alintaenergy

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Queensland Competition Authority
GPO Box 2257, Brisbane Q 4001

By email: electricity@qca.org.au

Draft Determination on Regulated Retail Electricity Prices 2014 - 15

Alinta Energy Retail Sales Pty Ltd (**Alinta**) welcomes the opportunity to comment on the *"Draft Determination on Regulated Retail Electricity Prices 2014 - 15"*.

Alinta Energy is both a generator and retailer of electricity and gas in Western Australia and the Eastern States energy markets. It has over 2500MW of generation facilities and in excess of 700,000 retail customers, including around 140,000 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 the Issues Paper.

At the outset Alinta would restate its view that price monitoring is our preferred approach for setting prices in a competitive market. Competitive markets function best where market forces are permitted to be exercised, driving market innovation and benefits for consumers. The continuation of price regulation carries with it on-going risk. As stated in the draft determination "*regulation will almost always be an imperfect substitute for competition*" [1] The continuation of price regulation, particularly where regulators have imperfect information on which to base their determination on what is the level of efficient costs and prices, creates market uncertainty for retailers. Inaccurate (non-cost reflective) price setting severely limits a retailer's ability to recover their prudent costs of operating in the market.

Alinta whilst being an active retailer in Queensland, we are currently only supplying and making offers to unregulated business customers. This decision continues to be based on the risk faced by retailers when attempting to operate in markets where regulated prices are not set at a level that allows retailers to recover their efficient costs of operating in the market. The complexities faced by the Authority in attempting to determine prices continue to be highlighted in the draft determination. The number of individual elements that require assessment and determination illustrates the level of complexity in attempting to set cost reflective prices.

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[1] 5.1.1 Introduction Draft Determination Regulated Retail Electricity Prices 2014-15 page 37

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It is with this in mind that Alinta supports the Government's commitment to replace retail price regulation with price-monitoring in south east Queensland by 1 July 2015. The move to price monitoring will create certainty for retailers.

Our further comments on the draft determination are contained in the following document. Should you have any questions or wish to discuss our submission please contact (02) 9372 2653 or via email: shaun.ruddy@alintaenergy.com.au

Yours Sincerely

Shaun Ruddy

Manager National Retail Regulation

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Network Costs

Prudent & efficient network costs as determined by the Australian Energy Regulator (AER) should be treated as a straight pass through provision within the cost stack of the price determination. Where there is any material change in network tariff allowed for by the AER, a sufficient pass through mechanism should provide for the pass through of the variation in a timely manner.

Wholesale Energy Costs

As has been previously stated in our submissions, Alinta does not support the Authority's approach to solely rely on a hedging / market based model for determining the Wholesale Energy Cost (**WEC**) allowance. The Authorities preferred methodology does not accurately reflect the way retailers hedge their portfolio as it does not include the cost of medium and long term hedge strategies, including building, underwriting or investing in generation. A prudent retailer will seek to manage price and load risks by hedging its load over time using a number of different instruments.

Given this a representative retailer's WEC it should be assessed on the basis that a retailer has layered in hedge cover over the short, medium and long term through a mix of contracts, and through either building, underwriting or investing in generation.

In the absence of price deregulation the Authority must ensure the methodology used in determining the allowable WEC accurately reflects what naturally occurs in the market. At a minimum the Authority should be looking to use a combination of both a hedging–based model and Long Run Marginal Cost (**LRMC**) methodology. Given wholesale market prices are naturally volatile, it is important that retailers are able to recover their costs of managing this price volatility.

Accordingly, Alinta remains of the view the WEC assessment should be made up of:

- a mix of 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 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 continues to support its position on the use of LRMC in determining the WEC, with the acceptable option of a mix of LRMC and market based prices with the weighting focused on the LRMC component.

Retail Costs

The Authority in its draft determination attempts to recognise Retail Operating Costs (ROC), given the Authority has also recognised the importance of competition the Authority should aim to ensure regulated prices reflect the cost of an efficient new entrant standalone retailer. As the draft determination states "*there are 15 retailers supplying residential and small business customers in Queensland*"[2]. Given the vast majority of these retailers are not large incumbent retailers it does not seem prudent to continue to base the ROC allowance on large incumbent retailers as it's not representative of the (true) efficient costs of supplying customers.

In assessing the ROC, the Authority has recognised typical costs faced by retailers including, customer administration (including call centres), corporate overheads, billing and revenue collection, IT systems, regulatory & compliance, customer acquisition and retention costs (**CARC**). Whilst having identified a number of prudent costs faced by retailers, there is significant difference in the level of costs faced by second tier retailers to those faced by large incumbent suppliers. These differing levels of costs need to be accounted for, further the additional costs faced by non-incumbents, such as credit support / prudential requirements must also be accounted for in the Authorities determination.

Customer Acquisition & Retention Costs

We support the continued inclusion of an allowance for CARC. As the Authority stated in the draft determination the basis for determining the level of CARC is not linked to particular forms of marketing, therefore the fact that some retailers have chosen to alter their marketing strategies should have no bearing on the Authorities review of allowable CARC.

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[2] Section 5.1.4 How Much Headroom, page 41

Regulatory Fees

Alinta supports the inclusion of a cost allowance to cover Regulatory fees. The allowance provided for within the determination must allow for the full recovery of the fees levied on retailers.

Margin

Alinta supports the continuation of an allowance for a retail margin to be included in the determination. The proposed level of margin (5.7%) remains contingent on the assumption that all other costs, WEC, ROC & CARC have been accurately assessed and determined.

Retailers require a reasonable level of margin / rate of return on their investment to enter a new market, taking into consideration the costs, level of investment and risk faced by a retailer. Where a retailer is unable to recognise a reasonable return for their investment (and risk) it will impact future investment in the sector and may result in existing participants seeking to exit the market.

Uniform Tariff Policy

The Customer Service Obligation (**CSO**) under the Uniform Tariff Policy has the impact of creating barriers to entry into the Ergon area. The CSO is effectively a subsidy which is not provided equally to all retailers. Alinta holds the view that the CSO, if it is to continue, should be paid at the distribution level, removing a market distortion, creating a level playing field allowing a greater opportunity for retailers to enter areas outside of the south east Queensland market.

Moving the CSO to a distribution pass through subsidy will also aid in the transition to a price monitoring regime.