Submission to QCA
Draft Determination Paper
Regulated Retail Electricity Prices 2015-16

February 2014

BACKGROUND

Ergon Energy Queensland Pty Ltd (EEQ) welcomes the opportunity to provide comment on the Queensland Competition Authority's (QCA) Draft Determination on Regulated Retail Electricity Prices for 2015-16.

EEQ is a proud Queensland company that provides electricity to more than 700,000 homes and businesses and helps regional Queenslanders manage their energy consumption. With our roots firmly entrenched in regional Queensland, we have a team of people servicing regional Queensland customers from our contact centres and offices located in Townsville, Rockhampton, Maryborough and Brisbane. We also firmly believe in supporting our local communities by providing regional jobs and engaging in community partnerships such as the Royal Flying Doctor Service.

EEQ acknowledges the increasing pressure electricity prices are placing on our customers' household budgets and businesses and support activity to create a cost-competitive market.

We are supportive of a competitive electricity market in Queensland and will eagerly observe the removal of regulated prices in the South East Queensland market from 1 July 2015 and the subsequent outcomes.

We acknowledge the challenges that exist around the Uniform Tariff Policy (UTP) with the removal of regulated prices in South East Queensland in 2015-16 and the State Government's future direction for the Queensland electricity market. We believe the requirements of the Delegation assist in ensuring that we remain on the pathway to achieving a competitive electricity market in regional Queensland.

In respect of the above, we believe a consistent approach to pricing needs to be applied to ensure we continue to transition along this path. We therefore support the QCA using the same methodology for pricing for 2015-16 as used in 2014-15. Further, EEQ supports tariff options that enable customers to respond to price signals, empowering them to take control of their energy costs either by load shifting or reducing total consumption.

In the remainder of this submission, EEQ has provided direct responses to each of the decisions from the QCA in its Draft Determination. We welcome the opportunity to discuss any aspects of this submission or to provide further information directly to the QCA.

Section 2 - Legislative Requirements and Pricing Framework

2.2.1 Residential and small business customers – Cost Base

Our draft decision is to continue to set notified prices based on the cost of supply in south east Queensland.

Response

EEQ supports this approach by the QCA on the basis that it is consistent with the UTP. However, EEQ's position remains that ultimately regional pricing structures should reflect EECL's tariff structures, but be appropriately supported by the UTP.

Affordability remains a key priority for EEQ and its customers, who continue to expect the electricity industry to operate in a manner that provides them with access to affordable electricity that meets their changing needs.

2.2.1 Residential and small business customers – Framework to determine notified prices

Our draft decision is to determine notified prices based on reasonable expectations of standing offer prices in south east Queensland. We will apply this approach by estimating the costs of supply in south east Queensland and adding a standing offer margin of 5% of total costs.

We will estimate the costs of supply for each retail tariff in accordance with an N+R cost build-up approach, where we treat the N (network cost) component as a pass-through and determine the R (energy and retail cost) component.

Response

As noted in our response to the QCA's interim consultation, EEQ supports the QCA's approach of setting notified prices for 2015-16 based on a reasonable expectation of South East Queensland price levels.

2.2.2 Large business customers

Consistent with previous determinations, our draft decision is to set notified prices for large business customers based on the lowest costs of supply in regional Queensland, which is Ergon Distribution's east pricing zone, transmission region one. We will also continue to estimate the costs of supply for each retail tariff in accordance with an N+R cost build-up approach, which is consistent with our approach to setting notified prices for residential and small business customers, as discussed above.

Response

EEQ supports maintaining the 2014-15 approach in line with the Queensland Government's UTP of using East Transmission Zone 1 Network costs for large business customers.

Section 3 – Network Costs

3.2.2 Applying Ergon Distribution tariff structures to time-of-use tariffs

Our draft decision is to apply option two to determine network charges for the time-of-use tariffs. We consider that this option provides a greater incentive for customers to move to time-of-use tariffs and the least customer impacts.

We note that customers can move between tariffs 11 and 12 twice a year without penalty. As a result, customers may take advantage of the off-peak rate in the Ergon Distribution based tariff 12 for the non-summer months and avoid the higher tariff 12 peak rate over the summer months by reverting to tariff 11. Over a year, this could result in customers paying less for network services than customers in south east Queensland, which may be inconsistent with the uniform tariff policy. It may also result in the time-of-use signals being ineffective at encouraging more efficient use of the network. However, it may encourage more customers to move to tariff 12 than if stricter conditions on tariff changes were imposed. These issues may also be relevant to the small business customer tariffs, because we understand that customers are charged a relatively modest fee after the first tariff change in a year.

We will consider whether stricter conditions should apply for the final determination and welcome comments from stakeholders on this issue.

On the basis of our assessment of customer impacts, we consider that tariff 12 can be moved to the Ergon Distribution structure without any transitional arrangements. However, as the impacts on some tariff 22 customers are more significant, we propose retaining the existing tariff 22 (based on the Energex tariff structure) for two years and allowing customers to voluntarily move to the new tariff during that period. Tariff 22 will be closed to new customers, meaning that only customers already on this tariff will be allowed to continue accessing it.

Ergon Distribution and Ergon Retail noted that meters would need to be re-programmed or replaced to enable Ergon Distribution structures to be used for time-of-use tariffs. They advised that it would be possible to achieve this by 1 July 2015 for the small number of customers on tariff 12, but that it would not be possible for all customers on tariff 22. As we have decided that the existing tariff 22 will be retained for two years due to customer impacts, we expect that this will provide sufficient time for Ergon Distribution to make the required metering changes to enable all customers to transition to the new tariff by 1 July 2017.

As tariff 22 will be retained, the new retail tariff based on Ergon Distribution's tariff structures will be tariff 22A.

Response

EEQ supports the QCA's position of encouraging customers to utilise TOU tariffs where this will provide an incentive for more efficient behaviour and certainty for all participants. However, the customer's capacity and willingness to regularly switch is untested in a 'real life' scenario and therefore caution is needed to ensure customers are not exposed to 'unexpected' cost outcomes.

Under the N+R approach, network tariff terms and conditions should be replicated into the retail tariff terms and conditions. Conditions for network tariff switching should therefore be replicated at the retail tariff level to ensure that the network switching terms and conditions are not altered by the retail tariff terms and conditions.

EEQ supports the QCA approach of allowing a two year transition period to transfer customers to tariff 22A. EEQ believe this will provide sufficient time for a targeted roll-out of meters to relevant customers if this is supported by an appropriate regulatory environment. EEQ considers it is critical to take into account the requirements on Ergon Network concerning the meter roll-out in defining the conditions for the transfer of customers to tariff 22A.

3.2.3 Tariff 13 and 41

Our draft decision is to remove retail tariff 13 from the tariff schedule, which means that customers will no longer have access to this tariff. We will retain tariff 41.

Response

EEQ supports the removal of tariff 13 as it is noted that a very small number of customers are currently using this tariff and the alternative tariff is not expected to materially impact those customers.

EEQ supports the QCA's approach of retaining tariff 41 on the basis that a large number of customers would be worse off under the alternative tariff.

Section 4 – Energy Costs

4.1 Wholesale Energy Costs

Response

EEQ supports the QCA's approach to determining wholesale energy costs. In particular, EEQ supports a continuation of the hedging based approach applied in a consistent methodology.

4.2 Other Energy Costs

While the LRET scheme is under review, at present the annual target is determined on the basis of achieving the goal of sourcing 41,000 GWh of electricity from large-scale renewable generation by 2020. After considering issues raised in submissions, and advice from ACIL Allen, we remain of the view that the market-based approach, using the most up to date targets and price information published by AFMA, is the most transparent approach and is likely to produce the most reliable estimate of costs to be incurred by retailers in 2015–16. Retaining a consistent approach for 2015–16 will also provide certainty to stakeholders.

We accept ACIL Allen's advice on this matter and its LRET cost estimates, which are outlined in Table 7. We expect to update these cost estimates for the final determination based on the binding RPP for 2015, which is expected to be published by 31 March 2015.

For the 2014–15 determination, ACIL Allen estimated SRES costs using the binding 2014 small-scale technology percentage (STP) target for the first half of the pricing period and the latest available non-binding 2015 STP target for the second half of the pricing period.

ACIL Allen recommended retaining its approach to estimate SRES costs and basing its estimate on the latest available non-binding STP targets, as the binding STP for 2015 has not yet been published. We expect to update these cost estimates for the final determination using the binding STP for 2015, which is due to be published by 31 March 2015, and the latest nonbinding STP for 2016.

EEQ supports a market based approach for determining LRET Costs. However, the ACIL Allen methodology does not adequately consider the regulatory uncertainty that has clearly been present during the RET Review during 2014 and the subsequent political uncertainty. For an electricity retailer the risk that the scheme might be abolished altogether meant that there were real risks in buying certificates for more than the 2014 surrender requirements. Many retailers would have delayed buying certificates for 2015 and 2016 requirements until, hopefully, there was more regulatory certainty. In particular, the period of very low LRET prices from February 2014 to July 2014 during the RET review period should be considered a period of market disruption and not given equal weight to other more stable market periods.

EEQ suggests that LRET prices during this period of market disruption not be used for determining the LRET costs for an electricity retailer for 2015 and 2016. Current market prices are now well above the LRET costs suggested in the draft determination and are more representative of the LRET costs of an electricity retailer for these years.

Section 5 - Retail Costs

5.1.1 Approach to estimating ROC

We have decided to continue to use a benchmarking approach to determine the ROC allowances for 2015–16 notified prices.

Response

EEQ supports the QCA's proposal to continue with the benchmarking approach.

5.1.2 Implementing the benchmarking approach – Establishing a benchmark allowance for residential and small business customers

We have decided to maintain the 2014–15 ROC allowance (including CARC) in real terms and will again include an allowance for regulatory fees (see below).

Response

EEQ acknowledges that in making its determination, the QCA is required under the *Queensland Electricity Act 1994* to consider competition and National Competition Policy requirements.

We support the retention of the CARC allowance as it remains a key component of retail tariff pricing and ensures that we do not deviate from the transition path which would allow an effective competitive market to develop further in regional Queensland.

5.1.2 Implementing the benchmarking approach – stablishing ROC allowances for large business customers

As we are not aware of any new evidence with which to update our estimates for 2015–16, we have maintained the 2014–15 allowances for large and very large business customers in real terms, and will again include an additional allowance for regulatory fees (see below).

Response

EEQ supports the QCA's proposal to continue with the 2014-15 benchmarking allowances for 2015-16.

5.1.2 Implementing the benchmarking approach – Regulatory Fees

We have included an allowance for regulatory fees of $0.23 per customer for residential and small business customers and $3.00 per customer for large business customers.

Response

EEQ supports the QCA's proposal to continue with the 2014-15 benchmarking allowances for 2015-16.

5.2 Retail Margin

We have continued to apply the benchmarking approach to estimate the retail margin and to calculate the retail margin as a percentage of total costs.

We have continued to set the retail margin at 5.7% of total costs, inclusive of the margin, and have applied it equally (on a percentage basis) to each component of each retail tariff.

Response

EEQ supports the QCA's proposal for retail margin.

Section 6 Competition and Headroom

6.1 Competition and Headroom

Our draft decision is to continue to include an allowance for headroom in notified prices for large business customers and to maintain the allowance at 5% of costs.

Response

EEQ acknowledges that in making its determination, the QCA is required under the *Queensland Electricity Act 1994* to consider competition and National Competition Policy requirements.

We support the retention of the headroom allowance as it remains a key component of retail tariff pricing and ensures that we do not deviate from the transition path which would allow an effective competitive market to develop further in regional Queensland.

6.2.1 Pass-through arrangements for 2015-16

Our draft decision is to continue to consider passing through differences in SRES costs, where the amounts provided in our 2014–15 determination are found to be materially understated or overstated as a result of differences between the non-binding and binding STPs.

We will revisit the need for any pass-through adjustment in our final determination when the binding STP is released.

Response

EEQ supports maintaining the current arrangement for pass through of SRES.

Section 7 - Transitional Arrangements

7.1 Re-Balancing the fixed and variable charges in Tariff 11

Our draft decision is to complete the rebalancing of the fixed and variable components of tariff 11, so that it reflects the costs of supply in south east Queensland.

Response

EEQ supports the decision to complete the rebalancing process for fixed and variable components of tariff 11 in order to complete the process of removing this form of cross-subsidisation, and to allow customers to make informed choices about their energy supply. However we do note that this rebalancing is likely to leave some customers worse-off than if the existing arrangement were maintained. EEQ will work with affected customers to ensure customers are aware of the impact, and where feasible, provide options to better manage their bill.

7.2 Transitional arrangements for obsolete and transitional tariffs

In previous determinations, we escalated the charges in each transitional and obsolete tariff based on the percentage increase in the charges in the standard business tariff that customers would otherwise pay.

While we consider that a 10% increase is not unreasonable, given the price increases customers have faced in recent years and that customers on the standard business tariffs will face small bill increases, we consider that an increase of 5% is more appropriate for 2015–16.

If the anticipated price increases for the standard business tariffs do not eventuate, we will reassess our position.

Response

EEQ considers the QCA should reconsider the floor price increase once the AER draft distribution price impacts are available in May 2015. Potentially, the application of a 5 per cent floor price increase may result in a significant price increase if the underlying cost reflective tariff level has reduced more than originally anticipated.