QCOSS

Queensland Council of Social Service

Submission to the QCA on the draft determination of regulated retail electricity prices 2015-16

27 February 2015

About QCOSS

The Queensland Council of Social Service (QCOSS) is the state-wide peak body for individuals and organisations working in the social and community service sector.

For more than 50 years, QCOSS has been a leading force for social change to build social and economic wellbeing for all. With almost 600 members, QCOSS supports a strong community service sector.
QCOSS, together with our members continues to play a crucial lobbying and advocacy role in a broad number of areas including:

- sector capacity building and support
- homelessness and housing issues
- early intervention and prevention
- cost of living pressures including low income energy concessions and improved consumer protections in the electricity, gas and water markets
- energy efficiency support for culturally and linguistically diverse people
- early childhood support for Aboriginal and Torres Strait Islander and culturally and linguistically diverse peoples.

QCOSS is part of the national network of Councils of Social Service lending support and gaining essential insight to national and other state issues.

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1. Acknowledgements

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Please note, from January 2015 the Consumer Advocacy Panel's functions have been transferred to Energy Consumers Australia.

QCOSS would like to acknowledge and sincerely thank all who participated in the development of this submission. Specifically, QCOSS thanks Mr David Prins of Etrog Consulting and Ms Linda Parmenter for assisting with technical advice and consultancy services. We also acknowledge the support and contribution from members of our QCOSS Essential Services Consultative Group who represent the interests of various groups of residential energy consumers across the Queensland.

2. Introduction

QCOSS welcomes the opportunity to provide comment on the Queensland Competition Authority's (QCA) Draft Determination on Retail Electricity Prices for 2015-2016. With the introduction of price deregulation in South East Queensland (SEQ) from 1 July 2015, the QCA is for the first time setting notified prices that will apply only to regional Queensland. This has brought some new challenges for the QCA in interpreting the intent of the Uniform Tariff Policy (UTP) and in determining how it should be applied. QCOSS believes that the decision made by the QCA for this determination is therefore of greater significance than usual.

In addition, the decision is being made at a time that the energy market is rapidly changing, with new technologies, contestability, and tariff reform bringing new challenges and opportunities to which both consumers and regulators will need to adapt. The decision comes at the back of a period of rapidly increasing electricity prices that have resulted in significant hardship for some customers. Electricity prices in Queensland have increased more than 85 per cent in the previous 5 years[1], and regional Queensland households are among the most vulnerable to impacts of declining energy affordability.

The risk of experiencing poverty is far greater for households outside capital cities. According to a 2013 report prepared for ACOSS[2], 15 per cent of regional Queenslanders are considered to live in 'after housing' poverty compared to 9.5 per cent in the greater Brisbane area. This is the widest differential between a capital city and the rest of the state in the nation.

Poverty in regional areas has a particular set of characteristics that include:

- Generally lower incomes;
- Reduced access to services such as health, education and transport;
- Higher unemployment and declining employment opportunities; and
- Distance and isolation.

QCOSS's recent regional Cost of Living Report[3] demonstrates that cost of living pressures can be closely connected to where people live and the resources available to them. The report shows there is considerable variation across regions, and in some locations in Queensland where households face high housing and transport costs, low-income households are finding it extremely challenging to meet the costs of even a very basic standard of living.

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[1] QCOSS, *Cost of Living Report.* Regional Edition 1, 2014.
[2] ACOSS. *Poverty in Australia: ACOSS paper 194*, 2012.
[3] QCOSS, *Cost of Living Report*. Regional Edition 1, 2014.

For these reasons it is critically important that prices for regional customers are minimised to the greatest extent possible. The current QCA determination (including decisions around the approach to the application of the UTP, decisions around tariff structures including the rebalancing of fixed and variable costs, and decisions about the methodology to calculate elements of the cost of supply in SEQ) all have an impact on the affordability of electricity for regional households.

This submission focuses on issues relating to residential customers and prices for residential tariffs only. The structure of this submission is to consider:

- Issues related to the overall approach by the QCA, particularly the framework used by the QCA to meet the policy parameters of the UTP, and the 'rebalancing' of tariff 11;
- The methodology issues related to the QCA's calculation of network costs including the underlying network tariffs the QCA proposes to use;
- The methodology issues related to Energy Costs and Retail Costs; and
- Other issues, including the proposed pass through mechanism and metering.

QCOSS supports the approach taken by the QCA in several areas of the draft determination and these areas are identified in the relevant sections of this submission. However, there are aspects of the draft decision where we have a different view on the approach that is proposed by the QCA. These areas provide the key focus of this submission. In summary, QCOSS recommends:

- That the QCA have reference to the market prices as well as standing offer prices available in SEQ in setting the prices for regional Queensland, so that regional prices are comparable to those paid by SEQ customers;
- That the QCA halt the proposed rebalancing of the fixed and variable costs given the significant impact on a large number of potentially low income and vulnerable customers, and the need for social policy reform in this area. Additionally, there is a possibility that future tariff reform may result in lower fixed charges, and raising the fixed charges now could result in customer confusion and difficulty transitioning to more effective price signals in the near future; and
- That the QCA revise its approach to the calculation of the retail costs in terms of Customer Acquisition and Retention Costs (CARC) and the retail margin, which includes headroom.[4] QCOSS believes the level of the CARC and the retail margin is too high, and not reflective of the actual costs for an SEQ retailer.

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4 Headroom is not a cost, and simply serves to increase the retailer's retail margin.

3. Issues related to the overall approach

3.1. Uniform tariff policy and the framework to determine notified prices

The QCA has been tasked with providing notified prices for regional Queensland customers in the Ergon Energy distribution area, in a manner that is consistent with the Queensland Government's UTP. Due to the anticipated removal of price regulation in SEQ from 1 July, the QCA must reassess its approach to setting notified prices in accordance with the delegation from the Queensland Government and the requirements of *The Electricity Act (1994)*.

The QCA has proposed that it will continue to base its framework for setting notified prices for regional customers on the cost of supply in SEQ, and that it will use a 'standing offer' approach. That is, in the absence of observable information about the standing offer prices that will apply in SEQ in 2015-16, the QCA is proposing to add a standing offer "headroom" of 5 per cent to the total costs of supply it has assessed for SEQ. We note that these costs already include a retail margin of 5.7 per cent.

3.1.1. Summary of the QCOSS position

QCOSS supports the ongoing application of the UTP and the QCA's decision to base regional prices on the cost of supply in SEQ. However, while QCOSS understands that the QCA is required to consider standing offer prices in SEQ as a basis for setting regional prices, QCOSS does not agree that the QCA is required by the delegation to apply the standing offer price to regional customers.

QCOSS maintains our position that the market offers available in SEQ should form part of the QCA's consideration of the efficient costs of supply, and also the "reasonable expectation of the prices available" as required by the delegation. A range of prices is currently available to SEQ customers. Standing offer prices are likely to be at the top of this range as retailers use these offers as the default contract against which more generous discounted market products can be compared.

QCOSS contends that:

- The delegation does not require the QCA to apply standing offer prices;
- The application of headroom in addition to the costs of supply and an appropriate retail margin is inappropriate;
- Given that the delegation does not require the QCA to apply standing offer prices, the QCA could reasonably adopt a position that would result

in setting prices somewhere between market prices and standing offer prices, to reflect the average price paid by SEQ consumers. Such an approach would be entirely consistent with the delegation from the Minister and the intent of the UTP.

3.1.2. Requirements of the Delegation

The Minister has advised the QCA:

> *"for the purposes of the delegation regional prices should, as much as is practicable, aim to ensure that small customers outside South East Queensland do not pay more than reasonable expectations of the prices which would be available to standing offer customers in south east Queensland".*[5]

The Minister's supplementary letter also refers to "*the Government's preference that the prices regional customers will pay are consistent with customers in south east Queensland'*".[6] This is the full extent of Government explanation of the intent of application of the UTP in this determination. QCOSS would argue that the delegation requires the QCA to *consider* the prices available to standing offer customers, but it does not require the QCA to *apply* standing offer prices.

As noted, there is a range of prices available to customers in SEQ including both notified prices and discounted prices available on market contracts. Standing offer prices will be at the top of that range. The delegation requires that regional customers should pay "no more" than the reasonable expectation of prices in SEQ. It does not require the QCA to put prices at the upper end of the range. They may in fact be set at the lower end of the range and still be consistent with the delegation.

The QCA has argued that QCOSS's position could result in customers in regional Queensland paying prices 'even further below cost'.[7] QCOSS submits this would not be inconsistent with Government policy nor is it relevant to the application of the UTP. These are two separate policy questions. The purpose of the UTP is to ensure consistency with prices paid in SEQ, not to minimise the extent of the differential between real costs incurred and the costs actually paid by customers in regional Queensland.

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[5] Queensland Competition Authority. *Draft determination on Regulated retail electricity prices for 2015-16*, December 2014. Appendix A

[6] Ibid. Appendix B

[7] Ibid. p 7

QCOSS does not support the QCA in stating that the standing offer approach to set notified prices for regional Queensland "will *still* deliver substantial benefits to regional customers" (our emphasis).[8] It is not relevant whether or not these customers will *still* benefit from the UTP. This is not a material consideration in the decision on notified prices. Rather the starting point is that it is Government policy that regional customers should not face the full costs of supply, and hence regional customers have not previously paid the full cost of supply.

Consequently, the 'benefits' referred to by the QCA are from a starting position of prices that have never actually been contemplated. From the perspective of the regional customer the reality is that prices for many households will be increasing. The policy is that they *should* benefit from the UTP and the QCA must set prices comparable to those paid in SEQ. The QCA has not been asked to set the highest prices, nor those closest to the real costs of supply. This is an important distinction.

3.1.3. Consideration of Market Prices in SEQ

In setting regional prices that are comparable with the "reasonable expectation of prices available" in SEQ, QCOSS believes that the QCA should have regard to the fact that many customers in SEQ will be accessing prices that are lower than the standing offer prices. QCOSS estimates approximately 63 per cent of customers in SEQ are now on market contracts.[9] The QCA's price comparator tool shows that the difference between the notified price and the best market offer available to the 'typical' customers in SEQ is at the present time $157 per annum.[10] This is a significant price differential, particularly for customers on very low incomes.

The QCA has rejected the possibility of using market prices 'because the terms and conditions in these contracts will vary from the default contract and from retailer to retailer.'[11] While it is true that terms and conditions may vary, it is not clear why the range of market contract prices cannot be used as a valid proxy or at least be taken into account in regional pricing. QCOSS' view is that the intent of the UTP is that regional customers should be no worse off than the SEQ customers. This means that they should also be entitled to lower prices as a benefit of the competition that customers in SEQ have access to.

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[8] Ibid.

[9] http://www.qca.org.au/getattachment/d440b59c-c286-44e3-b892-fd201f4b4a55/Customer-Statistics-September-2014.aspx. Accessed 1 March 2015. While this latest report refers to 45.2% of small customers being on market contracts, this figure includes customer in the Ergon area. When adjusted to include only SEQ customers, the result is approximately 63%.

[10] http://comparator.qca.org.au. Accessed 1 March 2015. Prices based on a customer consuming 4053kWh per annum

[11] Queensland Competition Authority. *Draft determination on Regulated retail electricity prices for 2015-16*, December 2014, p.7.

We see no reason that the QCA should be concerned about setting a price that is at the lower end of the range of prices offered to customers who *have* access to market offers, for customers who *do not have* access to retail competition. Many economic regulators and governments have taken an approach of tightly constraining the standing offer prices where there is no retail competition, and to ease off the constraints as retail competition is introduced and becomes more effective.

The approach initially in the absence of retail competition has been for regulated retail prices to reflect simply the retailer's costs of supply. As retail competition is introduced and becomes more effective, regulators have recognised an objective that is not just reflective of costs of supply, but also facilitating the development of competition in retail electricity supply.

The AEMC discussed these concepts in some detail in its Advice on Best Practice Retail Price Regulation Methodology.[12] In this discussion, the AEMC stated:

> *"While it is important for the development of competition that a regulated price is high enough to allow new entrants to compete, the regulated price essentially provides an upper limit on prices. Typically, competitors will price below this regulated price, and so customers in a competitive market will have a choice of market prices that are lower."*

Customers would expect to pay no more than the efficient costs of supply in the absence of retail competition. At that stage, regulated retail prices are set with this tight constraint of only reflecting the efficient costs. Then, as competition is introduced, regulators ease off the constraints and allow the regulated price to trend upwards, so that competition can develop with customers able to obtain supply at a price that is lower than the regulated price. The QCA followed this approach in its inclusion of 'headroom' in regulated retail prices, quite deliberately adding to the bills of consumers who remained on regulated retail prices, so that they paid above the level of efficient costs of supply in SEQ.

The vast majority of residential regional customers currently do not have a choice about the price they pay, while customers in SEQ do. QCOSS sees no argument for setting prices at a level higher than what customers in SEQ actually have to pay, even though some will - whether by way of choice, inertia or lack of information - remain on standing offer prices.

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[12] See *Advice on best practice retail price methodology*, final report, AEMC, 27 September 2013, pages 14-20

3.1.4. Headroom

In considering the standing offer approach and what prices apply in regional Queensland, QCOSS does not agree that the QCA should include headroom. QCOSS has previously outlined in some detail our views against the inclusion of headroom in the price stack for notified pricing. QCOSS view is that headroom is in reality no more than an additional retail margin, and once applied across all other costs including the “designated” retail margin of 5.7 per cent, the effective level of margin above the costs of supply is higher than 11 per cent.

The QCA has typically justified headroom to support competition, and this was the reason outlined for the inclusion of headroom in 2014-15 prices. In the current draft determination, the QCA justifies the inclusion of headroom for large customers by suggesting that its absence would be a barrier to competition.

We note that there is no specific justification provided by the QCA for including headroom in the prices for residential customers in the draft decision except as set out in an Appendix. For residential customers there will be no effective competition in regional Queensland whether or not headroom is included. Therefore, the QCA’s past arguments for inclusion of headroom cannot be justified because neither its inclusion nor its absence will support or provide a barrier to competition.

In QCOSS’s view there is no basis to include headroom as part of notified prices for regional Queensland. In fact, we strongly oppose it’s inclusion due to the affordability issues as referenced earlier in the submission.

3.1.5. Conclusion on the use of standing offer prices

QCOSS believes that the QCA could reasonably adopt a position that would result in setting prices somewhere between market prices and standing offer prices, to reflect some notion of average price paid by SEQ consumers. This would meet the intent of the UTP which is “*to ensure that small customers outside SEQ do not pay more than reasonable expectations of the prices which would be available to standing offer customers in south east Queensland*”.

There are different ways of achieving this, such as:

- By not allowing headroom as part of the pricing cost stack for regional Queensland; or
- By using market contract prices; or
- By reducing standing offer prices by the typical or average discounts applied to standing offer prices that are offered in SEQ.

These are feasible approaches, alone or in combination, and QCOSS believes that all would be consistent with Government policy.

3.2. Transition to fully cost reflective tariffs

The Ministerial delegation requires that QCA consider:

> *"for the standard regulated residential tariff (Tariff 11), complete the rebalancing of the fixed and variable components of Tariff 11 using the approach established in the 2013-14 Determination"*"[13]

The QCA proposes to implement the transitional arrangements for Tariff 11 that it outlined in its 2013-14 decision. This decision included a plan for a three-year transitional path to rebalance fixed and variable charges for Tariff 11 in order to reach full cost reflectivity by 2015.

QCOSS believes that there are compelling reasons to halt or at least slow the current transition. These reasons include:

- The significant impact of increased fixed charges on low income and vulnerable consumers;
- The fact that there has been no accompanying social policy reform or customer education to support and protect vulnerable consumers from these impacts over the previous two years of the transition path, despite the QCA identifying this as an area appropriate for government welfare measures; and
- The significant uncertainty about what will happen with fixed charges in future tariff reform approaches by the network businesses in Queensland.

3.2.1. Customer Impacts

The effect of completing the rebalancing of fixed and variable charges for 2015-16 prices is that the daily fixed charge will rise from 83.414 cents to 107.483 cents. QCOSS notes that the real figure will be up to 11 cents higher for Tariff 11 once metering charges (now unbundled from other network costs due to being reclassified by the Australian Energy Regulator (AER)) are included. Metering inclusive, the increase in fixed charges proposed for 2015-16 prices is approximately 42 per cent. This comes on top of a 66 per cent increase in the fixed charge in 2014-15 and almost 50 per cent in 2013-14. While increases in the fixed charge will be offset by lower volume charges for some customers, other customers will not consume enough to reap the benefits. It is well understood, and in the draft decision the QCA confirms, that higher fixed

[13] Queensland Competition Authority. *Draft determination on regulated retail electricity prices for 2015-16*, December 2014. Appendix A

charges relative to volume or usage charges will therefore result in higher costs for low consumption households.
QCOSS has long held and previously raised concerns about the impacts of the rebalancing of fixed and variable charges of Tariff 11 on low income and vulnerable customers. While the QCA correctly points out "that the offsetting reduction to the variable charge will benefit those financially vulnerable customers with high consumption", our concern is that there may be a greater number of financially vulnerable households that will experience a negative impact, because on the whole, low-income households tend to use less energy than other households.

For example, the average consumption of concession cardholders across several of Ergon's regions is between 14 per cent and 21 per cent lower than the average consumption levels of all households in the same region.[14] The notable exception is in the Wide Bay area where concession card holders use only 9 per cent less electricity on average. However this region not only has the lowest average usage compared to all other regions, it has one of the most disadvantaged populations in Queensland.[15] QCOSS acknowledges that there are both winners and losers from the rebalancing but believes the number of 'losers' in this case may be significant as well as the households that can least afford it.

By the QCA's own account, a 'single frugal person' may be exposed to a price increase of around 9 per cent due to tariff rebalancing. Using another example, a 'frugal couple' with an annual consumption of 3070kWh, will see a 5.4 per cent increase in their annual bill in this year. If we consider that in year one of rebalancing this same hypothetical household would have also seen an increase of 25 per cent and in year two a further 7.9 per cent, then this household - who may well be an on an income that has only increased by average CPI over that period - has experienced a very significant impact indeed over the course of this transition.[16]

We are concerned that the QCA has only superficially explored the customer impacts of completing the transition to cost reflective tariffs, and in doing so has failed to provide the consideration the delegation required. The QCA paper understates the impact when saying a 'typical' customer will see a price increase of a 2.7 per cent. Typical here means a household with median

[14] Information provided to QCOSS by Ergon Energy on 27 February 2015

[15] For example 83% of residents in Wide Bay fall into the "most disadvantaged" socio economic quintiles according to Queensland's former Office of Economic Statistical Research. See http://www.oesr.qld.gov.au/regions/wide-bay-burnett/index.php

[16] It is noted that in the previous two years the household at this consumption level was defined as a "frugal single person', whereas in the current determination the household at the same consumption level is labeled as a "frugal couple". QCOSS has compared the impact at the same consumption level to demonstrate the cost escalation for any household type with a similar consumption.

consumption level, but it does not mean the majority of households will experience only a 2.7% impact. There are a large number of households that will have a much higher impact according to the QCA modelling, and a significant number who will experience an increase of between 5 and 10 per cent. For example, the QCA's modelling shows that approximately 250,000 households will experience a price increase of 5 per cent or greater.[17] This represents approximately 40 per cent of the Ergon residential customer base and we can assume that many of these households are on low incomes.

3.2.2. Lack of policy measures concerning concessions or consumer education

The QCA has commented that:

> *"The needs of financially vulnerable customers are best met through targeted welfare assistance measures. … It is a matter for the Government to decide whether additional assistance measures are appropriate."*[18]

In its previous submissions to the QCA concerning the rebalancing of the fixed and variable components of Tariff 11, QCOSS supported the three year transitional approach on the basis that it was preferable to immediate implementation of cost reflective tariffs, and in order to allow time for government to respond with appropriate social policy responses to mitigate the impact on low income and vulnerable consumers. It has been, and still is, QCOSS' view that structural reform of energy concessions is necessary and that consumer education about electricity tariffs is required not only in preparation for price deregulation in SEQ, but also for customers to understand, adjust and budget for the potential impacts of higher fixed prices.

QCOSS is disappointed that neither concession reform nor a government led consumer education program to improve consumer energy literacy has occurred. The preferred approach to concessions of the previous two governments has been to maintain a flat concession but to increase the total quantum of the rebate. While increases in the rebate are always welcome, QCOSS notes that this does not address the horizontal equity issues that arise due to the fact that different eligible households experience different sized bills, while the amount of rebate remains constant. QCOSS has consistently maintained the view that energy concessions should be percentage based as

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[17] Queensland Competition Authority. *Draft determination on regulated retail electricity prices for 2015-16*, December 2014, p35. As it was difficult to discern household numbers from the graph published in the QCA determination a copy of the graph with household numbers identified was requested and provided by the QCA.

[18] Queensland Competition Authority. *Draft determination on regulated retail electricity prices for 2015-16*, December 2014, p 36.

applied in Victoria, rather than a flat payment amount. QCOSS has also been concerned that some individuals of very limited means, namely those holding health care cards rather than pensioner concession cards, do not have access to a concession at all. Queensland is the only jurisdiction in Australia, other than the Northern Territory, that does not extend energy concessions to health care cardholders. As a result, QCOSS' concerns about the impact of tariff rebalancing on low-income customers have not diminished.

While QCOSS understands that these may be issues for government to address, QCOSS believes that the delegation requires the QCA to provide more analysis than is currently being provided on the likely customer impacts, particularly on the numbers of households and the characteristics of those households. For example, the chart provided on page 35 of the draft decision to demonstrate the percentage price impact at various consumption points is not sufficiently clear about the number of households in each consumption band.[19] This is critical information for the community and for government.

Further, in considering whether to complete the transition to fully cost reflective prices, QCOSS believes the QCA should take into account the characteristics of the households that are likely to be impacted. The QCA should also have regard to the fact that neither concessions reform nor consumer education has occurred. Regardless of the fact those actions are not QCA's primary responsibility, they clearly have an impact on consumers and how the prices the QCA sets will impact households across the regions. This would be consistent with the requirement in the delegation for the QCA to consider the impact of its decisions on consumers.

3.2.3. Fixed charges and tariff reform

A further reason the QCA should consider ceasing the full transition to higher fixed costs is the uncertainty around the outcomes of the tariff reform process that is currently underway. In late 2014 the AEMC finalised a rule change that requires network businesses to provide cost reflective tariffs as far as practicable. Both Ergon and Energex have commenced consultation with stakeholders, and the level of fixed charges is one of the many areas of discussion. Both Ergon Energy and Energex are preparing their Tariff Structure Statements (TSS) and will be submitting them to the AER in November 2015. Their new suite of tariffs is likely to come in on 1 July 2017 although Ergon has

[19] QCOSS notes that the QCA provided this information on request and this was used to inform our assessment of the number of households that will experience a 5% or greater price increase.

flagged the "introduction of seasonal demand and energy tariff (circa 2016-2017)"[20].

These new tariffs will be set to recover the long run marginal costs with the residual costs recovered by a mix of fixed and volume tariffs. Over time, as more and more people take up the new demand tariffs, it is likely that the fixed and volume tariffs will also change depending on the size of the bucket of residual costs.

The Department of Energy and Water Supply's expert panel on tariff reform established by the previous Queensland government has suggested that in the longer term increasing the fixed charge is not preferred given the bluntness of the signal and the impacts on low consumption consumers.[21] They note that:

> *"When setting the values for each charging component, it is critical to strike an appropriate balance between the proportion of network costs recovered through the fixed, variable and demand charges. Consumers need to be able to respond to price signals and have an incentive to reduce peak electricity usage. Therefore it is not appropriate to recover all network costs through a fixed charge."* [22]

While the expert panel do acknowledge and accept the QCA's current transition path, clearly the use of fixed charges to achieve cost reflectivity is now completely out of step with current approaches. The expert panel argues that:

> *"improving the cost reflectivity of existing tariffs through further significant increases to the fixed charge is unlikely to lead to long term tariff stabilisation."*[23]

Given that Queensland has now embarked on the tariff reform path, and given the uncertainty about where this path will lead and what will eventuate with fixed charges, QCOSS believes it would be entirely reasonable to cease the current transition path and stop fixed charges from rising further at this time.

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- At the time of its original decision, the QCA itself considered the possibility that it would need to adjust the price path given the high level of uncertainty about the future level and structure of network prices. Noting the various ongoing reviews relevant to network prices the QCA observed that it was:
  "not inconceivable that the level and structure of network charges could

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[20] Ergon Energy (2014), Consultation paper, *Future Network Tariffs*. This can be found at www.ergon.com.au/futurenetworktariffs

[21] Electricity Expert Panel. Network Tariff Stabilisation Review. *Project1: Network Tariff Design for Residential Consumers*, 5 December 2014, p49.

[22] Ibid, p48.

[23] Ibid, p65.

change to such an extent that any price path set this year may over- or under-shoot the eventual cost-reflective tariffs for the majority of customers once these reviews have been completed and implemented."[24]

3.2.4. Delegation requirements

QCOSS anticipates that the QCA may point to the delegation from government as *requiring* it to complete the transition to fully cost reflective tariffs. However QCOSS believes the delegation would allow the QCA to slow or halt the transition. The word *'consider'* in the delegation is important and provides the opportunity for the QCA to propose alternative outcomes. The delegation does not say that QCA must complete the rebalancing this year, and QCOSS believes that to stop, or at least slow, the transition would be consistent with the delegation.

Indeed the QCA has in the past noted that where it is asked to 'consider' or 'give consideration' to a particular issue, its obligation is not only to give due consideration to the matter but to also consider any relevant related issues. The QCA may consider alternative approaches and at times adopt these in its final recommendation. For example, in its determination of retail electricity prices for 2013-14, the QCA was required to consider whether its approach to estimating energy costs could strengthen or enhance the underlying network price signals and provide greater incentives for customers to switch to time-of-use tariffs and reduce their energy consumption during peak times. The QCA considered the matter and determined that it would not strengthen or enhance the underlying network price signals or provide greater incentives for customers to switch to time-of-use tariffs and reduce their energy consumption during peak times.[25]

The Minister's letter included in Appendix B to the Draft Determination also states:

> *"I also understand the delegation sets out matters the QCA must consider and it is reasonable to expect that the QCA may consider other approaches in its consultation"*[26]

QCOSS believes the QCA is fully aware that its obligation is only to consider completing the transition this year. For example, in section 7.1 of the draft determination the QCA attributes its decision to complete the transition to the

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[24] Queensland Competition Authority. *Final determination. Regulated retail electricity prices 2013-14*, May 2013, p 90.

[25] The reasons for this determination were set out in discussion on pages 31-32 of the QCA's Final Determination of Regulated Electricity Prices 2013-14 in May 2013.

[26] Queensland Competition Authority. *Draft determination on regulated retail electricity prices for 2015-16*, December 2014. Appendix B.

decision to base notified prices on the cost of supply in SEQ, rather than the delegation.[27] However, QCOSS believes this is not a strong basis for deciding to complete the transition, particularly in the face of the customer impacts we have highlighted above.

The decision to base notified prices on SEQ costs of supply only covers the level of pricing or, as the QCA describes it, the costs of supply in SEQ. It says nothing about the structure of pricing or about the relative assignment of cost recovery between fixed and variable tariff components. The fact that elsewhere in respect of Tariff 12, the QCA considers the use of an Ergon Energy tariff structure rather than an Energex tariff structure, shows that the QCA has not considered there is a need to structure Ergon Energy tariffs in the same form as Energex area tariffs.

QCOSS therefore believes that QCA may decide to slow or halt the transition to full tariff rebalancing in its final decision, and for the reasons outlined above, QCOSS recommends that the QCA do so.

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[27] Queensland Competition Authority. *Draft determination on regulated retail electricity prices for 2015-16*, December 2014, p 34.

4. Network Issues

4.1. Network costs for 2015-16

QCOSS notes that the network costs are treated as a direct cost pass through, and that the costs identified in the QCA's draft decision are based on the Energex regulatory proposal to the Australian Energy Regulator (AER) submitted as part of the 2015-20 distribution pricing determination. QCOSS notes that the network costs in the final decision will be based on Energex's revised proposal submitted to the AER following the draft decision in April 2015. The AER final decision will not be available in time for inclusion in 2015-16 prices, however any revenue differences between the preliminary and final determination will be accounted for in the subsequent years of the determination period. QCOSS concurs with this approach by QCA.

4.2. Network tariffs to use for cost and structure

The delegation received by the QCA asks that the QCA, when determining the network components for each regulated retail tariff, consider:

> *"(d) (i) For residential and small business customers tariffs (with the exception of tariffs 12 and 22) in the EECL distribution area – basing the network cost component on the network charges to be levied by Energex and the relevant Energex tariff structure:*
>
> *(ii) For Tariff 12 residential time of use… basing the network cost component on the network charges to be levied by Energex, but utilising the relevant EECL tariff structures, in order to strengthen or enhance the underlying network price signals, and encourage customers to switch to time of use tariffs and reduce their energy consumption during peak times."*[28]

The QCA draft decision follows the suggested path outlined in the delegation and as a result has proposed to use Energex's costs and cost structure for Tariff 11, but Energex's cost and Ergon's cost structure for Tariff 12.

On the basis of the information provided, QCOSS is satisfied with this outcome. However, QCOSS is not convinced that there has been sufficient information and modelling of the alternative options to be fully satisfied that the proposal in the draft decision provides the *best outcome* for regional consumers.

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[28] Queensland Competition Authority. *Draft determination on regulated retail electricity prices for 2015-16*, December 2014. Appendix A.

QCOSS would like to see the alternative options and the potential customer effects of these options modelled in greater detail for the purposes of the final decision and in future determinations. It appears that the QCA has only provided analysis to justify the position suggested to it by the delegation. The alternative approach would have been to both model the various options and to assess the possible consumer impacts of each, at the same time considering broader policy and transitional issues.

In relation to Tariff 11 the QCA has offered the follow rationale for not basing Tariff 11 on the Ergon tariff structure:

> *"… all customers would be affected by the change in tariff structure, with some customers better off and some customers worse off. We consider that this change may be too significant to make in 2015-16 and does not align with the requirement in the delegation to consider basing the flat and controlled load tariffs on Energex tariff structures."*[29]

QCOSS accepts that a change in tariff structure for Tariff 11 would impact on all customers and create different outcomes for each different customer depending on their consumption levels. However, this is also true of the rebalancing of the fixed and variable components of Tariff 11, so is not a strong reason to reject the option in the first instance. QCOSS suggests the QCA could have explored the options for applying an Ergon structure to Tariff 11, as it did for Tariff 12, and in doing so could have outlined the potential impacts on different classes of customer usage.

QCOSS notes that the difference in structures for Tariff 11 between Energex and Ergon is that the volume charges for the Energex tariff are flat, while the Ergon tariff involves a three-rate 'inclining' block tariff (IBT) structure where the charges increase with each block. We are aware that the Ergon distribution fixed charged for Tariff 11 is nearly double the fixed charge of Energex's tariff. However, it is not clear that this would be the case following the application of the UTP. In the case of Tariff 12 where the proposal is to use Ergon's structure, the QCA settled on the option of making the fixed costs equal to the fixed charges in the Energex area, rejecting the option of maintaining the cost relativities of the Ergon tariff structure. Fixed costs being equal, it is possible the IBT structure for Tariff 11 could favour lower usage customers with lower rates, while imposing higher charges on higher usage customers than would be the case with a flat rate tariff.

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[29] Queensland Competition Authority. *Draft determination on regulated retail electricity prices for 2015-16*, December 2014, p12.

The difficulty for QCOSS is that because the QCA has not sufficiently explored this option, there is insufficient information for QCOSS to adopt a position on the merits of basing the tariff on Energex as against Ergon tariff structures.

Further, QCOSS does not agree that the delegation was intended to limit the QCA's consideration of to use the Ergon tariff structure as the QCA's statement above suggests. The QCA could consider basing the flat and controlled load tariffs on Energex tariff structures, in line with the delegation, but still ultimately decide on something different.

QCOSS therefore requests that the QCA undertake a more thorough examination of the options prior to the final decision and make those results publicly available.

4.2.1. Move between Tariff 11 and Tariff 12

The QCA draft determination raises the concern that under current rules relating to the TOU Tariff 12, customers can change tariffs twice a year without cost and they can therefore move between Tariff 11 and 12 seasonally to avoid higher costs. The QCA has noted that if customers are able to move between tariffs in this way it will not result in a more cost reflective tariff. The QCA asks for input on whether they should impose stricter conditions.

QCOSS agrees with the QCA that it would produce a poor outcome in terms of cost reflectivity if customers intentionally avoid higher summer charge by being on a lower price TOU tariff in non-summer months, and on a flat tariff in summer. Therefore QCOSS would not object to allowing customers to move between Tariffs 11 and 12 without penalty a maximum of once rather than twice per year should the QCA consider this more appropriate, as long as there is sufficient customer education and awareness of these rules. We believe tariff changing once per year without penalty should allow enough flexibility not to discourage take-up of Tariff 12 while still providing the protection for customers that was intended by allowing customers to change from a time-of-use tariff where they find they are unable to change their usage sufficiently to benefit. However, QCOSS would strongly emphasise our view and intention that this tariff should remain a voluntary tariff.

5. Energy costs

5.1. Basis for estimating wholesale costs

The QCA proposes to continue using a hedging based approach to estimating wholesale energy costs. QCOSS continues to support the hedging approach, which is transparent, and should reflect the costs of an efficient retailer. QCOSS endorses the arguments outlined by QCA to support the use of a hedging approach, noting that these are consistent with the views that QCOSS has expressed in previous submissions to the QCA in its setting of notified prices.

5.2. Wholesale costs for Tariff 31

QCOSS notes with concern the increase in wholesale energy costs for Tariff 31. Tariff 31 is a controlled load tariff that is used predominantly for hot water heating overnight. The QCA has referred to advice from ACIL Allen and has attributed this increase to the increased unit costs of fuel at night due to gas and coal being used for base load.

While QCOSS does not dispute the ACIL Allen commentary, or the underlying data which they are explaining, we have concerns about the fact that controlled load tariffs in recent times have been increasing in cost at a faster rate than Tariff 11, thus undermining the customer incentive to access these tariffs.

The use of controlled load tariffs has served as both an affordability measure for customers, and a benefit to the networks who have been able to divert load from peak time usage thereby deferring the need for augmentation and generating cost savings.

Currently the fixed costs for Tariffs 31 and 33 are recovered as part of the Tariff 11 fixed charges. From 1 July 2015 a separate meter charge for controlled load tariffs will add even greater fixed costs, at the same time the volume charge is going up. To increase costs, and thereby decrease the incentive to adopt controlled load tariffs, seems counter intuitive given the results policy makers are looking for from the tariff reform processes. While we understand this is not currently a matter for the QCA, we would suggest the future of these tariffs and how they will operate with other tariff options needs some greater consideration through the tariff reform process. It may be that the network businesses need to consider a reduced fixed charge for those who adopt controlled load tariffs, particularly if the volumetric charges no longer provide an incentive to customers to adopt the tariff.

5.3. Other Costs

There are other costs contributing to wholesale energy costs that QCOSS will briefly address. These include the costs of the Renewable Energy Target – Large and Small (LRET and SRET), National Energy Market (NEM) Fees, and Prudential Costs.

5.3.1. LRET and SRET costs

The QCA proposes to use a market-based approach to assessing the LRET costs using the 2014 renewable power percentage for the first half of the pricing period and the LRET target for the last half of the period. Similarly, the SRET costs are to be estimated using the binding 2014 small scale technical percentage target for the first half of the pricing period and the latest available non binding 2015 STP target for the second half of the pricing period. The Small-scale Technology Certificate (STC) prices were based on the clearing-house price of $40 a certificate.

QCOSS supports the use of the market-based approach for estimating LRET costs. In relation to the SRET, QCOSS has previously advocated for the use of market prices to estimate Small-scale Renewable Energy Scheme (SRES) certificate costs. This was on the basis that for several years there was a glut of certificates on the market trading at prices well below the clearing house price. No trades were going through the clearing house, so we considered using the clearing house price to be inappropriate.

We understand that the market price is now similar to the clearing house price, and trades are now going through the clearing house. If this is the case, using the clearing house price could be appropriate now, though that was not previously the case.

5.3.2. National Energy Market (NEM) participation fees

QCOSS has no issues with the methodology or estimates of the NEM Participation and ancillary services charges generated by ACIL Allen.

5.3.3. Prudential capital costs

QCOSS has previously argued that prudential capital costs should not be included as a separate itemised component of retailer costs. Other regulators have not separately itemised these costs, for example the Independent Pricing and Regulatory Tribunal (IPART) in New South Wales (NSW) as stated:

"We consider that these costs (for example the cost of meeting AEMO prudential requirements) are part of the normal costs for running a retail electricity business. These, along with other retail costs, are captured within our cost allowances."[30]

Given that the QCA has used IPART's general retail costs in its benchmarking, by separately itemising the costs of meeting Australian Energy Market Operator (AEMO) prudential costs, QCA is double counting the same costs. If and only if QCA were to remove these costs from the general retail costs, it could then legitimately separately itemise them.

As ACIL Allen advises the QCA, retailers can reallocate prudential obligations or may meet requirements through vertical integration, so there is considerable uncertainty as to the applicability of the calculation that has been used by QCA. QCOSS questions the appropriateness of the assumptions and methodology that have been used to calculate the costs, particularly as there is no benchmark of calculation by other retailers against which to compare. QCOSS would particularly question the use of the Weighted Average Cost of Capital (WACC) of Energex. The cost of capital of Energex for regulated network pricing determinations was not intended to be used for this purpose, and is certainly not applicable to a retailer of energy.

5.3.4. Energy loss costs

QCOSS notes that the QCA has calculated energy loss costs by applying transmission and distribution losses published by AEMO and aligning with AEMO's settlement processes. The current costs are based on 2014-15 figures but will be updated in April 2015.

QCOSS supports this approach in principle, however in the Australian Capital Territory the Independent Competition and Regulatory Commission (ICRC) has noted that the liability reporting point for LRET and SRES costs and NEM fees is at the node. This suggests that only the distribution loss factor should be applied to these costs.[31] QCOSS proposes that this approach be applied to the current determination.

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30 *Review of regulated retail prices and charges for electricity from 1 July 2013 to 30 June 2016*, Final Report, IPART, June 2013, page 73

31 See the discussion in *Standing offer prices for the supply of electricity to small customers from 1 July 2014 to 30 June 2017*, Draft Report, ICRC, February 2014, page 68. This position was maintained in the final report *Standing offer prices for the supply of electricity to small customers from 1 July 2014 to 30 June 2017*, Final Report, ICRC, June 2014, pages 21-23.

6. Retail costs

6.1. Retail operating costs

To establish the Retail Operating Costs (ROC) the QCA proposes to maintain the previous 2014-15 cost calculations in real terms using the benchmarking approach developed by IPART in NSW in 2013. The QCA will continue to allocate these costs to the fixed component of the retail tariff.
QCOSS agrees with the overall approach taken to establishing the ROC, however as discussed in section 5.3.3 above, QCOSS believes that if the QCA seek to retain prudential costs as separately itemised costs, they should then be removed from the general retail operating costs to avoid double counting.

QCOSS also notes that the QCA has again added regulatory fees to the benchmarked retail operating costs, where other regulators have taken these to be already included in their benchmarked retail operating costs. QCOSS believes the QCA should also remove these costs from the benchmarked retail operating costs if they are to be itemised separately, again to avoid double counting.

6.2. Customer acquisition and retention costs (CARC)

The QCA proposes that Customer Acquisition and Retention Costs (CARC) are to be applied as part of the retailer operating costs. CARC is essentially an allowance for the costs retailers incur for marketing and promotion to attract and retain customers.

In the past, QCOSS has opposed an allowance for CARC on the basis that it is not an appropriate cost to include in notified prices. QCOSS has also expressed the view in the context of state-wide notified prices that they are particularly unreasonable when calculated on a per customer basis, given that customers in regional Queensland are supplied by a single retailer who is not subject to competition and does not therefore need to undertake marketing activities. It therefore seems even less applicable now that notified prices are to be applied only to notified prices in regional Queensland where there is no competition.
We anticipate that the QCA may argue that this could result in lower prices for consumers in Regional Queensland relative to SEQ. We have two arguments in response to that assertion.

Firstly, even if true, it would not in itself be a problem that regional customers pay less than what is paid by the customers on standard prices in SEQ who remain on standing offer prices. As we noted earlier, the delegation from the Minister does not require the QCA to set prices at the highest end of the scale of the prices paid by consumers in SEQ, nor should they given that customers in SEQ have the option of choosing lower market offers whereas customers in regional Queensland do not.

Further, customer acquisition and retention costs could be expected to decrease in SEQ as a result of the intensification of competition and in order for retailers to provide more competitive offerings. In particular, door knocking as a strategy has been abandoned in SEQ, while retailers who wish to be competitive will find lower cost channels. Increasingly customers on market prices in SEQ should be paying less as a result of these efficiencies, and so it does not appear reasonable to QCOSS that customers in Regional Queensland should be paying artificially high allowances for CARC particularly when moving to a market contracts is not an option.

This is a strong reason for the QCA to recalculate the allowances for CARC for notified prices in regional Queensland, rather than to maintain the benchmark established in 2014-15.

6.3. Retail margin

The QCA draft decision is to set a retail margin cost of 5.7 per cent, extending the approach adopted by the QCA for 2014-15 notified retail prices. The retail margin is applied equally across each component of the retail tariff.
QCOSS has previously challenged this margin and proposed that a lower margin would be more suitable. The QCA has increased the level of retail margin twice now since 2012. QCOSS did not believe that it was appropriate to increase the margin from 5 per cent to 5.4 per cent in 2012-13 or from 5.4 per cent to 5.7 per cent in 2013-14. As we previously noted, the justification for the increase in 2012-13 seemed to be that 5.4 per cent was the mid-point of the reasonable range of 4.8 per cent to 6 per cent found by consultants in NSW[32], notwithstanding that the retail margin at the time (5 per cent) also fell within the reasonable range.

In support of our argument we also note (as we noted then) that the QCA had itself said “the current 5 per cent margin in Queensland is not unreasonable” and “the new pricing approach being established in this determination should reduce the risks faced by retailers in Queensland relative to the previous BRCI approach, including better alignment of the cost structure and price structure and the pass through of network costs”.[33] The increase in the margin in 2013-14 was again based on a decision in NSW, without apparent consideration of

32 Final Determination for 2012-13, pages 74-75
33 Final Determination for 2012-13, pages 74-75

whether the previous margin allowed in Queensland remained reasonable for Queensland.

QCOSS maintains that the allowed margin in 2012-13 should have been lower, and certainly not higher, than the previous 5 per cent level under the BRCI. QCOSS suggested that the margin should be lower because of the changes at the time in price setting methodology and the approach to establishing wholesale energy costs, both of which reduced retailers' risk.

Although the QCA has previously dismissed these views we believe our arguments still have merit and we therefore re-present them for the QCA's consideration. In addition to our previous arguments we would also like the QCA to consider the fact that retail competition is increasing in Queensland and especially in 2015-16 with full deregulation. Market contract prices are lower than notified prices, and the lower pricing would at least in part if not in whole come from reduced margins.

QCOSS therefore recommends that the QCA should take into account lower margins on market contracts in determining the appropriate level of retail margin to apply to notified prices in Regional Queensland. It would not be inconsistent with the delegation, and indeed it can be argued that it is consistent with the requirement to consider the impact on customers. These considerations should lead the QCA to maximise the affordability of electricity prices, and minimise unnecessary costs in setting notified prices.

7. Other issues

7.1. Pass through mechanism

The QCA has advised it will continue to apply a pass through mechanism for Small Renewable Energy Scheme (SRES), and that it does not believe there is a need to provide a materiality threshold.

QCOSS has previously opposed the inclusion of a pass through mechanism on the basis that it deflects responsibility from retailers to manage risks while inequitably passing such risks onto consumers who have no means of mitigating them. We have also argued that retailers lack incentives to control costs if they can just pass through costs that they incur in a given category, and we have sought to limit the application of pass through costs to events that would be wholly outside an efficient representative retailer's control. QCOSS is satisfied that the cost pass through mechanism outlined in the current draft decision does now address all these issues, and on that basis, we do not oppose the proposed mechanism in principle.

However, we are concerned by the QCA decision not to apply a materiality threshold. Without such a threshold it will be unclear on what merits and in conjunction with what other relevant factors each event will be considered. By providing materiality criteria in advance it would provide transparency on decisions related to over or under recovery. Without this there is a risk that there will not be symmetry in decisions regarding under or over recovery. Retailers may try to push for cost pass through where there has been under recovery of a low magnitude, or argue against cost pass through where there has been over recovery of a similar magnitude, both on the grounds of unquantified materiality thresholds. QCOSS therefore recommends the QCA consider and specify the materiality threshold in its final determination.

7.2. Metering costs

The QCA's draft determination notes that as the AER is proposing to reclassify type 6 metering services from standard control to alternative control from 1 July, metering costs will be removed from standard network charges and distributors will be allowed to charge separately for metering services. The result of this reclassification is that metering charges will no longer be included in notified prices, and customers will see a separate charge on their bills for metering. QCOSS notes that metering costs are not included in the fixed fee component of the notified prices outlined in the current draft decision. However the QCA has estimated the impact of the likely meter charge when modelling 2015-2016 regional prices in order to provide comparability with previous years. We appreciate that the QCA has done so as they are not insignificant costs adding at least 10 per cent to the already high fixed charges being proposed. The impact on customers will vary depending on their network tariff. For example, customers on Tariffs 31 and 33 will see a metering charge for the first time, and solar customers will also pay an additional metering charge.

This new approach is largely a matter determined by the AER and not by the QCA, and we have no disagreement with the approach taken by the QCA. However, QCOSS notes that there is a need for clarity on whether the Queensland Government will subsidise the metering costs even though it is not part of the notified price. The QCA has included Energex's metering costs in its modelling, however if the government does not apply the uniform tariff policy, we assume that it would be Ergon's meter costs that are ultimately passed on. QCOSS would appreciate advice from the Government about whether and how it intends to subsidise meter costs for regional customers to ensure that regional customers pay the same metering charges as SEQ customers.

A further area of uncertainty that needs to be addressed is how metering costs for Card Operated Meter customers will be charged following the AER's decision. This is an important issue given that customers using card operated meters are amongst the most vulnerable group in the State, and low incomes combined with the manner in which card meters operate and lack of affordability generally result in these customers being denied access to electricity and access to concessions to support affordability. QCOSS will seek to raise and discuss these issues with the new government and with Ergon Energy in the near future.