EnergyAustralia

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Dr Malcolm Roberts
Chairperson
Queensland Competition Authority
Level 27, 145 Ann Street
Brisbane, QLD 4001

Submitted online at: electricity@qca.org.au

Dear Dr Roberts,

Submission on the Draft Determination for Regulated Retail Electricity Prices 2014-15

EnergyAustralia welcomes the opportunity to make a submission to the Queensland Competition Authority (the Authority) on its draft determination for regulated retail electricity prices 2014-15 (Draft Determination).

EnergyAustralia is one of Australia's largest energy companies, providing gas and electricity to over 2.7 million residential and business customers. EnergyAustralia owns and operates a multi-billion dollar portfolio of energy generation and storage facilities across Australia including coal, gas and wind assets with control of over 5,600 MW of generation in the National Electricity Market.

In South East Queensland (SEQ), EnergyAustralia has been an active market participant supplying electricity to residential and business customers since the introduction of full retail contestability. As an active participant, EnergyAustralia welcomes the announcement from the Queensland Government of their intention to remove retail price regulation in SEQ from 1 July 2015. Having long advocated for deregulation of electricity prices in Queensland, EnergyAustralia considers the announcement a positive steps towards increasing competition for energy retail services and in turn encouraging greater innovation from market participants, improving overall customer service levels and ultimately ensuring efficient retail prices overtime.

In drafting our response to the Authority's Draft Determination EnergyAustralia recognise both the significant consultation completed establishing regulated retail electricity prices for 2013-14 and the Authority's preference to maintain a consistent approach between determinations thereby providing for a degree of regulatory certainty, particularly in light of the recent Queensland Government announcements.

Whilst EnergyAustralia agree with this approach in principle it still holds concerns over the methodology employed in estimating wholesale energy costs as well as the treatment of carbon costs if and when the Clean Energy Act is repealed. Details regarding our concerns and other commentary regarding the Authority's draft decision are outlined below. If you would like more information on this submission, please contact me on (03) 8628 1731.

Yours sincerely,

Joe Kremzer
Regulatory Manager

EnergyAustralia response to the Queensland Competition Authority

Draft Determination for Regulated Retail Electricity Prices 2014-15

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1. Wholesale Energy Costs

In this section we take the opportunity to reiterate our concerns regarding the current methodology adopted by ACIL Allen in developing its forecast of wholesale energy costs for the period. Whilst we disagree with ACIL Allen's approach and favour a long run marginal cost (LRMC) methodology we acknowledge this year's determination is likely to be the last in its application for those customers in South East Queensland (SEQ), whilst a decision regarding the regulatory approach for retail customers in Ergon Energy's supply area remains outstanding.

EnergyAustralia is of the opinion that were the Queensland Government not to progress with its proposed price monitoring scheme the Authority should give further consideration to using the LRMC method to estimate elements of retail electricity tariff components for future determinations.

With wholesale energy cost comprising up to 21% of a retailers total energy retail costs, the second largest single cost behind network expenses[1], it is imperative the Authority provide for as accurate as possible measure of the wholesale energy costs to be incurred by a retailer. While the QCA's current method of estimating actual wholesale energy costs provides an approach EnergyAustralia still considers that the LRMC methodology more robust and consistent with regulatory principles associated with setting prices.

Having reviewed the Authority's draft determination and its consultants final report we note several of the issues raised within our previous submissions as part of the current and previous years regulated retail pricing determination remain outstanding. Specifically, EnergyAustralia hold the following concerns:

- **Data:** In our submission to the Authority's 2013-14 draft determination EnergyAustralia highlighted the use of three years actual load data to establish load profiles as insufficient and likely to misrepresent high demand days leading towards a potential bias resulting in lower than average energy costs incurred for these periods. Our concerns regarding this methodology remain despite the inclusion of an additional year of actual data. As per our submission to last year's draft determination EnergyAustralia is of the opinion the more data samples used in the analysis the more reliable and robust the likely results from the modelling.

- **Scaling:** In our submission to the Authority's Interim Consultation Paper: Regulated Retail Prices 2014-15, EnergyAustralia noted the perceived flaws or limitations in the methodology when scaling load traces make any assessment or comment on the load forecasts difficult. ACIL Allen's draft report does little to convince us the current restrictions on the load traces accurately reflect the markets operation. Furthermore EnergyAustralia do not consider it appropriate nor transparent for ACIL Allen to reference previous work completed on behalf of Queensland's electricity network service providers as a basis for their decision without providing details of the findings from the work referred to. EnergyAustralia reiterate its preference for the AEMO 10% POE demand restrictions to be removed. Further EnergyAustralia would expect the NSLP peak demands in excess of the AEMO 10% POE to occur during evening peaks. This is consistent with the current trends, where the increasing Solar PV penetration is causing the NSLP peak demand to be delayed.

- **Pool Price:** In our submission to the Authority's Interim Consultation Paper: Regulated Retail Prices 2014-15, EnergyAustralia highlighted the lack of consideration given within the previous year's modelling to those pricing events between $70/MWh and $300/MWh. Specifically, EnergyAustralia highlighted these events were understated in the previous forecast potentially resulting in a considerable financial impact to retailers and representing a key source of regulatory risk. EnergyAustralia seeks comment from the Authority or the Authority's consultants ACIL Allen on how this impact has been better represented within the current modelling approach.

[1] SOTEM 2013 page 129

Further to these issues EnergyAustralia recognise the uncertainty associated with the Federal Government's desire to repeal the Clean Energy Act (CEA) creates an additional layer of complexity to establishing regulated retail prices for 2014-15. This complexity will extend further whereby any repeal of the CEA is back dated to a certain period and when impacts to the power generation sector follow from the Commonwealth Government's Direct Action Plan.

We recognise ACIL Allen's preference to retain a risk adjusted carbon price in establishing the wholesale energy costs and agree with their arguments that total cost recovery throughout the period is likely to balance. However, EnergyAustralia considers it more prudent of the Authority to establish a set of carbon inclusive and exclusive prices to be implemented if and when the CEA is repealed.

EnergyAustralia is of the opinion the carbon price assumption should be representative of the costs that retailers face whilst promoting cost transparency. At the time of making the final determination the CEA will remain in force making the carbon inclusive price the 'best estimate' of wholesale electricity costs. Such an approach will therefore result in greater transparency in setting electricity prices whilst meeting the expectations of consumers and the broader community.

In establishing a suite of carbon inclusive and exclusive prices, EnergyAustralia are concerned ACIL Allen have overstated the risk adjusted carbon costs by using the average daily differences of $7/MWh for the financial year. By overstating these costs for the year and then subtracting this value from the ASX Energy Futures base and peak contract prices, ACIL Allen have understated the carbon exclusive contract price and subsequently understated the carbon inclusive contract price. We see that the risk adjusted value of carbon (ie difference between carbon inclusive and carbon exclusive prices) reduces each quarter as we move from Q3 2014 to Q2 2015, due to the certainty of carbon repeal increasing. EnergyAustralia strongly advises ACIL Allen to determine the risk adjusted carbon allowance by quarter as opposed to taking an average for the financial year. This quarterly risk adjusted carbon allowance should be applied to derive the quarterly carbon exclusive and carbon inclusive prices consistent with the methodology presented in the draft determination.

2. Retail Operating Costs, Retail Margin and Headroom

In this section, EnergyAustralia provide brief comment in support of the Authority's decision regarding retail operating costs (ROC), retail margin and the maintaining an efficient, transparent headroom allowance in support of retail competition, hence better outcomes for consumers.

As per our submission to the Authority's Interim Consultation Paper: Regulated Retail Prices 2014-15, EnergyAustralia does not expect retail operating costs to change materially in 2014-15 and thus support maintaining the ROC in real terms. Furthermore, EnergyAustralia reiterate its support for retaining the current retail margin of 5.7% and headroom allowance of 5%. EnergyAustralia note the following comments in relation to each component:

- **ROC:** Were the Authority to continue in its role in setting regulated retail prices, in particular for those retail customers within the Ergon Energy network area, EnergyAustralia advocates that the present approach be replaced and the Authority undertake a detailed bottom up assessment of these costs for the Queensland retail electricity market.

- **Retail Margin:** EnergyAustralia considers this margin to be the minimum amount required by a retailer as a return on investment and considers the proposed retail margin may appear insufficient to ensure that electricity retailers are adequately compensated for the current risk and regulatory uncertainty within the Queensland electricity retail market.

- **Headroom:** Dependent on the regulatory approach to be adopted by the Queensland Government in setting prices for non-SEQ customers and the interaction of this approach with a price monitoring scheme for SEQ customers EnergyAustralia maintains that the value of the headroom allowance must remain in real terms for the foreseeable future.

3. Other Energy Costs

Whilst EnergyAustralia is satisfied with the Authority's decision in relation to the 'other energy costs' outlined within the Draft Determination, we provide brief comment in relation to the assessment of costs associated with large scale generation certificates under the RET.

Like the impact of uncertainty associated with carbon legislation, the forthcoming review and market commentary regarding the appropriateness and application of the RET scheme has significantly impacted the traded volume of LGC's on the futures market and in brokering houses. This reflects a reluctance of both renewable generators and retailers to enter into market trades.

Given this reduced level of trading, there is strong argument the current futures price does not adequately represent the costs incurred by a retailer in hedging their LGC exposure. This is particularly the case whereby, as extrapolated by ACIL Allen based on Origin Energy's submission, three quarters of the markets liabilities are transacted through other means. A similar level of market liquidity was seen as unreliable leading to the Independent Pricing and Regulatory Tribunal (IPART) adopting an LRMC in its retail pricing determination for 2013-16.

As per previous year's submissions, EnergyAustralia support the use of a LRMC methodology in estimating the LGC cost and disagree with ACIL Allen's comments in relation to the perceived difficulties outlined within their draft report associated with calculating the LRMC.

4. Cost Pass-Through Mechanism

As per our submission to the Authority's Interim Consultation Paper: Regulated Retail Prices 2014-15, EnergyAustralia does not foresee any material changes in costs that will need to be considered as part of a cost pass through review in 2014-15.

Whilst no material changes are anticipated at this time, EnergyAustralia is of the opinion that limiting the application of the pass through mechanism to only variations in network charges or costs associated with the small scale renewable energy scheme does not adequately reflect the risk and uncertainty of the current market particularly in regards to the repeal of the CEA and the review of the RET. Moreover, by limiting the application of the cost pass through mechanisms it is likely that the Authority's decision increases regulatory risks which in turn increases required rates of return on capital to compensate for this perceived increased level of risk.