2nd August 2011

Queensland Competition Authority
GPO Box 2257
Brisbane QLD 4001

Review of Regulated Retail Electricity Tariffs and Prices

Australian Power & Gas (APG) welcomes the opportunity to provide comments on the Queensland Competition Authorities (QCA) issues paper on the *Review of Regulated Retail Electricity Tariffs and Prices.*

At the outset we would state our firm view that in the interests of competition and providing benefits to consumers the QCA should look to phase out price regulation in favour of a regime where market forces set cost reflective pricing.

It is clear from this and other previous consultations that the QCA faces significant difficulty (and risk) when attempting to set representative prices and tariffs for the supply of electricity in the Queensland market.

The removal of price regulation remains our preferred approach to price setting. However in the absence of price deregulation APG supports the N+ R approach to price setting. The difficult in such a regime remains in determining not only the costs to be included in the N+R approach but also their value.

This is important given the Ministerial direction that tariffs are to be cost reflective.

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Additionally we would like to address a comment made in the issues paper. The comment is made in section 2.3(d) of the issues paper contains the broad statement that;

In general, retailers will prefer to sell more electricity in order to enhance their profitability.

This statement creates a perception that retailers are not concerned with efficiencies, which is far from the case. A preferable option for retailers to enhance profitability is through operating in an efficient market, one that is devoid of the overburden of prescriptive and unnecessary regulation.

Whilst not part of this review we believe the QCA should look to ensure that such an environment will exist under the National Energy Consumer Framework. We would be happy to discuss our views on this matter with the QCA at another time.

Our comments on the issues paper are contained in the following documentation. Should you wish to discuss any aspect of our submission I can be contacted on (02) 8908 2714 or via email at sruddy@auspg.com.au

Yours sincerely

[redacted]

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The Authority seeks stakeholder's views in relation to the pass through of network costs; in particular, should network and retail costs be separately identified on a customer's bill?

Australian Power & Gas (APG) believes there to be little value in separating out the network and retail costs on a customer's bill. This issue has been covered well in previous submissions where the issue was raised. Customers inherently sign up to a bundled tariff which is made up of both the network and retail tariff component.

The splitting out of network and retail costs so to appear separately on a customer's bill would require costly and substantial changes to the retailer's customer information and billing system. As the network cost component of a customer's bill cannot be varied, that is the customer is not able to change the network cost component, we would question the value of providing this information.

Whilst it would provide information about the amount of the network component on a customer's bill we struggle to see what the customer would do with this information. Providing information on the significants of the network component in the absence of providing information on how to address the cost would provide little to no customer benefit and will only add to the complexity of customer billing with the potential to create customer confusion. As such we could not support such a proposal.

Further should the QCA seek to impose such a requirement it should first ensure that the network companies are appropriately resourced (with a contact centre) to field calls from consumers on the application and amount of the network tariff.

Lastly any requirement to separate out the network & retail costs on a customer's bill would only create a greater level of divergence between Queensland and other jurisdictions. This divergence has the potential to add to the derogations as proposed under the NECF and thereby lessen the benefits under the NECF.

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Misalignment of network and retail tariffs and views on how this might be addressed

The misalignment of retail and network tariffs has long been an issue of concern for retailers. We believe the only practical solution is to require network companies to submit and for the AER to approve the network tariff earlier in the review process.

We believe the AER should be looking to commence the review process sooner so as to allow adequate time post the approval process for retailers to incorporate new tariffs into their billing systems.

Estimating Energy Costs

Whilst APG can see some merit in adopting a market based approach to determining energy costs we don't believe this should be attempted without the inclusion of a Long Run Marginal Cost (LRMC) mechanism so as to set a floor price for energy purchase costs. The LRMC is required to maintain confidence and stability in prices.

There remain a number of unknowns in the methodology and modelling parameters to be used in estimating the market-based energy purchase costs. The significant impact on pricing from either of the chosen methodologies, in our view requires a greater level of scrutiny and detailed assessment which is yet to have occurred.

There are vastly too many assumptions;

- Hedging strategy of a "representative retailer",
- Volatility of the wholesale market (at a given time),
- Retailers risk strategies, etc.

To be determined under the market based approach, any incorrect or inaccurate assumption may have significant repercussions. These risks further support the removal of price regulation, paving the way for a regime where actual (rather than assumed) market based pricing is adopted.

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Cost of Meeting Obligations under Environmental Schemes

APG strongly supports the view that Environmental Scheme costs must be accounted for within the retail tariffs. Such environmental scheme costs should be viewed as a direct pass through cost.

In assessing the costs full consideration must be given to the compliance, purchase and administrative costs associated with the relevant schemes.

Sufficient market data would now be available for the QCA to assess most of the costs associated with a retailer's compliance with obligations under the relevant schemes.

For example forwarded estimates of retailer's liability under the relevant schemes (e.g. Small Scale Technology Percentage & the GEC liability) are published in advance and may be used in the forward assessment of a retailer's liability and costs.

The data not generally available will be that associated with the administrative burden of compliance with the scheme, e.g. independent audits etc. Generally speaking retailers would be in a position to provide this level of information, all be it on a confidential basis.

As such we believe environmental scheme costs can be determined and must be included in the retail price.

NEM Participant Fees and Ancillary Service Charges

NEM participant fees and ancillary charges are a significant impost for retailers and as such need to be captured as part of the process for determining retail prices. The issues paper has suggested that due to the general stability of the charges that the QCA should be able (with relative accuracy) to forecast NEM fees based on existing trends.

IPART currently forecast NEM costs and ancillary service costs based on historical trends, while the ICRC forecast NEM cost by adjusting costs in the previous year by CPI.

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APG would support a forecast methodology that is based on existing trends that accounts for CPI increases.

We also hold the view a provision should be included where by upon review during the course of the determination period it has been identified the assessed costs have varied materially that these variations can be accounted for in a price / tariff reset.

Assessment of Retail Costs

The assessment of retailer costs further highlights the difficulties faced by the QCA in determining reflective costs under an environment where price regulation exists. The issues paper poses the question as to which type of retailer;

- Representative retailer,
- Incumbent retailer,
- New market entrant retailer,
- Stand-alone retailer,

should be used in modelling the build-up of retail costs. Each category of retailer will have differing costs. Further there is a mix of the above categories of retailers currently operating in the QLD market.

In the absence of price deregulation (where the retail cost issue would not exist) the QCA needs to ensure the retail costs taken into consideration are reflective of the most appropriate retail profile that will ensure consumer benefit and promote competition.

In this instance we believe that profile should be of a new market entrant with a medium customer base with a medium growth trajectory.

Retail Operating Costs

The QCA is seeking views on which costs should be included in the retail operating cost allowance. At a minimum APG believe the following retail operating costs must be included in retail operating cost allowance;

- Billing,
- Customer call centre,
- Credit & bad debt management and administration,

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- Energy trading activities,
- Administrative costs associated with regulatory compliance,
  - Environmental scheme compliance,
  - Licence compliance,
- Customer retention and acquisition costs.

In determining the costs to be included and their value retailers would be able to provide information (on a commercial in confidence basis) that could be used by the QCA in determining the allowable retailer operating costs.

A significant retailer operating cost will be compliance with the new CPRS / Carbon Tax. This complex scheme will require significant investment on the part of retailers to ensure compliance with the scheme and to ensure the effectiveness of the scheme. This cost must be recognised and included in the build-up of retailers operating costs.

Retail Margin

The QCA is seeking views on what costs should be included in determining the retail margin. As the QCA points out an adequate retail margin is required to continue to incentivise investment in the market, where the retail margin is not sufficient it will lead to underinvestment from existing retailers and deter new entrants to the market.

The retail margin needs to be set so it addresses the risks incurred by a retailer. In determining the appropriate retail margin the following risks (cost) need to be included;

- Return on capital investment, including a return on retailers operating costs and physical assets,
- Systemic risk, both price and volume risk factors,
- Debt and credit risk (as opposed to administration and management which is to be included in operating costs),
- General economic and business risk factors,
- Regulatory risk (accounting for the introduction of new and revised obligations placed on retailers during the course of the determination period, not limited to but including the introduction of the CPRS).

As for an adequate level of retail margin we note in previous determinations the QCA has concluded that a (gross) retail margin of 5% is appropriate. APG holds the view that at a minimum (gross) level of retail margin is in the vicinity of 9%.

There needs to be a greater recognition of the risks faced by retailers, particularly the price and volume risk factors associate with wholesale supply. In addition the risks associated with the introduction of the CPRS / Carbon Tax needs to be adequately recognised.

Setting the "R" Cost Component

In setting the "R" component of an N+R approach to price setting the QCA needs to ensure not to over complicate or prescribe the methodology used in setting the R component.

There are merits in pursuing a simple cost allocation approach when determining the R component of the tariff. In broad terms the R component needs to reflect the costs incurred by retailers in supplying customers, which includes an adequate level of retail margin.

To over complicated the determination of the R component into that of sub-categories of classes of customers in our view would add significant cost for little benefit.

Until such time as price regulation is removed a simplistic approach should be adopted to determining the R component.

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