Ref: JD/JS

16 April 2012

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Dear Mr Hall

SUBMISSION ON THE QUEENSLAND COMPETITION AUTHORITY'S DRAFT DETERMINATION: 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 submission on the Queensland Competition Authority's Draft Determination: Regulated Retail Electricity Prices 2012-13.

Should you require further information or wish to discuss any aspect of this submission, please do not hesitate to contact me on (07) 4092 9813.

Yours sincerely,

[redacted]

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Encl: Ergon Energy's submission.

Ergon Energy Corporation Limited
and
Ergon Energy Queensland Pty Ltd

Response to the Queensland Competition Authority's Draft Determination
16 April 2012

Regulated Retail Electricity Prices – Draft Determination Submission
Queensland Competition Authority
16 April 2012

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

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1. INTRODUCTION

Ergon Energy welcomes the opportunity to provide comment to the Queensland Competition Authority (QCA) on its *Draft Determination on Regulated Electricity Prices 2012-13* (Draft Determination).

Ergon Energy strongly advocates the need for reform and supports the general direction in which the reform has progressed. Separating the network (N) and retail (R) components, introducing time-of-use price signals and removing obsolete and declining block tariffs, all contribute to enhancing the cost reflectivity of electricity prices.

However, the pace of change proposed for some tariffs presents significant challenges to Ergon Energy and specific customer segments, notably large energy users and the farming sector. This submission outlines where Ergon Energy believes the organisation or its customers would not be adequately prepared for specific changes by 1 July 2012. In these instances Ergon Energy is seeking a transitional period to allow adequate time to adjust. Key challenges include:

- Where customers are changing to a significantly different tariff structure it can take up to two years to complete the meter changes and to accumulate meter data to assist customer decision making.
- Ergon Energy needs time to effectively communicate with customers and customers will also need time to understand the impacts of the new tariffs and what changes are needed to their operations, where possible, to minimise price impacts. Ergon Energy believes this is especially relevant for changes to tariffs that impact large business, farming and irrigation customers.
- Ergon Energy is being uniquely impacted by regulatory changes in both distribution and retail, including tariff reform and the National Energy Customer Framework. To comply with these reforms Ergon Energy is making significant systems, processes and equipment changes within challenging timeframes.

Ergon Energy welcomes the opportunity to engage with QCA prior to the Final Determination to ensure that tariff reform delivers the original intention to achieve cost reflective pricing, while minimising unintended consequences and ensuring customer, metering and systems readiness.

About this submission:

In this submission Ergon Energy has focused on providing general comments on the impact of the tariff reform process on customers, metering and the need for transitional arrangements, giving detailed comment on each of the QCA's preliminary views and proposing 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'.

- Where cost impacts are quoted they are based on EEQ customers only.

- Where reference is made to Large customers this represents the large business customers of EEQ.

Specific customer impact modelling will be made available to QCA. Ergon Energy will work collaboratively with QCA on the evaluation and interpretation of this modelling. This information is confidential to protect customer privacy and not available for public release.

2. GENERAL COMMENTS

Ergon Energy accepts the Ministerial Direction to the QCA to reform regulated retail electricity tariffs based on an N+R cost build-up approach and continues to support such an approach provided price issues and transitional requirements are effectively addressed.

The Ministerial Direction stresses that QCA "must consider the impact of price rises on consumers when determining regulated prices".[1] Accordingly, Ergon Energy believes that QCA must develop appropriate transitional arrangements to accommodate potential billing issues due to metering restrictions or where customers might experience a significant price shock.

Customer considerations

Customers need to be able to make informed decisions about their retail tariffs. Accordingly, customers require adequate notice of new tariff structures and pricing, particularly where there is a new component (e.g. demand), to allow them to adjust their personal or business arrangements to best manage the impact of the new regulated retail tariffs. Therefore, a comprehensive customer communication and engagement program will be required to ensure that customers are fully aware of the tariff reform changes and their response options.

For EEQ's Large customers (and some unique tariff classes e.g. farming tariffs) it is critical that QCA turn its attention to developing prudent transitional arrangements. The majority of Large customers in the Ergon Energy distribution area are not on demand based retail tariffs. As a consequence there is no demand profile for these customers making it difficult to make informed decisions about what will be the most appropriate tariff in the new structure. Customers will need at least 12 months of data to have confidence in choosing a tariff and will require further time to make suitable adjustments to their business operations.

Metering considerations

The Draft Determination details significant structural changes to retail tariffs which will impact on the metering installation of customers and the responsibilities of Metering Providers.

The ability of customers to transfer to tariffs that require meter changes will depend on both the availability of meters and installation schedules. The number of current sites impacted by the proposed changes is significant and beyond the resource capability of Ergon Energy to address by 1 July 2012. For example, changes to farming and large business tariffs could require site visits to between 7,000 and 10,000 installations. A meter audit, modification and replacement program in these customer segments may take up to 12 months.

Any metering change or modifications at customer sites may require additional work to the customer's installation that will create a financial impact on the customer concerned and delay the metering change or modification.

[1] QCA (March 2012) Draft Determination Regulated Retail Electricity Prices 2012-13: Appendix A, page 94.

Price signalling

The reform agenda recognises the importance of sending appropriate price signals to customers to:

- assist in the management of peak demand thereby reducing the required investment in both network and generation assets; and
- promote energy conservation (that is, an overall reduction in energy consumed).

QCA should, as part of the reform agenda, ensure price signals from the existing tariff structures are not materially weakened. The difference between peak and off peak rates should still provide a financial incentive to customers to shift load outside peak times.

Ergon Energy conducts several, significant demand management programs across its distribution area. The proposed changes to tariff structures and their relative pricing will cause unintended consequences due to the dampened price signalling between peak and off peak rates and the removal of time-of-use pricing for Large customers.

It is acknowledged that Ergon Energy and Energex have a responsibility to continually enhance network price signals[2]. However, QCA must be cognisant that this outcome cannot all be achieved by 1 July 2012 given the time required for the network businesses to materially change their network tariffs and the new approach to developing the pricing of regulated retail tariffs. Therefore, QCA should ensure that transitional arrangements appropriately mitigate any unintended or weakened outcomes during the start up phase of the reform agenda.

Transitional considerations

Ergon Energy is cognisant of the tight timeframes that QCA has operated under to release the Draft Determination and the complexities to arrive at a new retail tariff schedule with new prices. However, it is now critical to focus on the transitional arrangements required to achieve an ordered implementation of the tariff reform agenda.

It is not possible to implement all of the proposed changes to tariff structures and pricing by 1 July 2012 due to the significant metering, system and customer impacts. A two year transitional period is required.

Ergon Energy seeks these transitional arrangements to allow customers to assess the impacts on their business and make any necessary changes to their business operations in order to mitigate the extent of significant tariff and price changes. Of particular importance is consulting with Ergon Energy in regards to its Large business, irrigating and farming customers.

Additionally, Ergon Energy is recommending retention of many of the existing tariffs to enable the transition.

The two year transitional timeframe is requested for select tariffs to ensure:

- Customers have sufficient time to assess their energy requirements and impacts on business operations and arrange remedial work to their electrical installations and operations (including equipment) where required.

[2] The network price signals embedded in the network tariffs will flow through to retail tariffs under the reform agenda.

- Transfer of customers to the alternative tariffs. This may involve metering audits, upgrading and replacement, alteration to meter reading arrangements and as noted previously, significant customer engagement, particularly for Large customers.
- Metering changes can be implemented progressively and cost effectively.
- Systems can be built to correctly apply tariff conditions. The Draft Determination varies from the tariff changes outlined in the November 2011 *Draft Methodology Paper re: Regulated Retail Electricity Prices 2012-13* (Draft Methodology). The majority of these variations directly (and uniquely) impact Ergon Energy, specifically for Large customers.

3. SPECIFIC COMMENTS

3.1 Regulated Retail Electricity Tariffs

Ergon Energy supports the intent to determine the regulated retail electricity tariffs for 2012-13 based on an N+R cost build approach. Ergon Energy expects that the new N+R framework will allow for the rectification of cost reflectivity issues with the current retail tariffs and provide opportunities for the market to transparently respond to emerging issues, such as the carbon price and demand management initiatives.

However, Ergon Energy has identified there will be material challenges in implementing all the outcomes of this significant reform process in a short time period. In particular, consideration needs to be given to practical matters such as allowing sufficient time to effect necessary metering changes, as well as customer considerations for those segments that will be significantly affected by the proposed changes. Large customers, in particular, require sufficient time to fully understand the impacts of the new tariffs and adjust their business operations.

Specific discussion of metering, customer and transitional considerations for each individual tariff are discussed below.

3.1.1 Residential Tariffs

Significant growth in peak demand in recent years through installation of appliances such as air-conditioners has reinforced the need for distinctive price signals in retail tariffs. The concern that Ergon Energy has in implementing the proposed tariff reform relates primarily to the impacts on residential customers on fixed incomes or experiencing financial hardship.

Tariff 11

Ergon Energy accepts the proposed changes to Tariff 11.

Customer considerations

Ergon Energy notes the proposal for an increase in the Service Fee. The proposed fixed charge component is almost three times higher than the current Service Fee in the Notified Prices. The fixed charge costs would significantly exceed the benefits from a lower energy consumption rate. Low income households are highly represented in this category of customer.

While high energy use consumers may benefit from transferring from Tariff 11 and accessing Tariff 12 or by reducing consumption, low energy use consumers, particularly low income households, will find it difficult to make any significant changes to their usage. (Note: Ergon Energy has an established hardship program to assist any customers who face difficulties paying their bills).

The impacts of the high Service Fee could be reduced through QCA reconsidering the introduction of a head room allowance (refer to section 3.3.4) and the fixed and variable components of the retailer's costs (refer to section 3.3.2.1). A further option would be for the Government to consider social policy options to ameliorate impacts on low income households or hardship customers.

Metering considerations

Nil.

Transitional considerations

The changes to Tariff 11 are able to be implemented on 1 July 2012.

Tariff 12

Ergon Energy supports the introduction of Tariff 12.

Customer Considerations

The benefits to residential customers from switching to the new time-of-use (TOU) Tariff 12 will be dependant not only on how much energy is consumed but when it is consumed and the ability to transfer load out of the higher priced peak period.

Metering considerations

Any residential customer in the Ergon Energy distribution area will require a new meter to be installed prior to accessing the TOU tariff. For the large majority of customers this will require submission of a Form A (compliance notice) by an electrical contractor.

Transitional considerations

The changes to Tariff 12 are able to be implemented on 1 July 2012.

Tariffs 31 and 33

Ergon Energy supports the basis of these tariffs but is concerned about the significant price increases.

Customer Considerations

Customers on these tariffs would incur cost increases above 25 per cent for hot water, swimming pool filter operation and other similar loads. The increase in the rates for Tariff 33 compounds any price increases customers experience from their primary residential tariff, although the removal of the minimum payment does benefit some small users.

The impacts of the significant price rise for controlled load could be softened through QCA reconsidering the introduction of a head room allowance (refer to section 3.3.4) and other wholesale energy costs as discussed in this submission.

Metering considerations

Nil.

Transitional considerations

The changes to Tariffs 31 and 33 are able to be implemented on 1 July 2012.

3.1.2 Business, Farming and Irrigation Customers

The impacts of the proposed tariff reforms are not uniform across the business, faming and irrigation segments. The challenge of the tariff reform process is the need to allow sufficient time for these customers to adjust their business operations in order to respond to the new tariff structures and prices. Too rapid an introduction could have detrimental consequences. Not only will individual operators be affected, but there could be flow on effects for the communities in which they are based.

Large customers may experience very significant increases in electricity costs, primarily driven by the increased fixed charge components and introduction of demand charges. The degree of reform for these sectors has been extensive. The three elements of the reform impacting this group of customers are:

- moving to the full Ergon Energy network tariff as the N component;
- using an average price for customers using more than 4GWh per annum; and
- reducing the tariff options available to these customers.

Individually these elements are significant but combined the impact makes it very difficult for these customers to understand and respond when the reform is implemented in such a short timeframe. Many are major employers in their regional communities and the cost increases may result in increased financial stress in the community.

The introduction of a dedicated set of tariffs for Large customers is a significant shift from the original framework outlined in the Draft Methodology. Consequently, the metering solutions for these tariffs are not in place for the vast majority of the customers impacted. Significant engagement is required to explain the quantum of the changes proposed, to undertake analysis of the options for the customer and then time for those options to be implemented. The ability to conduct this analysis may be delayed pending required metering changes. Congruently, the current systems development specification for modification of Ergon Energy's billing and data systems to accommodate tariff reform does not address the need for these tariffs by 1 July 2012. This means system readiness cannot be guaranteed for that date.

To clarify Ergon Energy's statement in the response to the Draft Methodology that the N component for Large customers be based on Ergon Energy's network tariffs, it should also be noted that Ergon Energy stated "the price could be adjusted to take into account any Government policy requirements"[3], in recognition of the potential financial impacts for customers that may result from using the full Ergon Energy network tariffs. Further, Ergon Energy stated "it is important to stress that significant attention is given to transitional arrangements including comprehensive discussions with customers and stakeholders, including the Government"[4]. As such, whilst it was Ergon Energy's intention that Large customers should transition to Ergon Energy's network tariffs over time, it is ultimately a matter of Government policy to determine the transition timeframe and the pricing principles for Large customers.

The current approach by QCA to apply a flat R component to each network tariff has had the unintended consequence of weakening some of the pricing signals of the Notified Prices. For example, there is no time-of-use component in any of the demand retail tariffs or a time-of-use energy only tariff for Large customers. Business customers that have arranged their operations around a time-of-use pricing structure (i.e. shifted demand to off peak hours) are likely to be

[3] Ergon Energy Response to the Queensland Competition Authority Draft Methodology Paper 9 December 2011, page 6.
[4] Ibid, page 16.

disadvantaged by moving to a demand only retail tariff (i.e. charged for high demand in the off peak). This outcome removes the incentive to customers to shift demand from the peak, compounding the problem of growing peak demand. Ergon Energy recommends QCA consider introducing a TOU demand retail tariff (similar to the current Tariff 43) and making a TOU energy tariff available to Large customers, with appropriate pricing signals, to encourage customers to operate in off peak hours.

In view of the issues raised Ergon Energy recommends that there be at least a two year transitional period to ensure metering is in place and to allow customers to make informed decisions. In addition, it is imperative that Ergon Energy is consulted on the final outcomes of this tariff review.

Tariffs 20 and 21

Ergon Energy is generally supportive of the proposed treatment of Tariff 20 and the removal of Tariff 21.

Customer considerations

Ergon Energy notes that the cents per kilowatt hour energy charge of Tariff 20 has reduced and therefore the majority of small business customers on Tariff 20 are likely to experience reduced electricity costs.

Large customers are unable to access this tariff. Existing Large customers will need to be moved to another tariff. Time will be required to educate the customers concerned, inform their decision making process, enable them to change business operations and effect the change to the new tariff.

Metering considerations

Large customer's metering will need to be demand enabled and to be read as a demand meter not a consumption only meter.

A metering change or modification may require additional work to the customer's installation (such as removal of asbestos, re-wiring etc) that will create a financial impact on the customer concerned and delay the metering change or modification.

Transitional considerations

All customers currently accessing Tariff 21 will be transferred to Tariff 20 on 1 July 2012.

Ergon Energy is seeking a two year transitional arrangement to transfer Large customers off Tariff 20.

Tariff 22

Ergon Energy is generally supportive of the proposed treatment of Tariff 22.

Ergon Energy recommends QCA improve price signalling by adding a time-of-use R component rather than a flat energy component to the network tariff for Tariff 22.

Customer considerations

Customer impact will vary depending on their current use of electricity in the off peak as the off peak rate has increased substantially (i.e. nearly doubled); while those customers using predominantly peak electricity will experience a price reduction of around eight cents per kilowatt hour.

Tariff 22 provides a weak time-of-use signal. The proposed pricing has only around two cents difference between the peak and off peak prices, which is unlikely to provide a sufficient incentive for customers to invest in operational changes to shift load into off peak hours or change consumption patterns.

As Large customers are unable to access this tariff existing Large customers will need to be moved to another tariff. Time will be required to educate the customers concerned, inform their decision making process, enable them to change business operations and effect the change to the new tariff.

Metering considerations

Large customer's metering will need to be demand enabled and to be read as a demand meter not a consumption only meter.

A metering change or modification may require additional work to the customer's installation that will create a financial impact on the customer concerned and delay the metering change or modification.

Peak demand considerations

Ergon Energy has been encouraging customers to move to Tariffs 62 and 22 (often with use of timers on appliances) aiming to shift load away from peak times. This is particularly so for customers on rural networks. The objective is to provide incentives to customers to encourage them to change appliances (i.e. box for spilt systems; solar hot water, replacing old fridges etc) and behaviour. Changes to time-of-use periods and the relativity between peak and off peak rates may restrict demand management options and result in increased capital expenditure.

Ergon Energy is currently running a Single Wire Earth Return (SWER) Savers program which provides incentives to customers to move load to off-peak periods and currently they gain the benefit of the differential in Tariff 22 (and currently Tariff 62) rates between peak and off peak of approximately 18 c/kWh. Under the Draft Determination that will change to a differential in Tariff 22 rates of 2 c/kWh between the peak and off peak periods.

Ergon Energy estimates that for its small SWER program alone the proposed changes puts in jeopardy expected reductions in demand and resultant savings in infrastructure investment of around $13 million over the next five years.

Within the current delegation QCA is allowed to take any other matter into consideration that it considers relevant. Ergon Energy believes QCA should consider the impact on

potential and current demand management programs, as the success of these programs will have a significant impact on future price rises for customers.

Transitional considerations

Ergon Energy is seeking a two year transitional arrangement to transfer Large customers off Tariff 22.

Tariff 37

Ergon Energy supports having a transitional arrangement for Tariff 37 customers and seeks a two year transitional timeframe.

Customer Considerations

Ergon Energy notes that a significant price rise of 20 per cent is proposed. Ergon Energy has not had sufficient time to obtain customer feedback on the impact of this price increase. Ergon Energy proposes to provide feedback to QCA on this issue prior to the release of the Final Determination.

The challenge for customers on this tariff is the need to allow them sufficient time to transfer to a new tariff and may require them to adjust their business operations. Noting that any cost increases will not only impact the individual operator, but in many cases could create problems for the communities in which they are based. Many are major employers in their regional communities and the cost increase may result in increased financial stress in the community.

Time will be required to educate the customers concerned, inform their decision making process, enable them to change business operations and effect the change to a new tariff.

Metering considerations

Metering considerations are dependant on the tariff the customer transfers to, noting that for Large customers demand enabled metering will be required. In addition, small customers currently on Tariff 37 will require their meter to be reprogrammed if these customers elect to move to the alternative TOU Tariff 22.

Transitional considerations

Ergon Energy supports the transitional arrangements suggested in the Draft Determination but considers that two years may be required for customers to change their business operations to enable transfer to another tariff.

Tariff 41

Ergon Energy supports the approach to Tariff 41.

Customer considerations

Large customers are unable to access this tariff. Existing Large customers will need to be moved to another tariff. Time will be required to educate the customers concerned, inform their decision making process, enable them to change business operations and effect the change to the new tariff.

Metering considerations

Large customer's metering will need to be demand enabled and be read as a demand meter not a consumption only meter.

Traditionally a three phase demand meter is utilised for Tariff 41 however, the removal of Large customers from this tariff may require sourcing of an alternative single phase meter for small customers post 1 July. In addition, the meter will require monthly reads to comply with tariff conditions, which will increase metering management costs to Ergon Energy.

A metering change or modification may require additional work to the customer's installation that will create a financial impact on the customer concerned and delay the metering change or modification.

Transitional considerations

Ergon Energy is seeking a two year transitional arrangement to transfer Large customers off Tariff 41.

Tariffs 42, 43, 44 and 53

Ergon Energy supports the introduction of demand based tariffs for Large business, farming and irrigation customers. However, Ergon Energy is concerned about the timeframes proposed for their introduction, the financial impacts on customers and the lack of time-of-use price signalling.

Ergon Energy recommends continued access to a TOU tariff for Large customers. It is considered that more detailed analysis on the benefit of TOU tariffs for Large customers is required during the 2012-13 year.

These impacts are unique to Ergon Energy due to the low level of competition in the Ergon Energy distribution area meaning many customers are unable to choose an alternative supplier[5].

Customer considerations

Large customers, without demand capable metering, will require time to determine their load characteristics once metering has been installed, to ensure that they are transferred

[5] QCA (March 2012): Draft Determination Regulated Retail Electricity Prices 2012-13, page 47.

to the most appropriate tariff for their operations and can adjust consumption patterns if required. This is because the network tariffs, upon which these retail tariffs are based, have rates which are self selecting – that is, the load characteristics of the customer determine which tariff is most appropriate.

There is no time-of-use component in any of these tariffs. Business customers that have arranged their operations around a time-of-use pricing structure (i.e. shifted demand to off peak hours) are likely to be disadvantaged by moving to a demand only retail tariff (i.e. charged for high demand in the off peak). This outcome removes the incentive to customers to shift demand from the peak, compounding the problem of growing peak demand.

EECL will consider the inclusion of a time-of-use component in its network tariffs for Large customers. However, it is a lengthy process to change the existing network tariffs. A transitional arrangement for Large customers should allow for the continuation of time-of-use signalling.

Metering considerations

Large customer's metering will need to be demand enabled and be read as a demand meter not a consumption only meter.

A metering change or modification may require additional work to the customer's installation that will create a financial impact on the customer concerned and delay the metering change or modification.

Other considerations

Ergon Energy previously suggested that the N component for Large customers be based on EECL network tariffs but did note in the response to the Draft Methodology paper that the Australian Energy Regulator (AER) approved prices may require adjustment to incorporate Government policy requirements, recognising the potential financial impacts that may ensue. Ergon Energy will work with both QCA and Government to address this issue.

The Draft Determination proposes that existing Tariffs 43 and 53 be altered to align with EECL SAC Large network tariffs and introduces eligibility rules regarding access to this tariff. To improve clarity for customers that are currently on these tariffs or may be required to move to these tariffs under the new tariff schedule, Ergon Energy recommends the new tariffs for Large customers commence at number 44 through to 47. The tariff numbering and naming could read as follows:

- Tariff 44 – Large Business Customer – Demand Small
- Tariff 45 – Large Business Customer – Demand Medium
- Tariff 46 – Large Business Customer – Demand Large
- Tariff 47 – Large Business Customer – Demand High Voltage (HV)

Transitional considerations

Ergon Energy is seeking a two year transitional arrangement to ensure metering changes are in place, to undertake customer engagement and education to determine

which tariff is most appropriate for the individual customer and to implement these new tariffs into billing systems.

Tariffs 54 and 55 - Individually Calculated Customers (ICCs) and Connection Asset Customers (CACs)

Ergon Energy does not support the introduction of these tariffs on 1 July 2012 due to the high customer financial impact.

As noted by QCA, Ergon Energy had proposed that the Notified Prices for ICCs and CACs could be based on an average of the network prices applicable to these customers. Ergon Energy agrees with QCA's assessment that using an average is problematic due to the variations in site specific charges applicable to individual customers. Ergon Energy's modelling of the indicative prices in the Draft Determination has proven that there are significant distortions to customer's costs.

An alternative tariff arrangement is required for these customers and should form part of the transitional discussion, prior to publication of the Final Determination.

Ergon Energy is not in a position to implement these tariffs on 1 July 2012 because this represents the introduction of a new retail billing structure.

Tariffs 62, 63, 64 and 65

Ergon Energy does not support the immediate removal of Tariffs 62 and 65 from the tariff schedule.

Ergon Energy agrees with the removal of Tariffs 63 and 64 provided Tariff 62 and 65 remain in place to transfer customers to for an interim period.

Customer Considerations

The reduction in off peak timings available to customers on Tariff 65 and an increase in off peak energy prices by moving to Tariff 22 will introduce a range of impacts for irrigation customers. Large farming customers who no longer have access to a TOU tariff and are proposed to move to a demand charge environment may see significant price impacts and will need time to transition to new arrangements.

Metering considerations

The removal of Tariff 65 requires customers to transfer to Tariff 22. This has effectively changed the peak/off peak timings for these customers from a 12 hour off peak arrangement to a 10 hour off peak timeframe. Therefore, timing changes are required at meter or ripple control level, dependent on meter type, to address the shift. These metering changes cannot be addressed by 1 July 2012.

Large business customer's metering will need to be demand enabled and be read as a demand meter not a consumption only meter.

A metering change or modification may require additional work to the customer's installation that will create a financial impact on the customer concerned and delay the metering change or modification.

Transitional considerations

Ergon Energy is seeking a two year transitional arrangement for Tariffs 62 and 65 to ensure appropriate metering solutions are in place where needed for Tariff 65 customers and to undertake effective customer engagement and transfer customers to alternative tariffs.

Tariff 66

Ergon Energy notes that the N component for this tariff will be Energex network tariff 8500 not 8300 as proposed in the Draft Determination.

Transitional considerations

Ergon Energy is seeking a two year transitional arrangement to change the tariff structure within billing systems and to undertake effective customer engagement and transfer customers to alternative tariffs.

Tariffs 67 and 68

Ergon Energy supports the removal of these tariffs from the tariff schedule.

Tariff 71

Ergon Energy supports this Tariff being mapped to the Ergon Energy unmetered supply network tariff. However, the introduction of a fixed charge on a $ per lamp per day basis requires significant system build and will not be ready by 1 July 2012.

Customer Considerations

Ergon Energy confirms that it did provide data to QCA to show impacts on Street Lighting customers. The actual changes to Tariff 71 will not, by themselves, cause significant financial impacts.

Metering considerations

Nil**.**

Transitional considerations

Ergon Energy is seeking a transitional arrangement to incorporate the additional change to the tariff structure within billing systems.

Tariff 81

Ergon Energy supports the removal of this tariff from the tariff schedule.

Tariff 91

Ergon Energy supports the proposed changes to this tariff.

3.2 Energy Costs

3.2.1 Wholesale Energy Costs

Ergon Energy is pleased to note that many of the suggestions on how to calculate Energy Costs are supported by QCA and, as such, Ergon Energy has focused its response on those issues which it recommends further consideration is required.

3.2.1.1 Approach to estimating Wholesale Energy Costs

Ergon Energy supports QCA's conclusions 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; and
- there is sufficient available market data to calculate a hedging-based approach to estimate energy costs for 2012-13.

Ergon Energy agrees with QCA that there is no reason to include Long Run Marginal Cost (LRMC) from the point of view of the representative retailer, which doesn't have generation assets, nor is it necessary to include LRMC in the Notified Prices in order to promote competition in Queensland.

Ergon Energy is of the view that the approach for determining wholesale energy costs for controlled load and unmetered supply tariffs could be based on a hedging-based approach rather than based on forecast pool prices for 2012-13. However, Ergon Energy is of the view that this is unlikely to result in a material difference for setting 2012-13 tariffs. Accordingly, Ergon Energy is submitting these comments to improve the methodology for 2013-14 process rather than being specifically for 2012-13 process unless the QCA and its consultant ACIL Tasman determine otherwise.

Specifically, concerning the controlled load and unmetered supply wholesale cost of energy methodology Ergon Energy comments that a retailer would not separately hedge the controlled and unmetered load. Therefore, a hedging-based approach could still be used to estimate energy costs because it would simply be the difference between the result of using the Energex Network System Load Profile (NSLP), and the Energex NSLP plus the Energex Controlled Loads and Energex Unmetered Supply.

Ergon Energy also notes that the premium added to the contract prices due to time to maturity seems highly arbitrary. There is no evidence given that this exists and the justification of relative balance sheets is not sufficient to argue this level of contracting premium. If there is a premium for contracting earlier, this will manifest in higher prices during these periods and therefore a higher trade weighted price.

3.2.1.2 Customer Load Forecasts

Ergon Energy supports QCA's conclusions that the Energex NSLP and two controlled load profiles be used as the basis for estimating energy costs for regulated retail tariffs for small

customers. Consequently, an adjustment to the Energex NSLP is not required as most large business customers in Energex's distribution area have already moved to market and therefore the impact of the remaining volume of energy that large business customers (without an interval meter) contribute to the Energex NSLP is immaterial.

As a general pricing principle, Ergon agrees with QCA that the Ergon Energy NSLP should be used where the underlying network tariff being used in the retail tariff is sourced from the Ergon Energy network tariff schedule.

However, the Ergon Energy NSLP profile results from being a mixture of residential and business customers, small and Large customers, and controlled load and unmetered supply. Accordingly, whilst this is the settlement basis for AEMO charging to Ergon Energy Queensland for all of its customers, it is not reflective of the customer load profile for Ergon Energy Queensland's Large customers as a collective, who are the only customers that will be charged tariffs based on the Ergon Energy NSLP.

A suitable alternative cannot be determined for the purposes of setting Notified Prices for 2012-13. For future consideration, a suggested approach would be to use representative curves constructed by using interval meter data from similar segments of large business customers that have interval meters installed.

Ergon Energy is pleased to note the better estimation of future demand from Powerlink and agree that this is the best objective source for demand forecasting. It is unclear why ACIL Tasman has deviated from previous calculations for the Benchmark Retail Cost Index (BRCI) and is only using the 10% probability of exceedence (POE) instead of a weighting of 90, 50 and 10 as has been done in the past. This will tend to overestimate the peaks and therefore the spot prices which in turn will artificially inflate the costs[6].

3.2.1.3 Hedging Strategy

Ergon Energy is supportive of the hedging approach taken by the QCA, including using the trade weighted prices which is a better reflection of the actual costs faced by the representative retailer.

3.2.1.4 Spot Price Forecasts

Ergon Energy accepts the use of the proprietary market model as the best way of estimating pool prices, while noting previous comments on the issues with using these models in the response to the June 2011 *Review of Regulated Retail Electrical Tariffs and Prices Issues Paper* (Issues Paper) and the Draft Methodology. Also of note is the use of POE 10 for Queensland which, as discussed above, will tend to overestimate the peaks and therefore the spot prices which will ultimately artificially inflate the costs. It is unclear why ACIL Tasman has deviated from its previous calculations for the BRCI.

[6] ACIL Tasman (March 2012), Estimated energy purchase costs for 2012-13 retail tariffs, page 15. Available on QCA website http://www.qca.org.au/files/ER-ACIL-EstCosts1213-DraftRep-0312.pdf

3.2.1.5 Energy Losses

Ergon Energy agrees that QCA should use the most recent transmission loss factors and AER-approved distribution loss factors that are available from the AEMO website at the time of preparing its Draft Determination.

As stated by QCA it has changed its approach since the release of the Draft Methodology Paper. QCA is now basing some tariffs for Large customers on Ergon Energy network tariffs and charges, and it therefore has also used the corresponding energy loss factors for the Energex and Ergon Energy areas in calculating the accompanying energy costs.

It is important to note that distribution loss factors are not attributable to a settlement class as described by QCA in its Draft Determination or by ACIL Tasman in *Estimated energy purchase costs for 2012-13 retail tariffs* (Draft report) but rather to a specific network tariff code. The QCA Draft Determination must be corrected for this outcome.

In regards to the loss factors specifically applying to all Large customers in Ergon Energy distribution area (i.e. Tariffs 42, 43, 44, 53, 54, and 55), the QCA Draft Determination highlights the energy loss factors are as detailed in the ACIL Tasman Draft Report, specifically noting that the energy loss factor for the Ergon Energy NSLP is 1.08%.

The ACIL Tasman Draft report states:

> *"The transmission loss factor for the Energex and Ergon Energy's east zone area is based on the average energy-weighted marginal loss factor for the Energex and Ergon Energy east zone TNI's. This analysis resulted in a loss factor of 0.98 percent for Energex and 4.61 percent for the Ergon Energy east zone.*
>
> *The distribution loss factor by tariff in the Energex area and the Ergon Energy east zone are taken from the AEMO Distribution Loss factors for 2011/12. The estimated transmission and distribution loss factors for the tariffs and tariff groups in the Energex area are shown in Table 4."*[7]

The ACIL Tasman Draft Report states that the energy loss factor for the Ergon Energy NSLP is 8%, where the distribution loss factor is 3.6% and the transmission loss factor is 4.2%.[8]

Ergon Energy has a number of concerns with the calculation of the loss factor for the Ergon Energy NSLP:

- As stated above, the Ergon Energy NSLP is not the appropriate reference as each network tariff category can have a different loss factor. That is, a generic loss factor cannot be applied to ICC, CAC and SAC Large as a collective as each of these categories generally have a different underlying network tariff.
- Ergon Energy agrees that the Ergon Energy Distribution loss factors (DLF) should be based on the AEMO Distribution Loss factors for 2012-13[9]. This report highlights the following results:

[7] ACIL Tasman (March 2012) Estimated energy purchase costs for 2012-13 retail tariffs, page 17.
[8] Ibid, page 18.
[9] AEMO (April 2012), Distribution Loss Factors for The 2012-13 Financial Year, page 6.

Network Level	DLF Codes East Zone	DLF to Apply in 2012/13
Sub-Trans. Bus	GESB	1.007
Sub-Trans. Line	GESL	1.016
22/11kV Bus	GEHB	1.018
22/11kV Line	GEHL	1.038
LV Bus	GELB	1.077
LV Line	GELL	1.078

- Each of the above DLF codes relates to specific network tariffs, for example, Ergon Energy's SAC Demand Large East Zone has a GELL DLF applied to this network tariff[10]. Therefore in constructing a retail tariff for specific customer categories, consideration must be given to the underlying network tariff used and the corresponding DLF.
- The same approach would be applicable for determining losses where Energex's network tariffs have been used as the N component.

3.2.1.6 Carbon Costs

Ergon Energy is supportive of using a "clean" (carbon inclusive) curve despite liquidity issues. The transformation of carbon inclusive to carbon exclusive prices purely based on cost of carbon multiplied by the intensity factor seems highly simplistic. Should the carbon exclusive number become relevant for price setting, it is advised that the market model be run again and new dispatch profiles are used.

3.2.2 Other Energy Costs

3.2.2.1 Queensland Gas Scheme

Ergon Energy will continue to liaise the Government with regard to the Queensland Gas Scheme.

3.2.2.2 Enhanced Renewable Energy Target Scheme

Ergon Energy agrees the calculation for Large Scale Generation Certifications (LGCs) is fair and representative and as such, accepts the proposed methodology. However, Ergon Energy believes the calculation methodology for Small Scale Technology Certificates (STCs) is sub optimal and not representative of the market and should be reconsidered.

It is Ergon Energy's opinion the current QCA proposal for the calculation of the allowance for STCs to retailers overstates the cost of STCs and is not representative of the costs a representative retailer faces in meeting the legislated liability. This is demonstrated by the limited volume purchased through the STC Clearing House at the mandated $40.00/STC.

It is Ergon Energy's opinion that the market for STCs is the most liquid market for Electricity Market participants and has operated in an efficient and transparent manner since its inception. While Ergon Energy previously suggested the $40.00/STC Clearing House price in its response

[10] Ergon Energy (released 10 June 2011) Ergon Energy Network Tariff Guide for Standard Control Services 1 July 2011 to 30 June 2012, page 26.

to the Issues Paper, this position has changed due to Ergon Energy better understanding how the STC market is developing over time.

Having participated actively in the STC market and having confidence in its operation and integrity Ergon Energy believes the methodology should be changed to a calendar month average with a timeframe for observable price from 1 January 2011 to 30 March 2012. The relevant STP would then be applied to the respective compliance period and applied to the 2012-13 financial year.

As can be noted from the table on page 23, there has not been one calendar month in which the price of STC has averaged the Clearing House Price. Further, it can be seen that as the market has gained in both confidence and number of participants, (which is comprised of liable entities under Small Scale Renewable Energy Target (SRET), installers, aggregators and financial market intermediaries i.e. commercial/investment banks), market liquidity has improved and consequently, the market price has fallen responding to market fundamentals. As such Ergon Energy believes the Clearing House price for STCs is no longer warranted.

The calculation methodology Ergon Energy proposes is detailed as follows:

Average of Small Scale Renewable Energy Certificates (SRECs)	
Month	**Price ($/SREC)**
Jan-11	$37.08
Feb-11	$38.78
Mar-11	$39.04
Apr-11	$32.93
May-11	$25.72
Jun-11	$21.76
Jul-11	$22.73
Aug-11	$27.46
Sep-11	$30.63
Oct-11	$30.11
Nov-11	$30.11
Dec-11	$32.45
Jan-12	$31.80
Feb-12	$30.85
Mar-12	$29.18
Average Monthly Price	$30.71
2012 STP	23.96%
2012 $/MWh	$7.36
2013 STP	7.87%
2013 $/MWh	$2.42
2012/13 $/MWh	**$4.89**

This proposal represents a more cost reflective methodology, which more closely aligns to the Queensland Government delegation to QCA to develop a more cost reflective tariff structure.

3.3 Retail Costs

3.3.1 Representative Retailer

Ergon Energy supports 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 the response to the Issues Paper and Draft Methodology Paper.

3.3.2 Retail Operating Costs

Ergon Energy accepts the position of using a differential approach for determining the Retail Operating Costs (ROC) for small, Large and very Large customers. Ergon Energy also accepts the view of QCA that a higher amount of ROC is appropriate for Large and very Large customers.

However, Ergon Energy notes that there are many issues with how QCA has determined the regulated retail tariffs for Large customers, in particular the substantial change in the methodology that is reflected in the Draft Determination. Ergon Energy considers that there is insufficient time for QCA to properly determine a regulated tariff based on this new methodology and questions whether it will produce an outcome in line with the Government's objectives under the uniform tariff policy.

3.3.2.1 Fixed and Variable Components

Ergon Energy does not support the benchmarking analysis undertaken by QCA to support its view that ROC should be treated as 100% fixed costs for the following reasons:

- The IPART determination clearly reflects the decision to split ROC as 75% fixed costs and 25% variable (that depends on the amount of electricity used).[11]
- It appears QCA is relying on its interpretation of the IPART's analysis rather than on IPART's actual finding by questioning the Spreadsheet Model – Information Request Excel template prepared by IPART and distributed to retailers early in the regulatory process (as published on the IPART website).
- Ergon Energy considers that the Excel template is poor evidence in its own right given the retailers could have stated that energy consumption is a more appropriate variable component in their response to the template.
- QCA notes that some retailers outsource their back office functions and are charged a fixed amount per customer account. However, in Ergon Energy's view outsourcing of these functions is not part of the definition of the representative retailer. Further, how these retailers structure their contractual payment with the outsourcing entity does not itself reflect how the underlying cost is incurred by the representative retailer.
- It is clear that for the purposes of undertaking the retail margin analysis SFG Consulting also relied upon the ROC split being 75% fixed and 25% variable[12]. In the SFG Consulting Report to IPART for the purposes of that determination it is noted[13]:

[11] IPART (March 2010), Review of regulated retail tariffs and charges for electricity 2010-2013 Final report, page 141.
[12] Ibid, page 120.
[13] SFG Consulting Report (16 March 2010) Estimation of the regulated profit margin for electricity retailers in New South Wales, page 13.

"As the proportion of fixed costs in a retailer's cost structure increases, so does the volatility of its returns. For the purposes of estimating the retail margin we require an estimate of operating leverage, computed as the proportion of expenses which are fixed versus variable.

"We incorporate an assumption that volume-related costs comprise 80% of total costs and incorporate a range of 75 – 85% in sensitivity analysis. This estimation is derived from estimates for energy purchase costs – provided by Frontier Economics – network fees, operating costs and customer acquisition cost – which have been provided by IPART – and depreciation and amortisation estimates provided by the standard retailers."

- Accordingly, the bottom-up retail margin calculation undertaken by SFG Consulting would also likely change if the fixed variable percentage for ROC is also changed.

Ergon Energy considers that QCA should use the IPART methodology unless the QCA has obtained confirmation from IPART that their determination was erroneous in its methodology for the fixed and variable split of the ROC allowance.

3.3.3 Retail Margin

Ergon Energy supports QCA's decision to uplift the retail margin for a representative retailer to be similar to the IPART decision, i.e. 5.4% of total allowed costs, inclusive of the margin. However, Ergon Energy does not support the use of this retail margin for all customer classes.

Ergon Energy stated in the submission to the Issues Paper [14]:

Ergon Energy considers that an appropriate retail margin should be first calculated for the representative retailer and then be allocated across the different customer segments for the purposes of determining an appropriate risk margin to add to each retail tariff.

In regards to allocating the risk margin across different customer segments, there are a range of factors which will influence the required retail margin pertaining to a customer. A retailer may elect to differentiate its retail margin within and between customer segments for a variety of reasons, for example credit risk of a smaller number of Large customers versus a large collective of small customers, load shape and also due to the average amount payable by each customer segment.

Whilst Ergon Energy did not raise this issue again in the Draft Methodology Paper, it is critical to reiterate this matter now as QCA has decided to materially change how it is determining the retail tariffs for Large customers in Ergon Energy's distribution area, in particular, using Ergon Energy's network tariffs, Ergon Energy NSLP and a specific retail cost for Large customers.

Applying the IPART decision on retail margin to EEQ's Large customers is not appropriate for the following reasons:

- The retail margin is considered substantially excessive when compared to what Large customers would be required to pay under market contracts.

[14] Ergon Energy (5 August 2011) Response to the Queensland Competition Authority Review of Regulated Retail Electricity Tariffs and Prices Issue Paper, page 29.

- As noted in the Draft Determination "a key point to note is that the Authority must determine regulated retail electricity prices for all small customers and Large customers (those using more than 100 MWh per annum), whereas regulators in other jurisdictions are required to set prices for small customers only"[15].
- As noted in the Draft Determination "the benchmarks from these jurisdictions are most relevant in providing information on the costs of supplying relatively small customers"[16].

The same protocol detailed in the Draft Determination to differentiate the retail costs per customer for Large customers should be applied to retail margin. The outcome is that the retail margin for Large customers should be significantly lower.

3.3.4 Head Room Allowance

Ergon Energy is pleased to note that QCA has adopted many of its suggestions for how to calculate the energy and retail cost components. In particular, Ergon Energy is supportive of the use of a representative retailer defined as a mass-market, stand-alone retailer of sufficient size to have achieved economies of scale and ensuring cost of energy is determined solely by reference to the wholesale electricity market.

Ergon Energy is concerned about the lack of consultation on the inclusion of head room into the Notified Prices. There has been no previous consultation by QCA nor was the matter mentioned in the Ministerial delegation. There was no suggestion in either the Issues Paper or the Draft Methodology that QCA was considering including head room in the Notified Prices.

Ergon Energy strongly suggests that QCA undertake a full consultation process on whether to include head room and if it is included, what the appropriate level should be.

3.4 Other Issues

As noted Ergon Energy is supportive of the tariff reform process and is cognisant of the need to continue to review network tariffs and the evaluation of price signals.

3.4.1 Tariff for Card Operated Meters

QCA has calculated an average of the first and second inclining block rates, weighted these by the levels of consumption, to arrive at a single c/kWh rate that will be applied to customers on card operated meters. Customers on card-operated meters will also pay the higher fixed charges that apply to Tariff 11.

The tariff decision for residential customers using card operated meters is based, in part, on the assumption that customers on card meters have access to controlled load Tariffs 31 and 33 at the same cost as for all other residential customers. In fact, this is not the case. Of the 4,378 card operated meters installed for Ergon Energy customers, only 1,305 are two element meters that allow a customer access to both Tariff 11 and controlled load Tariffs 31 and 33. This leaves over 3,000 card operated meter customers without access to these controlled load tariffs. This is unlikely to change in the near future as the meter manufacturer stopped making the two

[15] QCA (March 2012) Draft Determination Regulated Retail Electricity Prices 2012-13, page 52.
[16] Ibid.

element meter two years ago, and Ergon Energy has been unable to find a suitable replacement.

Ergon Energy does not believe it is fair and equitable to charge these customers a tariff based on the first and second inclining block rates when these customers have no opportunity to ameliorate their electricity costs by using controlled load tariffs. Accordingly, Ergon Energy recommends QCA set the flat rate tariff to match the first block of the Tariff 11 and consider reducing the proposed fixed charge.

Note: Card Operated Meters are only able to accept rates to two decimal places. Accordingly, the rate quoted in Appendix D of the Draft Determination will need to be amended.

3.4.2 Terms & Conditions included in the Retail Tariff Gazette

Ergon Energy will continue to liaise with Energex and the Government to determine the terms and conditions applied to retail tariffs in the Gazette.

3.4.3 High Voltage Discount in Retail Tariff Gazette

Ergon Energy notes the retention of the HV credit where a customer is on a low voltage retail tariff in the draft Retail Tariff Gazette. While the ultimate responsibility for the Gazette lies with the Queensland Government, Ergon Energy recommends that eligibility for, and the level of, this credit is reviewed to ensure that an appropriate level of discount is provided to customers taking supply on a HV connection.