TRUenergy Pty Ltd
ABN 99 086 014 968

Level 33, 385 Bourke Street
Melbourne Victoria 3000
Telephone +61 3 8628 1000
Facsimile +61 3 8628 1050

enq@truenergy.com.au
www.truenergy.com.au

5 August 2011

Mr Gary Henry
Queensland Competition Authority
GPO Box 2257
Brisbane QLD 4001

via email electricity@qca.org.au

Dear Mr Henry

RE: Issues Paper: Review of Regulated Retail Electricity Tariffs and Prices

TRUenergy welcomes the opportunity to provide comments on the Issues Paper: Review of Regulated Retail Electricity Tariffs and Prices (the Issues Paper).

TRUenergy notes that the Queensland Competition Authority (QCA) has said that it considers that "all customers will be best served by a well functioning competitive electricity market".[1] Also the Minister's Delegation to the QCA notes that "Queensland electricity consumers should, wherever possible, have the opportunity to benefit from competition and efficiency in the market place."[2] TRUenergy agrees with this and believes that a key retail pricing objective, over the long term, must be to enable more Queenslanders to access competitive retail electricity prices.

In 2009 the Premier signed the updated Australian Energy Market Agreement (AEMA) which lists as one of its objectives "enhance the participation of energy users in the markets"[3] with furthering retail competition listed as an example. Given the agreed importance of competition, TRUenergy is disappointed with the lack of focus on it in the Issues Paper.

Another objective of the AEMA is to "streamline and improve the quality of economic regulation" in order to "lower the cost and complexity of regulation".[4] Thus it is also of concern that the Issues Paper appears to be based on the premise that heavy handed regulation is a necessary outcome, contrary to the AEMA. It would be preferable if the Issues Paper considered in detail the appropriate form of regulation and how best to ensure it is streamlined and keeps cost and complexity to an absolute minimum. Such an approach would help foster the development of a competitive and efficient retail electricity market, in accordance with the AEMA and delivering benefits for Queensland electricity consumers.

While the Minister's Delegation directs the QCA to establish prices for only the 2012/13 year,[5] there is nothing in either the Direction Notice or the Minister's letter to suggest that the pricing approach developed is not intended to be used for 2013/14 and beyond. Indeed to develop a new approach for 2012/13 and then another for 2013/14 is illogical and would add to regulatory cost and risk.

TRUenergy has previously highlighted the need for extensive consultation prior to the finalisation and implementation of a new price-setting methodology for 2012-13 and beyond. We appreciate this

[1] QCA, *Final Report: Review of Electricity Pricing and Tariff Structures - Stage 2*, November 2009, page i
[2] The Hon. Rachel Nolan MP. Minister for Finance, *Minister's Direction Notice to QCA*, April 2011, page 1
[3] Australian Governments, *Australian Energy Market Agreement (as amended)*, July 2009, page 8
[4] Australian Governments, *Australian Energy Market Agreement (as amended)*, July 2009, page 8
[5] The Hon. Rachel Nolan MP. Minister for Finance, *Minister's Direction Notice to QCA*, April 2011, page 1

opportunity to participate but are concerned that this appears to be the only occasion where we are able to engage with the QCA before the Draft Decision is released. Given the magnitude and importance of the changes being proposed, we believe more engagement would be appropriate.

TRUenergy provides the following comments on specific areas of the Issues Paper:

Network Costs & Tariffs

The cost drivers for a network business are different to those for the wholesale market and for retail operations. Hence tariff structures designed to align with network cost drivers will differ from those set to deliver retail pricing objectives. If retail pricing structures are set to equal network structures, then it is likely that the structure is sub-optimal from a network perspective, a retail perspective or possibly both. Where network structures and tariffs change, it is imperative that the timing of the finalisation of the new or amended network tariffs and the setting of retail tariffs be aligned to ensure that retailers are able to implement any necessary system changes and recover reasonable costs. This will also enable retailers to develop and offer products that best suit customer needs.

The Ergon CSO is designed to ensure regulated electricity prices are the same in all parts of Queensland. The reason that a CSO is required to deliver this outcome is that Ergon's network charges are higher than Energex's. TRUenergy supports changing the existing CSO from a retail level to a network level payment. The current CSO structure ensures that customers in the Ergon area are unable to access real retail competition. Furthermore, it exposes the state government to wholesale price risk which can cause the cost of the CSO to blow out significantly.

TRUenergy believes that it would only be appropriate to display network tariffs on bills if a detailed cost-benefit analysis showed that this was worthwhile. There would be significant costs to amend billing systems and the benefits are likely to be limited. Indeed given that residential customers have no ability to manage their network costs and it is only the bundled retail price that affects their consumption choices, showing network tariffs on bills will not change customer behaviour. Itemising network tariffs will make power bills more complex, however, which is likely to lead to confusion for some customers that will create a barrier to them accessing competitive offers.

Energy Costs

Energy costs are a function of the retailer's long term asset position, long term contracts and a mix of short term contracts; the optimal hedge level for a retailer will be a function of its risk profile. Due to the inherent risk of volatility in the spot market, retailers have largely been risk averse; consequently the hedging approach adopted by the QCA should reflect this. If the QCA wishes to avoid volatile power prices for consumers, a conservative hedging approach that minimises the impact of spot prices should be adopted. The QCA should adopt a stable and transparent approach but must avoid an overly simple averaging approach to market prices. This is because market uncertainties, such as those currently experienced in relation to carbon, will mean that a simple time-weighted approach will differ from a volume-weighted approach that accounts for value traded and is a better reflection of the real energy purchase costs.

Over the medium term, the Net System Load Profile (NSLP) is likely to be the most appropriate way of estimating the load profile for the Energex region. However, in the initial years of the new methodology, an adjustment must be made to recent NSLP data to remove the greater than 100MWh customers as these will not be in the NSLP going forward.

TRUenergy supports setting wholesale costs with reference to both market-based and long-run marginal cost (LRMC) estimates. Over the long term wholesale costs should not be lower than the LRMC to ensure long-term forward contracting does not diminish and generation investment decisions are not delayed. The Issues Paper claims that "higher energy cost allowances do not flow upstream to generators unless the retailer is altruistically supporting its suppliers". [6] This oversimplification applies only to the spot market and ignores the fact that a significant majority of electricity is effectively traded under fixed contracts.

---

[6] QCA, *Issues Paper: Review of Regulated Retail Electricity Tariffs and Prices*, June 2011, page 16

All market participants agree that new generation will be required in Queensland sometime between 2014 and 2016. The 2008-09 Major Economic Statement reconfirmed a policy position of encouraging "private sector investment in and ownership of economic infrastructure" [7] including new electricity generation. In the 2010 review of the Government Owned Corporation Generators (GOCs) the government confirmed that the GOCs "would not engage in expansionary business development activities relating to investment in new generation". [8] It is clear that the new generation required will only be built if the private sector is willing to invest.

Given the uncertainty already in the market regarding carbon costs, setting an energy cost allowance below LRMC will make retailers unwilling to enter long-term forward contracts at LRMC. This in turn will diminish the willingness of private capital to invest in the new generation capacity that Queensland clearly requires. Higher and more volatile wholesale electricity prices are likely to result, and the risk of blackouts will increase. It is hard to see how adopting an electricity pricing approach that is likely to hinder investment is in the long term interests of electricity customers. As a potential investor in new generation, we urge you to reconsider creating further investment uncertainty by not utilising LRMC as a floor price.

Further, setting the energy cost without reference to the LRMC will lead to greater volatility in household electricity prices. A quick look at the BRCI over the last few years highlights how volatile the energy purchase cost has been. Again it is difficult to see how adopting an electricity pricing approach that will lead to more volatile prices is in the long term interests of electricity customers.

Energy losses, both transmission and distribution, do need to be accounted for in the energy cost estimate.

With regards to schemes such as the Queensland Gas Scheme and the Renewable Energy Target (RET), TRUenergy recommends the adoption of a stable and transparent approach to forecasting both the targets and the costs. Costs should be based on long-run estimates to avoid volatility. RET compliance costs should be determined with reference to the LRMC of wind generation. TRUenergy forecasts suggest the market will require approximately 10,000MW of new renewable generation by 2020. It is assumed that the new entrant renewable technology that will meet most of the LRET will be wind technology due to it being the most cost competitive large scale renewable technology currently available. Any retailer with a significant RET liability will need to enter into long term power purchase agreements in order to fulfil their liability.

RET targets should be based on official requirements and estimates. In particular the QCA should avoid a repeat of the inappropriate and unreasonable approach it adopted to setting the 2012 Small-scale Technology Percentage (STP) for the 2011/12 BRCI. The QCA chose not to use the official estimate of 16.8% as it believed it would be adjusted and decided to use 9% instead. The official estimate has indeed now been adjusted but rather than being reduced by almost 8% it has been increased by more than 4% to 20.87%. A stable and transparent approach based on official requirements and estimates, with appropriate adjustments for regulatory changes (see below) would ensure such outcomes do not occur under the QCA's new price setting process.

Retail Costs

A stable and transparent approach should be adopted that ensures that all reasonable retail costs of supplying a customer in south east Queensland are included in the retail cost allowance. Given there is no actual stand alone retailer that supplies SEQ, using a new entrant/small second tier retailer is preferred. This also ensures that new entrants are not at a disadvantage relative to incumbents, meaning a barrier to entry is not created.

Queensland specific costs and regulatory obligations also need to be taken into consideration. The key principle must be that the overall costs are not understated. Understating or omitting any particular cost element undermines the fostering of competition and inhibits investment signals.

---

[7] Queensland Government, *Major Economic Statement: Mid Year Fiscal and Economic Review*, December 2008, page 27
[8] Queensland Government, *Shareholder Review of Queensland Government Owned Corporation Generators*, November 2010, page 12

Acquisition and retention costs need to be allowed for as these are reasonable costs incurred by any retailer in a competitive market. Such costs need to be recovered over a reasonable period, with consideration given to the higher churn rates experienced by new entrants compared to incumbent retailers.

Retail Margin

The retail margin must be set at a level that reflects the reasonable costs and risks of operating a retail business.

TRUenergy notes that IPART, in their Final Decision for regulated retail electricity tariffs for 2010-2013, provided a retail margin of 5.4%. TRUenergy believes retail regulatory risks are greater in Queensland than in New South Wales and should therefore warrant a higher retail margin. This is because NSW has a more stable review process and cost pass through provisions, highlighted by the Jan-Jun 2011 costs of the new SRES. IPART has defined cost pass through provisions to cover changes in legal and tax obligations such as this. However the BRCI did not account for this change, meaning retailers were exposed to this cost and to any similar future regulatory changes. Exposing retailers to uncontrollable costs such as this increases the risks associated with energy retailing, and in turn increases the required returns.

We note the risk asymmetry in the setting of retail margins. If the margin is overstated then this will encourage significant retail competition that will quickly erode these excess margins away. However if the margin is understated this will block competition, stifle innovation and discourage investment, none of which are in the long term interest of Queensland electricity customers.

The R Component

It is difficult to see the public benefit in the QCA attempting a detailed and intrusive retail cost allocation process. Any allocation must be competitively neutral – regulatory decisions must avoid making certain customers less attractive to second tier retailers or these customers will not be able to access competitive offers. The allocation process must also ensure that retailers are free to offer new or existing tariffs that better suit a particular customer's characteristics.

Delaying a move to cost reflective tariffs is unlikely to be in the long term interests of consumers. Where there are concerns regarding large customer increases resulting from the move to cost reflectivity, these are best addressed by targeted rebates and education programs, not by broad price regulatory distortions.

Over the longer term, customers will be better off if retail energy prices are disciplined by effective competition than they will be if prices are based on regulatory estimates. Where price regulation is considered necessary, it should be structured in such a way as to encourage innovation and facilitate a more competitive market. Fixing reasonable retail costs and margins for a period of three years, as is done by IPART in NSW, provides incentives for retailers to beat the benchmark and develop competitive offers below the regulated price.

Dealing with uncertainty

A mechanism to deal with unforseen events that a retailer could not reasonably be expected to manage is required. Without it, we are likely to see a repeat of the unacceptable situation when the Jan-Jun 2011 costs of the new Small-scale Renewable Energy Scheme (SRES) were never factored in to regulated prices by the QCA. This situation is set to occur again Jan-Jun 2012. If a pass through mechanism is not included this increases the risks associated with energy retailing, and in turn increases the required returns to account for this risk.

In contrast to the BRCI, IPART has defined cost pass through provisions to cover changes in legal and tax obligations such as the SRES. These provisions should be considered a minimum pass through standard.

Conclusion

TRUenergy believes the QCA should be aiming to establish a regulatory framework that is in the long term interests of Queensland electricity customers. While price regulation is in place, a stable and transparent approach that sets reasonable costs and returns will foster the development of a competitive and efficient retail electricity market.

We would appreciate the opportunity to discuss the issues raised in this submission with you in more detail and will be in contact to try and arrange this. Should you wish to discuss or clarify any of this before then please feel free to give me a call on (03) 8628 1120.

Yours sincerely,

[redacted]

Andrew Dillon
Regulatory Pricing Manager