28 October 2014

Dr Malcolm Roberts
Chairman
Queensland Competition Authority
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Brisbane 4001

Email: electricity@qca.org.au

Dear Dr Roberts

REGULATED RETAIL ELECTRICITY PRICES FOR 2015-16

Origin Energy (Origin) appreciates the opportunity to comment on the Queensland Competition Authority's (QCA) Interim Consultation Paper on Regulated Retail Electricity Prices for 2015-16.

Origin supported many of the findings of the QCA's final decision for 2014-15. It represented a significant improvement upon the previous year by importantly recognising more reasonable allowances for retail operating costs, retail margin and prudential requirements.

The QCA's decision for 2015-16 will only apply in the Ergon Energy distribution network as a result of the introduction of market monitoring in south east Queensland (SEQ) from 1 July 2015. As a result, Origin considers the QCA approach for this determination is an important first step towards putting in place the necessary pricing reforms to support a transition to full retail competition.

Pricing approaches

The Delegation issued by the Minister for Energy and Water Supply sets out matters the QCA is required to consider. The QCA must use the Network (N) plus Retail (R) cost build up methodology when working out notified prices.

The Minister has separately re-affirmed the Government's commitment to the UTP and the community service obligation (CSO) payment that underpins it. In making this commitment, the Minister has stated that regional prices should, as much as practicable, aim to ensure that small customers outside of SEQ do not pay more than reasonable expectations of the prices which would be available to standing offer customers in SEQ.

As a result, this effectively binds the QCA to base the network cost component on the level of network charges levied by Energex.

While the Delegation requires the QCA to consider network charges for 2015-16 only, it is important for the QCA to acknowledge the objectives of the Queensland Government's 30-year Strategy for Queensland's electricity sector in making its decision.

With respect to regional Queensland, the 30-year Strategy recognises that improving competition and outcomes cannot be achieved unless key barriers are removed.

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Until retailers other than Ergon Energy can access the CSO subsidy, competition will continue to be weak in regional areas. Therefore, moving towards a network-based CSO will allow all retailers to access the subsidised network prices and compete for regional customers. This provides the best means of delivering the goods and services that consumers want at prices that reflect efficient costs.

Complementing this reform should be the opportunity for customers to respond to price signals including, and in particular, those sent by the network business. This will involve a transition to more cost reflective network prices, recognising, however, that such a transition may be more challenging in some instances, such as for customers in western parts of the state where cost reflective prices could be prohibitive.

Origin recognises that the structure of the CSO is outside of the QCA's Delegation and that the Government's current interpretation of the UTP does not permit the QCA adopting cost reflective network prices to determine the notified prices for residential and small business customers. However, Origin considers that the QCA could take incremental steps to address the impediments to cost reflectivity by calculating the network cost components based on Ergon's tariff structure with Energex's cost level.

This approach would remove the outcome where customers face price signals that do not reflect the impact of their consumption and would therefore encourage efficient consumption and investment decisions to be made. It would also be a further step towards cost reflectivity while preserving the ability for Government to apply the CSO at a level it considers equitable thereby preserving the UTP. Furthermore, this approach would be compatible with the Australian Energy Market Commission's (AEMC) draft Rule for network pricing, which requires network business to develop individual cost reflective tariffs.

Energy costs

Origin notes that the market-based approach is currently the QCA's preferred methodology. This submission does not restate our views that a methodology based on long run marginal cost is more appropriate than a fully market based approach. Rather, we refer the QCA to refer to Origin's submissions to the 2014-15 consultation on Regulated Electricity Retail Prices.

There are ways for the QCA to enhance its current market-based approach that would more accurately capture a retailer's actual costs of supply, however.

Accounting for structural biases

Wholesale prices in Queensland are currently at historical lows, which are not an appropriate indicator of future expected prices because of certain structural biases prevalent in Queensland; examples include solar PV, which has had the effect of suppressing wholesale electricity prices, and the ramp up of LNG trains.

While the impact of the ramp up of LNG trains was recognised in QCA's calculation of wholesale costs for 2014-15, the need to account for it confirms the presence of structural biases in Queensland.

Consideration of how best to integrate the impacts of structural biases over a longer horizon is important to promote a stable price path year-on-year. This approach will reduce volatility in notified prices in future years, helping to mitigate the risk of price shocks caused by one-off events.

This approach is reflected in the AEMC's Final Report on "best practice retail price methodology", where the AEMC recommends that while futures prices should be used as the basis for estimating energy purchase costs:

- if these prices are likely to produce unreliable results (due to either insufficient liquidity in the contracts market; or
- structural market biases meaning that futures prices may not be a good representation of expected prices),

then a method that approximates the long-term costs of generation should be used to estimate energy purchase costs.[1]

Correlation between temperature and demand

In previous pricing decisions, the QCA has accepted the position put forward by ACIL that above certain temperatures, the relationship between temperature and peak demand weakens such that demand tends to reach a limit. However, Origin considers that to date, the nature of this relationship has not been adequately established since it is not extrapolated, but assumed. The result is that this approach arbitrarily caps the relationship between outlying temperature and demand, thereby reducing the efficacy of using actual temperature records. For these reasons, the QCA should provide clarity regarding how these limits are captured in its modelling.

Calculating Renewable Energy Target compliance costs

The QCA has also indicated that it intends to determine Renewable Energy target (RET) costs based on the legislated policy in place at the time of each decision. In principle, Origin agrees with this approach. However, in making its determination, the QCA needs to take into account the substantial reduction in liquidity for trading Large Scale Renewable Certificates (LGCs) due to the current policy uncertainty.

Given the lack of liquidity, it is not reasonable to suggest that a retailer could meet its LRET obligations based on buying LGCs in the market alone; there are insufficient volumes available. Supplementary supply sources like retailer-owned renewable plant or PPAs are required to make up the difference. As a result, current LGC market prices do not reflect the actual cost of retailers meeting their RET liabilities. Origin considers that in this context, a robust and transparent assessment of LRMC is a more reliable and cost reflective approach for determining RET costs.

Retail costs

Provision of headroom

In previous decisions, the QCA has included an allowance for headroom to facilitate the development of retail competition in SEQ and for large business customers in regional Queensland.

Origin recognises that any reasonable provision for headroom will be insufficient to promote retail competition in regional Queensland. However, Origin considers that the inclusion of headroom consistent with previous decisions would:

- assist the transition towards cost reflectivity;
- be consistent with how large business customers are treated in regional Queensland; and
- lessen the subsidy paid by taxpayers.

[1] AEMC, Advice on best practice retail price methodology, Final Report, 27 September 2013, p. iii.

Pass-through mechanism

In terms of the pass-through mechanism, Origin considers that adopting a consistent approach over time provides predictability for retailers, consumers and stakeholders. For this reason, we consider that the QCA maintain the existing cost pass-through mechanism in its current form.

Transitioning to more cost reflective tariffs

With respect to re-balancing the fixed and variable components of tariff 11, Origin considers that the balancing should be completed using the approach established in the 2013-14 determination.

Origin does not consider that providing access to transitional tariffs is consistent with the overall objectives of achieving cost reflective pricing. Origin recognises that in some instances, it is appropriate to allow customers who have made investments in infrastructure to continue to access the tariffs that were provided in good faith. However, Origin does not see any justifiable reason for these tariffs to be extended to other customers who have not been exposed to the same level risk.

Closing

Origin would be pleased to discuss any matters raised within this response further with the QCA. Please contact Sean Greenup in the first instance on (07) 3867 0620.

Yours sincerely

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