11 July 2017

Eva Wong
Australian Competition and Consumer Commission
GPO Box 520
Melbourne VIC 3001

Email: retailelectricityinquiry@accc.gov.au

Dear Ms Wong

Inquiry into Retail Electricity Supply an Pricing – Issues Paper

Energy Queensland Limited (Energy Queensland) welcomes the opportunity to provide comment to the Australian Competition and Consumer Commission, on its *Inquiry into Retail Electricity Supply and Pricing – Issues Paper*. The attached submission is provided by Energy Queensland, on behalf of its related entities Energex Limited, Ergon Energy Corporation Limited and Ergon Energy Queensland.

Should you require additional information or wish to discuss any aspect of this submission, please do not hesitate to contact either myself on (07) 3851 6416 or Trudy Fraser on (07) 3851 6787.

Yours Sincerely

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Encl: Energy Queensland submission to the Issues Paper

Energy Queensland Submission on the ACCC Inquiry into retail electricity supply and pricing

Issues Paper

Energy Queensland Limited

11 July 2017

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1 Introduction

Energy Queensland Limited (Energy Queensland) welcomes the opportunity to provide comment to the Australian Competition and Consumer Commission (ACCC) on its Inquiry into retail electricity supply and pricing. This submission is provided by Energy Queensland, on behalf of its related entities Energex Limited (Energex), Ergon Energy Corporation Limited (Ergon Energy) and Ergon Energy Queensland Limited (EEQ)). Energy Queensland is a recently established Queensland Government Owned Corporation that operates a portfolio of businesses providing energy services across Queensland, including:

- Distribution network service providers (DNSPs), Energex and Ergon Energy; and
- A regional service delivery retailer, EEQ, limited in its scope of operations by jurisdictional legislation.

Energy Queensland is committed to energising Queensland communities and it is focused on working across its portfolio of activities to safely deliver secure, affordable and sustainable energy solutions with our communities and customers.

Consistent with this, Energy Queensland is also committed to working with all relevant stakeholders to ensure tariffs are understood by customers and encourage the most efficient and effective use of the available resources including renewable energy and the utilisation of infrastructure and assets.

1.1 Electricity price regulation in Queensland

Ergon Energy Queensland provides customer retail services to more than 720,000 customers across an operating area of more than 1 million square kilometres (around 97 per cent of the state of Queensland). Accordingly, EEQ is the largest retailer in Queensland and is also the fifth largest energy retailer by customer numbers in the National Electricity Market (NEM).

EEQ is government owned and subject to price regulation by the Queensland Competition Authority (QCA). The QCA determines retail prices for customers in Ergon Energy's distribution area, as described further in section 2 below, and EEQ may only charge customers the regulated retail prices as prescribed in the Queensland Government Gazette.

1.1.1 Uniform Tariff Policy

A Uniform Tariff Policy (UTP) has been in place in various forms in Queensland for over 30 years, and was designed to equalise (from a customer's perspective) the total cost of electricity supply, irrespective of a customer's location in the State. That is, uniform tariffs applicable to the same customer class, but independent of geographical location or load shape within that customer class.

However, Energy Queensland understands the UTP was not achieved until 1986 after decades of price adjustments. At the time there was no effective means of targeting the different elements of the costs of supply – the network (transportation) costs, the costs of energy, and the retailer costs, in the original policy development. Therefore, the UTP was understandably focussed on achieving retail tariff price consistency.

In Queensland, the funding of the UTP through a Community Service Obligation (CSO) payment from consolidated revenue commenced with the corporatisation of the Queensland Government's electricity assets. For the 2016-17 financial year, regional Queensland customers will benefit from reduced electricity bills as a result of the UTP and a forecast $550m in total CSO payment. Since 1998, the Queensland Government, similar to other State and Territory Governments, has as part of the National Reform Agenda, gradually introduced competition to the jurisdictional electricity market, with the introduction of full retail competition for residential and small business customers in Queensland from 1 July 2007.

Given the unique geographical challenges involved in supplying electricity to sparsely populated areas in Queensland, there will likely always be a requirement to subsidise some regional customers. This has been a fundamental driver of the UTP since its inception and Energy Queensland expects that this issue will remain.

To the extent that some form of subsidisation of all or a subset of customers remains, Energy Queensland suggests this is done in a way that does not distort price signals and also supports retail competition.

2 Specific comments

2.1 Prices, costs and profits

As noted in section 1.1 above, EEQ is a government owned retail business which is subject to price regulation by an independent jurisdictional regulator, the QCA.

The process used by the QCA for deriving retail prices is subject to public consultation and is a mature and well understood process. The QCA uses a mix of bottom up and benchmarking processes to derive prices for regional Queensland.

Notwithstanding, the QCA's ability to determine the most efficient price is limited due to information asymmetries. If the price is set too low (below efficient price but above cost), competition will disappear and the incumbent will effectively extract monopoly rents. Retail electricity prices for residential and small business customers in south east Queensland are not regulated by the QCA, but are subject to price monitoring.

In other jurisdictions where price regulation does not apply, it is important to recognise that a review at a given time is only a snap shot and doesn't necessarily reflect trends over time. It should be noted that other forms of regulation can inhibit customers' decision making. For example, bans on time-of-use tariffs or information requirements which dilute key information that would otherwise be used by customers to make decisions around key products limit their ability to make efficient investment decisions.

As such, Energy Queensland supports a continued transition to ensuring the market is structured to allow competitive outcomes through appropriate, minimal regulation. This should ensure that barriers to entry/exit are low, access to information is universal, and market power is eliminated. In this context, the ACCC in making recommendations to the Australian Government should be mindful of the effect of those recommendations in the market. Changes that influence the supply demand balance need to be shown to be clearly beneficial to justify the potential disruption to the market.

2.1.1 Energy costs

The wholesale energy cost component of regulated retail electricity prices in Queensland is estimated by ACIL Allen using a hedging strategy approach. The QCA considers that ACIL Allen's approach is transparent and best reflects the actual costs retailers incur when purchasing electricity from the NEM. Increases in the regulated retail electricity prices for 2017-18 determined by the QCA are largely due to increases in wholesale energy costs. The increase reflects the projected continuation of the increase in gas prices for gas-fired generation and the continued tightening of the supply-demand balance in the NEM.

2.1.2 Network costs

Energy Queensland recognises that rising retail electricity prices in Queensland from the mid-2000s has been in part due to increases in network costs. From early 2000, Energy Queensland's distribution businesses' investment in new, replacement and augmented assets in the network increased in response to an aging network, population growth and shift, the mining boom, increased demand per capita and in an effort to meet customer's changing expectations around reliability and quality of supply driven by the uptake of lifestyle appliances. Furthermore, additional network investment was required from 2004 to meet higher reliability standards introduced in response to the Electricity Distribution Service Delivery (EDSD) Review.

To achieve higher reliability standards each of the Queensland DNSPs had to undertake a number of measures, including the obligation to meet N-1 security on bulk supply substations and large zone substations (5MVA and above) and sub-transmission feeders. Steps also needed to be taken to improve network planning processes, improve maintenance programs and to better communicate with customers on network outages. Whilst it was acknowledged by the EDSD Review Panel at the time that these recommendations would result in significant capital and operating expenditure, the impact of these reforms on price was not fully quantified.

Energy Queensland's DNSPs recognised the cost pressures created by the higher reliability standards introduced following the EDSD Review, and in 2007-08, they initiated actions for achieving security of supply on the distribution network that may be more cost effective and efficient in the long-term. Based on this work and the belief that greater flexibility was required to adapt to change and deliver value and choice to their customers, they made submissions to the 2011 Electricity Network Capital Program (ENCAP) Review for a change in policy settings. This review ultimately recommended a relaxation in the security criteria (N-1) and changes to Minimum Service Standards (MSS).

In February 2012 the Queensland Government directed the DNSPs not to seek revenue associated with the expected reduction in capital expenditure arising from the implementation of the recommendations of the ENCAP Review, by excluding it from the annual network pricing proposal.

In an effort to address the change in customer attitudes to price and reliability, the DNSPs continued discussions which led to new Distribution Authorities in September 2014 which flat-lined the MSS at 2010-11 levels and introduced probabilistic standards (as opposed to a deterministic N-1 approach) and a Safety Net. This has in turn led to significant reductions in the level of augmentation required and this was reflected in the DNSP's Regulatory Proposals for 2015-20.

During the 2010-15 regulatory control period, the Queensland DNSPs were expecting continued growth in peak demand driven by a mining growth; high State Domestic Product growth projections; economic and population growth in regional Queensland; continued investment to meet increasing reliability obligations; and reasonable customer expectations for the safety, quality and reliability of their power supply.

These key drivers framed expectations for demand over the 2010-15 regulatory control period and associated forecast expenditure (capital and operating and maintenance). However, within 12-18 months of the 2010-15 regulatory control period commencing, many of these drivers and assumptions had materially changed due to one or more of the following factors acting either independently or collectively:

- The price impact of the reliability standards introduced following the EDSD Review. Since the EDSD Review, reports indicate that annual capital expenditure on the Queensland network has increased.[1]
- Weaker global economic conditions. The effect of severe weather events in 2010-11, which flooded mining operations, also had a specific effect in Queensland (and was not replicated in the rest of Australia) leading to a drop in electricity consumption in that year.[2] The subsequent high $AUD also dampened trade-exposed economic activity, particularly in the manufacturing sector.
- Queensland households have adopted measures to reduce usage. Whilst these measures have resulted in an overall fall in consumption they have not necessarily resulted in reduced retail bills.
- Energy conservation and efficiency became a key lever for reducing carbon and mitigating climate change impacts.
- Climate change policies and subsidies for rooftop solar photovoltaic (PV) installations have led to a rapid increase in a number of households and businesses with solar PV. The uptake for solar PV has exceeded initial expectations with more than 26 per cent of Queensland households now with solar energy systems. 16 per cent of Queenslanders indicated they were looking to either purchase more panels or acquire solar PV in the next two years.[3]
- The installation of solar PV has a twofold effect on the network:
    1. It introduces an additional source of power for which, in the main, the networks were not designed; and
    2. The pattern of solar generation is such that the peak demand has not significantly dropped, whereas overall consumption has. The net effect is that the DNSPs must still build networks to cater for the peak, yet there are less units of electricity being distributed through which the majority of revenue was recovered.

In light of the changed operating environment, the Queensland DNSPs embarked on a period of improved efficiencies to identify areas offering the greatest cost reduction opportunities. The efficiency and effectiveness initiatives were complemented by independent analysis and interrogation of the underlying expenditure. The approach to reducing costs and improving efficiency was also informed by the various energy industry sector efficiency and productivity

[1] Queensland Government, 2011. *Electricity Network Capital Program Review 2011: Detailed report of the independent panel,* p65 (http://www.parliament.qld.gov.au/Documents/TableOffice/TabledPapers/2014/5414T5363.pdf)
[2] Queensland Commissioner of Audit, 2013. *Final Report – Volume 2.* February, p5.
[3] Colmar Brunton, 2017. Queensland Household Energy Survey 2016 – Summary Presentation, February

reviews (both at State and Federal level) that occurred over the course of the 2012-13 year and the results of various global benchmarking surveys regarding the efficiency of energy utilities.

Improved demand forecasting methodologies, organisational restructures, coupled with the capital expenditure savings identified by the DNSPs and ENCAP as well as government directions to absorb the financial costs of the Australian Competition Tribunal's decision on gamma and the full financial cost impact of Cyclones Yasi and Oswald, meant that the starting point for prices in 2015-20 were lower than they would have otherwise been. The AER's Final Determination noted that they expected a typical residential bill to reduce between 1 and 2 per cent per annum over the 2015-20 regulatory control period. This is reflected in the prices currently being paid by customers.

The first Tariff Structure Statement (TSS) for each of Energy Queensland's DSNPs set out 5 years of indicative network prices and was submitted to the AER on 27 November 2015. The final revised TSSs were approved in late February 2017.

Energy Queensland is committed to the delivery of tariff structures which balance the changing needs of our customers in Queensland, including their desire to take up their own energy options and increased technology, with the need to meet regulatory requirements.

Energy Queensland's DNSPs are currently pricing within structures and assignment policies set out within their approved TSSs. These TSSs set out a transition towards cost reflective pricing that is likely to continue over multiple regulatory control periods. Customer understanding and response to cost reflective network tariffs will drive down network costs in the long term, ultimately reducing network prices. This first step in reforming our network tariffs will ensure that customers will be paying efficient cost reflective tariffs so that they are better able to understand the implications of their consumption and investment behaviours.

Consumer education will be critical to enable customers to understand the consumption data provided by digital meters and drive efficient behaviour and investment choices based on that data, which will in turn support the continued evolution of tariffs to build customer choice. These issues will need to be considered for networks to achieve price reductions in the long term.

2.1.3 Environmental scheme costs

In 2013 the QCA released its Final Determination on Regulated Retail Electricity Prices 2013-14, which recognised that the cost of green schemes (the Renewable Energy Target) represented 3.5 per cent of the total costs on a residential bill, while the Solar feed-in bonus added a further 3.9 per cent to the bill.[4]

[4] Queensland Competition Authority, 2013. *Final Determination – Regulated Retail Prices 2013*-14. http://www.qca.org.au/getattachment/71cccdfa-ff37-4481-b8ac-188709ea1823/Final-Determination.aspx. Although the QCA releases a Final Determination on Regulated Retail Prices every year, the 2013 Determination has been referenced as the subsequent Determinations do not give an indication of how much environmental scheme costs contribute to the residential bill.

In June 2017 the Queensland State Government announced that Energy Queensland's DNSPs would not pass though jurisdictional scheme costs (the solar feed-in bonus) to consumers for a period of 3 years, thereby reducing the retail bill increase to 3.1 per cent for the average residential consumer[5].

2.1.4 Retail costs and margins

It is important to recognise the vital role that retailers play in the market. Without retailers customers would be exposed to the spot market which would make electricity unaffordable for vulnerable customers in particular. Retailers therefore play a crucial function in supporting the wholesale market by:

- providing the generators with a financially stable counterparty;
- reducing the number of counterparties from all end use customers to a smaller number of retailer counterparties;
- Power Purchase Agreements for new generation; and
- providing a counterparty for hedging instruments to reduce risk for generators

Customers in the main purchase their electricity in arrears. That is, they are provided credit by the retailer who purchases electricity and its transportation on their behalf before sending the customer a bill 1 to 3 months later depending on the customers meter reading cycle. In recognition of the essential nature of electricity, customers with a poor credit rating still have access to tariffs in Ergon Energy's distribution network region (or standing offers with local retailers in South East Queensland and other NEM regions without price regulation).

In areas with competition, customers can reduce the price they pay by shopping around for a better price. Customers can get the best price by agreeing to pay by direct debit, more frequently, and on time. By doing so they are reducing the costs for the consumer and representing a reduced payment risk to the retailer and as such are rewarded with a lower price accordingly.

Energy Queensland suggests that the unique characteristics of the regional Queensland operating environment should be recognised. For EEQ, these characteristics include:

- The imperative to service remote and isolated customers;
- Affordability issues faced by regional and remote customers;
- Policy mechanisms such as the delivery of drought relief programs and the CSO.

In addition to the above and the general retail operating costs associated with customer administration, call centres, corporate overheads, billing and revenue collection, IT systems, and regulatory compliance, EEQ delivers a hardship program for regional Queensland customers.

[5] Network Prices were already decreasing in 17-18 prior to the removal of the jurisdictional scheme amounts.

Managing customers experiencing hardship (which EEQ considers a core obligation) and debt management has a direct impact on EEQ's operating costs. As an example of this, the average handling time for a customer call related to hardship is significantly longer than a standard customer call. Extending and improving the customer hardship program has required greater human resources and community engagement expenditure to ensure greater access to the program and higher rates of graduation to assist customers.

Any delay in bill payment results in increased working capital funding costs to cover debtor balances.

2.2 Customers and their interaction with the market

Energy Queensland believes there would be significant benefit in greater consumer understanding in Queensland of the market structure, key players, the regulated process, how prices are established, the UTP in Queensland and how this compares with other regions, etc. In the absence of understanding, consumers are unlikely to proactively participate in market initiatives and as such, Energy Queensland recognises the need for more targeted engagement on these issues.

Energy Queensland acknowledges that customers ultimately drive changes in the electricity sector through adoption of new technologies and changed behavioural patterns as they attempt to manage energy costs. However, their ability to do so is often limited by financial constraints, knowledge of the products and services offered as well as an understanding of tariff reforms. Consumer education and a clear customer value proposition are critical to incentivise customers to make changes.

Energy Queensland suggests that a customer centric framework that empowers customers with data and information services will support customers to move to more efficient tariffs. However, Energy Queensland notes the Energy Networks Australia's Electricity Network Transformation Roadmap (Roadmap), which was released in April 2017, proposes that a fairer system of prices can be achieved in a reasonable timeframe with change to tariff assignment policy. That is, assigning customers to a demand tariff with a choice to opt-out will result in more customers on fair and efficient tariffs more quickly than if they are given the choice to opt-in. Energy Queensland also notes that smart meter technology is essential to ensuring a fair system of pricing that is more reflective of costs. Furthermore, the packaging of all energy products such as tariffs, solar PVs, battery storage, home energy management systems, energy audits etc., will need to be carefully considered to ensure the maximum benefits are delivered to customers.

The Roadmap also suggests that vulnerable customers may receive relief from bill stress and gain access to the energy market through bundled solutions which incorporate efficient appliances, simple energy management and distributed energy technologies and data access with simple financial solutions.