Australian Power & Gas

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Queensland Competition Authority
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Draft Methodology Paper on Regulated Retail Electricity Prices 2012-13

Australian Power & Gas (APG) welcomes the opportunity to provide comments to the Queensland Competition Authority (QCA) with respect to its *Draft Methodology Paper on Regulated Retail Electricity Prices 2012-13*. Our comments follow on our response to the QCA Issues Paper on the *Review of Regulated Retail Tariffs,* dated 2 August 2011. Further, we support the submission of the Energy Retailers Association of Australia (ERRA), of which APG is a member.

APG is a "second tier" electricity and gas retailer operating in the Queensland market since August 2010 where we actively compete to offer customers better prices and services against other energy retailers. We understand that it is Queensland government's objective to continue to ensure that consumers enjoy, wherever possible, the benefits of increased competition in the marketplace. It is with this understanding that APG has entered and positioned itself for long term presence in Queensland.

As stated in our response to the Issues Paper, we continue to maintain the firm view that QCA should look to phase out regulated pricing in favour of a regime where market forces determine cost reflective pricing. While we understand that this is not in scope under the Draft Methodology, we maintain that the best way to increase competition and protect consumer interests is to remove retail price regulation altogether.

In reviewing the Draft Methodology, we are concerned that new market entrants to the Queensland market such as APG will be disadvantaged, through:

- The use of a large incumbent retailer as the Representative Retailer profile used to determine retail costs and margin of retailers; and
- The immediate removal of the Long Run Marginal Cost (LRMC) mechanism which may disadvantage retailers under their existing commercial arrangements.

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Retail Costs

We are concerned that the Representative Retailer profile used to determine an appropriate retail operating costs, customer acquisition and retention costs (CARC), and retail margin continues to be based on a large incumbent retailer. We do not see this as a significant improvement over the Benchmark Retail Cost Index (BRCI) methodology currently in place which also relied on retail costs of large incumbent retailers to determine operating costs, CARC and retail margins.

As a new market entrant, APG does not have the economies of scale of large incumbent competitors resulting in potentially higher retail operating costs and CARC. Those costs that have to be absorbed and effectively erode the retail margin set in the Draft Methodology at 5%. A number of retailers commented to the QCA on the Issues Paper that allowing for the Representative Retailer to be a new market entrant or small to moderate sized retailer would encourage a formula that reflected a wider range of market participants. This would ensure that most retailers would not be disadvantaged by the economies of scale of large incumbent retailers being reflected in the pricing formulae. Ensuring a level playing field in the price determination for new market entrants will increase competition and ultimately better consumer outcomes.

We understand that other jurisdictions, such as South Australia, have adopted a new entrant retailer focus to ensure that electricity retailers will be able to effectively compete in the market and deliver the benefit of competition to consumers.

We therefore recommend as part of the review of the draft methodology's impact on retailers that consideration be given to ensuring that the Representative Retailer profile be one that will encourage market entrants and increased competition.

The Impact of Removing the LRMC

As stated in our comments to the Issues Paper, we see merit in the approach taken by the QCA in adopting a more market based approach to determining energy costs for retailers. However, we are concerned to see that QCA has removed the LRMC mechanism, the effective price floor, which will likely have serious repercussions on retailers existing wholesale purchasing arrangements and current customer contracts.

APG has been operating in the Queensland market since August 2010 and has built its offering of competitive rates to customers and our long-term wholesale purchasing position based on the current regulated retail methodology, which includes a price floor. Removal of the price floor may effectively price wholesale electricity purchased under long-term contracts above that of the regulated retail price thereby reducing the current headroom allowed under the current methodology. The net impact of this scenario may be higher prices experienced by consumers or reduction in the number of retailers able to viably operate in the market.

We therefore recommend that consideration be given by the QCA in its Draft Determination to ensure that the regulated retail costs do not disadvantage retailers established in the market and who have engaged customers based on pricing under the current methodology.

It is important to retail competition that retailers in the market are able to manage their margins with some degree of certainty. This becomes increasingly untenable if there are frequent or short notice changes in the methodologies under which pricing is set. We recommend that the QCA considers this when contemplating this and any further change that impacts retail pricing calculations prior to full deregulation.

Thank you again for the opportunity to comment on the *Draft Methodology Paper on Regulated Retail Electricity Prices 2012-13.* Should you wish to discuss any aspect of these or previous submissions to the QCA, I can be contacted on (02) 8908-2714 or via email at hpriest@auspg.com.au.

Yours sincerely,

[redacted]

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