Ref: CP

9 December 2011

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Dear Mr Hall

**RESPONSE TO THE QUEENSLAND COMPETITION AUTHORITY'S DRAFT METHODOLOGY PAPER: REGULATED RETAIL ELECTRICITY PRICES 2012-13**

Ergon Energy Corporation Limited and Ergon Energy Queensland Pty Ltd, collectively referred to as Ergon Energy, welcome the opportunity to provide a response to the Queensland Competition Authority's Draft Methodology Paper: Regulated Retail Electricity Prices 2012-13.

Should you require further information, please contact Jenny Doyle, A/Group Manager Regulatory Affairs on (07) 4092 9813.

Yours sincerely

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# Ergon Energy Corporation Limited and Ergon Energy Queensland Pty Ltd

**Response to the Queensland Competition Authority's Draft Methodology Paper**

**9 December 2011**

**Review of Regulated Retail Electricity Tariffs and Prices –
Draft Methodology Paper**

**Submission**

**Queensland Competition Authority**

**9 December 2011**

This submission, which is available for publication, is made by:

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**TABLE OF CONTENTS**

# 1.     INTRODUCTION

Ergon Energy welcomes the opportunity to provide comment to the Queensland Competition Authority (QCA) on its *Draft Methodology Paper on Regulated Retail Electricity Prices November 2011* (Methodology Paper).

**About this submission:**

In this submission Ergon Energy has focused on providing general comments in relation to the tariff reform process and provided detailed comment on each of the QCA's preliminary views and proposed approaches to determining the key elements of regulated retail tariffs and prices, where Ergon Energy considers it is relevant to comment.

This submission is provided by:

- Ergon Energy Corporation Limited (EECL), in its capacity as a Distribution Network Service Provider (DNSP) in Queensland; and

- Ergon Energy Queensland Pty Ltd (EEQ), in its capacity as a non-market area retail entity in regional Queensland.

In this submission, EECL and EEQ are collectively referred to as 'Ergon Energy'.

## 2. GENERAL COMMENTS

Ergon Energy welcomes the Minister's Delegation to the QCA to determine the regulated retail electricity tariffs for 2012-13 based on a network (N) and retail (R) cost build-up approach. Ergon Energy expects that the new N+R framework will allow for the rectification of issues with the current retail tariffs (identified by the QCA in its 2009 Review of Regulated Retail Electricity Tariffs and Prices) and provide for enough flexibility to allow the market to respond to emerging issues, such as a carbon price and demand management initiatives. In addition, the N+R framework will allow for network signals to be sent directly to non-market customers, thereby presenting a significant opportunity for distribution businesses to achieve improved asset utilisation and, consequently, for managing the long-term growth of electricity costs for customers.[1]

Ergon Energy supports the development of cost reflective retail tariffs that allow for economically efficient competition to prosper, however the retail tariffs should not be priced in such a way as to penalise customers who have little alternative to accessing the regulated retail tariffs. Ergon Energy considers that the unique circumstances of customers in regional Queensland (i.e. Ergon Energy's distribution area) must be taken into account by the QCA in setting the regulated retail tariffs.

Ergon Energy notes that the QCA stated that "*there is little if any competition*"[2] in Ergon Energy's distribution area. While this statement is correct for residential customers, there is some level of competition for business customers in regional Queensland.

Under the N+R framework the network tariff must be the principal building block for setting retail tariffs. Ergon Energy considers that the R component should support network tariff price signals to the customer.

As the QCA has noted, the wording of the Retail Tariff Schedule (i.e. the Tariff Gazette) is to be determined by the Queensland Government. Ergon Energy considers that the Tariff Gazette should reflect the underlying regulatory arrangements applying to the N component (e.g. allow for the pass through of alternative control service charges) and will raise this matter, and any other relevant Tariff Gazette issue, with the Government accordingly.

Ergon Energy is pleased to note that many of our suggestions on how to calculate the R component are supported by the QCA and, as such, Ergon Energy has focused its response on those issues which we believe require further consideration by the QCA (refer to Section 3).

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[1] Ergon Energy notes the QCA has proposed to use Energex's network tariffs rather than Ergon Energy's network tariffs for the N component, to the extent possible.
[2] QCA (2011) *Draft Methodology Paper Regulated Retail Electricity Prices 2012-13 November 2011* p 13

## 3. SPECIFIC COMMENTS

### 3.1 Representative Retailer

As discussed in our *Response to the Queensland Competition Authority's Review of Regulated Retail Electricity Tariffs and Prices Issues Paper 5 August 2011* (Response to the QCA Issues Paper) Ergon Energy considers that a representative retailer would be the most appropriate basis to determine costs, as opposed to an actual retailer, as there is no standard retailer in Queensland from which to readily source information. Therefore Ergon Energy is pleased that the Minister's Delegation and Terms of Reference has clarified that the QCA is to consider the retail costs that would be reasonably incurred by an efficient, representative retailer.

Ergon Energy supports the QCA's view that the representative retailer is a mass market, non-vertically integrated, incumbent retailer with sufficient size to have achieved economies of scale and retails electricity on a standalone basis. These retailer characteristics were supported by Ergon Energy in our Response to the QCA Issues Paper.

### 3.2 Treatment of Network Costs

The QCA noted in its Draft Methodology Paper that *"under the N+R approach required by the Delegation, retail tariffs are to be calculated with reference to Energex's network tariffs. As a result, the number and structure of regulated retail tariffs will mirror Energex's network tariffs, to the extent possible"*[3].

Unmetered Supply Tariffs

In relation to unmetered supply tariffs, we take this to mean that the current Public Lamps Tariff (Tariff 71) will be amalgamated with the other unmetered retail tariffs, that is, Traffic Lights (Tariff 81), Watchman Service Lighting (Tariff 91) and Other Unmetered Supply to mirror the one Energex network tariff for unmetered supply (NTC 9600)[4].

There will be differences in the application of a single tariff to multiple customer types and as such, this may cause confusion for customers and stakeholders. For example, an unmetered supply customer that is taking supply for street lights will incur additional charges for the appliances, whereas a customer that is taking supply for traffic lights will not incur any additional charges. Therefore, while Ergon Energy previously agreed with the proposed QCA approach[5] of maintaining a one-to-one relationship between network and retail tariffs, it is Ergon Energy's preference that the QCA continue with individual tariffs for Street Lights (rather than Public Lamps as Street Lighting Customers is a defined term under the Queensland *Electricity Act 1994 (Electricity Act)*) and Watchman Service Lighting in addition to the Unmetered Supply Tariff. While we appreciate that these retail tariffs will have the same tariff structure and rates, having individual retail tariffs will allow for improved clarity for customers with respect to whether any additional charges may apply e.g. the street lighting alternative control services charge.

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[3] QCA (2011) *Draft Methodology Paper Regulated Retail Electricity Prices 2012-13 November 2011*, p 15
[4] Energex Letter to QCA dated 7 July 2011 available at http://www.qca.org.au/files/ER-Energex-Prop2012-13TariffStructure-0711.pdf
[5] Ergon Energy (2011) *Response to the Queensland Competition Authority's Review of Regulated Retail Electricity Tariffs and Prices Issues Paper 5 August 2011,* p 6

### 3.2.1 Suitability of Energex's Network Tariffs

#### 3.2.1.1 Large Customers

The QCA identified that Energex's proposed network tariffs can provide the basis for regulated retail tariffs for the majority of large customers (up to four gigawatt hours (GWh) per annum), however Energex does not currently include any published tariffs applicable for customers consuming more than 4GWh per year. Beyond this level of consumption, Energex calculates individually tailored network prices which are not publicly available. To address this gap, the QCA proposes that it could require Energex to calculate one or two network tariffs that reflect the average of its cost-reflective network tariffs for all of its very large customers. These average prices could then provide the basis for calculating regulated retail tariffs for these customers.

The QCA note that *"...only where there is no applicable Energex network tariff for a particular customer class should the Authority consider any other basis for establishing a network plus retail bundled tariff for that particular customer class..."* [6] Ergon Energy suggests that this interpretation of the Government's Terms of Reference is too narrow, and that the QCA has the opportunity to consider alternatives to Energex's AER-approved network tariffs. Ergon Energy believes that if there are particular customer classes that are not eligible to access regulated retail tariffs in Energex's area (i.e. large customers) then Energex's network costs and network tariffs are not appropriate for these particular customer classes, and consideration should be given to basing the regulated retail tariffs on an alternative network tariff.

Ergon Energy suggests that the regulated retail tariffs for customers using greater than 100 megawatt hours (MWh) of electricity per annum (i.e. large customers) should be based on Ergon Energy network tariffs. However, recognising the potential for financial impacts for customers from a move to full network tariff pass-through, and the Government's decision to not extend its policy to make large customers ineligible for regulated retail tariffs to regional customers, Ergon Energy suggests that the QCA consider the following options for alternative N components:

- For customers classified as SAC > 100MWh per annum (SAC Large) the N component be based on Ergon Energy East Zone Transmission Region 1 demand network tariffs (as applicable to SAC Large customers), noting that the price could be adjusted to take into account any Government policy requirements.

- For customers classified as Individually Calculated Customers (ICCs) or Connection Asset Customers (CACs) Ergon Energy could provide an average price of its ICC and CAC network tariffs to be incorporated into the applicable retail tariff. This option builds on the approach suggested by QCA in the Draft Methodology Paper (but in relation to Ergon Energy network charges not Energex network charges). An extension of this option would be to have separate tariffs for ICCs and CACs (based on the average prices of the ICC and CAC network tariffs separately).

Having the N component based on Ergon Energy's network charges would more closely represent the network price signals applicable to large customers in Ergon Energy's area and not those of a different network, which has the potential to create perverse outcomes.

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[6] QCA (2011) *Draft Methodology Paper Regulated Retail Electricity Prices 2012-13 November 2011*, p 16

Ergon Energy would welcome the opportunity to work with the Queensland Government and the QCA to develop appropriate alternative N components for large customer regulated retail tariffs.

### 3.2.1.2 Street Lighting Customers

As discussed in our Response to the QCA Issues Paper, Ergon Energy supports the use of Energex's network tariff 9600 as the basis for the new regulated retail tariff for street lighting and suggested that Ergon Energy's street light asset charge should also be passed through to customers[7].

The QCA stated in its Draft Methodology Paper that *"unless Ergon Energy is able to better articulate and substantiate their proposition, the Authority will not be taking up their suggestion to include some additional asset charge".*  The QCA also noted that "*Ergon Energy claimed that the street light asset charge was incorrectly omitted from the current regulated retail tariff schedule"* [8].  This is incorrect.

Ergon Energy's street lighting services have been classified as an Alternative Control Service by the AER. As such under Section 90 of the Electricity Act, the street lighting asset charges are considered a distribution non-network charge (s90(7)).  The Electricity Industry Code allows retailers to pass through distribution non-network charges under clause 4.13.6.  This will continue to be allowed under the National Energy Customer Framework, as per 9.2 of the Standard Retail Contract in the National Energy Retail Rules.

Ergon Energy recommends the Gazette wording be amended to ensure customers clearly understand that additional non-network charges apply in addition to the retail tariff for the supply of energy.  The QCA has noted that the eligibility criteria and tariff terms and conditions are a matter for the Queensland Government and Ergon Energy will look to raise this matter with them.

As noted above, it is Ergon Energy's preference that the QCA continue with individual tariffs for Street Lights (rather than Public Lamps as Street Lighting Customers is a defined term under the Electricity Act) and Watchman Service Lighting in addition to the Unmetered Supply Tariff.

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[7] Ergon Energy (2011) *Response to the Queensland Competition Authority's Review of Regulated Retail Electricity Tariffs and Prices Issues Paper 5 August 2011,* p 8
[8] QCA (2011) *Draft Methodology Paper Regulated Retail Electricity Prices 2012-13 November 2011*, p 17

### 3.2.1.3 Other Tariffs

<u>Card-operated Meters in Remote Communities</u>

Ergon Energy agrees with the QCA proposed approach to create a regulated retail tariff available only to small customers on card operated meters based on one, or an average, of the charges in Energex's small customer network inclining block tariff.

<u>Other unmetered supplies</u>

The QCA note that regulated retail tariffs 81 (traffic signals) and 91 (watchman service lighting), along with tariff 71 for street lights, align with Energex's proposed network tariff 9600 (flat – unmetered).  Ergon Energy maintains its support of the use of Energex's network tariff 9600 as the basis for the regulated retail tariff for traffic lights.

Ergon Energy notes that in regard to watchman service lighting, and similar to the charges for street lights, Ergon Energy (like Energex) has additional charges for the installation and maintenance of the actual watchman light assets that apply in addition to the tariff for the supply of energy.  Ergon Energy recommends the Gazette wording be clear that charges apply in addition to the regulated retail tariff and as discussed above, a separate retail tariff for Watchman Service Lighting and Street Lights be maintained.

The QCA has noted that the eligibility criteria and tariff terms and conditions are a matter for the Queensland Government and Ergon Energy will look to raise this matter with them.

## 3.3 Energy Cost Component of Retail Tariffs

### 3.3.1 Estimating Wholesale Energy Costs

Ergon Energy supports the QCA's conclusion that a market-based approach (based on an assumed hedging strategy) is the preferred method for assessing the wholesale energy costs likely to be faced by retailers.

The QCA has noted that there are some concerns regarding the current lack of trading in forward electricity contracts and, guided by advice from ACIL Tasman (ACIL), has concluded that, while preferring to follow a hedging based approach, an alternative approach which does not rely on the availability of contract market data will be required to calculate retail tariffs for 2012-13.

The QCA has stated that it intends to rely on the ACIL proposed approach to estimate the wholesale energy costs for 2012-13. In general terms, ACIL's proposed approach is to estimate the price that a retailer would be willing to pay in purchasing energy to meet the load of customers while mitigating a range of risks, principally those flowing from the impacts on the spot price of weather and plant outages.

#### 3.3.1.1 ACIL's Approaches to estimating Wholesale Energy Costs

ACIL investigated four approaches to calculating wholesale energy purchase costs in its *Draft Methodology for Estimating Energy Purchase Costs* (ACIL Paper). While acknowledging that there are issues with all of the approaches ACIL concluded that a market based approach (Approach 2) is the best long term solution but that, due to a lack of liquidity in the contract market, an annual price distribution methodology (Approach 3) should be used until liquidity returned.

Ergon Energy notes ACIL's arguments for rejecting the use of the long run marginal cost (LRMC) of supply (Approach 1) and the combination of LRMC and market based approaches (Approach 4) as outlined in the ACIL Paper, particularly that the representative retailer is not vertically integrated with generation and therefore not exposed to LRMC except to the extent that this is passed through in the contract market.

Ergon Energy notes the difficulties in finding enough reliable data for the financial year 2012-13, particularly in the second half of this financial year. This has lead ACIL to the conclusion that Approach 3 – annual price distribution – is the best approach for the short term. Ergon Energy does not agree that this approach is the best way of resolving the data issues which is facing the market. This approach introduces a number of issues around cost-reflectivity, consumers and retailers' right to benefit from competition, stable costs, transparency and risk management as outlined below.

*Cost-reflectivity*

Retailers, especially the representative retailer as defined by the QCA, cannot sustain large movements in their cash flows as they lack the balance sheet of their generator counterparties. This means that retailers need to hedge for costs each year. While a generator can (typically) take the bad years where the under-recovered cost flows through to the balance sheet, this is not the case for retailers. This means that the retailer is much more concerned with contract prices than long term spot prices which they seek to have little exposure to.

The other issue with cost-reflectivity is the amount of issues which could fundamentally alter the market, particularly in Queensland, for the financial year 2012-13 including:

- The new Queensland Government-owned Corporation generator structure will only be in its second year;
- The carbon legislation has been passed and is planned to be introduced on 1 July 2012; and
- There has also been an increase in energy efficiency and an increased uptake of solar by electricity users, which in turn has contributed towards the weakening of electricity demand.

These contribute to a level of uncertainty which is difficult to account for in a market simulation model.

*Consumer/Retailer Benefits*

The annual price distributions (to be undertaken by ACIL in its preferred approach) will only take into account the competition on physical supply and demand. In recent years (gradually since 2008) the prices for financial hedges have decreased which should benefit consumers as well as retailers. Ergon Energy recognise that there may well be a strong link between the physical and financial market, however we also recognise that this may not be perfectly correlated and in most quarters there is a negative correlation (if the financial prices were high, generators contracted more and will be generating more which reduces the pool prices). This creates a mistiming of cash flows for the retailer.

*Stable costs*

The annual price distribution method is suggested only in response to the lack of market liquidity and would therefore fall away once the market has recovered. There is, however, no guarantee that the visible market will recover in time for the next retail tariff price determination which could lead to the continuation of the same issues being faced for 2012-13. This would add an additional year of revenue uncertainty and also potentially cause a large swing in the energy purchase cost component of the tariff. A market simulation model is very sensitive to short term changes in behaviour, and if these changes are modelled across scenarios where the behaviour did not occur (i.e. the behaviour is driven by temporal demand but repeated across all demand scenarios), this could lead to spurious and volatile results.

*Transparency*

The modelling has a large number of very subjective inputs which could materially alter the outcome and the lack of transparency of the modelling would make it difficult to establish whether an argument is correct or incorrect. This is an issue with any market model including the one used to date for the Benchmark Retail Cost Index (BRCI), however in the past the market model has only provided a small amount of exposure, most of which would have been covered by $300 caps (one way hedges). The lack of transparency would be more serious if it covered the entire wholesale energy purchase amount.

*Risk Management*

The last problem is predictability and risk management. In uncertain times, the representative retailer may want its trading strategy to match its revenue (tariff) and costs (energy procurement). If a market simulation model is used, the retailer will not know what the price (revenue) will be until close to the start of the period.  A contract market approach would allow the retailer to contract ahead of time with confidence that it will be compensated for its costs.

### 3.3.1.2  Market Liquidity

The main reason why the market based approach was not adopted for 2012-13 was the lack of liquidity of financial contracts in the market.  The lack of transparent deals is mainly due to retailers preferring to hedge using the carbon pass-through addendum which is not available on the Sydney Future Exchange (SFE).  This has lead to an increase in the number of direct or broker negotiated deals done in the market.  The uncertainty around carbon has also meant that some financial intermediaries have left the market.   These intermediaries would have traditionally been supplying liquidity through SFE deals.

In the first two quarters (Q3 2012 and Q4 2012), there has been more than 4,000 megawatts (MW) of flat Queensland contract traded on the visible market already (as at 15 November 2011).  This volume should be enough to use for representative prices for 2012.  Therefore the largest remaining issue is in the back end of the financial year (i.e. Q1 and Q2 2013).  Even though the trades that retailers have entered into are not visible, it is reasonable to assume that they would have been done with reference to the visible curves.  If there was a large deviation from the visible market, the counterparties should have traded this deviation out.  This means that although there have not been many actual trades going through for the second half of the period, the forward market should still give a good indication of what a representative retailer's costs are.

### 3.3.1.3  Carbon Pricing

The other problem with using the market approach is whether to use carbon pass-through contracts or non-carbon pass-through contracts (clean contracts).  Each individual retailer will have a view on what is prudent and it is difficult to know what proportion of clean versus pass-through a representative retailer would have hedged.

The difference between the two curves, being carbon inclusive and carbon exclusive, could be material particularly if hedging occurred a long way from settlement.  However, it is not expected that $300 caps would be materially affected by carbon in the first few years.

The two curves could be calculated as follows:

- Carbon exclusive: One of the brokers, Tradition Financial Services (TFS) has published prices of contracts with the Australian Financial Markets Association (AFMA) addendum since 28 April 2010.  Though this would only represent two years of data when the final calculation is made during April/May 2012, this would be sufficient to represent the cost to a retailer.  As we do not have reliable data before April 2010, Ergon Energy proposes to use 70% book build in year two to year one and 30% book build from year one to present.

The average price of the TFS addendum curve would be uplifted by $23/tonne CO2-e multiplied by the average emission factor which is calculated by ACIL as part of the normal process (as per the BRCI) of calculating the spot prices. Please note that in case there is no carbon scheme, or the scheme gets delayed, there is no basis for adding carbon to the TFS addendum curve.

- Carbon inclusive: The alternative is to use the clean curve which is published by d-cypha with the book build strategy suggested by ACIL.

As it is difficult to tell which products a representative retailer would use, Ergon Energy suggests calculating both curves and the larger of the two numbers should be used.

### 3.3.1.4  Preferred Approach

Ergon Energy maintains its position that the QCA should use volume weighted average prices to determine the cost of energy, however while the market is illiquid a book build period could be used instead. In the past, the BRCI has used a straight line two year book build approach which might not reflect how a retailer actually builds its book. In the ACIL Paper, ACIL uses an approach to build up a book which basically has 20% of the book bought three to two years from the start of the quarter, 50% two to one year out and 30% less than one year out[9]. This book build approach seems more reasonable than the one used for the BRCI and Ergon Energy would suggest using it in the absence of enough liquidity to calculate a reliable volume weighted price. Ergon Energy considers that the actual hedge levels and the method for determining spot prices used in the BRCI (80th percentile, 90th percentile and 105% for caps) are reasonable.

Ergon Energy recommends that once liquidity returns (i.e. there are more flat contracts for Queensland published by d-cypha[10] than there is expected physical demand), QCA should revert to using a volume weighted average price instead of a book build period, and only look at d-cypha trades.

Ergon Energy also recommends that the QCA publishes its preferred hedging approach as early as possible, even if an alternative approach to estimating wholesale cost of energy is intended to be used for 2012-13. While recognising that the QCA only has a delegation to determine the regulated retail tariffs for one year, as the market typically hedges for a longer period than one year, advance notice of the QCA's preferred hedging approach would allow for a retailer that wanted to match its costs with the expected revenue to have something to base its hedging strategy off. This will allow retailers to manage some of their wholesale energy purchasing risks.

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[9] ACIL Tasman (2011) *Draft Methodology for Estimating Energy Purchase Costs*, p 20
[10] This assumes that the carbon inclusive curve published by d-cypha will be become more liquid once the carbon scheme becomes operational.

### 3.3.2    Customer Load Forecasts

The QCA has proposed to estimate energy costs by tariff class rather than allocating total energy costs uniformly across all tariff classes.  The QCA assert that this approach is better than a uniform approach as it will better approximate the proportion of a retailer's total energy costs incurred in supplying each tariff class.

The proposed approach would be achieved by relying on load forecasts for each individual tariff provided by Energex for the 2012-13 year and on the forecasts in Australian Energy Market Operator's (AEMO) Electricity Statement of Opportunities (ESOO) for the demand and consumption forecasts in each NEM region.  As a result of this approach there would be a unique cost of energy calculation for each regulated retail tariff.

The QCA position on individual load forecasting appears to be based on its view that the cost of supplying energy to a particular group of customers will be dependent on the load profile of that customer group[11].  Therefore in order to allocate energy costs to reflect these cost drivers, the QCA will have to rely on Energex data for the load profiles for its various tariff groups.

Ergon Energy disagrees with this view and strongly supports the use of the Energex Net System Load Profile (NSLP) and associated Controlled Load profiles to estimate customer load forecasts for the following reasons:

1.  Ergon Energy asserts that the Energex NSLP and associated Controlled Load profiles would better estimate wholesale energy costs faced by the representative retailer.  The QCA has proposed that the representative retailer is a mass market, incumbent electricity retailer that is not vertically integrated with an electricity generator.  A mass market incumbent would consider its energy purchasing based on its portfolio, not by tariff class.  As the Energex NSLP and associated Controlled Load profiles is used to settle the wholesale energy market for non-interval metered customers (primarily non-market customers) the use of these profiles is more cost reflective from a retailer's perspective than the proposed individual tariff profile approach.

2.  Recalculating customer load forecasts at a tariff level adds further complexity to the calculation of wholesale energy costs.  Further, this added complexity is not justified when there is a publicly accessible, robust calculation of the load profile of mass market customers in South East Queensland available (Energex NSLP and associated Controlled Load profiles).  The development of NSLPs came about due to the need for the AEMO to determine the amount owed by retailers due to second-tier consumers with basic meters. As such, AEMO[12] has already considered this issue and determined an industry-accepted solution.

    *"A basic meter (also referred to as a Type 6 meter) records the total amount of energy consumed at a connection point from the initial energisation of the meter. Periodical readings of basic meters are used to determine the energy used between two points in time. These energy values are then used to calculate the energy component of a consumer's electricity bill. For Jurisdictions with Full Retail Competition (FRC), AEMO uses this energy to determine the amount owed by a retailer due to the retailer's second-tier consumers with a basic meter(s).*

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[11] QCA (2011) *Issues Paper Review of Regulated Retail Electricity Tariffs and Prices June 2011*, p 30-31
[12] AEMO (2011) *Understanding Load Profiles Published From Msats Version 5.2*, p 5

*Energy usage measured by a basic meter cannot be used in its raw format for wholesale settlement purposes in the National Electricity Market (NEM). This is because the electricity market is settled on 30-minute trading intervals whereas a basic meter reading is a single reading spanning a period of time, from a single day up to several months. Several possible solutions were considered for resolving this issue prior to the introduction of FRC.*

*Two options considered were the use of interval meters for all second tier sites or the introduction of a mathematical process, called profiling, to approximate half hourly basic meter readings. This process effectively replicates the functionality of an interval meter and thus allows a Type 6 meter reading to be settled on the wholesale market. Jurisdictions and regulators agreed that for consumers of less than 160MWh/year (100MWh/year in Queensland and NSW & 150MWh/year Tasmania) the latter option was preferable as it was a more economically efficient metering solution."*

3.  As noted by the QCA in its Draft Methodology Paper, there was consensus amongst retailers that Energex's NSLP is the most appropriate source of data for customer load forecasts, while noting that some retailers suggested that the Energex NSLP should be adjusted to account for large customers moving onto interval metering (discussed further below). There was no public suggestion to deviate from this approach.

Ergon Energy is of the firm view that the most appropriate source of data for customer load forecasts for the purpose of calculating the regulated retail tariffs is the Energex NSLP and Controlled Load profiles. The market settlement profile is more appropriate than an alternative customer load profile (e.g. Energex network profile) as this is how the customer load is settled by the retailer and is therefore cost reflective from a retailer's perspective.

Ergon Energy also maintains its preference that a historical trend analysis approach should be adopted to forecast the Energex NSLP and Controlled Load profiles. The main reasoning behind this is that the annual ESOO publication tends to overstate the increase in demand (e.g. the most likely forecast (50% chance of exceeding) in ESOO has overstated Queensland demand every year).

To give effect to the Queensland Government decision that large customers (those customers that consume greater than 100 MWh of electricity per year) in Energex's distribution area will no longer be eligible for the regulated retail tariffs from 1 July 2012, all large customers in South East Queensland will need to source electricity supply under a market contract. It is expected that customers will have until 1 July 2012 to source a market contract.

Some retailers have suggested that the Energex NSLP would need to be adjusted to take into account large customers moving onto interval metering from 1 July 2012. It is Ergon Energy's understanding that the vast majority of Energex's large customers already have interval read meters installed and that the associated interval read meter data of these sites (both first and second tier) are being sent to AEMO to support market settlement processes (including profile preparation). As such, the Energex NSLP already excludes the vast majority of interval read meter customers.

Ergon Energy considers that the impact of the remaining volume of energy that large customers (without an interval meter) contribute to the NSLP would be immaterial and therefore question the validity of adjusting the Eneregx NSLP for cost of energy calculations.

## 3.4 Retail Costs

### 3.4.1 Retail Operating Costs

The QCA proposes to use the current retail cost allowance as a starting point and to benchmark that allowance against those recently accepted in other jurisdictions in order to test its reasonableness. The QCA also propose that where reliable information on individual components of retail costs is readily available, the QCA will consider adjusting its estimate to include those costs.

Ergon Energy maintains its position that the Independent Pricing and Regulatory Tribunal (IPART) decision[13] on retail operating costs is a reasonable approach upon which to set retail operating costs in South East Queensland, being the bottom up and benchmarking methodology. Additional adjustments for Queensland specific retail operating costs will then need to be incorporated. Ergon Energy suggests that the QCA consider the IPART decision in its deliberations on the retail cost allowance.

### 3.4.2 Retail margin

The QCA proposes to undertake an assessment of the appropriateness of the current retail margin of 5% in the context of margins adopted in other jurisdictions.

Ergon Energy considers that the retail margin should reflect the return that a retailer requires to attract the risk capital, from equity and debt providers, that is necessary to provide electricity retail services. Therefore any consideration of compensation for risks faced by a retailer with respect to the R component (retail operating cost, wholesale energy purchasing costs etc) should be accounted for in the retail margin, not in the individual cost components.

While we acknowledge that the QCA's suggestion to differentiate load profiles across tariffs was to assist with recovery of different wholesale energy purchasing risk between customer segments, this approach obscures the return to retailers. As outlined in our Response to the QCA Issues Paper Ergon Energy is of the view that a retail margin should be allocated to each Energex network customer class. This would allow for the differences in risk profiles between customer segments to be reflected in the retail margin and negate the need for additional premiums or allowances to be included in the individual cost components.

Ergon Energy also maintains its position that the retail margin for the representative retailer should be determined by assessing an appropriate systematic return (e.g. the analysis undertaken by SFG Consulting for IPART) rather than merely on the basis of benchmarking to decisions from other jurisdictions. Given the current volatility in financial markets where both the cost of debt and equity is increasing it is important to ensure the retail margin is providing appropriate compensation. A simple benchmarking exercise, even if the benchmarking was predominately weighted towards the recent IPART decision, would not adequately compensate for the current market volatility.

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[13] IPART (2010) *Review of Regulated Retail Tariffs and Charges for Electricity 2010-2013 Final Report*, March 2010

## 3.5 Setting the R component of retail tariffs

The QCA stated that "*with very few exceptions, the number and structure of regulated retail tariffs will mirror Energex's network tariffs*"[14]. Ergon Energy supports this view as it will provide for continued alignment between the underlying network structure and the retail tariff structure, except for the unmetered supply retail tariffs (refer to section 3.2).

Ergon Energy agrees with the QCA proposal that the cost of energy should be recovered through the variable, consumption-based component of each tariff and with the QCA proposal to adopt the same approach as IPART adopted with respect to the recover of retail operating costs as these views are consistent with our Response to the QCA Issues Paper.

With respect to the use of the term "interval meter" in relation to time of use tariffs[15], Ergon Energy notes that the term "interval meters" refers to those meters that are classified as Type 1-4 meters and are applicable to customers using over 100 MWh per annum. Customers using less than 100 MWh per annum are provided Type 6 meters which are time-of-use capable, not "interval meters". That is, the meters do not maintain half hourly data and as such energy consumption recorded by these meters are included in the NSLP calculations.

## 3.6 Other Issues

### 3.6.1 Transitional Arrangements

Ergon Energy is cognisant that transitional arrangements may be required by different customer classes. As the price impacts of the proposed changes will not be known until the QCA's Draft Report, we cannot make any detailed comments on this matter at this time. However it is important to stress that significant attention is given to transitional arrangements including comprehensive discussions with customers and stakeholders, including the Government.

Matters driving the argument for transitional arrangements for affected customer groups extend beyond price impacts to metering replacement, site audit and resource impacts on network businesses.

There is a need to ensure consideration is given to the transitional requirements for the farming and irrigation customer group as this group is unique in that there is a diversity of electricity usage across the state and the sector's operations vary geographically and seasonally. Therefore, given the complexity of this sector, Ergon Energy is commencing a stakeholder engagement program to better understand the impact of tariff reform. The transitional arrangements for this group may need to reflect the diversity of these customers.

Ergon Energy maintains our position that it is important to maintain cost reflectivity from a retailer's perspective from 1 July 2012 and therefore any transitional arrangements (e.g. introduction of a glide path to cost reflective tariffs) should be through a targeted Government rebate or scheme.

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[14] QCA (2011) *Draft Methodology Paper Regulated Retail Electricity Prices 2012-13 November 2011*, p 41
[15] QCA (2011) *Draft Methodology Paper Regulated Retail Electricity Prices 2012-13 November 2011*, p 42