CCIQ Submission to the QCA consultation paper 'Regulated Retail Electricity Prices 2013-14: Cost Components and Other Issues'

About the Submission

CCIQ makes this submission in response to the QCAs consultation paper of December 2012 regarding cost components and other issues relevant to the determination of electricity prices for 2013-14. Due to direct relevant and overlap, CCIQ's response also includes our comments in response to the October 2012 consultation paper relating to transitional arrangements for obsolete tariffs. CCIQ believes these matters are best addressed collectively.

This submission does not address all discussion questions raised in the consultation papers but rather specifically deals with a number of issues relevant to business and industry users of electricity in Queensland. It is our strong view that electricity prices must be determined in a way that recognises the specific business, commercial and industrial requirements for electricity and mitigates the impact of electricity price increases for these users.

Preliminary Comments

CCIQ have ongoing concerns that the political, policy and regulatory context in which electricity prices are managed in Queensland are too focused on the residential consumer without due recognition being given to the contribution that a competitive business sector makes to employment and the economic and social wellbeing of all Queenslanders.

Regulated electricity prices have risen by more than 65 per cent over the past 6 years inclusive of those set under the previous BRCI methodology and the more recent cost reflective N+R build up approach. For individual businesses however, depending on tariff and electricity usage profiles, the price increases have been up to 200% just in the past 12 months alone.

What this reflects is ignorance to the burden on business and an incomprehensible cost shifting from residential users onto the Queensland business community for political purposes (noting that the Queensland Government placed a price freeze on residential tariff 11 for 2012-13, whilst instructing the QCA to remove a number of business tariffs and forcing many businesses onto costly market contracts with limited transitional measures). This no doubt was an unintended policy outcome but nonetheless cements cross subsidisation between commercial and residential users.

Electricity and energy costs consistently feature amongst the top 5 constraints on business growth for Queensland businesses (CCIQ Pulse Survey). Electricity is a major input into the production of every good and service. Business sector electricity demand is largely inelastic, and electricity prices directly impact on business competitiveness and profitability.

The Queensland businesses community is numb to the rhetoric and lack of genuine commitment to comprehensively reform the electricity market/sector in Queensland. CCIQ considers it a pointless exercise to continue to consult on and review the regulated retail tariffs and prices, without first overhauling the network tariffs, pricing structures and broader regulation of the sector.

CCIQ appreciates that many of these issues are outside the scope of this review and the responsibilities of the QCA. CCIQ finds it difficult to be able to respond to the QCA discussion questions specifically relating to the pricing methodology and cost components, when we fundamentally have significant concern regarding the overarching framework for the Queensland electricity market sector. Ongoing attempts to improve the regulated retail pricing methodology and retail tariffs is constrained by the fact that the electricity network is not focussed on delivering the same improved and efficient outcomes and may not have cheap energy prices as an objective. CCIQ does however acknowledge that that the State Government has recently released a 30 year electricity strategy directions paper that may address many of these overarching constraints.

Network (N) Cost Components

CCIQ continues to support the Network (N) plus Retail (R) cost build up approach as we believe it has the potential to achieve the most equity and transparency across tariff and user groups that over the long term lead to an efficiently priced electricity market in Queensland.

However CCIQ also believes that the effective setting of retail tariff prices continues to be constrained by underlying policy inconsistencies and broader market design issues. In particular, CCIQ believes there is evidence to suggest that:

- uniform tariff policy (UTP) is preventing greater competition in the Ergon distribution area (regional Queensland);
- full retail competition is not necessarily consistent with reducing peak demand and lower energy prices; and
- cost-reflective pricing is not achievable in the presence of the UTP as the cost of supply is significantly higher in regional Queensland.

Whilst CCIQ supports the policy intent of each of these policy areas, we are not convinced of the merit or effectiveness of the framework in which they are currently achieved. It therefore may be the time to consider a differentiation of tariffs in the Ergon area from that in the Energex areas; and/or a discussion regarding the ongoing need to regulate tariffs in the Energex area at all.

Many of the issues raised are due directly to the crossover between using Energex and or Ergon network charges as the basis for the regulated tariff structure and this clearly is not working. Most other jurisdictions in Australia have different regulated charges that reflect the costs in each distribution area.

Small Business Customer Tariffs

CCIQ supports using a similar approach to 2012-13 whereby the network cost component for small customer tariffs are based on the network charges to be levied by Energex, as this is consistent with the State Government's Uniform Tariff Policy (UTP) and minimises price increases for these customers.

Large Business Customer Tariffs

CCIQ does not support the QCA recommendation to base large customer tariffs on the network charges to be levied by Ergon.

Whilst we acknowledge that there is a concerted effort to shift towards full cost reflectivity and that large business customers in SEQ no longer have access to regulated tariffs and prices, we believe that basing large business tariffs on Ergon network charges will result in significant increase in the tariff price and will not achieve equity for businesses in regional areas compared to those business in SEQ. This is therefore inconsistent with the UTP.

What this also means is that residential and small business users in the Ergon area will not pay full cost-reflective prices, whilst their larger use competitors will pay prices reflecting the full network and distribution costs, effectively embedding a degree of cross-subsidisation between businesses users and small customers in the Ergon distribution area.

CCIQ believe that the better approach is to base large customer tariffs on the network charges levied by Energex, for their large user market contract customers. Alternatively CCIQ believes there may be merit in applying an averaged network cost approach which applies an average of the Energex and Ergon network costs for each tariff based on the total number of users in each tariff category/group. For example:

Energex Tariff (large customers) + Ergon Tariff (large customers)/size of network (number of customers) = average network cost (large customers)

Energy Costs

CCIQ believes that wherever possible market based and benchmarking approaches should be adopted which draws on the experience of other jurisdictions and incentivises the Queensland electricity sector to strive towards best practice and efficiency outcomes required to ensure low cost energy prices.

Accordingly CCIQ supports QCA recommended market price approach to estimating wholesale energy costs based on hedge modelling; and basing Environmental program costs (including QGS, LRET and SRES) compliance costs on market price information.

However CCIQ wishes to place on the record that in the presence of the carbon pricing scheme we do not believe that other environmental compliance schemes aimed at managing and reducing emissions should remain in place as they serve only to push up energy prices for consumers.

Time of Use (TOU) Energy Costs and Tariffs

Of particular concern to CCIQ and our members has been the impact on customers of significant changes in the pricing structure of Tariff 22, the business TOU tariff accessed by business customers who consume more than 100MWh per annum, and the only alternative tariff for many customers currently on obsolete tariffs.

CCIQ is concerned that there is very little differential between the peak and off-peak rates, resulting in there being little to no price incentive for businesses to manage their peak demand and energy use. The significant price increase in 2012-13 also significantly impacted businesses already on T22 and who have invested significantly and structured their business energy use to take advantage from previously discounted off-peak rates.

As has been highlighted by numerous QCA papers, the underlying Energex and Ergon TOU network tariff has itself little differential between the peak and off-peak rates and this is therefore preventing the QCA from developing a Time of Use tariff structures that rewards customers for shifting their energy consumption from peak pricing periods to off-peak periods.

CCIQ believes that the uptake of TOU presents the most significant opportunity for Queensland businesses to realise energy savings and for the Queensland energy market to systematically address rising electricity prices. However CCIQ continues to observe a lack of genuine interest in progressing time of use network and retail tariff structures. To act as an effective incentive, the pricing signals need to reflect not only the cost of supplying at off-peak, shoulder and peak periods, but must also acknowledge the cost of business restructuring and necessary investment.

Accordingly CCIQ believes that the Queensland Government should take a leadership role in advising on and developing TOU network and retail tariff structures.

Retail (R) Cost Components

Retail Operating Costs (ROC)

CCIQ supports the benchmarking approach being taken by the Authority to determine retail operating costs. However we share the collective view of other consumer groups that there is no justification for including an allowance for Customer Acquisition and Retention Costs (CARC).

We note the argument for the inclusion of CARC to support activities required to build a competitive market, and also the QCAs assessment that there is now highly effective competition in the electricity market in the Energex area. A consequence of the Queensland Government's Uniform Tariff Policy, Ergon Energy customers are paying for the costs of customer acquisition and retention, even where there is no effective competition, and therefore no funds are being expended on those activities. Previous analysis undertaken by the QCA also shows clearly that the Queensland allowance for CARC is above that allowed in NSW and South Australia.

Any allowance for CARC should be reasonable, not generous. In a normal business sense customer acquisition and retention costs such as marketing and customer service are not specific costs passed onto the market in full. Equally market growth and business expansion are costs normally paid for out of general revenue and profitability. It follows that it is in the energy retailer's best interest to attract and retain customers through efficiency and standards as this leads to greater market share and profitability. A specific allowance for CARC, especially in combination with retail margins and headroom seems excessive.

Therefore CCIQ believes the CARC allowance should instead be much lower, given that only a proportion of customers in Queensland are reasonably open to contestability. We propose that if there is to be an allowance for CARC in Queensland, it should be set at a rate benchmarked against NSW and South Australia, with an adjustment for the proportion of customers in those areas of Queensland where there is no effective competition.

Retail Margin

A retail margin is intended to compensate retailers for systematic risks. Accordingly the QCA, increased the retail margin from 5% to 5.4% in the previous 2012-13 price determination despite a number of objections from consumer groups consulted at the time.

CCIQ again contends that a retail margin greater than 5% is unreasonable and we strongly urge the QCA to review the current margin of 5.4% downwards.

Arguably, it could be lower, because the new N + R cost build-up pricing approach better assesses and reflects the operational costs for retailers thereby reducing the inherent risks that existed under the previous BRCI process.

Retail Headroom

To entice greater competition the Authority included an additional allowance for head room of 5% of cost-reflective prices for all tariffs in their 2012-13 determination. At the time the Authority argued that "by setting regulated prices somewhat higher than full cost, retailers will be attracted to enter the market and, as they compete for market share, non-regulated prices will be driven down". The figure of 5% was provided without any supporting justification, and without any apparent attempt to quantify what headroom might already be in the cost-reflective tariffs.

CCIQ therefore has many concerns with this decision, and believes primarily that retailers should be encouraged to seek out and create their own effective "headroom" by operating more efficiently and innovatively, and providing better customer service than the incumbents. That is the way to achieve sustainable entry to give longer term benefits.

Creating artificial headroom to attract retailers will not encourage efficiency or lower pricing. At most it will attract retailers offering no better service, as has been evidenced through numerous CCIQ surveys where electricity retailers have been rated average to poor in terms of quality and efficiency of service.

CCIQ therefore strongly urges the QCA to remove the headroom in notified prices for 2013-14 which had been allowed for in 2012-13; or review the 5% headroom allowance downwards following a better analysis of what headroom might already be in the cost-reflective tariffs.

Transitional Arrangements for Obsolete Tariffs

CCIQ notes that this is the second year where transitional arrangements for apparent obsolete tariffs are being considered due to the State Governments decision to place a hold on the removal of obsolete tariffs and capping of price increases for the 2012-13 pricing period.

It is CCIQs firm position that a further 1-2 year moratorium be placed on the removal of obsolete tariffs in light of the current state wide review and reform of the energy sector. CCIQ strongly supports the work of the State Government Inter-Departmental Committee (IDC) in reviewing the drivers of electricity prices including energy supply, network costs and retail competition. CCIQ firmly believes that as an outcome of this review and reform agenda, the policy and regulatory framework will be improved to deliver a better underlying cost and tariff structure.

Accordingly it makes no sense to CCIQ to place Queensland businesses, particularly those in regional Queensland and across significant industry sectors such as agriculture and manufacturing, under undue short-term hardship which may affect their immediate competitiveness and viability

However, CCIQ notes that this decision is outside the delegation and scope of the QCAs authority and therefore we ask that the Queensland Competition Authority be cognisant of the potential for changes to regulated retail electricity tariffs to have unintended but severe consequences on specific industry sectors or companies.

Accordingly, in relation to obsolete tariffs and reflecting the options outlined in the QCA Consultation Paper ‘Regulated Retail Electricity Prices 2013-14: Transitional Issues’, we ***support moving all customers on obsolete tariffs immediately onto new tariffs and discounting charges*** for all customers on those new tariffs by progressively smaller amounts each year (Option 2). This option provides the greatest level of certainty to businesses over long-term price changes, reduces the complexity of the tariff structures and transitional arrangements, and removes any distortive impacts associated with maintaining separate tariff structure and schedules whereby some businesses will be placed at a competitive disadvantage compared to others in the same region/industry sector.

This option also allows businesses who stand to benefit from new arrangements an opportunity to benefit immediately. Further, Option 2 provides a clear signal to network and retail businesses that they must expedite solutions to any outstanding “metering and distribution-related constraints” preventing businesses from shifting onto tariffs where they may be better off.

Discounts must however be applied universally to all affected customers and must be balanced with recognition of the capacity of businesses to pay and the impact of consecutive previous years of price increases. A three to five year transitional pricing path, which limits price increases to a maximum of 10 per cent is recommended.

In relation to the tariffs affecting large business customers, for the same reasons outlined above, CCIQ recommends the QCA applies the same approach as outlined for obsolete tariffs. That is, ***moving all customers on obsolete tariffs immediately onto new tariffs and discounting charges*** for all customers on those new tariffs by progressively smaller amounts each year.

Whilst not an issue within the scope of the QCA's review or delegation, CCIQ believes there is a concerning lack of support provided to the business community in the area of energy efficiency and that the previous Queensland Government failed to provide an energy policy framework supportive to business and the economy. Namely there needs to be greater investment in the states' infrastructure and more significant review of the network and retail tariffs collectively to provide genuine incentives to businesses reducing their energy use (e.g. time of use and consumption based tariff structures).

Finally in relation to transitioning T11 out of the 12 month price freeze implemented in 2012-13, CCIQ agrees with the QCA position that ***an immediate move to cost-reflective tariffs in one step in 2013-14 is the most appropriate approach***. This will also align with recommendations for an immediate transition for obsolete and large customer tariffs.

CCIQ further believes that social welfare implications are best addressed separate from the pricing methodology. In this regard, the argument for greater government action to provide incentives through time of use and consumption based tariffs, provide greater support and advice on energy efficiency, and reduce the underlying cost base within the energy market are relevant and highly important.