



22 March 2013

Queensland Competition Authority
GPO Box 2257
Brisbane QLD 4001

By email: electricity@qca.org.au

Dear Sir/Madam

RE: Regulated Retail Electricity Prices 2013-14 Draft Determination

The Energy Retailers Association of Australia (ERAA) and the Energy Supply Association of Australia (esaa) (the Associations) welcome the opportunity to make a joint submission on the *Regulated Retail Electricity Prices 2013-14 Draft Determination* (the Draft Determination).

In December 2012 the Associations provided a joint submission to the Queensland Competition Authority (the Authority) on the Regulated Retail Electricity Prices 2013-14 Transitional Issues Paper. The submission outlined:

- Options for transitioning to cost reflective charges for Tariff 11;
- Options for transitioning to cost reflective charges for obsolete tariffs inclusive of arrangements that will allow for competition in regional Queensland to occur.

This submission builds on these points and raises a few more issues specific to the Draft Determination.

Deregulated retail energy markets

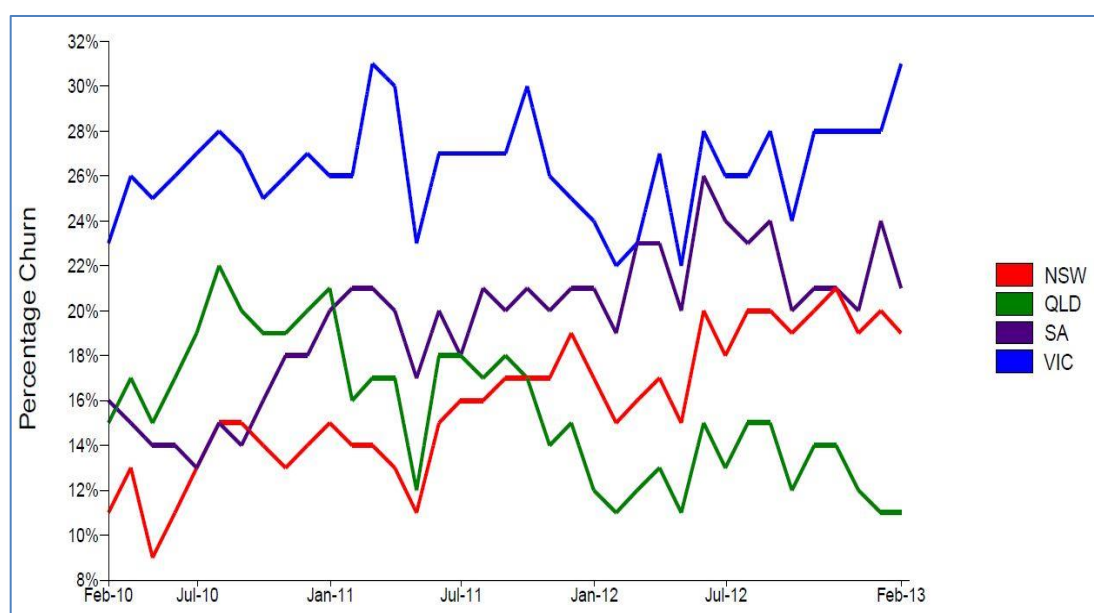
Although the focus of the Draft Determination is to determine the notified prices for regulated retail electricity tariffs from 1 July 2013 to 30 June 2014, the Associations have consistently advocated for deregulation of retail energy prices. Retail price regulation is inefficient, stifling product innovation and impeding competition. Additionally, it imposes regulatory risk on retailers, as the price path can be substantially changed at short notice as was experienced with the Tariff freeze imposed for the 2012-2013 period.

The Associations are concerned that the Authority has dismissed the impact that the 2012-13 Price Determination has had on competition.

As outlined in Figure 1 below, AEMO provides monthly statistics outlining the level of switching in a given state. In the Draft Determination the Authority downplayed the importance of the fact that switching rates in Queensland are lower than in other jurisdictions. The Draft Determination states that “while the Queensland switching

rate was 11% (annualised) in January, if Ergon Energy customers were removed from the calculation, the switching rate increases to approximately 15%. This compares to 20% in NSW, 24% in South Australia and 28% in Victoria.”¹ Whilst the Associations agree with the Authority’s assessment that a large number of contestable customers in Queensland are not motivated to switch due to cross-subsidies inherent in the Uniform Tariff Policy, the modified switching rates calculated by the Authority are still well below those in other states. The modified rates still demonstrate that customer switching in Queensland has halved since mid-2010, largely due to a reduction in activity in the Energex area. During this same period switching rates in other states have risen, as outlined by Figure 1. Given the Authority’s recognition that switching rates are an indicator of the competitiveness of a market, the Associations disagree with the Authority’s conclusion that this strong downward trend doesn’t necessarily indicate a reduction in competitive activity in Queensland.

Figure 1 – AEMO historical monthly annualised transfer rate - February 2013



Source: AEMO, 2013

The Authority also dismisses claims made by the Associations that new entrant investment is low and has declined since the 2012-13 Determination. The Authority justifies this by asserting that there are currently 15 retailers making offers to small customers in Queensland. It is important to note that whilst a retailer has a licence it does not mean they are active. As stated before, the Associations would also like to highlight that discounting in Queensland against the regulated Standing Offer tariff has changed substantially since 2008 when new entrants were competing more effectively. Since 2010, discounting has been led predominantly by only a few retailers, with some new entrants being forced to offer rates substantially above the Standing Offer tariff or simply ceasing to market in Queensland. Furthermore, some potential new entrants that were planning to enter the Queensland market have opted to divert resources to other states.²

¹ QCA, *Regulated Retail Electricity Prices 2013-14 Draft Determination*, p.52

² For new entrant retailers and large retailers outside of their Tier 1 jurisdictions, where they can exit a market in the case of low profitability, market exit incurs costs that can be significant. Accordingly,

The Associations request that the Authority justifies claims made in the Draft Determination that “On several measures, the level of competition appears to have been maintained or improved following the Authority’s 2012-13 Determination. For instance, there has been an increase in the number of active retailers, bigger discounts to the notified price, stable market shares of second tier retailers and an increase in the proportion of customers on market contracts.”³ These claims from the Authority that competition is stable (if not improving) appear to be in direct conflict with discussions the Associations have had with retail businesses. These discussions have identified a clear trend for increasing investment in Victoria and most recently in NSW, compared to a lack of interest in investment in Queensland. In NSW, investment has been steadily increasing since the sale of NSW Government owned retail assets. Conversely, Queensland new entrant investment has remained low, declining since 2010 and further declining since the 2012-2013 Determination and the Minister’s decision on Tariff 11.

Options for transitioning to cost reflective charges for obsolete tariffs

The Associations do not support the Authority’s proposal to retain some existing obsolete tariff arrangements for new customers. Allowing customers to switch back to obsolete tariffs is counter intuitive to the reason as to why a tariff was initially made obsolete – usually because of the cost inefficiencies of these tariffs. This, like the 2012-13 Tariff 11 price freeze: distorts the economics of the market; introduces potential financial risk for retailers operating in the market; and when assessing which markets to compete in, makes Queensland a more risky state to operate in than other states.

Definition of materiality for cost-pass through mechanism

As outlined within the Draft Determination, there are a number of non-systematic risks borne by retailers under the current regulatory framework that arise from variations between actual and estimated costs over the regulatory period. A prime example of this is the impact of estimating Small-scale Renewable Energy Scheme (SRES) liabilities, where significant variations between estimated and binding liabilities have imposed considerable costs on retail businesses in recent years. Requiring retail businesses to absorb costs that cannot be passed on creates financial pressure and adversely impacts the level of competition within the sector. To this end, the Associations are supportive of implementing a cost-pass through mechanism that allows for the recovery of costs incurred in previous regulatory periods.

The Associations do not support the Authority’s approach to determining the materiality of potential cost pass throughs as being adequate. The criterion provided in the Draft Determination is subjective and relies heavily on Authority’s discretion of cost pass through elements. The industry recommends that the Authority consult with industry on a more robust criterion to assess cost pass throughs and reduce the discretionary interpretation provided in the criterion. Having regard to the impact of the change in costs on the returns of retail business and the impact that this may have on regulated electricity prices and average customer bills does not provide industry with comfort. For example, should a cost element be of material nature, how will the Authority have regard to both the returns of a retail business and the impact on electricity consumers? Regardless of whether costs are determined as material, they will still influence the ability of retailers to offer discounts below the regulated

retailers may elect to maintain their current customers, or a small number of customers, in an unprofitable jurisdiction to avoid incurring costs of unwinding their wholesale books.

³ QCA, *Regulated Retail Electricity Prices 2013-14 Draft Determination*, p.55

electricity price and will definitely impact on slim margins awarded under the proposed determination.

Wholesale cost methodology

On behalf of the industry the Associations have expressed concerns about the lack of transparency in the methodology used to determine the wholesale cost allowance for the tariff setting process in Queensland. In particular, the Associations believe there is a problem with the Authority's reliance on a single point estimate of wholesale costs, drawn from a single calculation. Estimating future wholesale costs is inherently uncertain. Retailers face this uncertainty on a day-to-day basis and use a wide range of options to manage these risks, including purchasing different types of hedging products, long-term PPAs and investing directly in generation themselves. To assert as ACIL Tasman do, that a particular set of hedging products is the only benchmark that need be used fails to recognise this and thus fails to adequately capture "the actual costs of making, producing or supplying the goods or services" as the Authority's terms of reference requires.

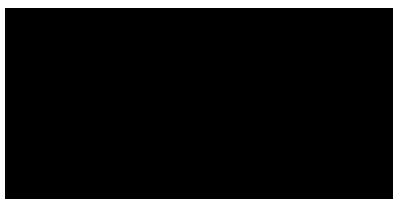
Reliance on a single point estimate is also more likely to result in a wholesale cost allowance that turns out to be inadequate for retailers to cover the costs. It is thus a greater threat to effective retail competition, to which the Authority must also have regard.

These issues would be most effectively addressed by a methodology that takes account of different approaches to procuring wholesale electricity including recognition of the longer term costs of generating electricity. Such methodologies have been successfully used in NSW and South Australia, the latter state recently transitioning to deregulated prices with competition having thrived under a more appropriate regulated price methodology free from regulatory distortion.

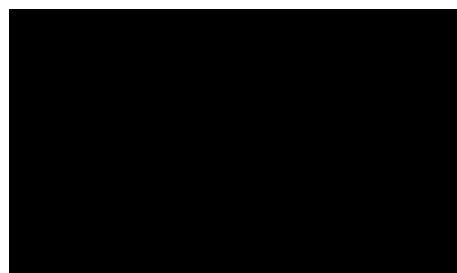
The process for setting 2013-14 prices is under way and we believe these issues need to be addressed in the final determination to provide assurance to retailers that they can compete in Queensland without the risk of regulated wholesale costs being set below reasonable levels.

Any questions about our submission should be addressed to either David Lee, email dlee@eraa.com.au telephone (02) 8241 1835, or Kieran Donoghue, email kieran.donoghue@esaa.com.au telephone (03) 9205 3116.

Yours sincerely



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