event of a cluster of high prices.

Because a retailer's cash flows are so volatile, the timing of payments – particularly receipts against Cost-of-Goods Sold (COGS) such as AEMO payments – is absolutely critical. A prudentials call by AEMO is required to be met in cash, effectively triggering a prepayment of this COGS item, which in itself can trigger a significant cash event for the business. For this reason overnight calls by AEMO must be avoided at all costs.

This means that the retailer must have excess prudentials on hand with AEMO. QEnergy has a limit-setting structure for Outstandings at Risk to ensure that at all times there is a prudentials buffer with AEMO, which in turn ensures that cash calls are avoided. This concept of compensation for the difficulties in managing access to capital (rather than cost of capital) has not been adequately accounted for in prior Determinations. QEnergy would be happy to discuss our limit-setting structures with the Authority and with ACIL Allen confidentially in more detail.

Energy Losses

The Authority seeks stakeholder's views on the following:

(a) What improvements might be made to ACIL Allen's approach to estimating energy losses for 2014-15?

(b) Is there any new information available to suggest alternative approaches might be better at estimating losses for 2014-15?

QEnergy has no specific comments here.

Retail Costs

The Authority seeks stakeholders' views on the following:

(a) Are there any compelling reasons why the benchmarking approach should not be used for 2014-15?

(b) Is there any evidence to suggest that retail operating costs have changed materially, making the 2013-14 values irrelevant?

(c) Is the Authority's 2013-14 approach to allocating the ROC allowance to retail tariffs cost-reflective?

(d) If not, what would be a more cost-reflective approach, and why?

QEnergy agrees that benchmarking is the best approach given the Queensland Government's stated intention to move to a price monitoring regime in 2015.

Retail Margin

The Authority seeks stakeholders' views on the following:

(a) Are there any compelling reasons why the benchmarking approach should not be used for 2014-15?

(b) Is there any evidence to suggest that the retail margin the Authority adopted for 2013-14 is not applicable for 2014-15?

QEnergy has no specific comments here.

Retail Margin to Tariffs

The Authority seeks stakeholders' views on the following:

(a) Is the Authority's 2013-14 approach to applying the retail margin to retail tariffs appropriate to use for 2014-15?

(b) If not, what would be a more appropriate approach and how would it be applied in practice?

QEnergy has no specific comments here.

Competition and Headroom

The Authority seeks stakeholders' views on the following:

(a) What is the impact of the Authority's 2013-14 Determination on competition in:

(i) SEQ in relation to residential and small customers; and

(ii) regional Queensland, particularly in relation to large customers.

(b) How could the Authority improve its assessment of the state of competition in SEQ?

The Authority is required to have regard to the effect of its price Determination on competition, and in QEnergy's opinion the Authority has failed in this regard as there is a clear relationship between retailer activity and the 2011/12 decision. QEnergy is a Queensland owned and operated retailer with the entirety of its staff located in South Brisbane yet does not actively market to customers in Queensland due to the lack of adequate headroom provided in the previous two Determinations.

The potential Queensland margin under the tariff is lower than elsewhere, which is why it does not make sense for us to deploy marketers in Queensland to acquire more customers. QEnergy would be glad to discuss our relative margin outturns to the Authority on a confidential basis.

This sentiment has also been reflected in public announcements by listed retailers AGL, Origin Energy and Australian Power and Gas.

From an industry perspective there are no advertisements from retailers in print, radio or on television, and direct marketing activity has ceased. All of this ceased shortly following the 2011/12 decision. In other words, the prime impediments to an otherwise healthy competitive environment have been the most recent regulatory price Determinations.

Transfer and switch rates are significantly lower than the rest of the NEM and have fallen over time, and a customer's ability to seek a better deal is not being driven by competitive outcomes but rather retailers who are seeking to retain customer numbers in a market with tight margins. There is very little acquisition activity being outworked because the cost of acquisition quickly erodes margin to the extent it is not worthwhile.

This contrasts directly with NSW where the regulated tariff has been set at a level appropriate to provide a level of healthy competition while still providing for an affordable fall back tariff for those who choose not to participate in the market.

(c) What information could assist the Authority in assessing the level of competition in regional Queensland for large customers?

(d) What impact are factors other than the Authority's price determinations having on competition in SEQ and regional Queensland?

Pass-through Mechanism

The Authority seeks stakeholders' views on how the Authority should apply a cost pass-through mechanism, and whether there is a need to apply such a mechanism when setting notified prices for 2014-15?

QEnergy supports the concept of a pass-through mechanism and would expect it to reflect the incorrect forecast percentages for SRES and LRET targets for the current Determination – and previous Determinations – as noted above.

We further consider that since this cost must be re-opened, and in recognition of the fact that retailers have systematically been required to fund this considerable forecast error for the last three Determinations, that the price used for SRES for the 2013/14 Determination should also be re-opened to reflect the fact that it had increased by the start of the Determination period to very close to the Clearing House Price as also noted above.

Tariff 11 transition

The Authority seeks stakeholders' views on whether there are any compelling reasons not to continue with the approach to transitioning Tariff 11 that was established in the 2013-14 determination.

QEnergy has no specific comments here

Obsolete tariffs

The Authority seeks stakeholders' views on the following:

(a) How should obsolete and transitional tariffs be increased towards cost- reflectivity, given the 10% increase applied in 2013-14?

(b) Any other suggestions on how customers might be transitioned to cost-reflective prices over the remaining six years of the transition period.

The Authority seeks stakeholders' views on whether access to transitional arrangements should remain open to all eligible customers.

QEnergy has no specific comments here.

Once again, QEnergy is grateful for the opportunity to comment on this paper and remains very willing to discuss any aspect of the Determination or our comments with the Authority or with ACIL Allen should that be of interest.

Yours sincerely

[redacted]

Kate Farrar
Managing Director