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Queensland Competition Authority
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By email: electricity@qca.org.au



Regulated Retail Electricity Prices 2014-15 – Draft Determination

General Comments

AGL Energy Ltd (**AGL**) welcomes the opportunity to provide comments to the Queensland Competition Authority (**QCA**) on its Draft Determination: Regulated Retail Electricity Prices 2014-15 (**Draft Determination**).

AGL supports the QCA's stated position that "a key objective of notified prices is to facilitate the development of competition in the Queensland retail electricity market¹".

This objective, in conjunction with the Queensland Government's stated intention to replace retail electricity price regulation with price monitoring in south-east Queensland by 1 July 2015 makes it essential that the notified prices for 2014-15 do not undermine the transition to deregulation.

Given these circumstances, AGL strongly supports:

- the methodology adopted by the QCA in its draft report of calculating two sets of retail prices, one including the full pass-through of carbon and the other with no carbon costs. This approach is the only effective and equitable manner for dealing with the timing uncertainty surrounding the repeal of carbon pricing;
- the QCA's use of a benchmark approach for setting retail operating costs, customer acquisition and retention costs and retail margin consistent with its 2013-14 Determination; and
- maintenance of the headroom allowance at a level consistent with the QCA's 2012-13 and 2013-14 Determinations.

AGL remains of the view that the current approach to setting regulated electricity retail prices does not deliver the optimal long-term policy settings for consumers and the industry alike and considers that a market based approach with an assessment of long run marginal costs (**LRMC**) of supply as a floor would be a more effective approach.

Notwithstanding this, this submission is focussed on the current approach adopted by the QCA and seeks to clarify a number of issues with the methodologies used by the QCA and ACIL Allen Consulting (**ACIL Allen**) in calculating the notified prices.

¹ QCA, Draft Determination: Regulated Retail Electricity Prices 2014-15, p38

1. Energy Costs

1.1. Wholesale energy costs

AGL notes the QCA's decision to retain its hedging based approach as used in previous years. AGL continues to support a wholesale energy cost (**WEC**) based on using a market-based approach with the LRMC of electricity generation as the floor. However, given the QCA's stated preference, this submission will only focus on the methodology used in the draft report.

1.2. Carbon policy uncertainty

The QCA has taken into account the submissions provided by AGL and other market participants regarding carbon price uncertainty including when it will be repealed, how it will occur and the impact it is having on current 2014-15 futures prices.

Consequently, AGL strongly supports the adjustments the QCA had made to its previous methodology to account for this uncertainty, namely:

- Determining both inclusive and exclusive wholesale energy cost estimates so that the QCA is in a position to calculate the relevant retail tariff depending on the circumstances regarding carbon pricing; and
- Using OTC forward contract data that excludes the impact of carbon at the time of trading and settles contracts using a 'carbon pass-through' clause developed by AFMA. This is the only practical data source for determining carbon inclusive and exclusive wholesale energy costs.

Importantly, the QCA has recognised the use of futures contract prices for 2014-15, which are carbon inclusive, would only be estimating an average energy cost for the financial year based on current views on likely carbon repeal outcomes.

Using such an annual estimate would assign enormous financial risk on retailers and is clearly not advisable. AGL also note that using such an estimate would greatly complicate the implementation of carbon repeal as retail electricity prices would be expected to decrease in line with the full cost of carbon.

1.3. ACIL Allen Modelling

Apart from using OTC forward contract data, the ACIL Allen methodology for modelling wholesale energy cost in the draft report is largely unchanged from that used in the 2012-13 and 2013-14 determinations.

For 2013-14, AGL queried ACIL Allen's methodology with regard to:

- scaling of the NEM regional peak demands to the AEMO 10% POE demand forecast resulting in the NSLP peak demand distribution being capped at 1 in 10 year demand rather than a 1 in 42 year demand;
- the approach used to develop the 39 simulated demand traces results in the peak demand levels being limited to the peaks in the 3 years of actual demands sets rather than taking into account the relationship between the 39 years of weather data and the peak demand levels in the Energex NSLP; and
- ACIL Allen's expectation that NSLP peak demand response to an increase in temperature softens where temperature exceeds 35 degrees.

In its review of these issues in the draft report, ACIL Allen has not been persuaded to adjust its methodology for 2014-15.

In principle, AGL remains unconvinced on the treatment of these matters but accepts that ACIL Allen has provided further detail in this draft report to support its position and that:

- the scaling of the regional peak demand to the AEMO 10% POE demand forecast is a limitation but ACIL Allen's analysis shows that it does not have a material impact on

the modelling result because of the lack of correlation of between NSLP peak demand and projected price peaks;

- the 43 demand traces are now linked to 4 years of actual demand data. AGL recognises this is an improvement.

However, AGL continues to have concerns with respect to some aspects of ACIL Allen’s demand derivation.

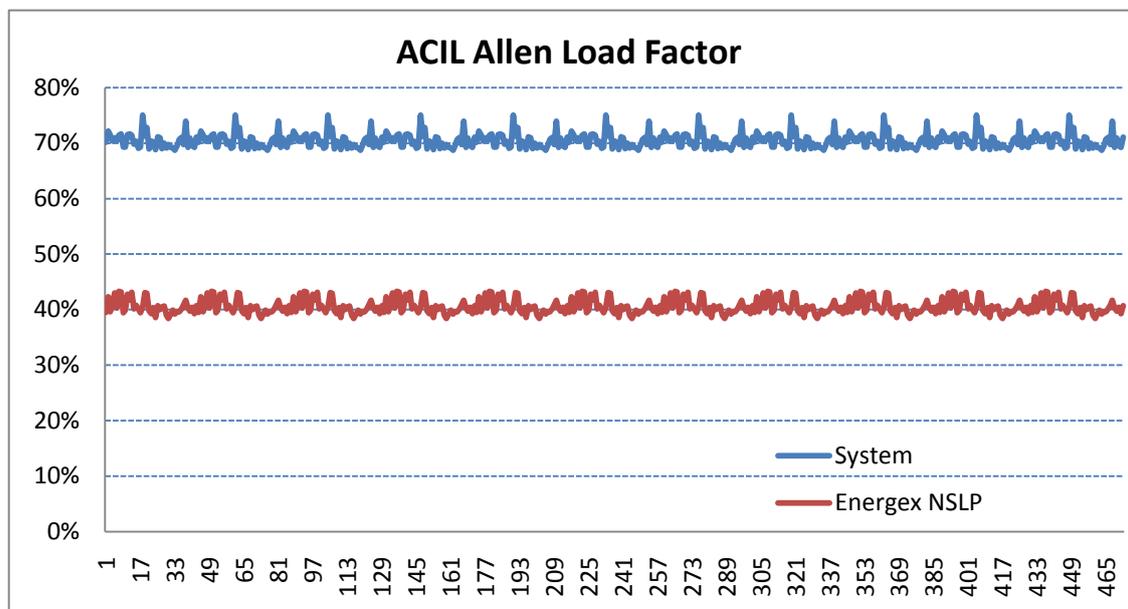
Maximum Demand Forecast

Since 2007, there have been only periods when Archerfield had consecutive days with daily maximum temperature above 35 degrees and both occurred on a weekend. The most recent hot days in Brisbane occurred on 3-4 January 2014 with maximum temperatures of 36.2 and 43.5 degrees respectively. The preliminary NSLP data published by AEMO shows that the maximum demand of the Energex NSLP increased from 2165 MW on 3 January to 2566 MW on 4 January 2014. AGL recognises that final NSLP profiles will be different from preliminary data but this shows a significant demand increase on consecutive hot days.

This evidence does not support ACIL Allen’s assumption of limited increase in demand at temperatures greater than 35 degrees. This is exactly the increase in demand that can lead to price volatility and potentially exposure to the spot price for retailers. AGL also note the lack of other historical weather and demand data for consecutive hot days which means that ACIL Allen’s assumption cannot be validated.

AGL also observes that the maximum demand of 2566 MW on 4 January 2014 (preliminary data) exceeds ACIL Allen’s simulated maximum demand of 2485MW for the Energex NSLP for 2014-15. AGL does not consider that the simulations of demand adequately capture the variability of the Energex NSLP. For example, there is a greater degree of variation between simulations in respect of the system demand forecast than there is for the Energex NSLP forecast. This is demonstrated in figure 1 which depicts the load factor of the simulations for the system demand forecast and the Energex NSLP forecast.

Figure 1: Load Factor of ACIL Allen’s Demand Forecasts



The graph illustrates there is a greater degree of variation in the system demand load factor than in the assumed load factor of the NSLP. This is contrary to expectations as residential air conditioning by and large drives peak summer demand.

The variability of system demand load factor should be less than variability in the NSLP load factor and the historical data for Queensland presented in Table 1 confirms this with load factor for the Energex NSLP varying over a large range compared to the variability in Queensland system load over the same 6 year period.

Table 1: Historic Load Factors

Year	Qld System Load		Energex NSLP	
	Load Factor (%)	Variation to average (%)	Load Factor (%)	Variation to average (%)
2008	70.70	103.44	38.26	94.38
2009	68.47	100.18	43.90	108.29
2010	67.21	98.34	40.74	100.49
2011	66.57	97.40	42.21	104.12
2012	67.51	98.76	38.84	95.81
2013	69.64	101.89	39.29	96.90
Average	68.35		40.54	
Range	4.13		5.64	

AGL also note there is a lack of clarity in respect to how ACIL Allen has assumed cap contract volumes. From the draft report, it is not clear whether the volumes have been set by reference to either 105% of the quarterly peak demand or with reference to 105% of the median of the 43 quarterly peak demands minus the base and peak contract volumes.

This should be clarified in the final report and AGL also requests that ACIL Allen publish the distribution of the 43 quarterly peak demands in each quarter for greater transparency and to allow participants to evaluate the likelihood of exposure to the spot market under the established hedging strategy.

1.4. Other energy costs

AGL supports the QCA's approach, as used in previous determinations, for estimating NEM fees, ancillary service charges and the small-scale renewable energy scheme (SRES) including the retention of the STC clearing house price.

However, AGL remains of the view that determining the cost allowance for LRET should theoretically include the range of costs that would be experienced by a retailer sourcing LGCs. The transparent market for LGCs is a residual one, fundamentally influenced by alternative investment decision and is not the most appropriate for setting a regulated retail electricity price.

2. Network Costs

The terms of reference requires the QCA to set notified prices for residential and small customers based on Energex network prices and for large customers, based on Ergon Energy network prices. The approach taken by the QCA is in accordance with the terms of reference and AGL supports it.

AGL also agrees that the QCA set the notified prices based on network tariffs submitted to the AER for approval in April with a pass-through mechanism if there is material difference between the submitted and final approved tariffs. In this instance, AGL would highlight that the likely repeal of carbon pricing would require the gazettal of a second set of notified prices during 2014-15 and any network charge variation could be smoothly incorporated at that time.

3. Retail Costs and Headroom

Given the planned move to price monitoring in southeast Queensland on 1 July 2015 it is important that there are no material changes to the QCA's setting of retail cost benchmarks for 2014-15. AGL therefore supports the QCA positions in the draft report of:

- maintaining the benchmark retail operating costs and customer acquisition and retention cost in real terms;
- allocating the ROC to the fixed component of the general supply tariffs;
- continuing with a benchmark retail margin of 5.7%; and
- retaining the headroom allowance of 5% of cost-reflective retail prices.

4. Other Issues

4.1. Cost pass through

AGL supports the cost pass-through mechanism for 2014-15 but is not in a position to determine whether there is any requirement for the pass-through to consider SRES costs from 2013-14.

This will only become apparent with the release of the binding STP for 2014.

4.2. Transitional Arrangements

The fixed and variable components of Tariff 11 continue to be set on a three year path to reach cost reflective levels by 1 July 2015. AGL has previously requested that the QCA pursue a quicker transition and attempt to set Tariff 11 to a cost reflective structure for 2014-15. We considered this an important step to ensure the move to price monitoring on 1 July 2015 was not complicated by further price transitioning.

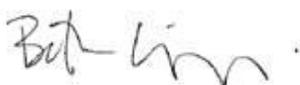
We note the QCA has decided to continue with its transitional approach with the target costs being based on current costs and charges. The QCA's approach may be acceptable but AGL urge the QCA to investigate any potential changes in network charge structure for 2015-16. It would ideal if the QCA were able to set its transitional price path using best available information on future underlying costs.

5. Conclusion

AGL remains concerned with some aspects of ACIL Allen's modelling of the WEC, especially where it may understate retailer's exposure to demand and price volatility. AGL does, however, concur with the QCA's treatment of the carbon pass through.

If you have any questions on the submission please contact Patrick Whish-Wilson on 07 3023 2426.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Beth Griggs'.

Beth Griggs
Head of Energy Market Regulation