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Queensland Competition Authority
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Regulated Retail Electricity Prices 2013-14 (Cost Components and Other Issues) – Consultation Paper

The Energy Supply Association of Australia (esaa) and the Energy Retailers Association of Australia (ERAA) (the Associations) welcome the opportunity to make a joint submission to the Queensland Competition Authority's (the Authority) Regulated Retail Electricity Prices 2013-14 (Cost Components and Other Issues) Consultation Paper.

Australia's energy industry owns and operates some $120 billion in assets, employs more than 51,000 people and contributes $16.5 billion directly to the nation's Gross Domestic Product.

The Authority considers that notified prices should not act as a barrier to retailers entering the market, but rather encourage customers to exercise market choice and provide a transition to effective competition and eventual price deregulation. The Associations are firmly of the view that the most appropriate way to facilitate efficient pricing and ensure a viable, sustainable and competitive electricity supply industry is to remove retail price regulation. Should the Queensland Government choose to regulate retail prices in this environment, an overriding focus on ensuring cost-reflective tariffs and promoting competition is a sensible approach.

Current state of competition in Queensland

The Associations are concerned about the Authority's preliminary assessment that "*neither the Authority's 2012-13 Determination, nor the Minister's decision on Tariff 11, have negatively impacted competition*". This assessment was based on data obtained from the Australian Energy Market Operator's (AEMO) Monthly Retail Transfer Statistics and also anecdotal evidence on market offers made to customers since the release of the Determination. The Associations consider that this assessment portrays an inaccurate representation of the current state of competition in the Queensland market. It is not the release of the Authority's final determination for 2012-13 that is relevant, rather the release of its final determination for 2011-12 in May 2011 and particularly the release of its proposed methodology for 2012-13 in November 2011. In early 2011, Queensland had a monthly churn rate similar to SA and well above NSW. The current situation is a significant decline in the Queensland churn rate leaving it well behind both NSW and SA. This is clear evidence of the Authority's decisions leading to a decline in competition.

The AEMO data highlights that churn in Victoria is generally higher than in other states. This is consistent with the VaasaETT report which suggests that Victoria is the most competitive market in the world based on churn and the number of new entrants actively operating in that market.[1] The data also highlights that churn activity in Queensland has declined and stagnated since the introduction of Full Retail Competition in 2008. Most recently, customer switching in Queensland has fallen well below all other National Electricity Market (NEM) States.

The Associations maintain the view that churn rates provide the best indication of the level of competition within the retail market. Advice from member businesses suggests that such activity in Queensland has declined (or ceased) since the 2012-2013 Determination and the Minister's decision on Tariff 11. While this is broadly consistent with the AEMO customer transfer data, information relating to customer switching solely between the large retailers (or conversely, churn that involves new entrants) is needed to provide a more accurate picture This level of granularity in transfer data is collected by AEMO, though it is not publicly available.[2] The Associations consider that it would be useful for the Authority to seek access to this information prior to making its final assessment on the effectiveness of competition in Queensland.

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. Further, some potential new entrants that were planning to enter the Queensland market have opted to divert resources to other States.[3]

With respect to diverting resources to other States, discussions with retail businesses have identified a clear trend for increasing investment in Victoria and most recently in New South Wales. 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.

[1] VaasaETT, *World Energy Retail Market Rankings 2012 – Presentation by Dr Philip E. Lewis at ERAA Retail Seminar*, 23 May 2012, Melbourne.

[2] AEMO transfer statistics include transfers between Tier 1 and Tier 2 retailers (being the local incumbents), though it is not possible to identify churn between the large retailers and new entrant retailers from the publicly available data.

[3] 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, 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.

Cost-reflective tariffs

To promote competition in regulated electricity markets, it is essential that tariffs are set at cost-reflective levels, with adverse consequences arising when setting the regulated prices too low. Cost-reflective retail tariffs allow businesses operating within the retail sector to recover the costs of electricity supply, as well as an appropriate return on investment, thus encouraging new market entry. In the event that prices are set above the cost of supply – including an appropriate retail margin – competition will erode margins back to efficient levels. Conversely, regulated tariffs set below the cost of supply impede full cost recovery, potentially compromising the financial viability of businesses operating within the retail sector and by extension, the electricity supply industry. In any case, regulated retail prices may have a distorting effect on the efficient operation of the wholesale market.

Cost-reflective pricing is also critical in the context of providing efficient and transparent price signals. Price signals are powerful tools to shape behaviour and are a fundamental aspect of resource allocation in almost all aspects of the Australian economy. Price signals have the potential to improve the efficiency of the energy system, including improving system utilisation by providing signals for time-of-use consumption, informing rational decisions on energy efficiency or responding to emissions reduction through carbon pricing. Notably, where energy prices are set below cost, those users cannot be expected to make rational energy efficiency decisions as the information they have is distorted. More specifically, below-cost prices will lead to the levels of energy efficiency being too low.

To ensure that consumers face efficient price signals, it is critical that Tariff 11 (the main residential tariff) is transitioned to cost-reflective levels as soon as possible. This can be achieved by setting the retail component at the level established in the absence of the Tariff freeze and addressing the current imbalance between the fixed and variable components of the tariff. Holding Tariff 11 (or any tariff) below cost is a blunt and very expensive measure that benefits all energy consumers receiving the discounted rate, even those that do not require assistance. Further, while Tariff 11 is not cost-reflective, consumers will have no incentive to consider switching to a cost-reflective time-of-use tariff, which is a more efficient tariff for shaping energy consumption patterns.

With respect to estimating the wholesale energy cost (WEC) component of regulated tariffs, it is acknowledged that this is an inherently complex exercise. The Associations maintain the most appropriate approach is one that ensures the WEC component is not less than the LRMC of electricity generation. The LRMC floor approach (currently utilised in New South Wales) appropriately reflects the asymmetry of setting regulated prices high or low and is consistent with the Authority's view that notified prices should be set at a level that encourages vigorous competition. In contrast, a market based approach will result in greater price volatility flowing from spot and contract markets into the retail path and ultimately, non-cost-reflective prices.

To the extent that cost-reflective prices are considered beyond the capacity of certain customers to pay, the Associations consider that such consumers should be supported by purposely designed, budget funded measures. These measures need to be appropriately targeted. The State's electricity rebate in its current form fails to adequately protect vulnerable customers, instead smearing payments across a broader group of consumers regardless of the need for assistance.

Uniform Tariff Policy

It is also noted in the consultation paper that the application of the Uniform Tariff Policy (UTP) may need to be reviewed as competition in South East Queensland (SEQ) intensifies and progress towards deregulation is made. In particular, there is a concern that the inability of rural customers to access lower market offers (available in SEQ only) is inconsistent with the intent of the UTP. The Authority suggests one option to remove this disparity would be to determine prices to apply outside SEQ by reference to SEQ market prices, though the Associations consider that this option fails to address the actual cause of the issue.

The application of the Government's Community Service Obligation (CSO) payment to Ergon Energy (retail) effectively creates a subsidy to Ergon Energy (retail) customers. This precludes other retailers (forced to absorb additional costs) from competing and as such, customers in the Ergon Energy distribution area remain on the regulated tariff. As discussed in earlier submissions to the review, a better approach would be to apply the Government's CSO payment at the distribution level, enabling retail businesses to compete for customers in the Ergon Energy distribution area based on the competitiveness of their charges.

Any questions about our submission should be addressed to either Shaun Cole, email shaun.cole@esaa.com.au telephone (03) 9205 3106 or David Lee, email dlee@eraa.com.au telephone (02) 8241 1835.

Yours sincerely

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