alintaenergy

9 January 2013

Mr Gary Henry
Director
Queensland Competition Authority
GPO Box 2257
Brisbane QLD 4001

Dear Gary

Regulated Retail Electricity Prices 2013-14: Cost Components and Other Issues

Alinta Energy appreciates the opportunity to provide a submission to the Queensland Competition Authority (**the Authority**) in relation to the above review.

Alinta Energy is both a generator and retailer of electricity and gas in the West Australian and Eastern States energy markets. It has over 2500MW of generation facilities and more than 700,000 retail customers, including about 90,000 customers in Victoria and South Australia. As an incumbent retailer in WA and a new entrant retailer in the National Energy Market, Alinta Energy is well placed to comment on this review.

Introduction

Alinta Energy, while an active retailer in Queensland, is currently only making offers to large unregulated customers. Regulated prices are currently set at a level which does not allow Alinta Energy to recover the efficient costs of supplying electricity to small customers.

Alinta Energy recognises the difficult task faced by the Authority in having to determine a regulated (safety net) price. If the Authority fails to set prices at appropriate levels, recognising the efficient costs and risks faced by retailers in supplying consumers, it will continue to impact the level of competition in Queensland. The preferred approach to ensuring competition exists (and improves) and that consumer's receive benefit from participating in the market is a staged move to full price deregulation.

Alinta Energy notes that since 2012 retail competition has declined in Queensland following the Authority's 2012 price determination and the Queensland Government's decision to freeze Tariff 11. Both of these events resulted in prices being set at unsustainable levels that do not reflect the true cost of supplying consumers, preventing smaller retailers including Alinta Energy from being able to recover their efficient costs and therefore compete in the market. Alinta Energy believes the decline in competition is a detrimental outcome for Queensland consumers who as a consequence are not able to receive the benefits of price and product innovation that competition provides.

Alinta Energy believes the Authority now has an opportunity to improve retail competition in the Queensland electricity market. In the absence of a move to price deregulation, Alinta Energy believes the following is necessary in order to improve the level of competition:

- A reasonable headroom for competition must be allowed for in the retail tariff. This would be best achieved by a reasonable assessment of wholesale and retail operating cost components or a specific headroom allowance;

Alinta Energy Retail Sales Pty Ltd • ABN 22 149 658 300
A Level 11, 20 Bridge Street, Sydney, NSW 2000 Australia
T +61 2 9372 2600 • F +61 2 9372 2610 • W alintaenergy.com.au

- A wholesale energy cost allowance must be based on a combination of Long Run Marginal Cost and market prices, to better reflect the costs incurred by retailers in supplying small electricity customers;
- Operating costs should not be set on the basis of an incumbent retailer, as was previously done in NSW, as this does not adequately account for critical aspects of a new entrant retailer's cost structure, such as branding and marketing costs, customer acquisition and network prudential (credit support) costs;
- Margins should be set in a way that allows a reasonable return while ensuring retailers are incentivised to enter the market; and
- The Uniform Tariff Policy should be administered through the network operator not the retailer to ensure retailers are free to compete in the entire Queensland market, not just the South East Queensland market.

Alinta Energy's specific comments on these matters are provided in the attached submission. If you would like to discuss this submission, please contact me on 08 9486 3762.

Yours sincerely

[redacted]

Michelle Shepherd
General Manager Regulatory and Government Affairs

Alinta Energy's Submission to the Queensland Competition Authority

Regulated Retail Electricity Prices 2013-14: Cost Components and Other Issues

Introduction

Alinta Energy has over 2500MW of generation facilities in Australia (and New Zealand), with retail energy customers in Western Australia, South Australia, Victoria, NSW and Queensland and a commitment to growth across the National Electricity Market. Alinta Energy owns and operates the 240MW Playford B Power Station, and the 2 x 272MW Northern Power Station 1 and 2 in Port Augusta. Alinta Energy holds a retail licence in Queensland for both gas and electricity, however at this stage only retails to large customers.

Subject to the outcome of the price review, Alinta Energy hopes to enter the small customer market in Queensland. However, at this point in time there remains insufficient headroom in regulated retail tariffs to allow for a new entrant retailer, such as Alinta Energy, to achieve a reasonable return on the investment and risk it faces in entering the Queensland small customer market, making market entry uneconomical.

Importance of Competition

Alinta Energy agrees with the Authority's comment that:

> *"...a key objective of notified prices is to provide a transition to effective competition and eventual price deregulation, particularly in SEQ...In particular, the Authority considers that notified prices should not act as a barrier to retailers entering the market and competing vigorously to acquire and retain customers."*[1]

Alinta Energy however does not believe the Authority has achieved its objective of setting regulated prices in a way which does not create barriers to entry. In fact, Alinta Energy's own experience is that prices have been set below the level at which a return can be made and it therefore cannot compete in the Queensland small customer market.

Alinta Energy believes its experience is not isolated and that there has been a decline in competition following the Authority's 2012 price determination and the Queensland Government's decision to freeze Tariff 11.

The Authority, as a matter of priority, must address the cause of this decline in competition caused by regulated tariffs being below efficient levels. In order to remove this barrier to entry, the cost components of the regulated price must be increased to efficient levels - including moving Tariff 11 to cost reflective levels in 2013/14.

Wholesale Energy Cost allowance

As outlined in Alinta Energy's previous submission to the Authority on its 2012/13 price review (*dated 9 December 2011*), a prudent retailer will seek to manage price and load risks by hedging its load over time using a number of different instruments. These instruments usually consist of the following:

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[1] QCA: "Consultation Paper Regulated Retail Electricity Prices 2013-14: Cost Components and Other Issues", December 2012, page 26.

- long term power purchase agreements or building generation plant for ongoing load which is relatively well known;
- layering in contract cover over time (flat swaps, peak and off-peak swaps) as load in the nearer term becomes more certain;
- purchasing caps to manage load which varies either due to seasonal influences (i.e. hot or cold weather) or due to intraday influences such as the morning and evening demand spikes;
- managing residual risk through other financial or insurance instruments, (e.g. weather derivatives); and
- buying any residual energy from the spot market.

Any model which seeks to represent a retailers' Wholesale Energy Costs (**WEC**) should therefore assume that a retailer has layered in hedge cover over the short, medium and longer term through a mix of contracts and through either building or underwriting generation. This assumption should include the relevant risk premiums incurred through a layered portfolio management approach.

Accordingly, Alinta Energy recommends the following approach:

- a mix of Long Run Marginal Cost (**LRMC**) of energy *and* market prices as appropriate proxies for the above portfolio approach (as LRMC reflects the cost of entering into long term power purchase agreements or directly investing in generation plant and market prices are a better reflection of the short term costs of managing load);
- market prices should be based on published market data;
- the hedging strategy applied should be conservative to ensure a retailers' price and volume risks are minimised; and
- an additional risk allowance should be provided for to cover unforeseen extreme load or price events (for example, a volatility allowance which reflects the liquid form capital on hand to fund any volume exposure to the market price cap).

Alinta Energy does not support the Authority's continued reliance on market prices, at the exclusion of LRMC. Such an approach will only serve to entrench the low (to negative) margins implied in the retail tariffs and the current barrier to competition.

Operating costs

Given the Authority has recognised the importance of competition, it should aim to ensure that regulated prices reflect the cost of an efficient new entrant stand alone retailer, with a reasonable size customer base. This would ensure a level playing field for all retailers.

Alinta Energy would be very concerned if the Authority set the operating cost allowance in line with an incumbent retailer's costs, as was the case in NSW. This meant the value applied for such critical aspects of a new entrant retailer's cost structure, such as branding and marketing costs and customer acquisition were not appropriately accounted for.

Alinta Energy believes that setting the operating costs based on an incumbent retailer costs will continue to preclude new retailers entering the market.

Margin

Alinta Energy believes it is critical the margin be set at a level that encourages new entrant retailers into Queensland.

It is widely recognised the impact of margin setting is asymmetric. That is, if margins are set too 'high' they will be mitigated as competitive tension increases within the margin. However, the consequence of a margin which is too low is two fold:

- the opportunity to offer price discounts by all retailers is diminished; and
- it discourages new entrants and tier two retailers from actively engaging in the market, ultimately entrenching the incumbent retailer's position in the market.

To meet the Authority's objective of encouraging competition, it should set a higher margin than provided for in previous determinations.

Uniform Tariff Policy

The government's Uniform Tariff Policy currently allows for a Community Service Obligation (**CSO**) payment to the rural retailer (Ergon). The CSO is effectively a subsidy which is not afforded to any new entrant retailer, restricting retailers from entering this market.

Alinta Energy would prefer the Government's CSO payment be paid at the distribution level, thereby facilitating additional retailers to enter the rural Queensland electricity market.