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Queensland Competition Authority
GPO Box 2257
Brisbane QLD 4001

Draft Determination — Regulated Retail Electricity Prices 2013-14

Thank you for the opportunity to respond to the Queensland Competition Authority's (QCA's) Draft Determination on regulated retail electricity prices for the year 2013-14. We support the submission that the Energy Retailers' Association of Australia (ERAA) has provided the QCA in response to the Draft Determination.

Simply Energy believes that the Draft Determination is inconsistent with the QCA's terms of reference and is damaging retail competition in Queensland. The terms of reference state that in making a price determination for each tariff year, the QCA must have regard to the following matters:

- The actual cost of making, producing or supplying goods or services
- The effect of the price determination on competition in the Queensland retail electricity market, and
- Certain specific matters such as the Uniform Tariff Policy, Time of Use Pricing, the N+R pricing framework and transitional arrangements.

In Simply Energy's view, the QCA continues to focus almost exclusively on determining a regulated retail price that reflects the actual cost of supplying retail services and ignores its obligation to determine a regulated price that also encourages retail competition.

Using actual wholesale costs does not facilitate competition

Simply Energy urges the QCA to consider the history of retail price caps across the NEM and that only where there is working headroom in a regulated price where retailers can compete, will retailers actively participate in trying to win customers in a region. Simply Energy is concerned that any proposed approach by the QCA to "track" relatively short-term wholesale contract costs will remove this working headroom and stifle competition in Queensland.

This highlights the irony for Governments when they seek to regulate retail electricity prices. In order to encourage and allow for competition, the regulated price must be greater than the market price. Governments wishing to see reduced wholesale prices to be reflected in household electricity bills must be prepared to consider full deregulation.

The continued use of market prices to set the wholesale energy cost (WEC) component of the regulated retail price does not provide sufficient headroom for non-incumbent retailers to compete. It results in a regulated price that competes with available market offers and thus undermines any incentive that customers may have to switch retailers.

Data published by the Australian Energy Market Operator shows that the rate of switching in Queensland is falling.[1] While 15% of customers switched retailers in July 2012, the rate of switching had fallen to 11% in February 2013. The rate of switching in Queensland is well below those experienced in other jurisdictions (see Table 1).

[1] AEMO Monthly Retail Transfer Statistics

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Table 1: 1 Monthly Annualised Transfer Rate, February 2013

Victoria	31%
New South Wales	19%
Queensland	**11%**
South Australia	21%

Source: AEMO Monthly Retail Transfer Statistics, January 2013

We note the QCA's statement that:

> … while the Queensland switching rate was 11% (annualised) in January, if Ergon Energy customers were removed from the calculation, the switching rate increases to approximately 15%. This compares to 20% in NSW, 24% in South Australia and 28% in Victoria.[2]

This may be a correct statement about the switching rate at a point in time. However, the Uniform Tariff Policy has been in place for some time and the switching rate in Ergon Energy's area would have been very low for an equally long period.

This would suggest that very little of the declining trend in the switching rate would be due to declining competition in the Ergon Energy area. Most if not all of the decline in the switching rate in Queensland as a whole could be attributed to declining rates of switching in the Energex area, an area of the state where competition should be flourishing.

Retail competition in Queensland is being hindered by existing arrangements and will be further undermined by providing insufficient headroom in the WEC of the regulated tariff.

QCA's is adopting an approach used to regulated monopoly elements of the industry

The QCA states that using market-based prices will:

> … produce price estimates more in line with actual market conditions and hence pass appropriate signals to consumers regarding the cost of their current consumption.[3]

We suggest that it is not the role of the QCA and retail price regulation to deliver an efficient price signal. This is what the competitive market is designed to do. A regulated retail rate should act as a "safety net" that protects those customers who are disinclined, or not sufficiently informed, to switch to a more competitive market offer, while at the same time providing the headroom that encourages competition from a broad range of retail competitors.

Having the regulated retail price set at an efficient level is an approach that is normally adopted for regulating the monopoly distribution and transmission elements of the industry — not the competitive retail market. The framework used to regulate distribution and transmission seeks to create incentives that mimic the competitive market because these companies do not face any competition.

In the absence of that competitive framework, distribution and transmission companies do not face the consequences of any poor investment or purchasing decisions that they may make. Their franchised customer base protects them from these consequences because a monopoly can simply raise its prices to recover from its mistakes. The incentive framework aims to shift the risk of poor decision making away from the customer and back on to the distribution or transmission company.

[2] QCA, *Regulated Retail Electricity Prices 2013-14 Draft Determination,* p.52
[3] QCA 2013 Draft Determination p, 23

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This is not the case with the competitive retail market. Retailers will wear the consequences of poor purchasing or investment decisions. Any attempt to pass these through to their customers will cause customers to switch retailers.

The consequences of the QCA applying a monopoly framework to a competitive market are that:

1. It makes entry for new retailers harder. New entrants sell much smaller loads than established retailers and may have a higher volume-weighted wholesale cost of energy than established retailers. The headroom for competition is not about the level of the discount offered by established retailers. Providing headroom is about providing enough ceiling space in the regulated price to allow for new entry. We suggest QCA has not considered this dynamic.

2. It ignores the fact that the wholesale market is dynamic. While wholesale energy spot prices may be lower now than they have been in recent years, they are just as susceptible to sharp increases. QCA's wholesale price determination does not allow sufficiently for unanticipated increases in the wholesale price for electricity. Even in the regulation of monopolies, regulators recognise the need for conservatism and provide plenty of headroom in price paths to allow for unanticipated changes in circumstances.

3. It ignores the fact that different retailers have different wholesale purchasing strategies and that these strategies evolve over time. Setting a wholesale energy prices too low detracts from innovation because it reduces the incentives that retailers have to try out more innovative wholesale purchasing approaches.

Facilitating competition

To comply with its terms of reference, the QCA should not be relying on market-based prices alone to determine the WEC. The mechanism for determining the wholesale contribution to the standing contract tariff must also allow for viable competition to thrive by creating "headroom" between the regulated tariff and market offers to customers.

The desirable level of a regulated price must exceed current competitive and efficient levels to create headroom to compete. Rather than relying on market prices alone, retailers including Simply Energy have consistently argued that the methodology the QCA should be using to determine the amount of this headroom is to consider the long run marginal cost of supply (LRMC).

Ideally, the QCA should have regard to both the actual cost of supplying retail services and the LRMC that facilitates competition and developing a methodology that incorporates consideration of both into determining the regulated WEC. We believe that the QCA should calculate the LRMC and use the forward market contract price of wholesale electricity for each year of the regulatory price period and select the higher of the two values when determining the price path.

In market conditions where the forward contracts are trading at lower levels than the LRMC calculation, this approach provides sufficient head-room for retail competition to flourish. Conversely, if market contracts rise to higher levels than the calculated LRMC, this approach would ensure that retailers are not forced to offer loss making retail contracts which are below the price levels which can be effectively hedged.

Simply Energy believes that a hybrid approach offers a number of advantages:

- The key advantage is that it ensures the regulated retail price is generally set at a level that provides for effective competition by allowing for a differential with the market offer rates available. This

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preserves an incentive for standing offer customers to enter the competitive market, and for competition to flourish.

- It provides a mechanism for the WEC to allow for increases in the forward contract market price. For example for situations where the supply and demand dynamics force market prices to rise above the LRMC for a time, using the higher of either the LRMC or the forward contract market price allows retailers to be able to offer tariffs which represent the true cost of hedging their load.

- Allowing headroom also minimises the risk that the QCA has to re-open the retail determination to allow for increases in wholesale costs.

A hybrid approach may also offer an advantage during the regulatory determination process. The calculation of both values may provide the QCA with a comparator that provides insight into whether the forward contract market price and the LRMC are significantly out of line with each other to cause concern for future investment and hence reliability in Queensland.

In the absence of deregulated pricing, Simply Energy encourages the QCA to reconsider the ramification of its Draft Determination on competition. Simply Energy also encourages QCA to note the recent South Australian experience where a similar approach was recommended and the negative industry reaction that followed.

Please don't hesitate to contact me on (03) 8807 1132 if you wish to discuss this submission further.

Yours sincerely

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