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Mr Gary Henry
Queensland Competition Authority
GPO Box 2257
Brisbane QLD 4001

via email electricity@qca.org.au

Dear Mr Henry

RE: Draft Determination – Regulated Retail Electricity Prices 2012-13

TRUenergy welcomes the opportunity to provide comments on the Draft Determination – Regulated Retail Electricity Prices 2012-13 (the Draft Decision). We have concerns about some of the positions adopted by the Queensland Competition Authority (QCA), particularly in relation to wholesale energy costs and believe that Queenslanders will have access to less competitive retail electricity prices if the Draft Decision is finalised in its current form, contrary to the Delegation.

A competitive electricity market must be a key objective

Under the Electricity Act the QCA as the pricing entity must consider “the effect of the determination on competition in the Queensland retail electricity market.”¹ This is consistent with Minister’s Delegation to the QCA which notes that Queensland consumers should “wherever possible, have the opportunity to benefit from competition and efficiency in the market place.”² TRUenergy agrees with both of these statements and believes that over the long term, Queenslanders will be better off if they are served by a competitive retail electricity market, and hence this should be a key policy objective.

Over the last several years, the Queensland retail electricity market has been undeniably competitive, with TRUenergy and other retailers winning market share off the incumbent businesses and consumers being the ultimate beneficiaries. The notion that, in a competitive market, price regulation is required to protect consumers is not supported by industry, by economic theory or even by other regulators. IPART in NSW contends that “retail competition offers the best protection to customers that retail prices will not materially exceed the efficient cost of supply.”³ Given this context, it is disappointing that the Draft Decision imposes a heavy-handed regulatory approach that seeks to determine cost elements in detail.

Wholesale Energy Costs

As the Draft Decision outlines, the use of Long Run Marginal Cost (LRMC) has its drawbacks and the considerations of the ICRC in the ACT are outlined as a key reason for the QCA not adopting LRMC.⁴ However it is pertinent to note that the ACT retail energy market suffers from a lack of competition

¹ Queensland *Electricity Act 1994* (current), Section 90 clause 5 (a) (ii)

² The Hon. Stephen Robertson MP. Minister for Energy, *Electricity Act 1994 Section 90AA(1) Delegation*, September 2011, page 1

³ IPART, *Strengthening the Foundation for Australia’s Energy Future*, March 2012, page 17

⁴ See QCA, *Draft Determination - Regulated Retail Electricity Prices 2012-13*, March 2012, page 45

and the ICRC's terms of reference do not require it to further competition. This is vastly different to Queensland and we would caution against reliance on the ICRC.

As submitted previously, the annual price distribution method proposed by ACIL Tasman creates more problems than it solves. One weakness is that it is a "double black box" in that there is no link to actual forward market prices. ACIL appear to now agree with this, asserting that this approach provides "a reasonable estimate of a likely range of energy purchase costs in the absence of risk management" but conceding that "an inability to estimate the risk premium ... with any surety present drawback for the methodology."⁵ Use of this method to set the wholesale energy cost allowance is not prudent given it does not reflect rational retailer behaviour.

ACIL also acknowledge that "using a contract hedging approach still has the disadvantage of a thinly traded market for the first half of 2013 and the ensuing contract price uncertainty."⁶ However it then calculates such an approach which leads to the following problems:

- The use of only D-Cypha data for Q3 & Q4 ignores the reality that significant volumes of AFMA transactions occurred in these quarters. We understand that larger volumes of AFMA transactions have occurred than are presented by ACIL;
- A significant volume of AFMA transactions were conducted prior to 8th Nov 2011 for Q1 & Q2 and form part of the contract portfolio for many retailers;
- It is not reasonable to assume that retailers would not hedge their controlled loads/unmetered supply. Load is hedged from a portfolio perspective and risk management frameworks are unlikely to allow an unhedged position.

Using ACIL's published data and applying industry approaches, TRUenergy is unable to replicate either of the methods ACIL has calculated due to the black box nature of the annual price distribution method and lack of information provided by ACIL relating to its results on the contract hedging approach. One problem appears to be that ACIL have off-peak periods defined as peak. Another concern is that ACIL's hedging calculations appears to lower the cost of hedging to the retailer in anticipation of profits being made from actual spot price outcomes. A heroic assumption such as this would not be made by a prudent retailer and hence this method should not be adopted by the QCA.

Given the acknowledged problems with both the annual price distribution method and the contract hedging method, we recommend the QCA reconsider its decision to abandon LRMC, at least for 2012/13. Beyond 2012/13 there is likely to be a strong case to put more reliance on the contract hedging method. However given the market operator is predicting generation shortfalls in Queensland by 2013/14, it is reasonable to expect market prices to rise to at least LRMC in the near future.

The Minister's letter asks the QCA to "balance the long term need for maintaining pricing stability with ensuring customers are not subjected to unnecessary price volatility in the short term."⁷ TRUenergy believes LRMC best delivers this for 2012/13.

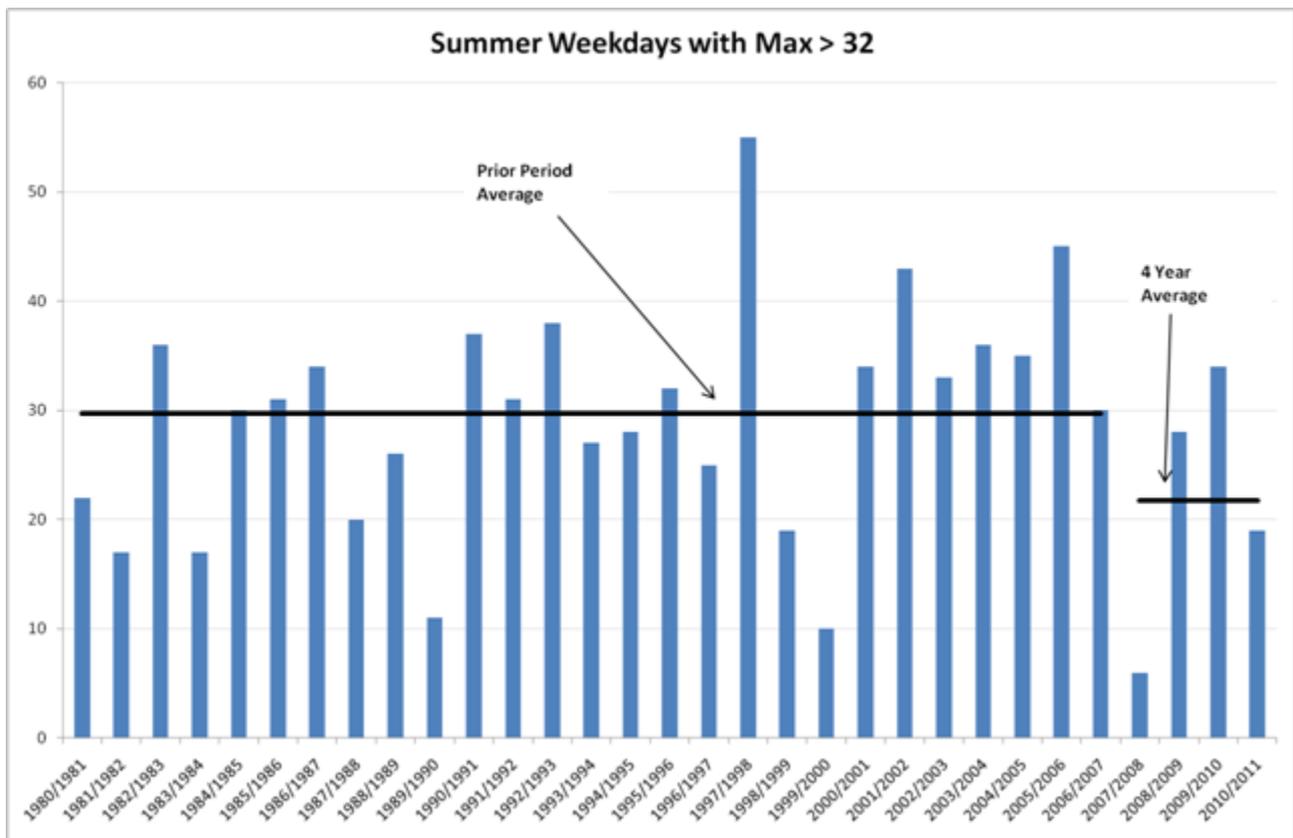
All market participants agree that new generation will be required in Queensland sometime between 2014 and 2016 and that the new generation required will only be built if the private sector is willing to invest. Setting an energy cost allowance below LRMC will make retailers unwilling to enter long-term forward contracts at LRMC, which in turn will diminish the willingness of private capital to invest in the new generation capacity that Queensland clearly requires. As a potential investor in new generation, TRUenergy again urge the QCA to reconsider creating further investment uncertainty and instead utilise LRMC as a floor price.

TRUenergy has previously raised concerns with the use of a single year of load data and this has now been changed to four years. Put simply, we believe four years is not enough, as evidenced by this graph showing the number of summer weekdays where the maximum temperature at Amberley exceeded 32 degrees centigrade.

⁵ ACIL Tasman, Estimated energy purchase costs for 2012/13 retail tariffs, March 2012, page 21

⁶ ACIL Tasman, Estimated energy purchase costs for 2012/13 retail tariffs, March 2012, page 21

⁷ The Hon. Stephen Robertson MP. Minister for Energy, *Letter to the QCA*, September 1 2011, page 1



A prudent retailer would not be hedging based only on the last four years.

With regards to energy losses, TRUenergy is concerned that losses have not been applied to all relevant categories.

Carbon

The Australian Energy Market Agreement was amended on 2 July 2009 to ensure that carbon costs be passed through to regulated retail tariffs in full.⁸ The projected average NEM emissions intensity for 2012/13 of 87% is below general market expectations and leads to wholesale price outcomes that are unreasonably low.

Representative Retailer

The Methodology Paper mistakenly used the current level of competition as a basis for adopting an incumbent retailer definition for the representative retailer and it is disappointing that this misunderstanding has been repeated in the Draft Decision.

As the Methodology Paper noted, the previous BRCI was an index not a cost build up approach as the new methodology will be. Critically, under the BRCI the "actual level of costs incurred by the representative retailer did not form part of the tariff"⁹ but under the new methodology it will. So the fact that the BRCI used an incumbent, standalone Queensland electricity retailer as the representative retailer is not particularly relevant to the current task. And for the Draft Decision to maintain the conclusion that the current market's competitiveness will continue if the BRCI definition continues to be used is a concern given that it has been previously highlighted to the QCA that this is asserting a cause and effect relationship that does not exist.

Retail Margin and Headroom

TRUenergy believes that the adoption of the same retail margin as IPART would be reasonable if the retail regulatory risks under the proposed model in Queensland will be similar to those under the

⁸ See MCE, *Meeting Communique*, July 2009, p1

⁹ QCA, *Draft Methodology Paper- Regulated Retail Electricity Prices 2012-13*, November 2011, page 8

current model in New South Wales. However we are concerned that this is not the case, due to factors such as:

- NSW has a more stable and predictable process with retail costs and margin set for three years, network tariffs as a pass through and annual reviews of the wholesale cost under a set methodology;
- NSW uses final network tariffs whereas in Queensland the Final Decision is made before network tariffs are finalised, exposing retailers to any network tariff variation;
- NSW has well defined cost pass through provisions to cover changes in legal and tax obligations such as the SRES; and
- NSW has an LRMC floor which greatly reduces the risk that a retailer cannot hedge for an amount equivalent to the wholesale cost allowance.

The QCA notes that it is unable to incorporate a cost pass-through mechanism in the Draft Decision. However the QCA goes on to claim that this is not a major concern in Queensland as there is only a one year price period. TRUenergy maintain this is a large issue, as evidenced by the SRES outcome for 2012. In setting the 2011/12 BRCI the QCA, on advice from ACIL, forecast the 2012 STP would be 9%, but the real outcome is 23.96%. The difference equates to an increase in retail costs of almost \$6/MWh for Jan-Jun 2012 that will not be recovered in retail prices. This is a major concern and represents a risk that is in no way compensated for by the 5.4% retail margin.

The Draft Decision includes an allowance for headroom of 5%. TRUenergy believes that if the cost elements underpinning the regulated prices were all set at reasonable levels that a potential competitor could match or beat and if the retail margin was adequate compensation for the operating and regulatory risks faced, a specific allowance for headroom would not be required to support effective competition. However, as outlined above, TRUenergy believes cost elements such as the wholesale energy cost have been set at unviable levels and the retail margin adopted is insufficient given the regulatory risks a retailer faces.

Given this context, the inclusion of an allowance for headroom is essential to ensure the proposed methodology has a chance of supporting a well functioning competitive electricity market. Indeed given the level of concern we have with various elements of the Draft Decision, we believe the headroom allowance, if anything, should be set at a higher level.

Conclusion

TRUenergy is a second tier retailer in Queensland and would like to grow its customer base. However we are concerned that the outcome of the Draft Decision will be a reduction in competition due in particular to the unreasonably low wholesale energy cost allowance.

In NSW, IPART notes that they "support the removal of price regulation in markets where competition exists."¹⁰ Where price regulation is considered necessary, it should be intended only as an interim measure accompanied by a transition to a competitive and efficient retail electricity market. An approach that leads to prices that are lower than efficient costs may lead to lower regulated prices in the short term, but will lead to a less effective market which is not in the long term interest of Queensland electricity customers.

Should you wish to discuss or clarify any of this before then please feel free to give me a call on (03) 8628 1120.

Yours sincerely,



Andrew Dillon
Regulatory Pricing Manager

¹⁰ IPART, *Strengthening the Foundation for Australia's Energy Future*, March 2012, page 17