16 April 2012

Mr Gary Henry
Director Electricity and Gas
Queensland Competition Authority
Level 19, 12 Creek Street
Brisbane Qld 4001

Dear Gary

DRAFT DETERMINATION REGULATED RETAIL ELECTRICITY PRICES 2012-13

Alinta Energy (Alinta) appreciates the opportunity to comment upon the Queensland Competition Authority's (the Authority) Draft Determination upon regulated electricity prices for 2012-13.

Alinta is an active investor in the energy retail, wholesale and generation markets across Australia. Alinta has over 2500MW of generation facilities in Australia (and New Zealand), and maintains over 670,000 retail energy customers in Western Australia, South Australia and Victoria with a commitment to growing its retail energy business in Australia. Alinta Energy Retail Sales was granted a licence to retail both gas and electricity in Queensland in March 2012, and has begun selling electricity to large use customers in the Queensland market. As yet, Alinta has not yet committed to entering the market for small use customers in the Queensland market.

Alinta would like to make the following key points in regards to the Authority's draft determination:

- Alinta agrees with the Authority that allowing a level of headroom is likely to promote competition in the Queensland electricity market.
- That any analysis of the level of headroom needs to be evaluated against the incentive properties of each individual component of the cost stack. In particular the reduction in the Wholesale Electricity Costs (WEC) allowance, and the decision to deviate from a LRMC approach to calculating the WEC, outweighs the allowance for headroom in the regulated price.
- The Authority's decision risks further entrenching the incumbents' position in the Queensland market at the expense of long term competition.
- 1 year price reviews adopted in the Terms of Reference to the Authority are unlikely to provide the best outcome for electricity consumers in Queensland and do not provide adequate certainty to retailers.
- Given the level of competition in the market the Queensland government should consider transitioning away from price regulation.

Alinta Energy Retail Sales Pty Ltd ABN 22 149 658 300
A Level 11, 20 Bridge Street, Sydney, NSW 2000 Australia
T +61 2 9372 2600 **F** +61 2 9372 2610 **W** alintaenergy.com.au

Headroom for competition

Alinta commends the Authority in recognising the importance of headroom when setting regulated electricity prices. However, it believes that allowing for sufficient headroom in regulated prices can be met via either of the following two approaches:

- To make a conservative determination on each component of the cost stack; or
- To allow for an explicit headroom component in the cost stack (which is the approach adopted by the Authority).

Regulators in other jurisdictions, while acknowledging the role that 'headroom' as a concept achieves, have not generally explicitly allowed for it in the composition of the cost stack. In order to adequately address the concept of headroom, some regulators have developed the methodologies that underlie each component of the cost stack in a conservative manner to allow sufficient head room.

Alinta does not necessarily believe that the Authority's approach to explicitly allowing a headroom margin is deficient, it does however believe that it needs to be evaluated in regards to what Alinta considers to be a conservative approach to key retailer controlled components of the costs stack. In particular, with the exception of networks costs, each component of the cost stack can conceivably fall within a range of reasonable values. In selecting the point in this reasonable range, erring on the side of caution is likely to further promote headroom without the need to explicitly account for it in the cost stack. Alinta's preference is that the Authority reconsider the WEC, Operating Costs and Retail Margin components of the cost stack so that they reflect values, while still falling within a 'reasonable' range, that best promote further competition in the Queensland electricity market.

Wholesale Electricity Costs

Of the most concern to Alinta is the Authority's determination of the WEC. As mentioned, while the Authority has incorporated an allowance for headroom, this headroom has been outweighed by the significant reduction in the WEC component (and any headroom that was previously available within this portion of the cost stack). The overall headroom under the revised methodology is therefore significantly lower (certainly from a new entrant perspective).

Alinta considers that any objective analysis of the level of headroom in the cost stack needs to be weighed against the overall impact of the change in individual components in the cost stack. As the Authority's approach to estimating the Wholesale Electricity Cost component of the retail tariff cost stack has moved away from a Long Run Marginal Cost (LRMC) methodology and therefore recognition of the long terms wholesale costs incurred by retailers, there is little incentive or headroom for a new entrant retailer to offer retail electricity at a competitive discount to the major incumbents, particularly when a tier two retailer prices in possible risks that arise from major structural variations to wholesale prices.

Impact on competition

Alinta is concerned that the Authority's draft decision will have a negative impact on competition. The restriction in headroom, in part driven by the absence of LRMC in the Wholesale Electricity Cost allowance, is likely to hamper the further development of a competitive market. Alinta is well placed to comment on this situation, as while it is committed to entry and activity in the Victorian and South Australian energy markets, it is yet to commit to the small customer Queensland market due to the level of uncertainty regarding the trajectory of retail prices.

Further, a regulated price without a sufficient level of headroom is likely to discourage active competitive strategies from tier 2 retailers, further entrenching the position of the large incumbent retailers in the market. In this regard we note that while the level of churn in Queensland shows an effective level of competition in the market, a significant amount of customer switching occurs from within incumbent retailers who offer their own standing customers market contracts.

Alinta is of the view that competition in the market, and therefore customers, are best served by competition from both 1st and 2nd tier retailers. Should the incumbents be allowed to dominate the South East Queensland market, then in the long run price competition among retailers will not be as strong as it would be in the presence of competitive 2nd tier retailers.

The single largest issue for tier two retailers is the level of regulated prices, and whether or not this level allows a new entrant to competitively enter the market and develop a business of sufficient size to compete with the larger incumbents.

Alinta encourages the Authority to particularly consider the impact of its draft decision on 2nd tier retailers and their ability to compete with the regulated price and the longer term impacts on competition and consumer benefit.

Shortcomings in the current regulatory framework and approach

Alinta acknowledges the Terms of Reference for this review required the Authority to determine regulated tariffs for a single year without special circumstance reopeners. Therefore, currently, there is no scope to consider a multiple-year price path, nor the opportunity to re-open tariffs post the final decision. Alinta would however like to reiterate its support for an expanded period for the setting of retail tariffs that would allow a determined price path for multiple years (ideally 3 years) with the opportunity for the pass through of unexpected changes in costs. We note that any pass-through mechanism should ideally be triggered for positive and negative impacts such as material changes to the Clean Energy Framework legislation to ensure that prices faced by consumers on standing contracts adequately reflect the costs of electricity supply at the relevant point in time.

Alinta encourages the Queensland Government to consider this issue in its Terms of Reference for the 2013/14 price review.

Future of price regulation

The Authority has concluded that the level of customers on market contract is evidence of sufficient level of competition in the retail electricity sector in Queensland. Given this conclusion Alinta believes it is timely to look to transition to a fully deregulated price setting process in the short to medium term. This will provide continuing benefits to consumers as more retailers enter the market driving electricity prices down and providing choice for customers.

Should you have any further queries in relation to Alinta Energy's submission, please contact Michelle Shepherd upon 08 9486 3762

Yours sincerely

[redacted]

Michelle Shepherd
General Manager Regulatory Affairs
Alinta Energy Pty Ltd