QCOSS
queensland council of social service inc
WORKING FOR A FAIR QUEENSLAND

Submission by the Queensland Council of Social Service (QCOSS) on the Queensland Competition Authority (QCA) Draft Determination: Regulated Retail Electricity Prices 2012-13.

About QCOSS Inc

Queensland Council of Social Service (QCOSS) is the peak body for over 600 welfare and community sector organisations in Queensland. For over 50 years QCOSS has worked to promote social justice and exists to provide a voice for Queenslanders affected by poverty and inequality.

QCOSS is funded by the Department of Employment, Economic Development and Innovation (DEEDI) and the Department of Justice and Attorney-General (DJAG) for an energy consumer advocate project in Queensland. The objective of the QCOSS Energy Consumer Advocacy Project is to examine and provide quality input into Queensland Government energy policies for all residential consumers in Queensland and with special consideration of the needs of pensioners, low income earners and energy consumers experiencing financial hardship. This work is supported by an advisory group involving other key consumer groups.

About this Submission

QCOSS has engaged Etrog Consulting Pty Ltd to provide advice to QCOSS on the QCA Draft Determination on Regulated Retail Electricity Prices with a focus on the matters that impact on residential consumers in Queensland. The report from Etrog Consulting that follows was prepared in consultation with and on behalf of QCOSS and should be taken as the QCOSS response to the QCA Draft Determination.

This consultancy was funded by the Consumer Advocacy Panel (www.advocacypanel.com.au) as part of its grants process for consumer advocacy projects and research projects for the benefit of consumers of electricity and natural gas.

The views expressed in this document do not necessarily reflect the views of the Consumer Advocacy Panel or the Australian Energy market Commission.

Preliminary Comments

The Queensland Council of Social Service (QCOSS) welcomes the opportunity to comment on the QCA draft determination on Regulated Retail Electricity Prices. QCOSS has actively participated in all stages of the QCA pricing and tariff review process as the outcomes are of great significance to Queensland consumers, particularly in view of the rising energy costs experienced by households in the previous five years. It is critically important that electricity price increases are both fully justifiable and minimized to the greatest extent

possible. The methodology used to determine the regulated price must therefore be defensible and based on the most accurate data available. Our views as to the appropriateness of the QCAs assessment of retail and energy costs are outlined in the submission prepared by Etrog Consulting on our behalf. While there are many points on which we note our support for the QCA approach, our submission raises a number of issues in relation to the calculation of costs including:

- The method used to calculate Carbon Costs
- The inclusion and allowance for Customer Acquisition and Retention Costs
- The increase in the allowance for the retail margin
- The calculation of the SRES costs
- The inclusion and allowance for headroom.

The manner in which costs are allocated and recovered across the customer base through tariff design is also of great importance to consumers because tariff design can benefit some groups of consumers while others are significantly disadvantaged.

Our submission therefore also comments on the significant impact on some customer segments that will result from the revised tariff arrangements, in particular, as a result of the 200% increase in the fix charge component and as a result of the introduction of an inclining block tariff. Throughout the tariff review process QCOSS has argued that there should be a public and full examination of the customer impacts of the proposed changes, before such changes are introduced. We have also strongly argued that the introduction of an inclining block structure would require a review of the current concessions and other support arrangements to ensure that the value of the current public safety net is maintained and that assistance for consumers is well targeted and equitable. Neither of these two critical steps has occurred to date.

The QCA acknowledges that the effect of the new tariffs is that low, average and high energy consuming customers will experience different overall price increases. Low consumption customers (amongst whom low income households are overrepresented) will on average experience a 13.2% (or $104) increase per year, average consumption customers just 3.9% (or $52), and high consuming customers in the order of 14.9% (or $389 per year). These are only average increases for each grouping. In reality, some customers at the extremes of low and high consumption will be significantly worse off. Through QCOSS work in energy we know there are pensioner households whose quarterly bills are as low as $95 before their pensioner concession is applied. For these households the affect of the increase in the fixed charges will be a doubling of their bills from July 1.

At the other end of the spectrum – for households consuming large amounts of energy - there will be significant price impacts related to consumers being charged in the third and highest cost tier. While we support the overall objective of encouraging a reduction in energy use, we maintain that there are some low income households that have high usage for reasons beyond their control such as poor quality housing and/or appliances, household size and composition, or medical conditions that require additional energy use. Assistance in the form of concessions and support for energy efficiency are required for such households.

While we understand that concessions and other assistance are matters for the Queensland government - and we intend to write to the government separately on these issues as soon as possible - we argue that it was within the remit of the QCA, given the instructions in the Ministerial delegation, to take account of the price impacts on various

customer segments in making it's determination. We consider that the QCA has failed to do so.

In addition, we suggest that in its final determination the QCA should introduce arrangements to ease the transition from the old tariffs to the new for customers who would otherwise be facing significant price increases. The QCA has accepted that such arrangements are suitable for commercial and farming customers, and we believe that residential customers similarly need to time to understand and adjust to the new pricing structures that they will face.

Further detail in relation to all these matters and additional points follow in the attached submission. We look forward to continuing to represent the interests of Queensland consumers in energy related matters. For further information or to clarify any aspect of this submission, please contact Linda Parmenter, Manager Low Income Consumer Advocacy on 3004 6900 or email lindap@qcoss.org.au.

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Etrog Consulting

REPORT

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Regulated Retail Electricity Prices 2012-13: Comments on Draft Determination

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1. INTRODUCTION

This report has been prepared by Etrog Consulting Pty Ltd for Queensland Council of Social Service (QCOSS). It comments on the Draft Determination on Regulated Electricity Prices to apply in Queensland from 1 July 2012 to 30 June 2013, which was published by the Queensland Competition Authority (the Authority) on 30 March 2012, inviting submissions from interested parties.

At the same time, the Authority also released a report written by ACIL Tasman on estimating energy purchase costs for use by the Authority in its Draft Determination, and other supporting documentation.[1]

The Authority has requested that submissions to the Draft Determination should be received by 13 April 2012. This report has been developed in consultation with QCOSS with the understanding that QCOSS is intending to include this report in its submission to the Authority on the Draft Determination.

The remainder of this report comments on various matters in the Authority's Draft Determination on Regulated Retail Electricity Prices for 2012-13, and largely follows the same structure as the Draft Determination.

- Section 2 covers network costs.
- Section 3 covers energy costs.
- Section 4 covers retail costs.
- Section 5 covers cost-reflective retail tariffs and prices.
- Section 6 covers competition, transitional and other issues.

1 The Authority's Draft Determination and the ACIL Tasman paper and other documentation have been published on the Authority's website at www.qca.org.au/electricity-retail/NEP/draftDec.php.

2. NETWORK COSTS

Chapter 2 of the Draft Determination sets out the Authority's proposal on how to incorporate network costs in regulated retail electricity prices for 2010-13 in Queensland. It is divided into two sections:

- Section 2.1 covers Treatment of Network Costs; and
- Section 2.2 covers Maintaining Alignment of Retail and Network Tariffs.

Our comments here follow the same structure.

2.1. TREATMENT OF NETWORK COSTS

The main comment we wish to make on section 2.1 of the Draft Determination is that the introduction of the residential inclining block tariff will have significantly different effects on customers with different levels of usage of electricity.

We note in particular the following changes in Tariff 11 Network Use of System (NUOS) charges (Energex network charge 8400)[2] from the implemented 2011-12 charges to the proposed equivalent charges for 2012-13 (including GST):

- Increase in the fixed charge from 36.3c/day to 38.5c/day
- Change in variable rates for energy usage from 9.7064c/kWh for all units consumed, to:
  - 8.6955c/kWh for the first 13.69 kWh/day (approximates to 5000 kWh pa)
  - 16.522c/kWh for the next 13.69 kWh/day
  - 20.8703c/kWh for all remaining consumption.

Some of the implications of these changes as they impact on retail tariffs are discussed in section 6.2 below.

2 Network tariffs are comprised of both Distribution Use of System (DUOS) tariffs – which relate to the network charges incurred for use of the ENERGEX distribution network; and Designated Pricing Proposal Charges (DPPC) – which relate to the network charges incurred for use of the Powerlink transmission network. The Network Use of System (NUOS) tariff represents the sum of DUOS and DPPC.

2.2. MAINTAINING ALIGNMENT OF RETAIL AND NETWORK TARIFFS

We were pleased to read in the Draft Determination that the Authority sees some merit in our suggestion to revise regulated retail prices only if the AER approved network prices were materially different to those proposed by the distributors and used as the basis for retail prices.[3]

We largely concur with the view of the Authority:

> The Authority considers that, should the need arise, regulated retail tariffs that apply from 1 July 2012 could be amended to reflect any material changes to network tariffs that are approved by the AER, including any adjustment to compensate retailers for altered network charges incurred by them prior to regulated retail tariffs being adjusted. However, as per the Delegation, the Authority's role in relation to setting notified prices for 2012-13 ends on 31 May 2012.

We note only that the reference to "any adjustment to compensate retailers for altered network charges" suggests in the word "compensate" a one-way adjustment to allow the retailers to recover more than they previously had. We believe that any adjustment should be applied without discrimination, whichever is the direction of the adjustment and propose the following wording instead:

> The Authority considers that, should the need arise, regulated retail tariffs that apply from 1 July 2012 could be amended upward or downward to reflect any material changes to network tariffs that are approved by the AER, including any adjustment for altered network charges incurred by the retailers prior to regulated retail tariffs being adjusted. However, as per the Delegation, the Authority's role in relation to setting notified prices for 2012-13 ends on 31 May 2012.

We also suggest that to avoid later argument the Authority should set out a materiality threshold in its Final Determination.

3 Draft Determination, page 18

3. ENERGY COSTS

3.1. INTRODUCTION

Under the Delegation, the R component of each retail tariff is to include appropriate allowances for energy and retail costs.

The Delegation requires that the energy cost component of each regulated retail tariff should include the cost of purchasing energy, environmental and renewable energy costs, energy losses and NEM fees.

3.2. WHOLESALE ENERGY COSTS

Wholesale energy costs (energy costs) relate to the costs incurred by a retailer in purchasing electricity to cover the load of its customers. While this electricity is ultimately purchased from the NEM (the spot market), there are a range of measures that a retailer can take in order to reduce its exposure to volatile prices in the spot market, including purchasing financial derivatives (futures, swaps, options etc.) to offset its exposure, entering longer-term power purchasing agreements with generators or investing in generation assets.

3.2.1. Approach to estimating wholesale energy costs

Building on our previous submission and the comments made in the Draft Determination, we concur with the Authority's decision not to include estimates of LRMC in any way in its energy cost estimates for 2012-13, and instead to adopt a market-based approach

Should the Authority consider a change to that decision in its Final Determination, it should refer to our previous submission and the Authority's own Draft Determination for reasons as to why its Draft Determination should not be changed in this respect.

We accept the market-based approach to estimating wholesale energy costs that is set out in the Draft Determination, with one significant exception. The Authority has said:[4]

> ACIL found that the levels of trading of 2012-13 base, peak and cap contracts in the d-cypha Trade futures market were comparable to those for previous years for all quarters except for base and peak contracts for the first two quarters of 2013. For these quarters, ACIL considered it could use the d-cypha Trade prices, but remove trades prior to the carbon tax legislation passing parliament[5] because, prior to this, it was difficult to ascertain what proportion of carbon costs were being passed through in the contract price.

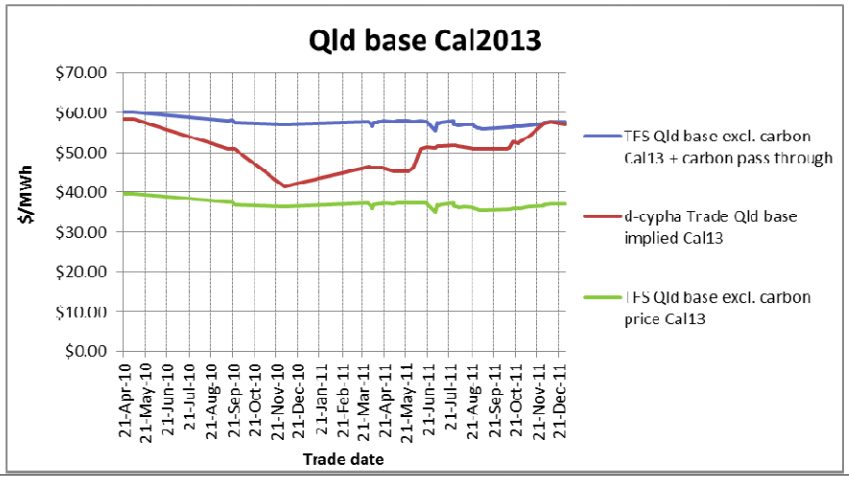
4 Draft Determination, page 24

5 The Clean Energy Future legislation passed the Federal Parliament on 8 November 2011.

We suggest that the removal of trades prior to the carbon tax legislation passing Parliament is not appropriate. Those trades did actually occur, and it was reasonable for an efficient retailer to conduct those trades. The d-cypha Trade prices would stand without any additional carbon tax premium being paid if the carbon tax was later introduced. Hence they represented a far more efficient way for retailers to hedge their wholesale energy costs, and retailers used that method to hedge some of their purchases. Before the carbon tax legislation passed Parliament, the d-cypha Trade prices did not fully reflect the carbon tax uplift that was later built into the prices after the legislation passed Parliament. Therefore, leaving out those earlier trades misses out on those lower overall prices, and artificially inflates the overall allowance for wholesale energy costs in the regulated retail prices for 2012-13.

This issue is discussed in section 3.2.2 of ACIL Tasman's report which accompanied the Draft Determination. Discussion centred on Figure 7 in ACIL Tasman's report, which is reproduced here:

Figure 7 **Time series comparison of contract prices for Calendar 2013 base contracts – TFS excl. carbon & d-cypha Trade**



Note: d-cypha Trade Qld base price for calendar year 2013 is implied from quarterly contract prices
Data source: ACIL Tasman analysis based on TFS and d-cypha Trade data

As stated in the ACIL Tasman report:

> Figure 7 demonstrates how the futures market has priced the carbon price component in d-cypha Trade 2013 futures over time.
>
> The step change in June 2011, occurring when the Government announced details on the timing and level of carbon tax, reflects an increase in probability, although still less than 100 percent, that a carbon price would be in place in 2013, while from November 2011, when the carbon tax legislation passed the Senate, the red line meets the blue line, indicating that the futures market has factored in a 100 percent probability of a carbon price in 2013.
>
> …

As demonstrated in Figure 7, the futures market started to factor in 100 percent probability of a carbon tax in 2013 from 8 November 2011 when the Senate passed the Clean Energy Future (CEF) legislation.

In effect, from 8 November 2011, the 2013 futures price is identical to the price of 2013 OTC contract excluding carbon plus the carbon pass-through (see Figure 7).

The effect of excluding prices before 8 November 2011 is to estimate wholesale energy prices based on the blue line rather than the red line. It is pretty clear from Figure 7 that retailers hedging using prices quoted by d-cypha Trade before 8 November 2011, when there was more uncertainty regarding the carbon tax, actually hedged based on the red line rather than the blue line, and therefore paid much less than the allowance for wholesale energy costs being given in the Draft Determination

Carbon costs are considered further in section 3.2.6 below.

The approach to estimating wholesale energy costs for 2012-13 should incorporate the use of d-cypha Trade prices, and should not remove trades prior to the carbon tax legislation passing Parliament.

3.2.2. Customer load forecasts

We have no significant issues with the Authority's positions regarding customer load forecasts.

3.2.3. Hedging strategy

We are comfortable with the Authority's hedging strategy including the assumption that a retailer would spread its energy purchases over a four-year period with the cost of purchasing the required hedging contracts to cover the forecast loads being based on d-cypha Trade contract price data. Our main concern as mentioned in section 3.2.1 above is the removal in some of the modelling of trades prior to the carbon tax legislation passing Parliament, which essentially means that in those cases the modelling covers a period much shorter than the four-year period stated in the Draft Determination. With those removed trades reinstated, the hedging strategy would be fit for purpose.

3.2.4. Spot price forecasts

We previously commented:

> Instead of using a proprietary model to forecast spot prices, the Authority could rely on historical spot price outcomes against which to model forward contract prices, following the lead of the ICRC.[6] This should produce results that are more transparent, and more easily checked and auditable. It would remove the Authority's reliance on an external consultant with their own proprietary model, and enable the Authority to undertake the modelling in-house or to put the modelling out to competitive tender to a wider range of consultants, given the removal of the requirement for a proprietary model.

We are pleased that in the Draft Determination the Authority "acknowledges that proprietary spot price forecasting models can be opaque and that some stakeholders would prefer an approach to determining spot prices that can be independently verified through publicly available data". We also note the Authority's observation that this year the historical data would not take into account a new carbon tax likely to be imposed from 1 July 2012.

3.2.5. Energy losses

We note and concur with the Authority's proposed approach to accounting for energy losses.

3.2.6. Carbon costs

In the Issues Paper, the Authority noted that if a carbon tax were to be implemented by the Commonwealth Government from 1 July 2012, the costs associated with this tax would need to be accounted for in its energy purchase cost estimates.[7]

There are various ways in which the impacts of the carbon tax on energy purchase costs can be estimated, some with more merit than others.

6 See *Final Decision: Retail prices for non-contestable electricity customers 2010-2012*, Report 7 of 2010, ICRC, June 2010, section 7.3.1, available at http://www.icrc.act.gov.au/__data/assets/pdf_file/0018/194310/Report_7_of_2010_11_June_2010.pdf

7 Draft Determination, page 32

The approach taken by the Authority is based on carbon-inclusive modelling that has been undertaken by ACIL Tasman, with a separate adjustment then being made by ACIL Tasman to quantify the component of the carbon-inclusive cost estimate that is attributable to the carbon tax:[8]

> As proposed in the Draft Methodology Paper, the Authority has prepared two sets of hedging-based energy costs – one set that is carbon exclusive and one set that is carbon inclusive.
>
> …
>
> Given that the Clean Energy Futures legislation was passed by the Commonwealth in November 2011, it is now almost certain that the carbon tax will take effect from 1 July 2012. As a result, the Authority has based its Draft Determination on ACIL's carbon-inclusive energy cost estimates for 2012-13.

We concur with the approach taken by ACIL Tasman to undertake carbon-inclusive modelling, but we question the way in which ACIL Tasman has then quantified the component of the carbon-inclusive cost estimate that is attributable to the carbon tax. As stated by ACIL Tasman:[9]

> Prices without carbon do not include the assumed 87% pass through of the average carbon price of \$23.00/tCO_2-e for 2012/13 included in the prices with carbon. The 87 percent pass through means that 87 percent of the carbon price in \$/tCO_2-e is passed through to the electricity price in \$/MWh. This is based on a NEM emissions factor of 0.87tCO_2-e/MWh.

The Authority has further explained ACIL Tasman's method of quantification as follows:[10]

> To estimate the cost of carbon, ACIL applied the AFMA ACB addendum methodology and estimated that the average intensity of NEM generation will be 87% for 2012-13.

8 Draft Determination, page 33

9 See the notes to Table 6 and Table 15 in the ACIL Tasman report

10 Draft Determination, page 33

We can provide further background to this method of quantification by explaining that the Australian Carbon Benchmark (ACB) Addendum to which the Authority has referred was published by the Australian Financial Markets Association (AFMA). AFMA has published four versions, in December 2008, December 2009, March 2010 and August 2010. Each version has been made available to be built into other trade documentation between contracting parties. It is a means by which parties to contracts (who may be carbon-emitting or non-carbon emitting generators or banks or other financial institutions) can choose to specify payment obligations between them in different circumstances. It is not an agreed legislative or regulatory calculation of carbon tax impact.

Regarding where the figure of 87% derives, it seems that the assumed 87% "pass through" of the average carbon price of \$23.00/tCO_2-e for 2012-13 that ACIL Tasman has presented to the Authority derives from the average NEM carbon intensity (tCO_2-e/MWh) (ACI) of 0.8696, which is the projected average NEM emissions intensity for calendar year 2013 from ACIL Tasman PowerMark modelling. There is also an implicit assumption that these costs would be fully "passed through" from generators to retailers (and to consumers).

We would add our observation that the figure of 87% (or 0.8696) is not uncontested, and the relevance of the AFMA ACB addendum methodology is also contested. Full "pass through" is also not necessarily an outcome in the competitive wholesale energy market. As recently as 5 April 2012, the Independent Competition and Regulatory Commission (ICRC) of the ACT stated:[11]

> It is important to understand that, although the AFMA ACB addendum quantifies an allowance for a price on carbon, that allowance may or may not turn out to reflect the actual impact of the introduction of a price on carbon on electricity prices. The Commission notes, for example, the work undertaken by Frontier Economics for the Australian Energy Market Commission.[12] This work was based on the impact of the carbon price on wholesale electricity costs within the context of the original Carbon Pollution Reduction Scheme. The report included a summary of the percentage of pass-through as calculated by various consultants. The estimated percentages ranged between approximately 20% and 120%, and the average was approximately 70%. While the current carbon price package differs from that proposed as part of the Carbon Pollution Reduction Scheme, the Commission considers that the main conclusion of the report remains valid, namely that the impact of a price on carbon on electricity prices remains uncertain.

11 Retail prices for franchise electricity customers 201214, Draft report, Report 2 of 2012, April 2012, ICRC, page 9, available at www.icrc.act.gov.au/energy/electricity

12 Frontier Economics 2009

While we do not necessarily agree with other statement in the ICRC Draft Decision, we do believe that this paragraph is essentially accurate, and in particular we draw the Authority's attention to the Commission's final words quoted above:

> … the impact of a price on carbon on electricity prices remains uncertain.

This analysis is all consistent with the fact that carbon costs are not a "pass through" to retailers. Costs that are modelled and contested cannot be "pass through" items. As we said previously in our reports on the Authority's Issues Paper and Draft Methodology Paper, carbon pricing should not impinge directly on retailers. Rather it will impinge on generators, and will be reflected in energy purchase costs in future contract prices and forecast spot prices. It will thus be accounted for in energy purchase costs.

One of the reasons why we are concerned about how the carbon tax component is calculated is that there are recent reports of statements from the Queensland Government that prices for Tariff 11 will be frozen other than the addition of the impact of the carbon tax, and that carbon costs will separately itemised on electricity bills.[13] If these reports come to fruition, it will be particularly important for consumers that the Authority portrays the impact of the carbon tax accurately.

A further point to note is that the ACCC has highlighted that carbon price claims must not be misleading.[14]

It is also unclear what if any use ACIL Tasman has made of the ACI figure of 87% (or 0.8696) in its carbon-inclusive modelling of wholesale energy costs.

The Authority should ensure that any assumptions that it or ACIL Tasman makes about the average NEM carbon intensity (tCO_2-e/MWh) (ACI) or other aspects of carbon tax impacts in its Final Determination are robust and justified. This may be important to support Government policy.

13 See for example *Premier Campbell Newman slashes VIP box spending*, Courier Mail, 11 April 2012, available at www.couriermail.com.au/news/queensland/newman-slashes-vip-box-spending/story-e6freoof-1226323271353 and *Cabinet moves to ease living costs*, Queensland Times, 10 April 2012, available at www.qt.com.au/story/2012/04/10/lion-dance-welcomes-new-cabinet.

14 See www.accc.gov.au/content/index.phtml/tag/carbon

3.3. OTHER ENERGY COSTS

3.3.1. Queensland Gas Scheme

We continue to support market prices as the most accurate indicator of the representative retailer's cost of purchasing Gas Electricity Certificates (GECs) to comply with the requirements of the Queensland Gas Scheme.

We also still disagree with the Authority's proposal to estimate GEC costs using a longer time series of data, on the basis that the GEC market is currently oversupplied and that using a longer time series would therefore over-estimate the price of GECs paid by an efficient retailer.

As stated by the Authority (albeit in another context in regard to Large-scale Generation Certificates): "a low volume of trading does not necessarily mean market prices are unreliable".[15]

ACIL Tasman has reported that "the GEC market is now oversupplied with low prices".[16] The effects of this oversupply should not be overlooked, and must be taken into account in estimating the costs of scheme compliance for an efficient representative retailer.

> The Authority should use the same length of time series to estimate GEC costs for 2012-13 as it used previously in the calculation of the BRCI for 2011-12.

3.3.2. Enhanced Renewable Energy Target scheme

On 1 January 2011, the Renewable Energy Target scheme was split into two separate schemes – the Small-scale Renewable Energy Scheme (SRES) and the Large-scale Renewable Energy Target (LRET), collectively known as the Enhanced Renewable Energy Target.[17]

15 Draft Determination, page 37

16 ACIL draft methodology, page 23

17 Draft Determination, page 36

3.3.3. The Large-scale Renewable Energy Target (LRET)

The LRET sets annual targets for the amount of electricity that must be generated by large-scale renewable energy projects like wind farms. Retailers must purchase a set number of Large-scale Generation Certificates (LGCs), which is determined on the basis of achieving the annual target. The number of LGCs required to be surrendered by retailers to discharge their liability each year is determined by ORER's Renewable Power Percentage (RPP). Retailers are required to surrender STCs and LGCs to fulfil their ERET obligations. If a retailer fails to meet its obligations, it will incur a penalty.

We support the use of market-based data to estimate the costs of LGCs. We agree with the Authority that a market-based approach is more likely to reflect the costs to retailers of complying with various environmental schemes and that it is superior to an LRMC based approach for a range of reasons.

3.3.4. The Small-scale Renewable Energy Scheme (SRES)

The SRES covers small-scale technologies such as solar panels and solar hot water systems installed by households and small businesses. Retailers have an obligation to purchase Small-scale Technology Certificates (STCs) based on the expected rate of STC creation, which is determined by the Office of Renewable Energy Regulator's (ORER) Small-scale Technology Percentage (STP).

We remain concerned that the Authority intends to continue to rely exclusively on the ORER's Clearing House price of $40 to estimate the costs to an efficient representative retailer of purchasing all its STCs for 2012-13.[18] While this may be used to estimate the cost of some of the STCs that an efficient representative retailer would purchase, we note that the Authority and ACIL Tasman have both acknowledged that a proportion of STCs are being purchased based on market prices that are readily available. Based on advice from ACIL Tasman, the Authority is proposing that it cannot estimate the cost of an STC to an efficient representative retailer taking into account these market prices, "because it would require forecasts of the proportion of STCs likely to be traded in 2012-13"[19]

18 Draft Determination, page 38

19 Draft Determination, page 38

We do not accept this approach. Essentially in taking this approach the Authority has estimated the proportion of STCs likely to be traded in 2012-13 outside the Clearing House, and has deemed that estimate to be zero. We do not believe that the Authority can justify zero to be the best estimate of the proportion of STCs likely to be traded in 2012-13 outside the Clearing House. Therefore, this approach does not comply with the Authority's obligation under its Delegation. We suggest that the Authority is required to make the best estimate it can of the proportion of STCs likely to be traded in 2012-13 outside the Clearing House, and we suggest that the fact that there are trades and market prices will show that best estimate not to be zero. As stated by ACIL Tasman: "an active market for STCs has developed outside the clearing house".[20]

The market prices are also known. Again in the words of ACIL Tasman: "The current market price (as at February 2012) for STCs is around $31".[21] According to the Clean Energy Council (CEC), the current market price at 10 April 2012 is $28.90.[22] ICAP Energy Australia also posts frequent updates to STC prices on its blog.[23]

All that remains is to estimate the proportion of STCs being traded. The proportion is not zero. If ACIL Tasman and the Authority cannot provide a more appropriate estimate, we will provide one. According to a newspaper report in February 2012:[24]

> The oversupply of certificates has pushed down the market price to about $31, meaning trade on the government registry is virtually paralysed with a backlog of more than $280 million worth of certificates.
>
> "It does mean that if people took at face value they would get $40 and put them in the (government) clearing house, they will wait a long time," said John Grimes, chief executive of the Australian Solar Energy Society. "The message to those people is that really there is no guarantee that those certificates will ever be cleared out of there. I certainly don't see the price of certificates rising to $40."
>
> The delay is also hitting installers, who often take the certificates off the buyer's hands in return for an up-front discount. One major firm, which did not want to be named, told The Age it was pulling its certificates out of the government registry and selling them on the market at an estimated drop in value of $1 million.

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20 ACIL Tasman report accompanying the Draft Determination, page 54

21 ACIL Tasman report accompanying the Draft Determination, page 54

22 Source: www.cleanenergycouncil.org.au. It may be possible to obtain historic price data from the CEC, or from TFS Green from whom the CEC sourced its data – see www.cleanenergycouncil.org.au/cec/resourcecentre/REC-prices/STC-further-info

23 See www.icapenergy.com.au/blog

24 *Cloudy outlook for solar rebates*, David Wroe, 6 February 2012, available at http://www.theage.com.au/opinion/political-news/cloudy-outlook-for-solar-rebates-20120205-1qztn.html

On that basis, we propose an estimate that the percentage being purchased through the clearing house is zero, and the percentage being traded at market prices is 100%.

> In estimating the cost of STCs, the Authority should take into account the fact that an active market for STCs has developed outside the clearing house, and the current market price for STCs is well below the official $40 price. An efficient representative retailer should be expected to be taking advantage of that market and not paying $40 to purchase all its STCs.

3.3.5. NEM participation fees and ancillary services charges

We have no issue with NEM participation fees and ancillary services charges being estimated in future as per the previous BRCI framework.[25]

25 Draft Determination, pages 38 to 39

4. RETAIL COSTS

The final cost component to be determined relates to the cost of services provided by a retailer to its customers.

4.1. INTRODUCTION

In determining the retail cost component, there are some specific requirements provided in the Delegation, namely, that the Authority must consider the retail costs that would reasonably be incurred by an efficient, representative retailer (the characteristics of which are to be determined by the Authority).

The Authority is also required to determine an appropriate retail margin, giving consideration to any risks not compensated for elsewhere.

4.2. REPRESENTATIVE RETAILER

The Authority considers that the representative retailer is one that:[26]

- Is an incumbent retailer of sufficient size to have achieved economies of scale;
- Serves small and large retail customers in Queensland and other jurisdictions across the NEM;
- Has a mix of market and non-market customers;
- Retails electricity on a stand-alone basis; and
- Is not vertically integrated with an electricity generator.

We concur with the Authority's view.

4.3. RETAIL OPERATING COSTS

Retail operating costs (ROC) relate to the costs of the services provided by an electricity retailer to its customers.

26 Draft Determination, pages 47 to 48

4.3.1. Benchmarking of retail operating costs

We agree with the benchmarking approach being taken by the Authority. We agree that "it is appropriate to make some adjustments to account for jurisdictional differences where reliable information on the individual cost components exists",[27] but we continue to caution that with substantial adjustment up or down, the benchmark approach will lose its validity, as it will morph into an actual costs approach that is not properly thought through.

We note that the Authority has decided against relying on publicly available information on retail operating costs. We agree that it should not be relied upon, but should not be dismissed as completely irrelevant. Other regulators do make use of such information.[28] The Authority reviewed the most recently available cost information reported by publicly listed Queensland retailers, and should report on its findings and take them into account in its Final Determination. If a retailer is being allowed retail operating costs that vary widely from its reported cost data, the differences should be fully explained.

We concur with escalating ROC by CPI.

4.3.2. Customer Acquisition and Retention Costs (CARC)

We have previously expressed our view that view that there is no justification for including an allowance for CARC. We retain this view, though we understand that the Authority is intent on retaining such an allowance.

We note that the inclusion of CARC explicitly allows for marketing to support a competitive market. It implicitly recognises that there is effective competition in the electricity market in the Energex area, because an efficient representative retailer would only be expending any funds on customer acquisition and retention if that was the case. Because of the Queensland Government's Uniform Tariff Policy, it also has the side effect that Ergon Energy customers are paying for the costs of customer acquisition and retention, even where there is no effective competition, and therefore no funds are being expended on those activities.

We are particularly concerned regarding the statement of the Authority that it "will maintain the current, perhaps generous, CARC component going forward".[29] This is presented without any further analysis.

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27 Draft Determination, page 52

28 See for example Draft Determination, page 48, where it is reported that IPART benchmarked retail operating costs against various sources, including "cost information disclosed by publicly listed retailers".

29 Draft Determination, page 52

Any allowance for CARC should be reasonable, not generous. Analysis of Table 4.3 on page 53 of the Draft Determination shows clearly that the Queensland allowance for CARC is above that allowed in NSW and South Australia. It should instead be much lower, given that only a proportion of customers in Queensland are reasonably open to contestability, as against all customers in those other two states. We propose that if there is to be an allowance for CARC in Queensland, it should be set at a rate benchmarked against NSW and South Australia, with an adjustment for the proportion of customers in those areas of Queensland where there is effective competition.

> If the Authority is to make an allowance for CARC, it should be at a much lower level than that proposed in the Draft Determination.

4.3.3. Fixed and variable components

We agree with the view of the Authority "that each customer should pay for ROC only once (regardless of the number of tariffs under which they may be supplied). For example, a residential customer may receive supply under tariffs 11, 31 and 33 given the different applications to which each of these tariffs applies. If a fixed ROC allowance was included in each tariff, this customer would in effect be paying three fixed (per customer) charges when only one was required."[30]

4.4. RETAIL MARGIN

We concur with the view of the Authority, previously also stated in the Draft Methodology Paper "that the retail margin should compensate retailers for systematic risks through the retail margin while non-systematic risks are compensated for elsewhere in the determination".[31]

We do not believe that it is appropriate to increase the margin from 5% to 5.4%. The justification for the increase seems to be that 5.4% is the mid-point of the reasonable range of 4.8% to 6% found by consultants in NSW.[32] The justification has been made notwithstanding that the current retail margin of 5% also falls within the reasonable range. The Authority itself has said that "the current 5% margin in Queensland is not unreasonable" and "the new pricing approach being established in this determination should reduce the risks faced by retailers in Queensland relative to the previous BRCI approach, including better alignment of the cost structure and price structure and the pass through of network costs".[33]

30 Draft Determination, page 61

31 Draft Determination, page 63

32 Draft Determination, page 66

33 Draft Determination, pages 66 to 67

This being the case, the allowed margin in 2012-13 should if anything be lower, and certainly not higher, than the previous 5% level under the BRCI.

The arguments on page 67 of the Draft Determination regarding an LRMC floor are also not relevant to the retail margin since those are not systematic risks, and as the Authority has stated, headroom is a separate matter considered elsewhere. If a LRMC floor were appropriate, it would have been incorporated in the energy costs. The Authority rightly did not include LRMC in energy costs, and the retail margin is not the place to add something extra to offset a good decision elsewhere in a pricing determination.

We retain the view that the existing gross retail margin of 5% of total costs that was allowed in the BRCI calculations is realistic, and should not be any higher in the new tariffs. Arguably, it could be lower, because the retailers will be compensated based on efficient costs, rather than the BRCI mechanism that might have borne no relationship to their actual efficient costs and was not cost-reflective. Under the BRCI, retailers therefore faced higher risks than should be the case under the new framework for setting regulated retail prices.

5. COST-REFLECTIVE RETAIL TARIFFS AND PRICES

Under the N+R approach, retail tariffs are to be aligned with network tariffs. Chapter 2 set out the Authority's consideration of the relevant network tariffs (the N component), upon which retail tariffs are to be based.

Chapters 3 and 4 set out the Authority's consideration of energy costs and retail costs (ROC and the retail margin) which together comprise the R component of retail tariffs.

This chapter brings together the network tariffs and prices with the energy and retail operating cost estimates from those earlier chapters then adds on the retail margin to arrive at the bundled (cost-reflective) retail tariffs and prices.

This chapter of the Draft Determination brings together results from previous chapters, and raises no new issues on which we wish to comment here.

6. COMPETITION, TRANSITIONAL AND OTHER ISSUES

Chapter 6 of the Draft Determination discusses other issues relevant to the price determination process that have not been dealt with elsewhere, namely:

- The impact of the Authority's price determination on competition in the Queensland retail electricity market;
- Transitional arrangements for customers facing significant price increases; and
- The eligibility criteria and other terms and conditions pertaining to retail tariffs.

6.1. COMPETITION CONSIDERATIONS

For the purposes of the Draft Determination, the Authority has decided to include an additional allowance for head room of 5% of cost-reflective prices for all tariffs.[34]

We have many concerns regarding this decision, which we discuss in this section of our report.

6.1.1. The role of competitive activity to derive longer term benefits for consumers

We understand that the Delegation requires that, in calculating notified prices, the Authority should ensure its price determination has regard to the effect of the determination on competition in the Queensland retail electricity market, consistent with the Government's policy objective that consumers, wherever possible, have the opportunity to benefit from competition and efficiency in the market place.

We also accept that this suggests that there is some longer term benefit to be derived by maintaining an actively competitive market rather than pursuing a short term minimum price approach which may stifle or eliminate competition from the market.

However, we have some concerns with the following paragraph in the Draft Determination:[35]

34 Draft Determination, page 77

35 Draft Determination, page 73

> The longer term benefit derives from the downward pressure on prices that competition naturally brings to the market. By setting regulated prices somewhat higher than full cost, retailers will be attracted to enter the market and, as they compete for market share, non-regulated prices will be driven down. The more active the competition, the closer retailers will reduce prices to their individual, efficient costs of supply. While regulated prices will be unaffected, customers should be able to access lower priced market offers from competing retailers.

While there is some truth that competition drives down costs, there is much more to the competitive market than just lower pricing. Longer term benefit derives from the improved customer service and not just downward pressure on prices.

It may be true that "by setting regulated prices somewhat higher than full cost, retailers will be attracted to enter the market and, as they compete for market share, non-regulated prices will be driven down" in the shorter term. But the way to achieve longer term benefits for consumers is not to attract retailers because there is an artificial extra margin in the supply chain for them to exploit. Rather, retailers should be attracted to a market because they can operate more efficiently and innovatively, and provide better customer service than the incumbents. That is the way to achieve sustainable entry to give longer term benefits.

Creating artificial headroom to attract retailers will not encourage efficiency or lower pricing. At most it will attract retailers offering no better service. Following the logic of the Authority, without headroom, competition will be stifled. This means that the Authority thinks that retailers will not compete when regulated prices are set at what the Authority considers to be cost-reflective prices with a reasonable margin. We disagree with that assertion, on the basis that we believe retailers can compete in that scenario, through a combination of offering superior customer service, innovative product development, more efficient and economic purchasing and operations, and perhaps accepting lower margins.

But if the Authority's logic were accepted, then the implication is that headroom will drive down prices no further than the level at which they would have been had no headroom been allowed – because that is the level at which the Authority believes competition is stifled.

6.1.2. The effects of allowing for headroom in regulated electricity prices

The overall effects of adding headroom would thus include:

- No additional longer term benefits in improving customer service or lower prices than would have been achieved without headroom.
- Short term additional costs incurred by all consumers until competition drives prices down to the levels at which they would have been without explicit allowance for headroom.

- Longer term ongoing additional costs for headroom for those customers who through inertia or other reasons remain on price-regulated tariffs even though more competitive offers might be available to them.

- Ongoing longer term additional costs for customers in the Ergon Energy area that do not have access to competitive offers.

One of the cornerstones of the retention of retail price regulation even after retail competition is introduced is to provide a safety net for those customers who have not yet embraced competition. Customers who remain on regulated tariffs even after competition is introduced should be assured by the role of the Authority that they are paying a reasonable price based on cost-reflective prices and a reasonable margin. Instead, by advocating for "headroom" of an additional 5% the Authority is essentially proposing to regulate that customers who remain on regulated tariffs pay 5% more than they should be paying.

A further point regarding the regulated tariffs is that the terms and conditions of supply are also set out in regulation, whereas the market offers available to customers may vary those. It may not be possible for customers to obtain competitive offers that have terms and conditions that replicate the standard terms and conditions. Adding headroom will therefore mean that customers who desire to benefit from the standard terms and conditions may only be able to do so at a premium to efficient supply costs, on an ongoing basis. Allowing retailers to charge a premium for standard supply is not justifiable.

6.1.3. Other regulators' views on headroom

There are reasons – as set out above – why all energy regulators have refused to be swayed by retailers' arguments requesting "headroom". Rather than fill this report with quotes from regulators on this issue, we provide just one, from IPART:[36]

> A number of stakeholders suggested that the Tribunal should set target tariffs *above* cost-reflective levels for standard retailers, to provide greater encouragement for competitive entry. The Tribunal does not consider this to be appropriate. It considers that charges to customers should be based on the costs of supply *and no more*. It strongly believes that including an allowance in target tariffs for costs that are not incurred by standard retailers is not desirable from an economic efficiency perspective.

36 *NSW Electricity Regulated Retail Tariffs 2004/05 to 2006/07*, Final Report and Determination, IPART Determination No 1, 2004, June 2004, page 8, available at www.ipart.nsw.gov.au/files/d8cd67c3-b819-4497-b5d0-9f4f010fafd8/Det04-1.pdf.

This strong belief articulated by IPART has been similarly articulated in many other regulatory decisions, in the electricity industry and in other industries. It would be a bold move for the Authority to depart from the existing economically sound principles on which regulated pricing of electricity and of other products and services is based.

The Authority has referred in its Draft Determination to the views of others, principally IPART and ESCOSA, who "both noted that certain aspects of the way they calculated regulated prices meant that new entrant retailers could face lower costs, for example, by supplying more than the regulated load or by using lower cost energy trading strategies".[37] Such opportunities also exist in this Draft Determination. They come into the category of retailers who have more efficient and economic purchasing and operations competing against the regulated prices, which we discussed above.

6.1.4. Headroom in existing tariffs

The Authority should not necessarily expect to find the opportunities in its Draft Determination for retailers to operate more economically or efficiently. That is for retailers to do their own research and market analysis. It may have come as a surprise to the Authority that QEnergy found "that the way notified tariffs were originally set meant that there was 20% and 30% headroom in residential and business tariffs respectively".[38] But it is the role of an innovative new entrant such as QEnergy to find such opportunities and exploit them, even at the same time that incumbent retailers do not find the same opportunities, or decline to admit that they exist. As stated by the Authority, "retailers have consistently argued that the BRCI under-estimated their actual costs of supply".[39] This is similarly unsurprising.

Figure 6.2 in the Draft Determination[40] illustrates that under the BRCI discounts to the regulated prices consistently exceeded the Authority's calculations of headroom. This is consistent with retailers who are experts in this area finding the opportunities that the Authority does not find. As discussed above, it is the way competition works elsewhere as well. As shown in Figure 6.2, the maximum discount to the notified price offered by retailers under market contracts has ranged between 7% and 10% since the commencement of FRC. This will reflect both the actual headroom that retailers perceive and the prices that will attract customers to change retailer. Even if headroom is higher than that, retailers will not necessarily offer discounts that are bigger than they need to. Our interpretation of Figure 6.2 is that it is likely that headroom under the BRCI exceeded the 6% figure suggested by the Authority.

37 Draft Determination, page 74

38 Draft Determination, page 74

39 Draft Determination, page 74

40 Draft Determination, page 76

The Authority seems to find it difficult to reconcile what it sees as a contradiction:[41]

> The above analysis suggests that there is a reasonably modest amount of head room of around 6% currently in Tariff 11. While the Authority has no data on retailers' actual costs, as retailers consistently argued in the past that the BRCI underestimated their actual costs, it would seem reasonable to conclude that actual head room is no greater than the levels suggested in Figure 6.2.
>
> This is contrary to claims by QEnergy that head room is actually significantly greater than 6%. For this to be true, the BRCI must have substantially over-estimated retailers' actual costs.

The Authority is apparently missing the point that costs can differ substantially between retailers, depending on the efficiency of their operations.

Large retailers who operate across customer segments and products and in many jurisdictions also have many ways in which they can allocate and report costs. As stated in the Draft Determination[42] and discussed in section 4.3.1 above:

> AGL cautioned against using its reported cost data as it claimed this did not represent the total costs of operating its retail business.

Such comments should alert the Authority that large retailers can report costs in various ways. Claims that the BRCI underestimated their actual costs, and similar claims, have to be read taking that into account.

6.1.5. Additional headroom allowance for 2012-13

As stated above, the Draft Determination includes an additional allowance for head room of 5% of cost-reflective prices for all tariffs.[43]

The figure of 5% is provided apparently without any supporting justification, and without any apparent attempt to quantify what headroom might already be in the cost-reflective tariffs. Nor has the Authority quantified what benefits customers might see from this additional allowance. It is our view that a radical departure from accepted practice such as creating an additional allowance for headroom should at least be accompanied by regulatory cost-benefit and other regulatory impact analysis. A range of figures should be presented in such analysis, and the most appropriate one chosen, based on the analysis. There is no time left to do this now, but it may be considered in future years.

41 Draft Determination, page 76

42 Draft Determination, page 54

43 Draft Determination, page 77

This is all notwithstanding our view that there should be no such additional headroom allowance in the tariffs.

Our view is that no additional headroom allowance is warranted for 2012-13. It should therefore be obvious that if the Authority nonetheless includes an additional headroom allowance in its Final Determination, it should be set as low as possible.

Finally on this topic, we note that the Delegation requires the Authority to base its determination on an N + R cost build-up approach to setting notified prices, where:

- The N (or network cost) component is treated as a pass through; and
- The R (or energy and retail cost and margin) component is determined by the Authority.

If the Authority makes an additional allowance for headroom, it will have gone outside of the remit of the Delegation by instead basing its determination on an N + R cost build-up approach to setting notified prices, where:

- The N (or network cost) component is treated as a pass through;
- The R (or energy and retail cost and margin) component is determined by the Authority; and
- An additional allowance is determined by the Authority for headroom – which is not a component that is specified in the Delegation.

The Authority should make no additional allowance for headroom in notified prices for 2012-13.

6.2. THE IMPACT OF PRICE RISES ON CONSUMERS

QCOSS represents the interests of residential consumers, with a particular focus on low income and other vulnerable consumers, many of whom are relatively small users of electricity, because they do not have the high-usage electrical equipment that more affluent households may have, such as swimming pool pumps and large air conditioning systems.

That is not to say that all low income households are low users of electricity. Indeed there are also low income householders who support large families, and there are those who are high users of electricity because of medical requirements or poor quality housing and inefficient appliances. People who are home during the day may also be using more electricity because they require cooling throughout the day, while others may be able to switch off cooling when they are out during the day and rely instead on the cooling systems provided by others, such as their employers. Customers with low income but high usage of electricity may be particularly in need of concessions in the form of a package of support outside any tariff mechanism.

Given different tariffs that in total are revenue neutral, i.e. they bring in the same revenue when applied across the customer base, tariffs which have higher fixed charges and lower variable charges have an adverse impact on lower usage consumers as compared with tariffs which have lower fixed charges and higher variable charges. Conversely, higher usage customers would prefer tariffs with lower variable charges and higher fixed charges.

6.2.1. The Authority must consider the impact of price rises on consumers when determining regulated prices

As stated in Chapter 1 of the Authority's Draft Determination, on 22 September 2011, the Authority received a Delegation from the Minister for Energy and Water Utilities (the Minister) under section 90AA(1) of the *Electricity Act 1994* requiring it to determine notified electricity prices[44] to apply from 1 July 2012 to 30 June 2013 (the price determination). The Delegation also includes Terms of Reference for the price determination. The Minister's covering letter and Delegation were provided in Appendix 1 to the Draft Determination.

Chapter 1 of the Draft Determination outlines various relevant requirements that the *Electricity Act 1994*, *Electricity Regulation 2006*, and the Delegation place on the Authority. However, it does not include the following comment in the Minister's covering letter, which we believe is important:

> *With the introduction of the new price setting methodology in 2012-13, the Government wishes to again stress that the Authority must consider the impact of price rises on consumers when determining regulated prices.*

The Authority could on this basis do one or both of the following:

- Set prices at levels at which they would not otherwise be set – taking into account the impact of prices on consumers; and
- Introduce transitional arrangements.

6.2.2. The option to set prices at levels at which they would not otherwise be set – taking into account the impact of prices on consumers

There are many precedents in setting prices for electricity at levels at which they would not otherwise be set – taking into account the impact of prices on consumers, the social impacts of price increases.

44 Notified electricity prices are the regulated retail electricity prices that a retailer may charge its non-market customers, as defined under section 90 of the *Electricity Act 1994*

Some examples are as follows:

- For many years, the Independent Competition and Regulatory Commission (ICRC) in the ACT has rejected the inclusion of an allowance for customer acquisition costs in its electricity retail pricing determinations, and has explicitly said that it has had regard to the social impacts of its decisions in not including a customer acquisition cost.[45]

- Though the approach has since changed, for many years the Independent Pricing and Regulatory Tribunal (IPART) in NSW for many years regulated retail prices that limited price changes to tariffs in such a way that they were not cost-reflective.[46]

The terms of reference of every review differ. The purpose of bringing these examples is not as evidence that the Authority can or should similarly set prices at levels at which they would not otherwise be set – taking into account the impact of prices on consumers. That is self-evident from the Minister's covering letter to the Delegation. The purpose is rather to illustrate to the Authority that when it follows the Minister's direction it will be acting in a way that has many precedents.

However, the Authority is not following this path in its Draft Determination. It has decided not to implement the option to hold a tariff below its cost-reflective level or delay the movement of some customers to fully cost-reflective prices on an ongoing basis.[47]

As a result, changes are to be implemented from 1 July 2012 which will have significant impacts on some consumers for which they may be ill-prepared, as we discuss here.

6.2.3. Transitional arrangements

In Chapter 6 of the Draft Determination, the Authority has considered the impacts of some of the changes to notified electricity prices to apply from 1 July 2012 to 30 June 2013, and has introduced some transitional measures to smooth the move from old tariffs to new tariffs for some customers who would otherwise be facing significant price increases. However, the Authority has not introduced any transitional measures or allowed its Draft Determination to be influenced in any way by the impact that it will have on the main residential tariffs 11, 31 and 33. This is notwithstanding the fact that as set out in Chapter 7 of the Draft Determination, the effects of the Draft Determination include:

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45 Many references can be cited. See for example, among many, *Retail prices for non-contestable electricity customers 2010-12*, Final decision, Report 7 of 2010, ICRC, June 2010, page 41, available at www.icrc.act.gov.au/__data/assets/pdf_file/0018/194310/Report_7_of_2010_11_June_2010.pdf

46 See for example *NSW Electricity Regulated Retail Tariffs 2004/05 to 2006/07*, Final Report and Determination, IPART Determination No 1, 2004, June 2004, available at www.ipart.nsw.gov.au/files/d8cd67c3-b819-4497-b5d0-9f4f010fafd8/Det04-1.pdf where IPART limited the increase in individual tariffs to CPI+2.5% or CPI+3% so that they transitioned towards cost reflective levels, but did not reach cost reflective levels in all cases.

47 See the Draft Determination, pages 80-81

- A 29.8% increase in Tariff 31;
- A 25.9% increase in Tariff 33; and
- The annual fixed charge component of Tariff 11 will more than triple from $105.07[48] to $316.09[49] (including GST) – in other words, an increase of over 200%.

Many of the most vulnerable consumers have low usage of electricity, and the new proposed regulated tariffs and prices will have a very deleterious effect on them. For very low usage consumers, the tripling of the annual fixed charge component of Tariff 11 will mean that the increase in their bills will be substantial in proportion to their current electricity bills.

Some vulnerable customers have high usage levels, often through circumstances over which they have little or no control. These customers will also see large changes in their bill. The Authority has, for example, said in Chapter 7 of the Draft Determination that a customer with annual consumption of 11,000 kWh can expect a bill increase of 14.9% or $389.

We expect that retailers will also have similar concerns about the effects that new tariffs and prices will have on their customers.

The rationale that the Authority has stated for considering transitional arrangements for some customers and not others is as follows:

> As a general principle, the Authority agrees with the view put by retailers that any social welfare concerns arising from implementing the new regulated retail tariffs would be best addressed through direct assistance by the Government rather than by continuing to distort electricity prices. However, while the Government could provide financial assistance to those in need, this is not necessarily the appropriate solution for all adjustment issues customers may face. For example, the issue for commercial or farming customers adjusting their operations to the new tariff structures may be more about the time needed to make changes than about the welfare needs of the customer.

Even if it is accepted that any social welfare concerns arising from implementing the new regulated retail tariffs would be best addressed through direct assistance by the Government, there is inherently a contradiction here that somehow commercial or farming customers need time to adjust to new tariff structures but residential customers do not. We believe that residential customers also need time to understand the new tariff structures that they will face.

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48 Calculated on the basis of 12 monthly service fees at $7.96 per month plus GST per metering point

49 Calculated on the basis of a daily service fee per metering point of 78.674c plus GST, and an average of 365.25 days per year

The Authority also seems to be assuming that direct assistance will be in place for all those residential customers that will require it from 1 July 2012. While we would like to think that will be the case, we think it an unsafe assumption, for reasons which include the following:

- Low income customers are supported by a range of concessions and other measures in line with the Queensland Government's social policy objectives. The existing measures may prove highly inadequate to be effective at assisting low income consumers given the changes in prices that these tariff changes introduce for vulnerable customers. Major restructuring of the concessions framework may be required. It will take time for the Government to make any necessary design and implement changes to assistance packages.

- It may not yet be known what the effects will be on different customer groups.

- The tariff changes may change the group of people who need to be targeted for direct assistance, and they may take time to identify themselves or be identified.

- Financial counsellors and others who advise consumers need time to understand how the new tariffs will affect their clients, so that they can give them appropriate advice on their use of electricity, their budgeting, and any assistance that may be available to them.

A further issue with the large increases in the costs of energy consumed on controlled off-peak Tariff 31 and Tariff 33 is that we fear that these increases will detract from the system efficiency gains and cost savings that are derived from encouraging customers to move consumption from Tariff 11 to these tariffs. On the other hand, some customers with high usage may still see advantage in shifting usage to these tariffs in order to avoid paying for energy in the more expensive blocks of usage in the new inclining block Tariff 11. We suggest that customer impact analysis and customer education should be undertaken to ensure that customers still see the benefits of controlled off-peak tariffs. The price signals and other messages associated with the new pricing arrangements need to be aligned in order to retain the benefits that controlled off-peak tariffs can bring. This is consistent with the statement in the Delegation that one of the matters that the Authority must consider is that consumers should benefit from efficiency in the marketplace.

We are pleased that the Authority has shown in its Draft Determination that it has the remit to put in place transitional arrangements. The Authority now needs to extend the scope of those transitional arrangements that it proposes in its Draft Determination.

The Authority should consider transitional arrangements for residential consumers, and particularly low income and other vulnerable consumers.

6.3. ACCOUNTING FOR UNFORESEEN OR UNCERTAIN EVENTS

As explained in some detail in our previous submissions on the Issues Paper and Draft Methodology Paper, we do not support a cost pass-through or catch-up mechanism.

Given that the Authority has determined that it does not have the capacity to implement such a mechanism, we do not need to repeat our previous arguments here.

> We do not support a cost pass-through or catch-up mechanism. We do not believe that the gazetted prices should be adjusted via a cost pass-through during the tariff year or via a catch-up mechanism in a subsequent tariff year.

One exception to the above may be if a change of Government policy requires the Authority to make changes to regulated pricing during the tariff year. In that case, we would expect the Government to provide the necessary Delegation to the Authority so that the Authority would have the capacity to implement the required changes.

6.4. TERMS AND CONDITIONS OF RETAIL TARIFFS

While the Authority is responsible for determining the retail tariffs and prices, the Queensland Government (in conjunction with Energex and Ergon Energy) is responsible for determining the associated eligibility criteria and other terms and conditions.[50]

We have not undertaken a full review of the terms and conditions in Appendix D. We have, however, noted for example:

> Residential customers will have the option, from 1 July 2012, on application in writing or another form acceptable to the retail entity, of switching from Tariff 11 to Tariff 12, provided they have the appropriate metering installed. Prior to June 2013, customers will also be entitled to a further option of switching back to Tariff 11. Additional charges may also apply should a customer wish to switch tariffs again prior to 30 June 2013.[51]

It is unclear on what basis these terms have been set. For example, what additional charges might apply and how might they be determined?

> We urge the Authority to impress upon the Queensland Government the importance of determining the associated eligibility criteria and other terms and conditions in an open consultative process.

50 Draft Determination, page 86

51 Draft Determination, page 113