REPORT

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Review of Regulated Retail Electricity Tariffs and Prices

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1. INTRODUCTION

This report has been prepared by Etrog Consulting Pty Ltd for Queensland Council of Social Service (QCOSS). It comments on the Issues Paper on Regulated Retail Electricity Tariffs and Prices which was published by the Queensland Competition Authority (the Authority) on 24 June 2011, inviting submissions from interested parties on a range of issues the Authority will be required to consider in conducting its review of regulated retail electricity tariffs and prices, including in relation to network costs, energy costs, retail costs and the structure of tariffs.

Energex's network tariffs are the basis on which regulated retail electricity tariffs will be constructed in Queensland from 1 July 2012. For each network tariff, there will be a corresponding retail tariff. While the Authority does not approve network tariffs, it also welcomes comments from stakeholders on the network tariff structure proposed by Energex and its implications for the development of retail tariffs and prices.[1]

The Authority has requested that submissions to the Issues Paper and comments on Energex's proposed network tariff structure for 2012-13 should be received by 5 August 2011. This report has been developed in consultation with QCOSS with the understanding that QCOSS is intending to include this report in its submission to the Authority on the Issues Paper on Regulated Retail Electricity Tariffs and Prices, and Energex's proposed network tariff structure for 2012-13.

1.1. QCOSS' CONSTITUENCY

QCOSS represents the interests of residential consumers, with a particular focus on low income and other vulnerable consumers, and we would have liked to have been able to model the effects that the new proposed regulated tariffs and prices will have on QCOSS' constituency, and to have taken into account the results of that modelling in this report. However, we have found it impossible to do any meaningful modelling, because there is too much uncertainty. Even in Energex's proposed network tariff structure for 2012-13, the block sizes are only proposed, we don't have data showing the distribution of usage across the Energex area for customers at large, let alone for low income consumers, we do not know what will be the magnitude of the fixed charge as compared to the variable charges in the network tariffs, and we do not know what will be the magnitude of the differences between the variable charges in each block of the proposed inclining block tariff. Will they be significantly different, or hardly different? As explained later in this report, these issues will be very significant to QCOSS' constituency, and could have a major effect in determining whether low income consumers are better off or worse off as a result of the proposed changes.

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1 The Issues Paper and Energex's proposed network tariff structure for 2012-13 have been published on the Authority's website at www.qca.org.au/electricity-retail/RevEPandTS/IssuesPaper.php.

We urge the Authority and the Queensland Government to make available at the earliest opportunity sufficient data to enable this modelling to be undertaken, and also for those parties to release any modelling that they have already undertaken to support the policy decisions that have been made to date.

Low income customers are supported by a range of concessions and other measures in line with the Queensland Government's social policy objectives. Depending on the outcomes that result from the current review of regulated electricity tariffs and prices, the existing measures may be adequate or may prove highly inadequate to be effective at assisting low income consumers in future. Major restructuring of the concessions framework may be required, and it is better that this is known sooner rather than later, so that appropriate changes can be made to the concessions framework in time before new regulated tariffs and prices are implemented. Financial counsellors and others who advise these consumers also need prior information on how any new tariffs will affect their clients, so that they can give them appropriate advice on their use of electricity, their budgeting, and any assistance that may be available to them.

1.2. STRUCTURE OF THIS REPORT

The remainder of this report comments on various matters in regard to the Issues Paper on Regulated Retail Electricity Tariffs and Prices, and Energex's proposed network tariff structure for 2012-13.

- Sections 2 and 3 consider energy costs and retail costs respectively.
- Section 4 covers tariff structures in general.
- Section 5 covers various other issues.

2. ENERGY COST COMPONENT OF RETAIL TARIFFS

2.1. ESTIMATING ENERGY COSTS

The Authority has asked how energy costs should be reflected in regulated tariffs. We believe that energy costs should be estimated based on actual costs of supplying energy, and quoted market prices for contracts are a good proxy for that. Long Run Margin Cost (LRMC) is a theoretical concept and is not a reflection of what retailers actually pay. There is no basis for a LRMC "floor", and if there were to be a "floor" it would reasonably be counter-balanced with a "cap". In regard to an LRMC "floor", we concur with the comment in the Issues Paper:

> *The Authority also questioned why this security would be needed with regulated prices but not if the market was entirely deregulated, in which case only market costs would be available.*[2]

We ask the same question and have no reasonable answer other than that a LRMC "floor" is not required. We agree with the view of the Independent Competition and Regulatory Commission (ICRC) that regulated retail prices should not be used to attempt to correct concerns about the long-term investment in electricity generation.[3]

We also point out that a LRMC approach is opaque as it requires the Authority to rely on an external consultant who will calculate LRMC based on their proprietary model. That model will not be released to others, each consultant's proprietary model will produce a different result, and no-one other than the consultant can reproduce the results. The workings of the model and the results cannot be checked or audited. In contrast, using publicly available market prices is transparent and easily reproducible.

Instead of using a proprietary model to forecast spot prices, the Authority could rely on historical spot price outcomes against which to model forward contract prices, following the lead of the ICRC.[4] This should produce results that are more transparent, and more easily checked and auditable. It would remove the Authority's reliance on an external consultant with their own proprietary model, and enable the Authority to undertake the modelling in-house or to put the modelling out to competitive tender to a wider range of consultants, given the removal of the requirement for a proprietary model.

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2 Issues Paper, page 10

3 See *Final Technical Paper: Model for determining the energy purchase cost of the transitional franchise tariffs*, Report 3 of 2010, ICRC, March 2010, section 3.2, available at http://www.icrc.act.gov.au/__data/assets/pdf_file/0009/184878/Report3_2010_Technical_Paper_Final_ICRC_Web.pdf

4 See *Final Decision: Retail prices for non-contestable electricity customers 2010-2012*, Report 7 of 2010, ICRC, June 2010, section 7.3.1, available at http://www.icrc.act.gov.au/__data/assets/pdf_file/0018/194310/Report_7_of_2010_11_June_2010.pdf

2.2. ACCOUNTING FOR ENERGY LOSSES

As stated in the Issues Paper:

> *AEMO calculates system loss factors for each NEM region and these are publicly available on its website. Distribution losses are approved and published by the AER.*[5]

These are the loss factors that impact on retailers' costs, and these are the ones that should be applied in the estimation of energy costs. The Authority should not use average loss factors published by Powerlink, as these do not bear upon the energy costs faced by the retailer.

2.3. COSTS OF MEETING OBLIGATIONS UNDER ENVIRONMENTAL SCHEMES

These should be estimated using market prices, as these best reflect the costs actually incurred by retailers.

2.4. CARBON PRICING

Carbon pricing should not impinge directly on retailers. Rather it will impinge on generators, and will be reflected in energy purchase costs in future contract prices and forecast spot prices and will therefore be accounted for in the energy purchase cost methodology discussed above, as envisaged in the Issues Paper. To a large extent, these prices already reflect future expected carbon pricing. It is possible that there will be extra administrative requirements on retailers, which will impinge on retail costs, but they cannot currently be foreseen.

2.5. NEM PARTICIPATION FEES AND ANCILLARY SERVICES CHARGES

We have no issue with these being estimated in future as per the existing Benchmark Retail Cost Index (BRCI) framework.

5 Issues Paper, page 16

2.6. SUMMARY OF COMMENTS ON THE ENERGY COST COMPONENT

Energy costs should be estimated based on actual costs of supplying energy, and quoted market prices for contracts are a good proxy for that. LRMC should not be used.

Methodologies that rely on proprietary models that cannot be checked or audited should be avoided.

Loss factors should be those that are used in wholesale settlement, and not the average loss factors that are derived by Powerlink.

Other costs should be based on actual costs derived from market prices. Carbon pricing should only add to retailers' costs where proven to have a material impact that is not accounted for elsewhere.

3. RETAIL COSTS

3.1. THE NATURE OF THE RETAILER WHOSE RETAIL COSTS ARE CONSIDERED

The Issues Paper raises the important question of the nature of the retailer whose retail costs will be considered in regulated retail electricity tariffs in Queensland.

Given that they are regulated retail electricity tariffs, we believe that the appropriate retailers to consider are the actual retailers that are supplying electricity under those tariffs in the Energex area. Predominantly these are AGL and Origin Energy – both sophisticated retailers with large economies of scale through serving large numbers of customers in Queensland, and literally millions of customers across the National Electricity Market (NEM). The allowances that are made for retail costs in the regulated retail electricity tariffs should recognise these economies and expected efficiencies.

Some allowance may be made for the fact that in Queensland, any retailer operating in the State serving eligible customers on market offers may be asked to serve those customers on regulated tariffs. These would be existing retailers operating in Queensland, and not new entrants, and therefore their market entry costs are already sunk (though they could be relatively new to Queensland).

> Regulated retail electricity tariffs should be based on the costs of retailers that are actually required to offer regulated retail electricity tariffs. These are retailers that are already operating in Queensland and already offering market contracts. In analysing retail costs as a component of regulated retail electricity tariffs, the Authority should recognise that most of the customers on regulated retail electricity tariffs in Queensland are served by AGL and Origin Energy – both sophisticated retailers with large economies of scale through serving large numbers of customers in Queensland, and literally millions of customers across the NEM. The allowances that are made for retail costs in the regulated retail electricity tariffs should recognise these economies and expected efficiencies.

3.2. TREATMENT OF CUSTOMER ACQUISITION AND RETENTION COSTS (CARC)

3.2.1. First consideration of CARC by the Authority in the BRCI calculations

When the BRCI was first calculated in 2007, CRA noted that with regard to whether any customer acquisition and retention costs should be included in the calculation of the Queensland BRCI for 2007-08, there were three major options:[6]

6 Calculation of the Benchmark Retail Cost Index for 2006-07 and 2007-08, Final Report, 7 May 2007, section 4.1.9, available at http://www.qca.org.au/files/CRA_BRCI.pdf

1. Allow the retailer the acquisition and retention costs of maintaining scale.

2. Do not allow acquisition and retention costs, but make an allowance for loss of scale that results from net customer losses if no acquisition or retention is undertaken.

3. Make no allowance for acquisition or retention costs or for loss of scale.

CRA's advice to the Authority at the time included the following:

- *Option 1: Acquisition and retention costs to retain scale:* These are real costs incurred by retailers. The costs relate to standard tariff customers on the basis that they enable retailers to maintain scale and therefore serve all customers more cost effectively. Allowing costs to the incumbent increases headroom and therefore increases competitive activity. New entrants effectively get allowed these costs too when they win customers because they are marketing against the standard tariff. However, these costs do not relate to supplying standard contract customers. It is anti-competitive to allow these costs only to the incumbent. It is difficult to assess the actual costs that might be incurred to retain scale as against growing the business – but estimates are possible.

- *Option 2: Allow for loss of scale:* If a retailer loses scale through not engaging in marketing activities, then it is right to adjust retail costs per customer for that loss of scale. The BRCI uses scale as part of the definition of the standard retailer. However, loss of scale is not a direct concern of the regulator. In the cost build-up approaches used in other jurisdictions, the higher fixed costs of loss of scale could potentially be taken into account when and to the degree they occurred.

- *Option 3: No allowance for acquisition or retention costs, or loss of scale:* A retailer with significant market share at the beginning of FRC will be likely still to have a significant market share at the end of one year, even without an allowance being made in the standard prices. However, if a prudent retailer with significant market share could be expected to incur additional costs through loss of market share, these additional costs should be allowed.

In an Addendum report that year, CRA also noted that a submission from Griffith Law School adamantly opposed the inclusion of customer acquisition costs (as in option 1), stating that including such costs "is completely unnecessary, favours the incumbent retailer and, we believe, is anti-competitive".[7]

7 Calculation of the Benchmark Retail Cost Index for 2006-07 and 2007-08, Addendum, 1 June 2007, section 4.2, available at http://www.qca.org.au/files/E-Calculation%20of%20the%20BRCI%20-%20Addendum%20-%201%20June%202007.PDF

The approach of the Authority that year was to follow option 2 – allowing for loss of scale. In later years, this was changed to option 1 – allow acquisition and retention costs to retain scale. In each case, the choice was made based on what fitted with the Authority's terms of reference for the calculation of the BRCI, which will no longer be relevant from 1 July 2012.

Notwithstanding the demise of the BRCI, we believe that many of the observations in CRA's original advice remain relevant, and we draw attention in particular to CRA's original comment, quoted above that acquisition and retention costs do not relate to supplying standard contract customers.

3.2.2. Treatment of CARC in other Australian jurisdictions

Customer acquisition costs and retention costs were originally included in retail price determinations in NSW in 2007 when IPART was required to consider a mass market new entrant, and this approach was then copied in other Australian jurisdictions.

Not all jurisdictions accepted this approach.

Victoria

There was never any allowance for customer acquisition costs or retention costs in any of the regulated retail tariffs that were set in Victoria, and competition still thrived. Victoria was still then considered to be the most competitive electricity market with the highest rates of customer churn and transfer anywhere in the world. This shows that an allowance for customer acquisition costs or retention costs is not required in order to create "headroom" for competition to develop.

ACT

In the ACT, ICRC has consistently refused to include an allowance for CARC in its regulated retail prices, and has only allowed instead for "sales and marketing, being primarily the costs of communicating the TFT [Transitional Franchise Tariff] arrangements" as efficient costs.[8]

In its most recent determination, ICRC countered arguments that an allowance for CARC needed to be included in regulated tariffs to encourage competitive behaviour, by stating the following:[9]

8 *Final determination: Investigation into retail prices for non-contestable electricity customers in the ACT*, ICRC, May 2003, section 4.7, available at http://www.icrc.act.gov.au/__data/assets/pdf_file/0009/16677/finaldeterminationretailpricesmay2003cw.pdf – and quoted in later ICRC determinations ever since

9 *Final Decision: Retail prices for non-contestable electricity customers 2010–12*, Report 7 of 2010, ICRC, June 2010, page 54, available at http://www.icrc.act.gov.au/__data/assets/pdf_file/0018/194310/Report_7_of_2010_11_June_2010.pdf

> *… the Commission considers that a 'regulated' franchise tariff, where franchise customers are able to benefit from ActewAGL Retail's economies of scale and where customer acquisition costs are not included in the franchise tariff, is likely to provide greater benefits to customers than a notional 'competitive' tariff that is determined by the Commission.*

We concur with this view of ICRC. CARC has no place in regulatory tariff determinations that have appropriate terms of reference.

3.2.3. Conclusion regarding treatment of CARC

The regulated retail electricity tariffs apply to customers that have not chosen a competitive market offer, and to customers that specifically request to be put on a regulated tariff. There are no customer acquisition costs or retention costs involved in offering regulated retail electricity tariffs, and no allowance should be made for such costs in the regulated tariffs. While some jurisdictions have included these costs in their calculations on setting regulated retail tariffs, this was because their Terms of Reference required them to do so.

No allowance should be made for customer acquisition and retention costs in retail electricity tariffs in Queensland.

3.3. RETAIL MARGIN

We believe that the existing gross retail margin of 5% of total costs that was allowed in the BRCI calculations is realistic, and should not be any higher in the new tariffs. Arguably, it could be lower, because the retailers will be compensated based on efficient costs, rather than the BRCI mechanism that might have borne no relationship to their actual efficient costs and was not cost-reflective. Under the BRCI, retailers therefore faced higher risks than should be the case under the new framework for setting regulated retail prices.

3.4. DEALING WITH UNCERTAINTY

The Authority asks various questions in regard to accounting for unforeseen events:

> *The Authority seeks stakeholders' views on the following:*
>
> - *Is a mechanism required to account for the impact of unforeseen events on the R component of retail tariffs?*
> - *If so, should the mechanism apply to both the retail operating cost and energy cost components or just the more volatile energy cost component?*
> - *What specific events should be included or excluded?*

- *Should a materiality threshold apply? If so, how should it be determined?*
- *What other issues should the Authority be aware of?*[10]

It is our view that it is generally not appropriate to revise tariffs mid-year based on unforeseen events. It deflects responsibility from retailers to mitigate the effects of such events, even though they are the parties that are generally best placed to do just that. It is inequitable to pass such risks onto consumers who have no means of mitigating them.

Retailers lack incentives to control costs if they can just pass through costs that they incur in a given category. For example, the Authority suggests that "unforeseen AEMO changes (such as a reserve trader or direction event)" may be types of events that would be subject to cost pass-through events occurring.[11] That type of event generally occurs because retailers have not contracted adequately for wholesale purchases, so allowing such an event to have cost pass-through is counter-productive.

We concur with the view of the Authority that "Cost pass-through mechanisms tend to be included where a price path is longer than one year as forecasting becomes more difficult the longer the price path", whereas "The Direction that the Authority received does not include a multi-year pricing approach".[12]

We note as does the Authority:

> *… there remains the possibility that, even in a single-year pricing period, there may be major changes which may need to be accommodated by amending retail prices. For example, on 1 January 2010, substantial changes were made by the Commonwealth Government to its RET scheme. As a consequence of those changes, retailers incurred higher energy costs from 1 January 2010. However, in Queensland under the BRCI legislation, regulated prices were not able to be amended during the 2010-11 pricing period to reflect this increased cost, nor were the higher costs incurred in the last six months of 2010-11 able to be recognised in setting 2011-12 regulated prices.*
>
> *Retailers supplying non-market customers simply had to absorb these higher costs for those customers for the six months in question.*[13]

10 Issues Paper, page 35

11 Issues Paper, page 35

12 Issues Paper, page 34

13 Issues Paper, page 34

The Queensland retailers faced this risk based on the existing gross retail margin of 5% of total costs that was allowed in the BRCI calculations. Therefore, if this risk is now removed, that margin should correspondingly be reduced to allow for the lower risks that the retailers would now face.

4. TARIFF STRUCTURES IN GENERAL

In this report section, we comment on the structure of regulated retail electricity tariffs and prices in general as they may be applied in Queensland. In doing so, we comment on Energex's proposed network tariff structure for 2012-13, and how that might impact on the regulated retail electricity tariffs and prices. We agree with the Authority that "it is essential that the network tariffs provide a clear and easily understood basis for dividing customers into reasonably homogenous groups to whom the associated network costs, and subsequently energy and retail costs, can be sensibly allocated."[14]

This section is not solely concerned with Energex's proposed network tariff structure.

4.1. FIXED VERSUS VARIABLE CHARGES

As mentioned in section 1 above, QCOSS represents the interests of residential consumers, with a particular focus on low income and other vulnerable consumers, many of whom are relatively small users of electricity, because they do not have the high-usage electrical equipment that more affluent households may have, such as swimming pool pumps and large air conditioning systems. That is not to say that all low income households are low users of electricity. Indeed there are also low income householders who support large families, and there are those who are high users of electricity because of medical requirements. Housebound persons may also be using more electricity because they require cooling throughout the day, while others may be able to switch off cooling when they are out during the day and rely instead on the cooling systems provided by others, such as their employers.[15]

Given different tariffs that in total are revenue neutral, i.e. they bring in the same revenue when applied across the customer base, tariffs which have higher fixed charges and lower variable charges have an adverse impact on lower usage consumers as compared with tariffs which have lower fixed charges and higher variable charges. Conversely, higher usage customers would prefer tariffs with lower variable charges and higher fixed charges.

In recognition of this, in many jurisdictions electricity retailers offer tariffs with lower fixed charges or no fixed charges, for the benefit of lower usage customers.

14 Issues Paper, page 7

15 Customers with low income but high usage of electricity may be particularly in need of concessions in the form of a package of support outside any tariff mechanism.

For example, in New Zealand, the *Electricity (Low Fixed Charge Tariff option for Domestic Consumers) Regulations 2004* require electricity retailers to make available low fixed charge tariff options for residential consumers.[16] In Britain, many electricity retailers offer tariffs with no fixed charge.[17]

The fixed charge component of a retail electricity tariff is intended to cover the fixed costs of supply that do not vary with consumption, such as the fixed cost component of the network charges to the retailer and the fixed costs of the retailer's billing and payment processing. However, many customers do not understand the purpose of fixed charges and think they are paying something for nothing. Some retailers in other jurisdictions offer tariffs without fixed charges in order to take this into account and to give themselves a positive marketing advantage in a competitive market against retailers that do include a fixed charge component in their tariffs.

We note with some concern that the Authority was considering "the question of whether energy costs are in fact fixed or variable and hence how they should be reflected in the fixed and variable components of retail tariffs".[18] The Issues Paper then reports correctly that:

> *In its review of retail electricity tariffs for 2010-13, IPART considered energy costs to be 100% variable.*

This is the correct approach. There is a further paragraph in the Issues Paper that states that:

> *energy costs … may be largely fixed (for a period of time at least) if hedging contracts are used extensively. This is because a price is locked in for a certain quantity of electricity for a specified period of time.*

This is not fully accurate. Hedging contracts lock in variable costs – at fixed monetary amounts per unit of energy ($/MWh). But these are not "fixed costs". A retailer does not enter into fixed "take or pay" contracts for purchasing electricity to meet each customer's needs. There are balancing transactions that take place in the spot market when the retailer's sales do not exactly match its hedging position. The marginal effect of a customer consuming one less unit is that the retailer has one more unit to trade in the spot market. This clearly demonstrates that energy purchase costs are wholly variable.

16 See http://www.legislation.govt.nz/regulation/public/2004/0272/latest/DLM283614.html

17 See for example http://customerservices.npower.com/app/answers/detail/a_id/95/~/how-do-you-apply-your-prices where the energy retailer 'npower' explains that there is no fixed charge element on most of its "credit tariffs". (These are the tariffs other than pre-payment tariffs.)

18 Issues Paper, page 31

The only components that should be in the fixed charge of regulated retail electricity tariffs in Queensland are the fixed component of network charges, and some element of retail costs.

Tariffs with no or low fixed charges and higher unit charges also provide an additional incentive for consumers to reduce the energy that they consume. We suggest that Energex should also take that into account in setting its underlying network tariffs for 2012-13, which will form the basis for future regulated retail electricity tariffs.

> We suggest that the Authority should consider setting regulated retail electricity tariffs with the lowest level of fixed charge that is compatible with its Ministerial Direction. In doing this, the Authority should take into account the effects on low users of electricity of high fixed charges, and the demand response and conservation advantages of tariffs with low or no fixed charges.

4.2. BLOCK SIZES AND RELATIVE PRICING AS BETWEEN BLOCKS

The regulated retail electricity tariffs are to be based on an inclining block network tariff. The factors in ensuring the effectiveness of the tariff in providing an equitable outcome for low usage customers and providing appropriate incentives for demand response include the appropriateness of the block sizes in the tariff and the differences in pricing between blocks.

We note that Energex's proposed network tariff structure for 2012-13 has the following structure for the domestic inclining block tariff consumption charge:

- Block 1: 0-5000 kWh per annum
- Block 2: 5001-10,000 kWh per annum
- Block 3: 10,001+ kWh per annum

The Queensland Government has stated in various recent documents that the average annual residential electricity use in Queensland is 7882 kWh per annum.[19]

This means that even the average consumer will consume some units of electricity in Block 2, and many low usage consumers will also consume units in Block 2. Only the larger than average consumers will consume electricity in Block 3.

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19 See for example *Submission to the Queensland Competition Authority – Response to the Draft Decision on the Benchmark Retail Cost Index for Electricity: 2011-12*, prepared by the Department of Employment, Economic Development and Innovation. February 2011, available at http://www.qca.org.au/files/E-NEP1112-QGOVBRCISub-0211.pdf where it is written: "The consumption figure of 7,882 kWh has been independently verified as representative of Queensland annual residential consumption and was used for the Government's Q2 statement."

These breakpoints between blocks (at 5000 kWh and 10,000 kWh per annum) are not unreasonable. In order to provide more meaningful comment on the levels of the breakpoints, we would like to see a distribution of the usage levels of residential customers in Queensland, so we can see what proportion of customers and of usage would be captured in each block, based on current usage patterns.

Our initial view, in the absence of that distribution information, is that we endorse the second breakpoint (10,000 kWh per annum) being at above average usage. We suggest that the first breakpoint should be a little higher; a little lower than but closer to the average annual usage level of 7882 kWh per annum. This will enable lower usage consumers to maintain all their usage in Block 1, and may provide an incentive to the average customer to reduce their usage to be wholly within the Block 1.

We also expect the differences between the prices in each of the blocks to be meaningful. Otherwise the point of having inclining block tariffs will be lost.

We note that if the variable Retail (R) component of the retail tariff is set at a uniform value (c/kWh), the differentials in the network tariff will be diluted. We propose that the retail tariff R component should also be set on an inclining block basis, so that the differential prices in the network tariff blocks are maintained in the retail tariff.

We endorse maintaining the breakpoint between Block 2 and Block 3 at above average usage. We suggest that the first breakpoint should be a little higher; a little lower than but closer to the average annual usage level. We would like to see a distribution of the usage levels of residential customers in Queensland before commenting further on the breakpoints between blocks. We propose that the retail tariff R component should also be set on an inclining block basis, so that the differential prices in the network tariff blocks are maintained in the retail tariff.

4.3. PRO RATA APPLICATION OF BLOCK SIZES

We note that Energex's proposed network tariff structure for 2012-13 states that it anticipates that its block sizes will be billed on a pro-rata basis. Allocating block sizes on a pro-rata basis raises several issues, two of which are considered here:

- Varying lengths of billing periods;
- The effects of bill estimation; and
- Seasonal differences.

The underlying point behind each of these is that if blocks are not applied pro-rata in an appropriate manner, customers' usage can move unnecessarily between blocks, and this may have detrimental effects on customers through no fault of their own.

4.3.1. Varying lengths of billing periods

Suppose that the breakpoint between Block 1 and Block 2 is 5000 kWh as proposed by Energex. Suppose that a customer uses 13.5 kWh every day (ignoring seasonal effects which are discussed below). The user consumes 13.5 * 365 = 4927.5 kWh per annum. In a leap year they consume 4941 kWh. In each case, all their usage should be in Block 1.

However, consider the case where the customer is billed quarterly, and the pro rata application of the block size is then allocated on a quarterly basis, i.e. 1250 kWh per quarter. There is no problem if each billing period is exactly 91.25 days. But of course it isn't. Suppose in a year the customer has one billing periods of 96 days, one of 95 days, and two of 87 days. This is not an unreasonable scenario. The user's consumption in each quarter is now 1296, 1282.5, 1174.5 and 1174.5 kWh in each billing period respectively. The annual usage is still under 5000 kWh, so should be wholly within Block 1, but the quarterly usage exceeds 1250 kWh in two quarters, pushing, in this case, 78.5 kWh into Block 2.

This can easily be avoided if the blocks are allocated on a daily rather than quarterly pro rata basis.

4.3.2. The effects of bill estimation

If bills are estimated through a missed meter reading through no fault of the customer, the customer should not be penalised as a result.

Normally an estimated bill is corrected at the next meter read. Estimation errors only have cashflow effects; the total that the customer pays is not affected unless prices have changed in the meantime (usually annually). However, inclining block tariffs can penalise a customer for an estimated bill, even without a price change in the period.

Consider a hypothetical customer using 1250 kWh per quarter. Assume even billing periods, and Block 1 applies up to 5000 kWh per annum, or 1250 kWh per quarter. Suppose one meter read is missed and the customer is estimated to have used only 1200 kWh that quarter instead of the 1250 kWh actually consumed. All consumption is billed in Block 1. At the next meter read, the user is found to have consumed 2500 kWh since the last meter read, so the remaining 1300 kWh are now billed, 50 kWh of which are now billed in Block 2. Alternatively, the user may have been over-estimated to have consumed 1300 kWh in the first quarter and then assumed to consume only 1200 kWh in the second quarter. Either way the customer is charged for units in Block 2 that were never actually consumed in Block 2.

This can easily be avoided if previous estimated bills are revisited when an actual meter read is obtained, back to the last actual meter read, by allocating a single block for the whole period between actual meter reads, and removing the estimated read from the equation.

The way this would work can be considered with reference to the hypothetical customer discussed in the paragraph above. This customer has an actual meter read, and then misses the next quarterly meter read. The next read is successful, and it is then recorded that the customer used 2500 kWh since the last meter read. What should then happen is that the whole six month period between actual meter reads is considered one period for block pro rata purposes, and thus in this case all consumption in that period is appropriately assigned to Block 1. That way, more accurate billing takes into account all available information, so that customers are not over-charged for units in a higher block due to a missing meter read and estimated bill.

Acceptance of customer own reads should also be considered as a mechanism to avoid customers getting estimated bills. The Queensland Electricity Industry Code, at section 4.10.1, allows a customer self read to be used as the basis of a bill, although this method has to be agreed between the small customer and the retail entity. Customers should be provided with the information that this may be an option for them.

4.3.3. Seasonal differences

In reality, consumers do not use the same amount of electricity each quarter. There are known seasonal variations. In Queensland where more electricity is used for cooling than for heating, summer usage is likely to exceed winter usage. Thus a customer that uses for example 5000 kWh in total per annum is unlikely to use exactly 1250 kWh per quarter. The pro rata application of the blocks throughout the year could take these variations into account.

We make this suggestion knowing that the Ministerial Direction states that seasonal tariffs are not to be considered. This suggestion is not for seasonal tariffs. Rather, it relates to how a non-seasonal all-year tariff is applied in practice.

We are aware of two jurisdictions that apply this in practice – in Ontario, Canada where more electricity is used (for heating) in winter than in summer,[20] and the UK where more gas is used (again for heating) in winter than in summer.[21]

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20 See http://www.ontarioenergyboard.ca/OEB/Consumers/Electricity/Electricity+Prices which states: "The threshold that defines higher and lower electricity prices for residential Regulated Price Plan consumers is set at 600 kilowatt hours per month during the summer (May 1st to October 31st) and 1,000 kilowatt hours per month during the winter (November 1st to April 30th). This difference recognizes that consumers use more electricity for lighting and indoor activity in the winter and that some Ontarians are reliant on electricity for their heating source."

21 See for example http://customerservices.npower.com/app/answers/detail/a_id/95/~/how-do-you-apply-your-prices where the energy retailer 'npower' explains that its block 1 gas units totalling a maximum of 4572 kWh per annum are charged very unevenly throughout the year, applying to only the first 46 kWh per month in summer months, and to the first 882 kWh per month in winter months.

This seasonal pro rata application of blocks could also apply to estimated bills. This is common practice in the UK where electricity and gas meter readings are typically estimated based on:

- The amount of energy the customer has used in the past, based on previous meter readings;
- The average amount of energy used by other customers with similar usage patterns; and
- Whether it's a time of year when you are likely to use more or less energy.[22]

As discussed in section 1 above, we would have liked to have been able to model the effects that the new proposed regulated tariffs and prices will have on QCOSS' constituency, and to have taken into account the results of that modelling in this report. We have been unable to do so, and our comments in regard to the pro rata application of the blocks throughout the year, as elsewhere in this report, are subject to being able to undertake such modelling.

4.3.4. Summary of issues with pro rata application of block sizes

Pro rata blocks should be applied on a daily basis.

Previous estimated bills are revisited when an actual meter read is obtained, back to the last actual meter read, by allocating a single block for the whole period between actual meter reads, and removing the estimated read from the equation. That way, more accurate billing takes into account all available information, so that customers are not over-charged for units in a higher block due to a missing meter read and estimated bill,

Pro rata allocation of blocks could take into account seasonal variations in electricity usage.

4.4. TIMES OF APPLICATION OF PEAK AND SHOULDER PERIODS IN THE VOLUNTARY TIME OF USE (TOU) TARIFF

We note that Energex's proposed network tariff structure for 2012-13 has the following structure for the voluntary residential TOU tariff:

- Monday to Friday

22 See for example http://www.atlantic.co.uk/uploadedFiles/CoreMarketingSites/Assets/Documents/CustomerCharterAtlanticFeb2011.pdf

  - Off peak 10pm-7am
  - Shoulder 7am-4pm; 8pm-10pm
  - Peak 4pm-8pm
- Saturday/Sunday
  - Off peak 10pm-7am
  - Shoulder 7am-10pm
  - No Peak

We endorse this as a reasonable structure, including the following components which we view favourably:

- 4pm to 8pm Monday to Friday are reasonable times for a peak period. It is likely to correspond to peak times for energy usage. It is also a reasonably short period of time, which allows consumers to take action to shift usage away from that period. In particular, we are pleased that the tariff structure does not reflect the time periods that are being applied in some residential TOU tariffs in Victoria, where peak is defined in some instances as 7am to 11pm Monday to Friday: that does not give consumers any reasonable opportunity to shift anything other than controlled loads away from peak periods on weekdays. A three-part tariff (peak, shoulder and off-peak) provides much more flexibility in this regard than a two-part tariff (peak and off-peak only), and we endorse a three-part tariff on that basis.

- The shoulder period is sufficiently long and at appropriate times to allow some load to be shifted to it away from peak periods.

- The off-peak period allows for controlled load to be scheduled at lowest cost.

We also view favourably that there is no peak period on Saturdays and Sundays, on the basis that there is unlikely to be such large amounts of energy usage on those days. One change we would propose is to extend the Saturday and Sunday tariff structure to public holidays. This is on the basis that:

- Public holiday energy use is more likely to reflect weekend use than working day weekday use; and

- Consumers are likely to expect weekend prices to extend to public holidays, particularly when the public holiday creates a “long weekend”. They are likely to be confused if weekday prices apply on public holidays, and inadvertently pay more as a result.

The objective and scope of this report do not extend to commenting in detail on any aspect of business tariffs. However, we do wonder why Energex is proposing a business TOU tariff structure that is different from the proposed residential tariff structure. We wonder why the business TOU peak period is proposed to extend from 12 noon to 9pm (and thus is longer than the residential peak period), and why the off-peak period is proposed to start an hour earlier – at 9pm – as compared to 10pm in the case of the residential consumer. We also wonder why the proposed business TOU tariff appears to be the same all seven days of the week, including having peak times on weekend days (and public holidays).

Our concern is that consumers with responsibility for both residential and business premises may be unnecessarily confused by having different rates in each premise (though we know that historically rates have differed in their time application). We are also concerned that having different TOU tariff periods may dilute the demand management benefits that a TOU tariff should give. We would welcome some explanation as to the basis on which the proposed business TOU structure has been derived, and why it differs from the proposed residential TOU structure. We are also concerned to ensure that business tariffs fully recover the costs of supply of electricity to business customers, so that there is no cross-subsidy by residential customers.

TOU tariffs should have peak periods that are relatively short, and give reasonably opportunity to shift load from peak periods.

Peak periods should not apply at weekends and on public holidays.

4.5. FUTURE PROCESSES FOR APPROVAL OF NETWORK TARIFFS

We are concerned that the Authority may have no role in the approval of the Energex network tariffs for 2012-13, yet will still be required to approve retail tariffs based on the network tariff structures that are approved in a separate process with the AER.

We believe the Authority should consider what processes should be put in place to enable parallel development of compatible network and retail tariff structures, in conjunction with Energex, the AER, and the Queensland Government.

5. OTHER ISSUES

5.1. COST REFLECTIVITY

We note the emphasis in the Minister's Direction Notice that all tariffs (except as specified) are to be cost-reflective. We also note the Authority's comment that the annual calculation of the BRCI by the Authority through which regulated retail electricity tariffs are currently set does not involve an assessment of the efficient cost of supplying electricity.[23]

> We welcome the change to ensure that future tariff setting will be based on an assessment of the efficient cost of supplying electricity, and that only efficient costs should be included in future assessments by the Authority.

5.2. UNIFORM TARIFF POLICY

As stated in the Issues Paper:

> *A feature of the Queensland retail electricity market is the application of the Uniform Tariff Policy (UTP). In order to ensure uniformly priced electricity to all customers throughout the State, the Queensland Government currently ensures pricing parity between rural and regional customers and those in South East Queensland through a regional subsidy.*
>
> *The UTP allows customers of the same class to access uniform retail tariffs and pay the same notified price for their electricity supply, regardless of their geographical location. The UTP works by subsidising customers in Ergon Energy's distribution area where notified prices are considerably lower than the actual costs of supplying electricity. The actual costs of supply are high because electricity must be transported over long distances and there are fewer people to share these costs.*
>
> *In order to support its UTP, the Queensland Government currently provides a regional subsidy by way of a CSO payment to fund the difference between the actual costs charged by the distributor and the amount that is recovered by Ergon Energy Queensland from notified prices.*[24]

23 Issues Paper, page 4

24 Issues Paper, page 4

We confirm that this matches our understanding of the UTP and how it operates. We understand that the costs of supply are high in Ergon Energy's distribution area, because network costs are higher, regional generation costs are higher, and line losses are higher in remote and rural areas. Because of this, as stated in the Issues Paper, in much of the State, there is no alternative for consumers other than to access electricity supply at the notified (regulated) price. Notified prices therefore continue to remain an important feature of the Queensland retail electricity market, and will continue to do so in the future.

We also note the following relevant commentary in the Issues Paper:

> *… in Ergon Energy's distribution area retailers will be charged the (generally higher) cost reflective Ergon Energy distribution price. Where Ergon Energy Queensland is the retailer, it will be able to take advantage of the Queensland Government's CSO contribution in the usual way to meet any shortfall between this charge and its actual costs so that non-market customers across the State are able to access electricity supply at a price consistent with the Government's uniform tariff policy. However, other retailers with non-market customers (or competing for market customers) would have to absorb this shortfall.*
>
> *An alternative approach might be to apply the Government's CSO at the distribution level and allow all retailers to compete for customers in the Ergon Energy distribution area based on the competitiveness of their retail charges.*[25]

While agreeing with the Authority that there should be benefits to customers in the Ergon Energy area to have access to full retail competition, we note that giving customers access to retail competition does not guarantee that the competition will be effective, particularly in regional and rural areas.[26]

We believe the Queensland Government should affirm its ongoing commitment to the Community Service Obligation (CSO) to protect customers in the Ergon Energy area from the very high electricity prices that could result if the CSO was lifted. We commend to the Government the alternative approach suggested by the Authority – to apply the Government's CSO at the distribution level – as this would allow for full retail competition across the State.

25 Issues Paper, pages 8-9

26 See for instance a recent report by the Public Interest Advocacy Centre (PIAC) *Choice? What Choice? – a study of consumer awareness and market behaviour in the electricity market in five regions of New South Wales: Cooma, Lismore, Bourke, Wagga Wagga and Orange*, 15 June 2011, available at http://www.piac.asn.au/publication/2011/06/choice-what-choice

5.3. ITEMISATION OF NETWORK CHARGES ON CUSTOMERS' BILLS

The Authority reports:

> *In Stage 1 of the 2009 Review, there was significant opposition from retailers to the suggestion that the network cost component of a customer's total bill should be separately identified.*
>
> *Retailers generally claimed that, to provide this additional piece of information to customers, would require substantial and costly billing system changes. The retailers therefore proposed that only a single bundled price be shown on customer bills.*
>
> *While not disputing these claims, the Authority noted that customers could be informed to some extent of the cost of the network component of their bill through the publication of the separate N and R components in the tariff schedule.*
>
> *Nevertheless, it remains an open question whether and how customers should be informed of the contribution of both network and retail components to their total bill.*[27]

We do not see any purpose to separately identifying the network component on a customer's bill. It is the total tariff that the customer has to pay. It is the total tariff that motivates the customer to modify their behaviour or usage pattern. Customers cannot opt out of one component. Separately itemising different components may serve to confuse, and will only add to costs, for no benefit.

Some customers may be curious to know how their bill is made up of various components.

We generally support customer education initiatives, and allowing customers to gain a better understanding of all aspects of how their electricity is generated, transmitted and distributed, and the roles of the various parties in the supply chain. But we do not support those initiatives if they will add significant costs to the industry that will ultimately be borne by customers for no real benefit.

5.4. MAINTAINING ALIGNMENT OF RETAIL AND NETWORK TARIFFS

We support customers being given at least one month's notice of retail tariff changes before they come into effect. One way to resolve this may be to influence the Australian Energy Regulator (AER) to approve network tariffs earlier than currently, to allow sufficient time for retail tariffs then to be set taking the approved network tariffs into account.

27 Issues Paper, page 9

We support the view:

> *The Authority considers that an important aspect of introducing new tariffs is ensuring that customers are provided with sufficient information and time to make informed decisions about the impact of their electricity usage on their bills.*[28]

28 Issues Paper, page 33