Regulated Retail Electricity Prices
2013-14

Response to Transitional Issues

December 2012

SunWater appreciates the opportunity to have input into the setting of transition arrangements for the 2013/14 year and beyond.

Transition Tariffs Support Offpeak Usage

SunWater has many Large sites on the transition tariffs, mostly on transition tariffs 22 and 43 to take advantage of offpeak rates by pumping overnight and on weekends. While the new demand tariffs (tariffs 44 to 48) have all been based on the N + R approach to cost reflective pricing, there is currently no offpeak pricing signal in Ergon's Large network tariffs and so there is no ToU signal in the new demand tariffs. This means that the many SunWater sites that are rightly benefitting from offpeak rates on transition tariffs 22 and 43 are disadvantaged by a move to the new demand tariffs.

The N + R approach to franchise tariff pricing was an outcome of QCA's Review of Electricity Pricing and Tariff Structures, finalised in November 2009. As the QCA noted in their final report, the Ministerial Direction specified two key criteria to guide the QCA's decision-making in the review:

> "The Ministerial Direction requires that the Authority examine alternative tariff structure options that:
>
> (a) support cost reflective tariffs; and
>
> (b) encourage more efficient use of electricity, including by encouraging demand-side management."

The QCA's interpretation of these criteria was summarised in the following paragraph of the final report:

> "Cost reflective tariffs provide each customer with appropriate pricing signals to reflect the underlying cost of supplying electricity to them. Tariff structures that provide correct signals when electricity costs more to supply (for example, during periods of peak network capacity) can encourage customers to make decisions that reduce the need for costly network capacity increases. Given the appropriate price signals, customers can then decide when and how much electricity to consume."

While the new suite of demand tariffs for Large customers could be argued to be cost reflective, the pricing signals are clearly not appropriate as they provide no signal regarding *when electricity costs more to supply* and therefore provide no information for *customers to make decisions that reduce the need for costly network capacity increases*. As it currently stands, the new demand tariffs signal to customers that it is irrelevant whether or not a customer contributes to peak demand. This is a perverse outcome that undermines a large part of the intent of the electricity tariff review.

SunWater acknowledges that this outcome was not the intention of the QCA's tariff review and is largely beyond the control of the QCA in this current price setting process. After all, the Authority can only work with the various pricing inputs as presented; the fact there are no ToU signals in Ergon's Large customer network pricing means there will be no ToU signals in the Large customer retail prices. However, SunWater believes the Authority should take into consideration the intent of the tariff review and use the one tool they have at their disposal, the transition tariffs, to help manage this perverse situation. The transition tariffs

preserve the ToU pricing signals and therefore should be retained to provide customers with incentives to avoid peak demand times. The one certainty in this process is that removal of the transition tariffs will lead directly to an increase in peak demand as customers such as SunWater will not be able to economically justify a continuance of their offpeak usage behaviour.

Time Required for Network Pricing Signal Development

The absence of a ToU pricing signal in the network charges is difficult to comprehend given that the dramatic increases in network charges over the past five years have invariably been attributed to the dramatic increases in peak demand on the network. SunWater fails to understand how the major cost driver of increasing network costs has not revealed itself in the network pricing and consequently is having no influence on franchise tariff retail pricing.

Judging from the presentations given by Ergon and Energex at the recent QCA workshop in Brisbane, the network companies are working hard to develop appropriate peak pricing signals within their suite of network tariffs. In particular, Ergon has stated that their tariff changes will not be implemented before 2014-15. Given timing issues between the annual network price setting process and the QCA's annual retail price determination, it is quite feasible that appropriate peak demand pricing signals will not appear in the new demand tariffs until 2015-16. This suggests that the transition tariffs should be maintained for at least another three years to provide a smooth transition to the new tariffs.

Time Required to Absorb the Impacts of Electricity Reviews

As outlined in the QCA's workshop presentation, there are currently over 10 separate State and Federal reviews or panels in place that could impact on electricity pricing. There has probably never been a time of greater uncertainty in the electricity market since market deregulation. In the face of such uncertainty, it would seem to be the wrong time to force customers off the transition tariff structures to the new demand tariffs knowing that these new tariffs could change dramatically as an outcome of these reviews. On this argument alone, the transition tariffs should be retained until the outcomes of these reviews are known.

Investment Decisions Driven by Existing Tariff Structures

For over 20 years there has been a very strong retail pricing signal regarding usage in peak times which has led SunWater to make significant long-term investments in plant and infrastructure to take advantage of low offpeak rates. This has presumably had benefits for the electricity network by keeping peak demand lower than it would otherwise have been.

SunWater has invested in larger pumps and balancing storages to move pumping load out of peak times. The effect of removal of the ToU pricing signals via the removal of the transition tariffs will be two-fold. Firstly, existing investments in excess capacity to allow offpeak pumping will be undermined by the removal of the transition tariffs. The capacity will still exist but will be stranded by the removal of the cost benefits of offpeak pumping effectively reducing returns from the original investment. Secondly, any new investment in plant and infrastructure will not be able to justify offpeak pumping capacity as part of the investment decision. Therefore, the inappropriate price signals of the new demand tariffs will guide investment decisions towards day-time or 24 hour pumping, thereby locking in increases in peak demand for the long-term; once a smaller pump and surrounding infrastructure is

installed, the option to take advantage of future offpeak pricing signals has been removed for upwards of 30 years.

The current pricing signals under the new demand tariffs will have immediate effects on current investment returns and could have long-term ramifications for peak demand. Therefore, the QCA is justified in maintaining the transition tariffs for a longer period to allow customers such as SunWater to extract the economic investment from existing plant and infrastructure and to buy time to correct the pricing signals so that long-term investment decisions don't lead to perverse outcomes.

SunWater's Responses to Specific Questions Raised by the Authority

(a) How should the Authority determine whether transitional arrangements are necessary for each obsolete tariff? What would be considered a "significant" price impact?

The Authority should assess the appropriateness of the new demand tariffs in their current form.

The Authority should consider the level of investment made by customers to shape their operations around the availability of offpeak tariffs.

(b) Are there any non-financial reasons why obsolete tariffs should be retained or other transitional arrangements put in place?

No comment

(c) If transitional arrangements are necessary:
(i) Should the obsolete tariffs be retained and escalated or should other transitional arrangements be put in place?

SunWater believes that the obsolete tariffs should be retained and escalated.

(ii) What would be a reasonable level of annual price increase and over what time period should transitioning occur?

SunWater believes the obsolete tariffs should be escalated to reflect the underlying increases to the cost components of retail prices only. A reasonable time period for transitioning to occur is three years. This will provide time for the network companies to build appropriate ToU price signals into their network pricing, will allow customers to benefit further from investments made based on the previous tariff structures and will allow customers time to restructure their operations and re-educate their workforces in response to the new tariff structures.

(d) Any other suggestions on how customers might be transitioned from below cost prices to prices that more closely reflect the cost of consumption?

No comment