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13 December 2011

Queensland Competition Authority
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Dear Sir/Madam,

RE: Draft Methodology Paper Regulated Retail Electricity Prices 2012-13

Lumo Energy Australia Pty Ltd, (Lumo Energy) would like to thank the Queensland Competition Authority, (QCA), for the opportunity to comment and provide feedback on the Draft Methodology Paper Regulated Retail Electricity Prices 2012-13.

At the outset Lumo Energy would assert that it is firmly of the view that the long term pricing interests of consumers is best served via the removal of retail price regulation. This ensures market forces set cost reflective pricing and drives innovation and competition.

It is clear that the QCA's task of setting a representative retailers cost is both complex and generates significant risk for the market and subsequently consumers. If the R component is calculated too low, consumers will lose the competitive market and competitive offers, which are readily available in markets such as Victoria, will no longer be available to them.

The QCA's paper states that the Authority must, as much as possible, give regard for the objectives as set out in the Direction and the Electricity Act.[1] Lumo Energy believes that the determination of the representative retailer as an 'efficient' retailer doesn't meet the required objective of the Direction. The proposed methodology doesn't reflect retailers true cost and as such will lead to reduced competition.

Lumo Energy would also question on what basis the Authority makes the assumption that *"an abnormally active market might also suggest that potential profits in the market are high (perhaps due to the regulated retail tariffs being set too high) which would also encourage retailers to spend an unreasonable amount on marketing while offering customers large discounts"*. Based on our interactions with the market this statement is unfounded and should not be a factor in determining a true cost reflective price.

We strongly believe that to maintain competition the costs assumed should be those incurred by a smaller retailer. A small retailer will likely carry less capital and therefore be required to be more risk adverse as they are unable to self-insure the risk above a long term mean outcome. If smaller retailers are unable to pass on these additional hedging costs they will not be able to remain

[1] In addition, and consistent with section 90(5) of the Electricity Act, the Authority is required to have regard to (a) the actual costs of supplying electricity and (b) the effect of the determination on competition in the Queensland retail electricity market, consistent with the Government's policy objective that consumers, wherever possible, have the opportunity to benefit from competition and efficiency in the marketplace.

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competitive and will either exit the market or take on more risk which could have detrimental effects to the wider market should a stress event occur.

Working capital is a large cost for a retailer that is not represented when calculating R; it is even more evident if proposing to measure costs at the mean, as retailers must carry increased working capital to manage the short term prudential spikes that can occur as a result of high price events.

Whilst carbon uncertainty has led to reduced liquidity in ASX futures, there has been a liquid and transparent OTC market trading exclusive of carbon. As ACIL Tasman recommends with environmental certificates, the methodology should take account of the AFMA OTC electricity curve. This provides a far more reflective cost incurred by retailers to hedge forward than looking back at spot outcomes. ACIL Tasman continues to reiterate that where a market price can be obtained it should be used in calculating retailers' costs. There is clearly a market that exists to price retailers' wholesale costs and therefore should be used.

Lumo Energy is strongly of the view that this market price should be used in favour of a non-transparent "black box" approach and supports ACIL Tasman's concerns around using this approach to pricing. It is critical the pricing methodology be applied to the tradable market against which retailers are actually pricing the forward wholesale risk. The lack of transparency with the proposed approach fails to allow retailers to understand and therefore manage the longer term risk of price tariffs. The "black box" simulation of unplanned outages in the market appears to fail to recognise the change in bidding behaviour that can occur with the generators that remain available. The failure of Plant not only takes that volume from market but allows remaining Plant to capitalise and potentially increase volatility and price outcomes.

With regards to section 6.1 Setting the R component of retail tariffs – we assume this means that any inclining block structure introduced into network tariffs will be reflected in the retail tariffs. This is imperative to ensure that network price signals are passed through, and that there is minimal impact to retail margins.

Finally we strongly urge the QCA to further investigate pass-through mechanisms for unforeseen events. Unforeseen events that cannot be passed through the retail tariff would likely create situations where market offers would need to be set a rate higher than the retail tariff, therefore again impacting on competition.

Lumo Energy welcomes the opportunity to participate in further discussion. Please contact Aneta Graham, General Manager Regulatory Affairs and Corporate Relations on 03 8680 6439 to discuss.

Yours sincerely,

[redacted]

Dean Carroll
Chief Executive Officer