Submission to QCA
Draft Determination Paper
Regulated Retail Electricity Prices 2016-17

April 2016

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 2016-17.

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 customers from our customer solutions centres and offices located in Townsville, Rockhampton, Maryborough and Brisbane. We also firmly believe in supporting our local communities through regional employment opportunities and engaging in community partnerships such as the Royal Flying Doctor Service (Queensland).

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

Customer hardship has become a significant issue for EEQ customers. Relevant reporting to the QCA between December 2013 and June 2015 showed the number of customers in its hardship program had more than doubled.

EEQ has had a dedicated team assisting customers in hardship since 2006. This team's activity has increased with the demand for the program. EEQ's focus is on assisting customers move out of hardship and into a position where their cost of electricity is sustainable and does not put further pressure on family budgets.

EEQ appreciates the opportunity to provide input into the QCA's 2016-17 price determination through this submission. In the remainder of this submission, EEQ has provided direct responses on certain aspects of the Draft Determination.

EEQ welcomes the opportunity to discuss any aspects of this submission or to provide further information directly to the QCA.

Response to QCA Draft Determination

Section 2 – Legislative Requirements and Pricing Frameworks

2.2.1 Residential and small business customers

Our draft decision is to determine notified prices based on expected standing offer prices in south east Queensland.

Response

EEQ supports the QCA's position of determining notified prices for small residential and business customers based on expected standing offer prices in south east Queensland. We acknowledge that standing offers will evolve once prices are deregulated in south east Queensland from 1 July 2016 and encourage further consideration of appropriate price benchmarks in future determinations once competitive standing offers become more widely available.

Section 3 – Network Costs

EEQ supports the QCA's approach to estimating Network Costs in the Draft Determination.

Section 4 – Energy Costs

EEQ supports the QCA and ACIL Allen Consulting (ACIL) findings that energy costs have increased and are driven by:

- an increase in electricity demand from Queensland-based liquefied natural gas (LNG) projects
- higher fuel costs for gas-fired generation
- increased solar generation which is continuing to reduce daytime demand but has no effect on peak demand. This is resulting in the Net System Load Profile (NSLP) becoming peakier and more expensive to hedge.

4.2.1 LRET costs

We remain of the view that ACIL Allen's market-based approach, using the most up-to-date targets and price information published by AFMA, is likely to produce the most reliable estimate of LRET costs to be incurred by retailers in 2016–17. Retaining a consistent approach for 2016–17 will also provide certainty to stakeholders.

Response

EEQ reiterates its position from its submission to the QCA's Interim Consultation Paper that the regulatory uncertainty associated with the Federal Government's RET review significantly affected the efficient operation of the market, increasing the risk of forward purchases to cover future liabilities. This risk materialised in an observed suppression in market activity as participants avoided building long Large-scale generation certificate (LGC) positions pending the outcome of the review. This behaviour ultimately flowed through to an artificial suppression in the LGC price over the period.

Due to this, ACIL's approach[1] of examining market prices over a two year period does not reflect the behaviour of an efficient retailer (as demonstrated by market behaviour) in the face of the significant regulatory intervention.

Although the price has increased since the 2015/16 determination, EEQ's position is that the costs determined in 2015/16 did not reflect the hedging costs an efficient retailer would reasonably face and this issue remains in the 2016/17 draft determination.

EEQ recommends that the QCA consider the impact of such policy interventions on the efficient operation of the market when determining a method for estimating LGC prices.

Section 5 – Retail Costs

EEQ acknowledges the effort undertaken by the QCA and ACIL in conducting its first comprehensive review of retail costs. The QCA's Draft Determination includes significant changes to the methodology for determining retail costs including the allocation of those costs to notified tariffs.

Both the QCA and ACIL have highlighted difficulties they encountered in estimating efficient retail costs through bottom up analysis[2].

These difficulties were exacerbated by structural changes currently underway within the industry. For example, the AEMC power of choice program (including the introduction of competition in metering services) and deregulation of the south east Queensland retail market, will impact retail business models and cost structures. It is important that the QCA recognise these changes in determining an appropriate retail cost methodology in their annual determinations.

EEQ acknowledges the difficulties associated with developing a new methodology for benchmarking and allocating retail operating costs to tariffs. The variability in the data provided by retailers is reflective of a wide range of business models, risks and commercial practices. Using an 'averaging' approach for developing key benchmarks, such as the standing offer adjustment, may distort an efficient cost allocation and application of costs to tariff components.

EEQ is of the view that cost reflectivity in the allocation of retail costs to tariff components is important. As noted by the QCA "the principle of cost reflectivity informs the decision on where retail cost allowances should apply in each tariff". Although ACIL has relied on data supplied by retailers to determine its allocation, the high degree of variability in the characteristics of retailers and their customers may not reflect the allocation of an efficient retailer supplying regional Queensland customers. EEQ requests the QCA review this allocation in future price determinations.

Given the complexities encountered in determining retail costs for this determination period, EEQ considers it prudent for the QCA to review its methodology for benchmarking and applying retail costs in the 2017/18 determination process. This would allow the QCA and ACIL to

[1] QCA, 2016/17 Draft determination of regional regulated electricity prices, p 18
[2] QCA, 2016/17 Draft determination of regional regulated electricity prices, p 25

benchmark costs against competitive standing offers available in the newly deregulated south east Queensland market for the purposes of developing a standing offer adjustment. It would also afford stakeholders more time to consider and comment on the new approach.

EEQ supports the QCA's position that it would not be beneficial to conduct a bottom-up review of retail costs on an annual basis and that annual cost increases should be calculated using a defined escalation method. EEQ also supports the QCA's position that detailed reviews should be conducted where material changes in cost drivers emerge.

To provide customers and other stakeholders with visibility, EEQ asks the QCA to share the detail of their approach to escalation and definition of material change in cost drivers.

Section 6 – Other Issues

6.1.1 Estimating price differentials in south east Queensland

Based on the information available, the QCA considers that differentials between market offer and standing offer prices will prevail in south east Queensland for small customer tariffs in 2016–17. Ultimately, the size of the differential between market and standing offer prices immediately following deregulation is uncertain and will likely be the result of individual retailers' pricing strategies, changes in underlying costs of supply, and other incentives created by the regulatory and legislative environment.

As we cannot predict the likely size of this price differential with any certainty, we consider it reasonable to assume it will remain at a level similar to that seen in the south east Queensland market at the moment.

Analysis of the existing differential between notified price standing offers and retailer market offers reveals the average level of effective net discounting is around five to six per cent for a typical small customer's total annual bill. We consider this is not materially different from the headroom allowance of five per cent which has previously been applied to small customer tariffs.

There is no compelling evidence to conclude that the price differential between market and standing offers in 2016–17 will be any higher or lower than the level observed in the market in 2015–16. On this basis, our draft decision is to add an amount above the efficient costs of supply in south east Queensland that would deliver a similar average price differential in 2016–17, all other things being constant. We consider that an amount of five per cent of total costs—equal to the headroom allowance applied in previous years' determinations—is a reasonable estimate of the amount required to deliver similar price differentials to those observed in 2015–16.

Response

The QCA note a number of limitations on their method of estimating the standing offer differential including the analysis being based on regulated 'standing offers' in SEQ[3]. Considering these limitations, EEQ supports the QCA's approach for determining an appropriate price differential to apply to efficient cost of supply in south east Queensland, being the amount

[3] QCA, 2016/17 Draft determination of regional regulated electricity prices, p 42

of five per cent of total costs – equal to the headroom allowance applied in previous years' determinations.

EEQ recommends the QCA review this approach in following years as the deregulated market in south east Queensland matures.

6.1.2 Estimating headroom for large business customer tariffs

In the absence of any further information, or compelling reasons to change the level of 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 five per cent of total efficient costs.

Response

EEQ supports the QCA's approach of including an allowance for headroom in notified prices for large business customers. EEQ is in favour of increasing competition in regional Queensland on the basis that it will lead to better customer outcomes.

EEQ would also like to acknowledge the QCA's comments around barriers to competition, particularly the limitation on large customers accessing notified tariffs once they have accepted a market contract[4]. This may discourage large customers from entering the competitive market as it removes access to regulated retail prices.

EEQ considers this is an unnecessary policy constraint which inhibits the growth in competition in the regional Queensland market.

6.2.1 Cost pass through mechanism

Consistent with the approach adopted in our 2015–16 determination, we will consider passing through differences in SRES costs, where the amounts provided in the 2015–16 determination are found to be materially understated or overstated as a result of differences between the non-binding and binding STPs.

Response

EEQ supports the use of a cost pass through mechanism to account for events outside the control of a regulated entity, including material differences in Small-scale Renewable Energy Scheme (SRES) costs due to binding and non-binding Small-scale Technology Percentage (STP).

[4] QCA, 2016/17 Draft determination of regional regulated electricity prices, p 44