EXECUTIVE SUMMARY

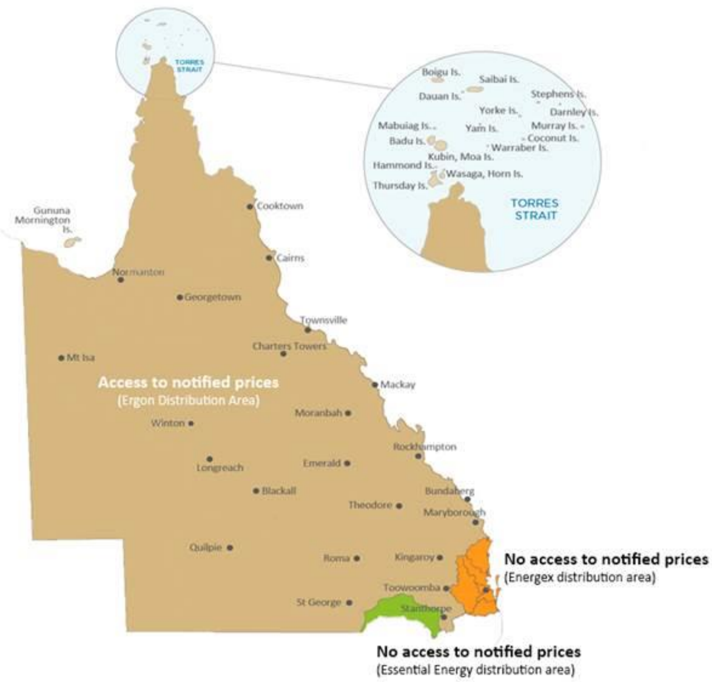
The Queensland Competition Authority (QCA) has made a draft determination on the regulated retail electricity prices (notified prices) to apply from 1 July 2017 to 30 June 2018. In general, notified prices are paid by customers who have not entered into a negotiated or market contract with their retailer. The QCA has been delegated the role of setting notified prices by the Minister for Energy, Biofuels and Water Supply and is required to set prices in accordance with that delegation and the *Electricity Act 1994* (the Electricity Act).

The purpose of this draft determination is to provide stakeholders with the opportunity to comment on the QCA's proposed approach to determining notified prices, and other pricing-related issues (for example, transitional arrangements). While the notified prices in the draft determination are based upon the most up-to-date information available at the time of publication, they are indicative only. It is highly likely that there will be changes in the expected costs of supply and consequently, notified prices, between the draft determination and the final determination, which is to be released by 31 May 2017.

Who can access notified prices?

Notified prices are only available to residential, small business and non-market[1] large business customers in the Ergon Energy Corporation Limited (Ergon Distribution) distribution area. Notified prices are not available to regional customers located outside of this distribution area.[2]

Figure 1 Access to notified prices



[1] Large business customers supplied by Ergon Retail are classified as 'non-market' customers. Large business customers supplied by other retailers in regional Queensland are classified as 'market' customers.

[2] Customers in Essential Energy's distribution area in southern Queensland do not have access to notified prices, but Origin Energy receives a subsidy from the Queensland Government to ensure that non-market customers in that distribution area pay no more than similar customers that have access to notified prices. Retail price regulation in the Energex distribution area was removed on 1 July 2016.

What is the QCA's proposed approach to setting notified prices?

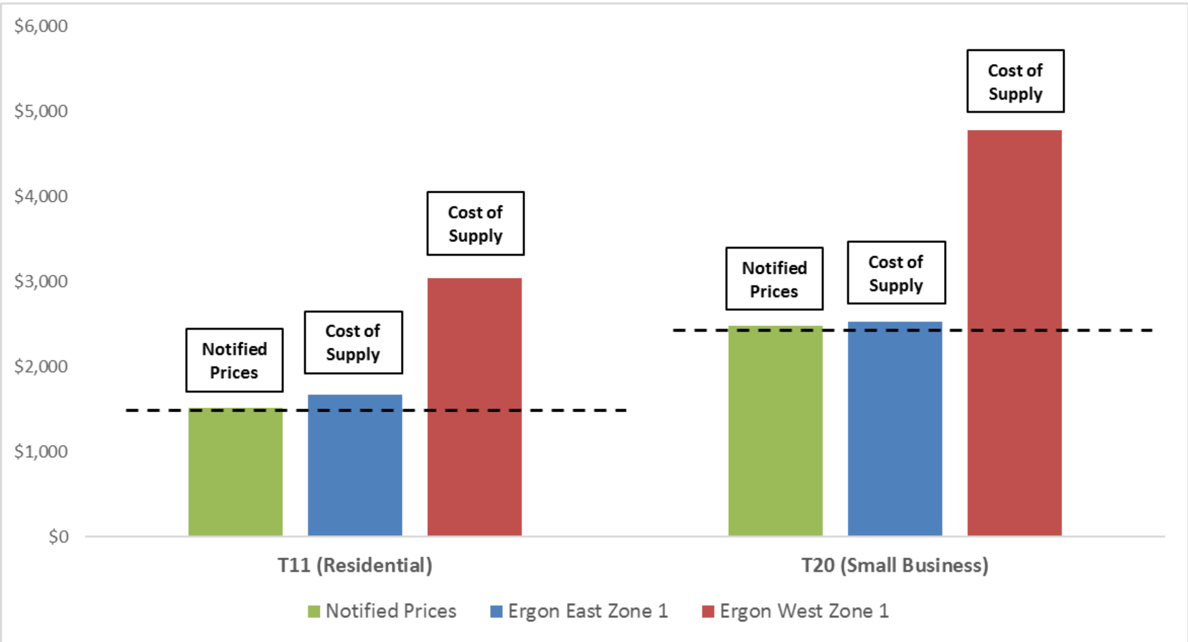
The QCA's proposed approach to setting notified prices for 2017–18 is largely consistent with the approach we took in the 2016–17 price determination.

In accordance with the Queensland Government's Uniform Tariff Policy (UTP), we propose to continue to base notified prices for residential and small business customers on the costs of supplying electricity in south east Queensland (i.e. the Energex distribution area). We also propose to continue to base notified prices for large business customers on the lowest costs of supply in regional Queensland (i.e. Ergon Distribution's east pricing zone, transmission region 1).

The application of the UTP will mean that notified prices for residential and small business customers in regional Queensland broadly reflect the expected prices for similar customers on standing offers in south east Queensland. It also means that notified prices for large business customers in regional Queensland will be based on the lowest costs of supply in regional Queensland[3], rather than the actual costs of supply. As the actual costs of supplying residential, small business and some large business customers are generally higher[4] than notified prices, this approach will benefit customers in regional Queensland.

To cover the difference between notified prices and the costs that Ergon Energy Queensland Limited (Ergon Retail) actually incurs to supply regional customers, the Queensland Government pays Ergon Retail a subsidy. This subsidy is significant, with the Queensland Government expecting to pay $561.2 million[5] to subsidise regional electricity customers in 2016–17.[6]

Figure 2 Draft notified prices for typical small customers compared to actual costs of supply in regional Queensland (incl. GST)



Note: The cost of supply excludes standing offer adjustment. Ergon East Zone 1 refers to Ergon Distribution's east pricing zone, transmission region 1. Ergon West Zone 1 refers to Ergon Distribution's west pricing zone, transmission region 1.

[3] Ergon Distribution's east zone, transmission region one.

[4] The difference in the costs of supply is largely due to the higher network costs associated with supplying electricity over long distances to a low-density customer base.

[5] $2.8 million dollars of this subsidy is paid to Origin Energy for customers in the Essential Energy distribution area.

[6] Queensland Government, State Budget 2016–17—Budget Strategy and Outlook, Appendix A, June 2016, p. 215.

We also propose to again use the network (N) plus retail (R) cost build-up approach to calculate notified prices for 2017–18. Under this approach, we base the N costs on the relevant network tariffs approved by the Australian Energy Regulator (AER) for Energex or Ergon Distribution. This means the N costs are generally treated as a pass-through. We determine the R costs (energy and retail costs) using the latest information, including observations from competitive retail and wholesale electricity markets in Australia.

In broad terms, the N plus R methodology produces estimates of efficient south east Queensland price levels for residential and small business customers. However, to be consistent with the Queensland Government's UTP, the price levels for these customers need to reflect the expected standing offer prices in south east Queensland. Consequently, to maintain consistency with the UTP, it is necessary to add an amount to the N plus R estimates, which reasonably represents the expected differential between our estimates of efficient price levels and expected standing offer price levels (the standing offer differential).

Consistent with our approach in previous price determinations, we propose to include an allowance for headroom in notified prices for large business customers only. The use of a headroom allowance is a generally accepted approach to stimulating competition and customer engagement in emerging competitive markets. Given that competition in the large business customer segment in regional Queensland has the potential to develop further, particularly in areas where notified prices more closely reflect the actual costs of supply, we consider that the inclusion of an allowance for headroom will support competition, by encouraging customers to engage in the market and seek out better offers.

Why are notified prices expected to change between 2016–17 and 2017–18?

Notified prices are expected to change between 2016–17 and 2017–18 due largely to movements in energy costs and network costs.

Energy costs are expected to increase for all customers in 2017–18, primarily driven by increases in wholesale energy costs and Large-scale Renewable Energy Target (LRET) costs. The QCA's consultant, ACIL Allen, has advised that the increase in estimated wholesale energy costs 'reflects the projected continued tightening of the demand-supply conditions in the Queensland region as well as other regions of the NEM [National Electricity Market] in 2017–18 due to the increase in demand from in-field gas compression associated with the LNG export facilities, little additional renewable capacity in Queensland[7], and the removal of Hazelwood power station in Victoria[8].'[9]

ACIL Allen has also advised that LRET costs are expected to increase due to large-scale generation certificate (LGC) prices continuing to increase 'on the expectation that there will be a shortfall in LGC supply by 2018.'[10]

However, the increase in energy costs has been largely offset by expected decreases in network costs between 2016–17 and 2017–18 for many notified prices. These decreases are a result of the AER's final decisions on Energex's and Ergon Energy's 2015–20 distribution determinations. The offsetting impact of network costs means most notified prices are only expected to increase by small to moderate amounts despite the substantial increase in energy costs.

[7] While a number of new renewable energy projects are planned, only a limited amount of new renewable generation will be fully operational in 2017–18, with a number of renewable energy projects likely to commence operation towards the end of, or after, the 2017–18 financial year in mid-2018.

[8] Wholesale electricity is sold through the NEM, which allows electricity to trade across five interconnected regions (Queensland, New South Wales, Victoria, South Australia and Tasmania). The interconnected nature of the market means changes in the demand/supply balance in one region will impact on other regions of the NEM.

[9] ACIL Allen, Estimated Energy Costs–2017–18 Retail Tariffs, 11 January 2017, p 24.

[10] ACIL Allen, Estimated Energy Costs–2017–18 Retail Tariffs, 11 January 2017, p 25.

How will the QCA's draft determination impact on customer bills?

The notified prices in this draft determination will not affect customer bills; the only notified prices that will apply to customers, and therefore have an impact on customer bills, are those in the QCA's final determination. The draft notified prices are indicative only, as it is highly likely that there will be changes in the expected costs of supply and consequently, notified prices, between the QCA's draft and final determinations.

To illustrate the hypothetical impacts of the draft determination on customer bills, we have provided comparisons of the annual amount typical customers[11] would have paid under 2016–17 notified prices and the annual amount that they would potentially pay under the draft 2017–18 notified prices. It is important to note that this information is only intended to show the potential impact of the annual change in notified prices on a typical customer's bill. It is not intended to demonstrate the annual change in the total amount a customer will pay their electricity retailer in a given year.

Many customers will incur additional charges that are not set by the QCA and cannot legally be included in notified prices. For example, most customers will also pay metering charges. These charges are set by the AER and will vary from customer to customer depending on a range of factors, including (but not limited to) the type of meter installed, the number of tariffs a customer uses and whether a customer has a solar power system. As these charges do not form part of notified prices or the QCA's price determination, they have not been included in the customer impact analysis for notified prices.

Residential customers

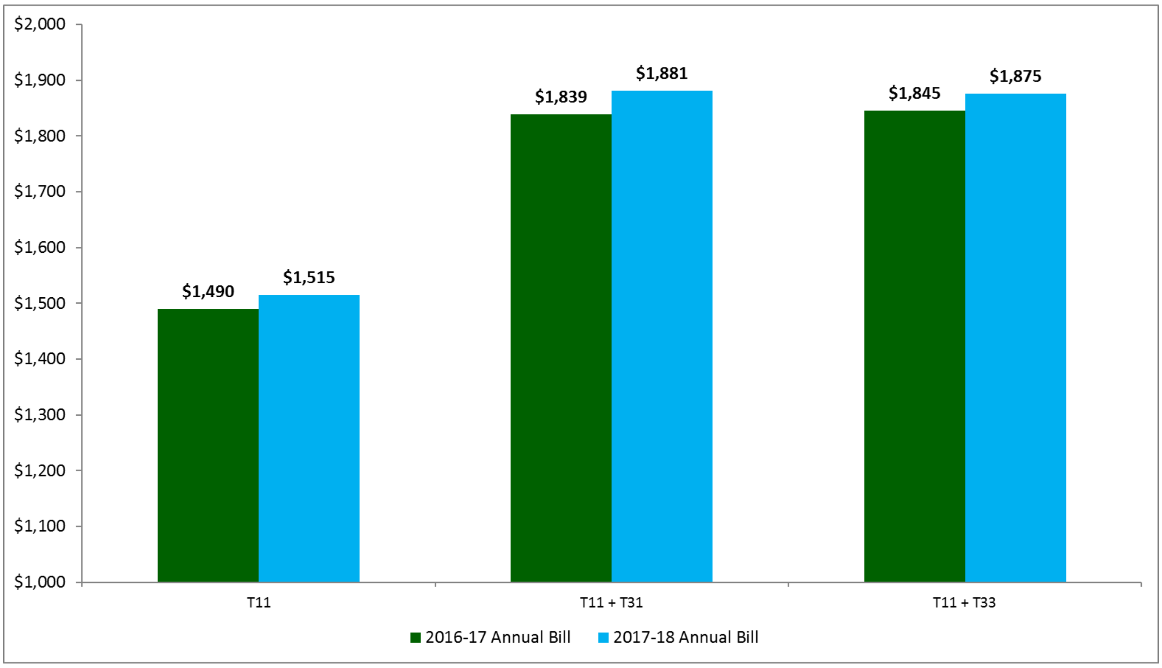
The main retail tariff for residential customers is tariff 11. Many customers on tariff 11 are also on one of the controlled load tariffs (tariffs 31 and 33)[12].

The annual notified price bill for a typical customer on tariff 11 is expected to increase by 1.7 per cent from $1,490 (GST inclusive) to $1,515 (GST inclusive) as a result of the draft change in notified prices between 2016–17 and 2017–18. For a typical customer on a combination of tariffs 11 and 31 or tariffs 11 and 33, the expected increase will be 2.3 per cent and 1.6 per cent respectively. However, the impact on individual customers will vary depending on their consumption. Customers with lower consumption than the typical customer will face smaller increases while higher-consumption customers face larger increases.

[11] The typical customer for a given retail tariff is the median or middle customer in terms of consumption out of all customers on that tariff in regional Queensland. The typical customer consumption data is provided by Ergon Retail and more information is provided at Appendix H.

[12] Controlled load tariffs may be used for appliances such as water heaters and pool pumps. These tariffs are cheaper than tariff 11 as customers are only guaranteed supply for a set number of hours (tariff 31 guarantees supply for 8 hours per day and tariff 33 guarantees supply for 18 hours per day).

Figure 3 Draft impact of the change in notified prices on typical residential customers (incl. GST), 2017—18



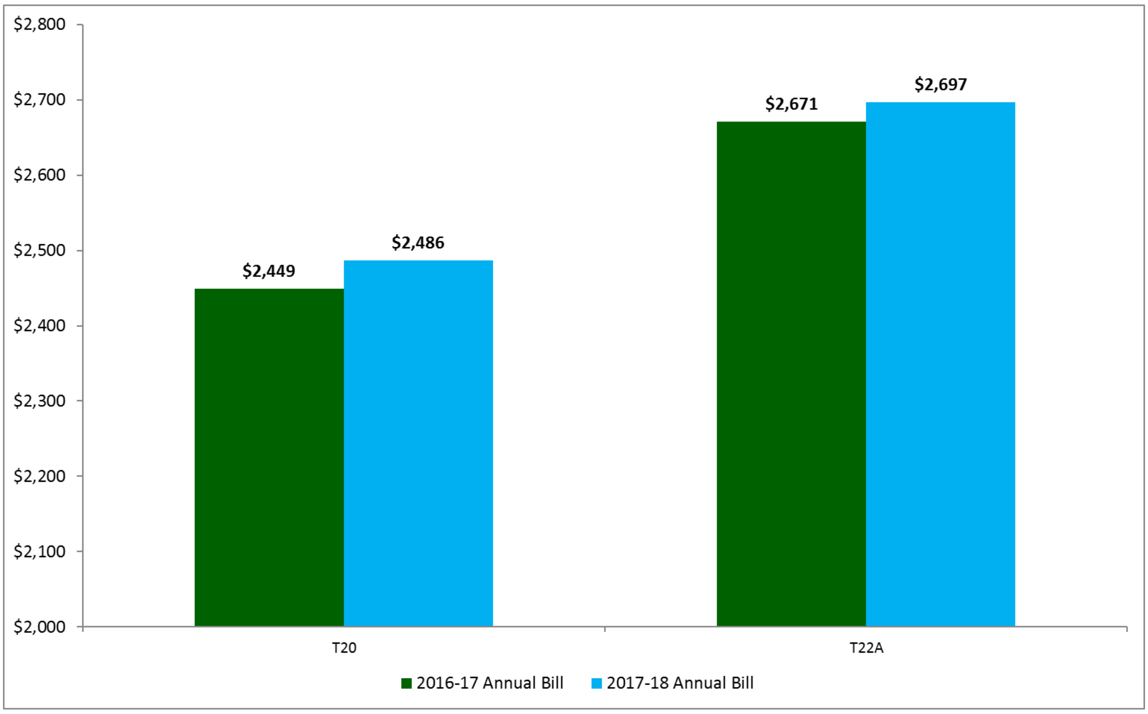
Note: The annual bill amounts have been rounded to the closest dollar.

Small business customers

The annual notified price bill for a typical customer on the main small business tariff (tariff 20) is expected to increase by $37 or 1.5 per cent as a result of the draft change in notified prices between 2016–17 and 2017–18. For a typical customer on the seasonal time-of-use tariff (tariff 22A), the expected increase will be slightly lower at 1.0 per cent.

However, it is important to note that bill impacts for individual customers will vary depending on their level of consumption and, if the customer is on tariff 22A, the pattern of their consumption.

Figure 4 Draft impact of the change in notified prices on typical small business customers (incl. GST), 2017—18

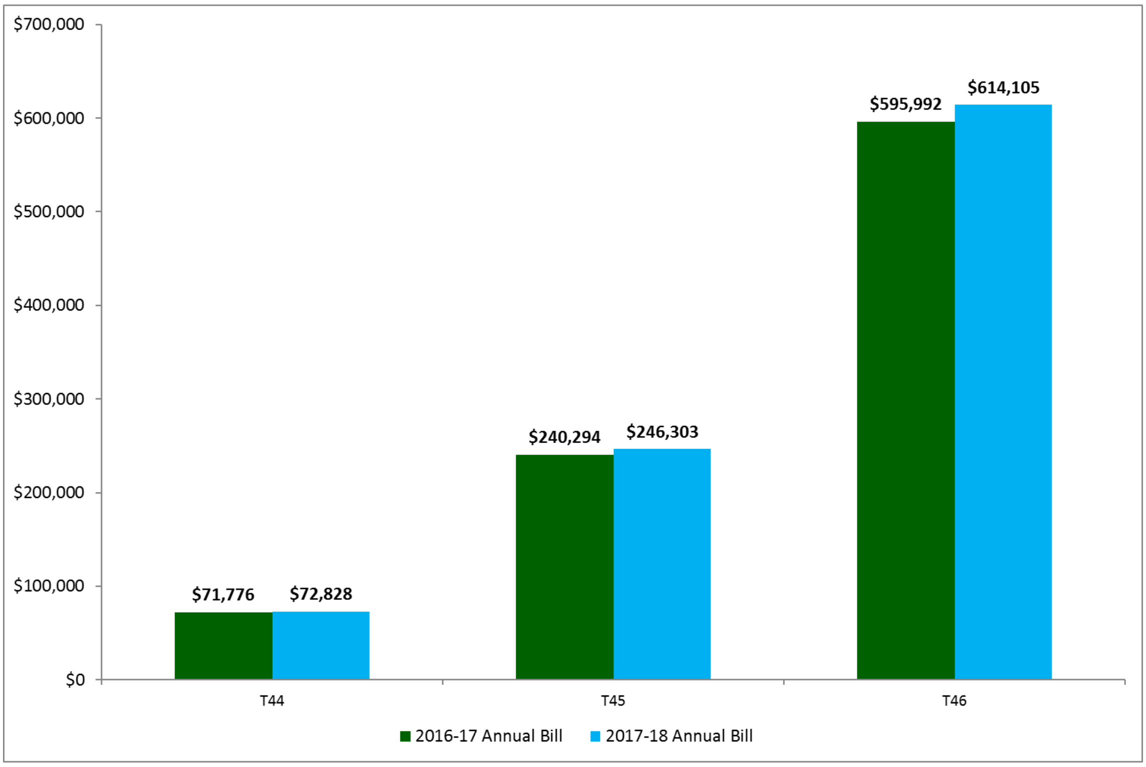


Note: The annual bill amounts have been rounded to the closest dollar.

Large business customers

Typical large business customers can expect increases in their annual notified price bills of between 1.5 per cent and 3 per cent as a result of the draft change in notified prices between 2016–17 and 2017–18. However, it is important to note that bill impacts for individual customers will vary depending on their level and pattern of consumption.

Figure 5 Draft impact of the change in notified prices on typical large business customers (incl. GST), 2017—18



Note: The annual bill amounts have been rounded to the closest dollar.

What is the QCA's proposed approach to transitional and obsolete tariffs?

Some business customers, including farmers and irrigators, are supplied under transitional or obsolete tariffs. These retail tariffs are legacy retail tariffs for which there is no corresponding network tariff. As a result, their prices cannot be determined under the N+R cost build-up methodology.

Transitional and obsolete tariffs have been made available for several years to allow customers to transition to standard business tariffs and recoup some of the investments made to suit the level and structure of transitional or obsolete tariffs. Based on information from Ergon Retail, many customers on these tariffs may face lower electricity bills if they moved immediately to a standard business tariff but some customers would face much higher bills.

The QCA proposes to maintain transitional arrangements for 2017–18 and to adjust the charges in each transitional and obsolete tariff in line with the percentage increases in the standard business tariffs customers would otherwise pay. The QCA also proposes to apply an additional escalation factor to limit charges for transitional and obsolete tariffs falling further below cost in dollar terms. This approach is consistent with the QCA's general approach in previous price determinations.

The QCA also proposes to introduce transitional arrangements for customers on existing high voltage retail tariffs, as Ergon Distribution intends to phase out the network tariff underlying these tariffs in 2017–18. Under the proposed transitional arrangements, the two high voltage retail tariffs (tariffs 47 and 48) will be classed as obsolete and therefore only available to existing customers for a transitional period of five years. Consistent with our approach to other transitional and obsolete tariffs, we propose to adjust these tariffs in line with changes in the relevant standard business tariffs, and apply escalation factors to limit charges falling further below cost in dollar terms.

We consider that the proposed approach strikes the right balance as it will allow existing customers on the two high voltage retail tariffs time to adjust their operations before moving to alternative retail tariffs. It also ensures that new customers do not make long-term investment and business decisions based on legacy high voltage tariffs that will only be available for five years. Given that many of these customers are likely to be using very large amounts of energy (tariff 48 customers are some of the largest energy users in Queensland) and making significant capital investments, we consider it is important that they make those decisions based on the correct pricing signals.

Next steps

This is a draft determination only and we intend to consult extensively prior to finalising our determination in May 2017. We will be holding public workshops on the draft determination in Bundaberg, Cairns, Emerald, Toowoomba, Townsville and Brisbane from 13 March 2017. Stakeholders are encouraged to attend these workshops and to make submissions on the draft determination. We will consider all issues raised in submissions in making our final determination for 2017–18. More information on the workshops and how to make a submission is available on our website, www.qca.org.au. Submissions close on **3 April 2017** and our final determination will be published by 31 May 2017.