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Queensland Competition Authority  
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### **Review of Regulated Retail Electricity Tariffs and Prices – Issues Paper**

The Energy Supply Association of Australia (esaa) welcomes the opportunity to comment on the Queensland Competition Authority's (the Authority's) Review of Regulated Retail Electricity Tariffs and Prices Issues Paper.

esaa is the peak industry body for the stationary energy sector in Australia and represents the policy positions of the Chief Executives of over 40 electricity and downstream natural gas businesses. These businesses own and operate more than \$120 billion in assets, employ 52,000 people and contribute \$16 billion directly to the nation's Gross Domestic Product.

esaa acknowledges the Authority's recent work, in accordance with a Ministerial Direction received in May 2011, to report on a pricing methodology for the determination of the cost components under an N (network) + R (retail) approach. As outlined within the Issues Paper, it is intended that the new methodology will be structured so as to better reflect actual retail costs in regulated prices. This transition may well be an improvement relative to the current Benchmark Retail Cost Index (BRCI) methodology which does not involve an assessment of the efficient cost of supplying electricity. Accordingly, while esaa remains firmly of the view that the most appropriate way to address the risks associated with non-cost-reflective tariffs is to remove retail price regulation, the Association acknowledges that a specific mandate to pursue cost-reflectivity is a useful step towards price deregulation.

The Association has long supported the removal of retail price regulation where retail markets are contestable. Open, competitive energy markets free from distortions such as retail price regulation naturally encourage prices to be efficient through the development of competitive market offers. Competition in retail electricity markets, as in other sectors of the Australian economy, incentivises businesses to improve service, develop products that meet consumer needs and find ways to lower their costs and to pass those costs onto consumers. As a result, retail prices are set as low as is sustainably possible while businesses can still make an appropriate return.

Retail price regulation in contestable electricity markets is an inherently fallible and risk-laden exercise that can be self-fulfilling. Regulating prices in potentially competitive markets whereby regulated tariffs may be set below the cost of supply impedes the efficient operation of the market. It creates financial pressure for industry

participants forced to absorb costs that cannot be passed on and removes incentives for energy companies to enter the market and compete for small-use customers. Conversely, in the event that prices are set above the cost of supply – including an appropriate retail margin – competition will erode margins back to efficient levels. The risks are thus asymmetric, with greater adverse consequences arising from setting the regulated price too low.

The task of setting appropriate retail prices that are competitive but still allow retail businesses to meet their costs and manage risks is becoming increasingly complicated, largely as a result of uncertainty surrounding the impacts of the Federal Government's recently announced Clean Energy Future package. While specific detail relating to the carbon price trajectory to be included in the package has been released, the direct impact of the carbon pricing policy on wholesale energy costs remains to be seen. Furthermore, it is likely that this uncertainty will be particularly acute until effective financial instruments to hedge carbon costs emerge.

Given the asymmetric risk profile identified above, esaa considers that the risks to the electricity market from the under recovery of carbon costs far outweigh the risk of over recovery in a contestable electricity market. Accordingly, the Association further considers that the Authority should take heed of these risks, particularly in relation to the derivation of the wholesale energy cost component of regulated tariffs, where a lack of historical data from which to derive forecasts is likely to create additional complications.

Should the Government wish to protect some consumers against price rises then this is best achieved through social policy measures, such as Community Service Obligation (CSO) payments, rather than through distorting retail electricity prices. Importantly however, given the significance of facilitating competitive energy markets, the Association considers that these payments should be applied in such a way that retail businesses are able to compete for grid-connected electricity market customers based on the competitiveness of their retail charges. Where this is not achieved, barriers to entry are created which ultimately stymie the evolution of competitive retail markets.

esaa considers that the government can avoid the risks of setting a price either too high or too low by removing electricity retail price regulation and allowing the competitive market to find the efficient price. However, should governments choose to regulate retail prices in this environment, flexibility in the setting of retail price caps and an appropriate methodology that ensures fully cost-reflective pricing are imperative to ensure a financially viable and competitive retail sector.

esaa also views the implementation of a cost-reflective time-of-use tariff for domestic customers as a progressive move towards recognising that network charges have a role to play in signalling the price effects of customer behaviour. However, restricting the full pass through of the costs associated with any network tariff structure limits the transference of price signals encouraging more efficient consumption patterns. As such, the Association considers that network charges must not be constrained by regulation over and above that provided through the Australian Energy Regulator (AER).

If you require any further information in regard to this submission please contact Kieran Donoghue, [kieran.donoghue@esaa.com.au](mailto:kieran.donoghue@esaa.com.au) or 03 9670 0188.

Yours sincerely



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