6 September 2013

Queensland Competition Authority
GPO Box 2257
Brisbane QLD 4001

Submitted via email: electricity@qca.org.au

Dear Sir/Madam,

Re: Regulated Retail Electricity Prices for 2014-15

Lumo Energy would like to thank the Queensland Competition Authority (the Authority) for the opportunity to make a submission in response to the Interim Consultation Paper on Regulated Retail Electricity Prices for 2014-15.

Lumo Energy is 100% owned by Infratil Limited, a company listed on the New Zealand and Australian Stock Exchanges. Lumo Energy currently retails across the National Electricity Market, and is one of the largest second tier energy retailers. As such, it has a keen interest in the outcome of the proposed amendments and the extent to which it promotes efficient investment in the Queensland electricity market that is in the long term interests of consumers.

Competition in Queensland

Lumo Energy strongly supports and welcomes the recent announcement made by the Queensland Government to deregulate prices in South East Queensland from 1 July 2015 onwards. A competitive market ensures price reflectivity and incentivises energy retailers to improve their products and services to meet the needs of their customers.

It is imperative that the Authority sets the regulated retail electricity prices for 2014-15 in a manner that allows for a smooth transition into price deregulation. Lumo Energy supports the Authority making a price determination that promotes a competitive market, where regulated prices are reflective of prices in a competitive arrangement.

Time of use signals

In light of the Interdepartmental Committee on Electricity Sector Reform (IDC) recommendation for flexible pricing, Lumo Energy raises concerns about using network tariffs as the basis for retail tariffs. It is important to note that technology changes are required for retail tariffs to reflect a time of use network tariff. Lumo Energy strongly supports the upgrade of metering technology to allow flexible pricing arrangements and remote services that provide better outcomes for customers.

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Wholesale Energy Costs

Lumo Energy has concerns with the hedging-based approach undertaken by ACIL Allen for the Authority. Energy costs must be reflective of the risk parameters of second-tier and new entrant retailers, particularly in protecting themselves against extreme price events.

The approach must factor in a range of high demand and high price stress test scenarios, irrespective of the level of their occurrence. The current approach understates the real pool prices and peak demand risks that a prudent retailer would consider when deciding on their hedging strategy. As a consequence, it generates a contract portfolio and expected purchase price that leaves an extreme and untenable risk position for retailers.

The concern with extreme outcomes reflects the fact that a single (even improbable event) – if it occurs – could increase the risk of bankruptcy. Thus, retailers will also conduct a "stress test" of their position under extreme market outcomes, and ensure that their hedging position protects their continued viability. This additional objective for hedging may require a much higher level of contract cover than the current approach predicts.

Risk management decisions of prudent and efficient retailers are the product of a far more complex exercise. The scenario above is true for all retailers, but of particular importance for second tier and new entrant retailers, because the relative size of their balance sheet provides reduced capacity to absorb risks. Lumo Energy recommends that this scenario should be included in the hedging-based approach undertaken by ACIL Allen for the 2014-15 review.

The current uncertainty associated with whether a carbon price remains also creates costs for retailers today who need to manage carbon exposures inherent in futures pricing. The Authority, therefore, needs to also ensure that it properly factors in the costs this uncertainty is creating for retailers. Lumo Energy suggests that the ACIL Allen review takes into account AFMA contracts as these provide a good proxy for energy prices.

Retail Costs

Lumo Energy supports retail costs being reflective of all retailers in the market to ensure that it encourages competition. It is clear that the Authority's task of setting a representative retailers cost is both complex and generates significant risk for the market, and subsequently consumers. If the R component is calculated too low (as per the current determination), consumers will lose the competitive market and competitive offers, which are readily available in markets such as Victoria.

Lumo Energy strongly believes that to maintain competition the costs assumed should be those incurred by a smaller retailer. The most significant driver of the difference in retail operating costs is the size of incumbent retailers relative to new entrant retailers. The size of incumbents means that scale efficiencies can be achieved, particularly where fixed costs are spread across a larger customer base, but scale efficiencies means they will also achieve lower variable costs per customer.

Additionally, a second-tier or new entrant retailer will likely carry less capital and therefore be required to be more risk adverse as they are unable to self-insure the risk above a long term mean outcome. If smaller retailers are unable to pass on these additional hedging costs they will not be able to remain competitive and will either exit the market or take on more risk, which could have detrimental effects to the wider market should a "stress event" occur.

Lumo Energy believes that once price deregulation occurs in South East Queensland, or where price caps are set at a level that enables competition, second-tier and new entrant retailers will then be further encouraged to make their businesses as efficient as possible by delivering the most competitive offer they can to customers.

Lumo Energy looks forward to continuing to work with the Authority and other stakeholders through the further stages of the review. As such, we would welcome the opportunity to meet with the Authority to further discuss the issues raised in this submission.

If you require any further information, please contact me on 03 8680 6439 or Stefanie Macri on 03 8683 2427 to discuss this submission further.

Yours sincerely

[redacted]

Aneta Graham
General Manager, Regulatory Affairs & Corporate Relations
Lumo Energy Australia Pty Ltd