

19 November 2015

Queensland Productivity Commission  
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Lodged (online): [www.qpc.qld.gov.au/inquiries/electricity-pricing/submission-form/](http://www.qpc.qld.gov.au/inquiries/electricity-pricing/submission-form/)

### **Electricity Pricing in Queensland – Issues Paper**

The Energy Supply Association of Australia (esaa) welcomes the opportunity to make a submission to the Queensland Productivity Commission's (QPC) Electricity Pricing in Queensland Issues Paper.

The esaa is the peak industry body for the stationary energy sector in Australia and represents the policy positions of the Chief Executives of 34 electricity and downstream natural gas businesses. These businesses own and operate some \$120 billion in assets, employ more than 59,000 people and contribute \$24.1 billion directly to the nation's Gross Domestic Product.

At the beginning of 2015 the Queensland energy sector was sitting on the cusp of major reform. Close to 12 months later, the scene has changed considerably – price deregulation in south east Queensland (SEQ) has been delayed and there is a range of outstanding challenges that are yet to be addressed. Given rapidly changing market dynamics, addressing these outstanding reforms is critical. Not only will it provide Queensland consumers with improved product choice, service quality and price discounts over the near term, it will also ensure the electricity supply sector is well placed to adjust to future challenges. The QPC has an important role to play in this regard. In particular, it has the opportunity to reaffirm the need for market deregulation in SEQ and set the path to a competitive, sustainable and consumer-focused electricity supply sector in Queensland.

The electricity supply system in Australia is undergoing a period of transformation. Advances in technology are fundamentally changing the way electricity is made, moved and consumed. Consumers have also experienced sharp rises in electricity prices in recent years as the system keeps pace with strict network reliability standards and a range of other cost pressures, including environmental policies.

This transformation is juxtaposed with delayed market reform across a number of jurisdictions, including Queensland. Rather than addressing the issues raised by this transformation and promoting greater competition and improved efficiencies within the sector, governments have opted for short-term interventions such as freezing the standard residential tariff (Tariff 11). Such an approach not only undermines earlier reform efforts, but also fails to provide customers with the flexibility to adjust to changing market dynamics over the long-term, which will ultimately be to their detriment.

The Electricity Pricing Inquiry provides a timely opportunity to investigate contemporary issues and emerging challenges and reiterate the need for strategic market reform that is in the long term interest of Queensland energy consumers. In this respect, the Association considers there are four complementary reform areas that must be addressed, namely: price deregulation; flexible pricing and advanced metering; improved customer protections for vulnerable customers; and minimising market distortions.

These priority reform areas are discussed below. For more detailed discussion of these and other issues raised in the Issues Paper, please see Attachment 1.

### **Driving competition in retail markets through price deregulation**

The need for a regulated price-setting approach in SEQ has diminished and may even have become detrimental to the further development of competition in the region. As noted in the Australian Energy Market Commission's (AEMC) 2014 Retail Competition Review, competition in SEQ is effective, but can be expected to improve once retail price regulation is removed. Deregulation of the SEQ market on 1 July 2016 is therefore an important and timely reform.

South Australia and New South Wales have provided the most recent example of how market deregulation enables competition to thrive, with businesses able to respond more flexibly to market forces. This environment facilitates improved product choice, service quality and price discounts for consumers over the long term. Of note, Adelaide recorded a 2.7 per cent<sup>i</sup> reduction in electricity prices in the 12 months following price deregulation in January 2013. This was well below the national average which increased by 6.1 per cent<sup>ii</sup>.

Consumer engagement and participation are important facets of a competitive market. Advising consumers about changes in the market and raising awareness about how to change energy plans in the lead up to market deregulation will be important. Implementing the Consumer Education Campaign Strategy previously developed by the Queensland Department of Energy and Water Supply, in partnership with energy retailers, industry bodies and consumer advocacy groups, could play an important role in facilitating this engagement.

Options to facilitate competition in regional Queensland must also be examined. The application of the state's Community Service Obligation (CSO) payment at the retail level effectively acts as a subsidy to Ergon Energy (retail) customers, precluding other retailers from competing. The Association considers a better approach is to apply the CSO payment at the distribution level. This will enable retail businesses to compete for customers on a level playing field based on the competitiveness of their charges and quality of service.

### **Empowering customers through flexible pricing and advanced metering**

The rapid uptake of rooftop solar photovoltaic (PV) panels and high penetration of energy intense domestic appliances – especially air-conditioners – has reinforced the need for more efficient and equitable tariff structures. Under the current flat rates offered, consumers do not face cost-reflective prices and this leads to unfair cross-subsidies.

Queensland is at the forefront of this issue, with a world-leading solar PV penetration rate of around 25 per cent<sup>iii</sup> and a standard residential tariff (Tariff 11) that has historically been heavily biased toward variable charges. Rebalancing of the fixed and variable components of Tariff 11 was recently completed, but this is not a long-term solution.

New tariff structures that reflect the true cost drivers of the system are required. This implies accounting not only for how much energy is consumed but also the time and rate at which it is consumed, consistent with the make-up of network costs.

Work is already under way on establishing fairer electricity pricing for all customers, consistent with the AEMC's recent Distribution Network Pricing Arrangements Rule Change. Implementing these tariff changes along with the deployment of advanced metering infrastructure is essential to improve the efficiency of the electricity supply system and ensure each user pays their fair share of system costs over the long term.

### **Providing appropriate and effective concessions for vulnerable customers**

While electricity costs play a small part in most household budgets, price rises and changes to tariff structure may have a greater impact on vulnerable households. This is not a reason to delay reform. Rather, it highlights the need to ensure appropriate protections for vulnerable customers are in place.

The state's electricity rebate in its current form fails to adequately achieve this, providing a flat \$320.97 payment to senior and pension concession card holders only, regardless of the need for assistance. Revisions to the framework are needed to provide eligible Health Care Card holders with access to the rebate. Existing arrangements for seniors that are not means tested should be phased-out and replaced with ongoing assistance restricted to seniors who meet a fair means test.

### **Minimising market distortions**

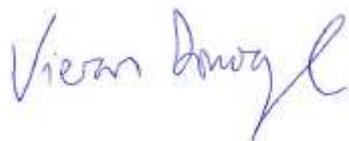
The electricity generation sector has been subject to a range of distorting policy interventions and political uncertainty, most of which have stemmed from the pursuit of government climate change and energy policy objectives. Although it may be premature to draw conclusions regarding the effectiveness of the current wholesale market design, which has in essence been robust to these distortions, the price signals arising from the current market framework appear unlikely to drive an efficient transition in the near term.

In light of this, the Association does not believe a state-based renewable energy scheme is in the interests of Queensland electricity customers. An aggressive target of 50 per cent would significantly undermine investment signals in the National Electricity Market (NEM), particularly where the subsidisation is not tied to the wholesale price in some way. It will also put upward pressure on electricity prices over the long term.

The propensity to recover renewables policy costs through electricity prices is also becoming increasingly more problematic. Now that solar PV is a viable alternative for most households, inflating the retail price to recover unrelated policy costs is distorting investment decisions. The grid is no longer a full monopoly and hence using power bills to fund policies creates winners and losers. The two most straight forward alternatives are using general revenue or a general levy on households and/or businesses. In addition to not adding any additional costs, serious consideration should also be given to removing the existing policy costs from retail prices.

Any questions about our submission should be addressed to Shaun Cole, by email to [shaun.cole@esaa.com.au](mailto:shaun.cole@esaa.com.au) or by telephone on (03) 9205 3106.

Yours sincerely

A handwritten signature in blue ink that reads "Kieran Donoghue". The signature is written in a cursive style with a long, sweeping tail on the letter 'e'.

**Kieran Donoghue**  
General Manager, Policy

## 1. Productivity in the electricity supply chain

Energy productivity in Australia has been increasing at around 1 per cent per annum since the late 1970s and 2 per cent per annum in the last decade.<sup>iv</sup> Total energy productivity has improved by 38 per cent since 1996, following the creation of the NEM and (partial) implementation of competition policy in Australia.<sup>v</sup> If the current rate of energy productivity (over the last decade) was to be sustained, Australia would come close to improving its energy productivity by around 50 per cent by 2030 on 2009 levels.

Despite this improvement, it is recognised the electricity supply system in Australia is undergoing a period of transformation. Declining electricity demand coupled with the rapid uptake of solar PV has created new challenges for the traditional electricity supply model. Queensland is at the forefront of this issue, with a solar PV penetration rate of around 25 per cent<sup>vi</sup>. Consumers have also experienced sharp rises in electricity prices in recent years as the system keeps pace with strict reliability standards and a range of other cost pressures, including environmental policies. Under current policy/regulatory setting, these factors have the potential to impede energy sector productivity over time.

In recent times, efforts to improve energy sector productivity have manifested themselves in energy efficiency initiatives. But it is important to note energy productivity is ultimately influenced by a range of different factors and activities, including price changes, the changing structure of the economy, policy measures and new technologies. Further, energy productivity can be measured in a range of differed ways. In addition to primary energy use per \$GDP, other key indicators may include energy infrastructure utilisation, take-up of cost-reflective tariffs, carbon intensity of the economy, the impacts of structural change and multi-factor productivity of energy industries.

In the Association's view, the development of a more dynamic, flexible and consumer focused electricity supply system in Queensland is critical to improving productivity across the electricity supply chain. Key to achieving this is ensuring market and regulatory frameworks allow for allocation of costs to participants in line with the requirements they place on the system and allocation of revenues to participants in line with the benefits they provide to the system. It is also important to be mindful of Queensland's position in the NEM and the national energy reform agenda. These issues are particularly relevant in the context of driving efficient investment in the electricity generation sector and improving the utilisation of electricity network infrastructure.

### **Avoiding market distortions in the electricity generation sector**

The electricity generation sector has been subject to a range of distorting policy interventions and political uncertainty arising from the pursuit of government climate change and energy policy objectives. Simultaneously, structural economic changes and technology developments in the industry have caused demand shocks and created further uncertainties.

The current wholesale market design has to date been robust to these distortions. The AEMC's assessment of competition in the NEM concluded there was no evidence of sustained market power.<sup>vii</sup> Analysis of wholesale spot and contract market outcomes showed results that are consistent with a wholesale electricity market that responds to the

supply/demand position broadly in the way that would be expected of a workably competitive market.<sup>viii</sup>

But it cannot be taken for granted that the market can continue to sustain persistent intervention. While Queensland wholesale electricity prices have been higher than in other NEM regions in recent years, driven in part by demand growth arising from the liquefied natural gas (LNG) facilities at Gladstone, wholesale electricity prices continue to be depressed across the NEM. Further, early signs of the strains that these changes are putting on the wholesale and contract markets and the physical system can be seen in South Australia.

In recent weeks, this region has seen: the abrupt bringing forward of the closure of the Port Augusta power plants and Leigh Creek mine (with around 450 job losses arising); a rapid escalation of future contract prices for 2016; extreme volatility in frequency services markets; and a significant blackout serving as an unfortunate reminder of the increasing dependence of SA on energy from Victoria.

A key element to this turmoil is the challenge of adjusting to a rapid rise in the proportion of intermittent renewables in the electricity generation mix (i.e. wind and solar). Even if these sources are destined to become dominant in Australia's electricity mix, it is not appropriate to ignore these challenges or assume them away. In order to avoid future unintentional negative outcomes on the structure and efficient operation of the wholesale electricity market – on which the great majority of homes and businesses are still dependent – the rationale for encouraging additional supply through a state-based renewable energy target must be carefully considered. Aside from the importance of avoiding the problems now emerging in SA, it is important to be mindful of a number of other critical issues.

- Queensland, along with the rest of the NEM, is chronically oversupplied with generation capacity. The Australian Energy Market Operator (AEMO) estimates the current level of surplus capacity in Queensland at 2,200-2,850MW<sup>x</sup> and forecasts surplus capacity of 1,100-3,650MW<sup>x</sup> at 2023-24. Attempting to add more generation to an already oversupplied market fundamentally undermines the business case for investment, whether renewable or otherwise. This makes it harder for new investment in renewables to earn an adequate return.
- The esaa recently completed a survey of major banks that revealed Australia's electricity generation sector has become almost unbankable. The "State of the Debt Markets for the Energy Supply Industry"<sup>xi</sup> study found banks are reluctant to support any new renewable energy projects in Australia unless they are underwritten by guaranteed price contracts, which in turn are unlikely under current conditions of chronic oversupply and weak wholesale prices.
- Unless there is enduring bipartisanship, the introduction of a state-based renewable energy target does not add to long term policy stability, particularly in the absence of fixed price contracts. An investor looking at a generation project cannot have much confidence that a new state-based target will be in place for that period, which undermines the ability of such a scheme to support investment.
- While the amount of renewable generation a state-based scheme will deliver is unclear, it is certain that it will increase retail prices for Queensland electricity users. Some users will be able to avoid paying for their share of scheme costs (along with other green

costs) by investing in distributed generation. While this is a legitimate customer decision, the introduction of a state-based scheme that arbitrarily makes distributed generation more attractive will result in other customers paying higher electricity bills.

- The supposed job benefits of renewable subsidy schemes are a fallacy.<sup>xii</sup> This argument is based on only looking at the jobs created in the sector being subsidised and ignoring the lost jobs (including jobs that don't get created) elsewhere in the economy, because spending is diverted to the subsidised sector. Further, it should be noted that wind and solar projects have far lower operational jobs than the existing coal mines and generators.

In light of the above, the Association does not believe a state-based renewable energy scheme is in the interests of Queensland electricity customers. An aggressive target of 50 per cent would significantly undermine investment signals in the NEM, particularly where the subsidisation is not tied to the wholesale price in some way. It will also put upward pressure on electricity prices over the long term and is unlikely to deliver the purported employment benefits when job losses in other areas are taken into consideration.

Customers who want to pay more for electricity in return for more renewable energy investment can already do so using a voluntary scheme called GreenPower. The fact that few of them do shows a revealed preference for customers to prioritise lower bills over more renewables, despite expressing general support in surveys and opinion polls.

### **Improving electricity network utilisation**

There has been a significant focus on electricity network regulation in recent years, driven principally by concerns around the impact of network capital expenditure on electricity prices. The current incentive-based regulatory framework provides electricity network businesses with incentives to reduce expenditure wherever possible while maintaining safe and reliable supply. A comprehensive review of Australia's electricity network regulations in 2012 also delivered greater powers to the Australian Energy Regulator (AER) to scrutinise capital expenditure even more closely.<sup>xiii</sup> But in the Association's view, the key to improving capital allocation and network utilisation in the future is the provision of more cost-reflective network tariffs.

Electricity consumers tend not to face prices that reflect the true costs they impose on the system. The combination of widespread use of air conditioners and the increasing rollout of solar PV have resulted in significant cross-subsidies among households. These effects have a significant impact on the network component of retail tariffs.

As such, new tariff structures that reflect the true cost drivers of the system are required. This implies accounting not only for how much energy is consumed but also the time and rate at which it is consumed, consistent with the make-up of network costs.

This will assist with improving the efficiency of the electricity supply system and reduce the level of cross-subsidisation inherent in current flat tariff structures. It will also add more value to storage devices, given batteries can assist with reducing a household's peak demand. Similarly, it will make it easier to efficiently integrate electric vehicles into the system.

The Queensland Government has an important role to play alongside industry in encouraging the development of, and transition to, these new tariff structures. This approach will allow

consumers to flexibly adjust to cost-reflective price signals and ensure each pays their fair share of system costs, the long-term benefits of which are improved system utilisation and least-cost electricity supply.

Advanced metering is also a critical element of the reform agenda. In conjunction with market deregulation and more cost-reflective and flexible tariff structures, advanced metering will enable consumers to realise the full benefits of broader and more diverse product offerings tailored to their particular needs. These issues are discussed in further detail in *Section 4*.

### **Removing retail price distortions**

To date the preferred method of underwriting renewables policy costs is to recover them through retail electricity prices. When this approach was first adopted it was less harmful than it is today. Previously it would make consuming electricity less attractive, at the margins, as the unit price was higher. But the overall impact was modest, as other than a few households with solar PV (or other distributed generation), all electricity was consumed from the grid.

Now that solar PV is a viable alternative for most households, inflating the retail price to recover unrelated policy costs is distorting investment decisions. The grid is no longer a full monopoly and hence using power bills to fund policies creates winners and losers. This problem is likely to be exacerbated in the future as the cost drivers for electricity prices ease but policy costs continue to increase. It would be a perverse outcome if underlying costs are going down, but government decisions continue to push up retail prices, leading to an overinvestment in technologies such as solar PV, which in turn increases policy costs.

At a minimum, governments need to stop adding new policy costs into retail electricity prices. This is not to say they need to stop pursuing the underlying policy objectives (e.g. increased investment in renewables, emissions reductions etc.) if they are supported by a strong rationale, just that another funding mechanism needs to be used. The two most straight forward alternatives are using general revenue or a general levy on households and/or businesses. In addition to avoiding further costs, serious consideration should also be given to removing the existing policy costs from retail prices.

## **2. Deregulation in south east Queensland**

SEQ has developed a mature and competitive retail market that now supports a mix of retailers from small new entrants to large incumbents. This view was reflected in the AEMC's latest retail market review, which confirmed that competition is effective in SEQ and delivering choice and savings to consumers.

To date, retail price regulation has remained the only true impediment to vibrant competition in the region. As noted by the AEMC, "there is sufficient competition in the South East Queensland electricity market for customers to benefit from removal of retail price regulation. This can be expected to promote further competition in the market to deliver innovation, greater choice and competitive prices in South East Queensland."<sup>xiv</sup> The removal of price regulation in SEQ by 1 July 2016 is therefore an important and timely reform.

### **Driving competition in retail markets through price deregulation**

*Price regulation impedes competition*

The Association has consistently advocated for deregulation of the retail energy market to drive the best outcome for consumers. Open, competitive energy markets free from distortions such as retail price regulation naturally encourage prices to be efficient through the development of market offers. Competition in retail electricity markets, as in other sectors of the Australian economy, incentivises businesses to improve service, develop products that meet consumer needs and find ways to lower their costs and to pass these savings onto consumers. This ensures retail prices are set as low as is sustainably possible while businesses can still make an appropriate return.

Retail price regulation in contestable electricity markets is an inherently fallible and risk-laden exercise that can be self-fulfilling. Regulating prices in potentially competitive markets whereby regulated tariffs may be set below the cost of supply impedes the efficient operation of the market. It creates financial pressure for industry participants forced to absorb costs that cannot be passed on and removes incentives for energy companies to enter the market and compete for small-use customers. Conversely, in the event prices are set above the cost of supply – including an appropriate retail margin – competition will erode margins back to efficient levels. The risks are thus asymmetric, with greater adverse consequences arising from setting the regulated price too low.

South Australia and New South Wales have provided the most recent examples of how market deregulation enables competition to thrive, with businesses able to respond more flexibly to market forces. The end result is improved product choice, service quality and price discounts for consumers over the long term.

Of note, Adelaide recorded a 2.7 per cent<sup>xv</sup> reduction in electricity prices in the 12 months following price deregulation in January 2013. This was well below the national average which increased by 6.1 per cent<sup>xvi</sup>. South Australia, New South Wales and Victoria also boast materially higher customer switching rates – approximately 17 per cent, 19 per cent and 26 per cent per annum respectively, compared with 13 per cent in Queensland.<sup>xvii</sup>

Declining or stable pricing in SEQ on 1 July 2016 would be an ideal outcome for industry and consumers. It would also immediately validate the Queensland Government's decision to implement such a fundamental market reform. But the ability of retail businesses to deliver such pricing outcomes – particularly in the short-term – is dependent on a range of other cost drivers, particularly network tariffs.

*Improved customer choice should be encouraged, not constrained*

Improved product choice and price discounts are clearly beneficial for consumers, but the spread of market offers provided in competitive retail markets is sometimes identified by governments and consumer groups as an area of concern. In particular, there is a view that such arrangements disadvantage those customers that do not engage in the market and remain on the standing offer. The Victorian retail energy market has been at the centre of recent commentary around this issue and the Competition Markets Authority is currently undertaking a review of the retail energy market in the United Kingdom.

While the Association strongly agrees that consumer engagement is an essential element of a well-functioning and competitive retail sector, it is important to put this issue in context. In the case of the Victorian retail electricity market, close to 90 per cent<sup>xviii</sup> of residential consumers are currently accessing discounted market offers. Further, seeking to manufacture particular market outcomes (e.g. lower standing prices) for the small proportion of consumers

that do not engage in the market will likely constrain competition and impede product choice and discounts more broadly.

The esaa recently commissioned Professor Stephen Littlechild to explore these issues in the context of retail energy markets in the UK and Australia.<sup>xix</sup> The UK retail market has been subject to a range of interventions since 2008. In particular, the Office of Gas and Electricity Markets (Ofgem) has variously introduced prohibition on regional price differentiation; proposed (then later withdrawn) a provision for Ofgem itself to set a standing charge for all customers of all suppliers; and sought to encourage more customer engagement by introducing strict requirements limiting the number and tariffs that suppliers can offer.

These interventions have distorted prices and profits in the UK retail energy market. In several cases, measures that were designed to lower prices and increase competition had the exact opposite effect, the impact of which ultimately falls on consumers. This was reflected in the CMA's provisional findings, which noted that Ofgem's policies on regional non-discrimination and simple tariffs have had an adverse effect on competition.<sup>xx</sup>

Professor Littlechild recently noted: "the CMA finds that Ofgem's policies since 2008, on regional non-discrimination and simple tariffs, have had an Adverse Effect on Competition, and should be discontinued. Ofgem accepts this. Just pause a moment: this is the most damning indictment of a utility regulator in any sector since privatisation and regulation began. A regulator with a duty to promote competition has been found to have spent the last seven years undermining it, and continues to do so today."<sup>xxi</sup>

Drawing on the UK experience to appraise recent commentary around the level of profits and margins in Victoria since retail price controls were removed, Professor Littlechild notes that the relevant competition indicators/metrics suggest the retail market in Victoria is competitive.<sup>xxii</sup> Further, the implementation of some form of price cap to benefit those who don't engage in the market is likely to increase prices for those who do and generally reduce competition such that all customers are worse off.<sup>xxiii</sup>

### **Ensuring adequate customer protections**

Significant progress has been made to improve customer protections and support the transition to market deregulation in SEQ. As noted by the QPC:

- Application of the National Energy Retail Law has provided Queensland consumers with additional protections under the National Energy Customer Framework (NECF). This includes providing consumers with better tools to engage in the retail market (e.g. access to the AER's price comparison website) and better support if they are in financial hardship.
- Under the Competition and Protection Legislation, retail price regulation in SEQ will be replaced with a market monitoring regime. The Queensland Competition Authority (QCA) will be responsible for monitoring the SEQ market, which will include the publication of an annual market comparison report. This is in addition to the annual publication of retail market performance and competition assessment reports by the AER and AEMC.
- The Queensland Government will retain a reserve power to reintroduce retail price regulation. This power could only be exercised if an independent review of the SEQ

market concludes competition has become ineffective and recommends price controls be reinstated. Similar price setting provisions exist for the retail gas market in Queensland, though they haven't been exercised since 1 July 2007. New South Wales, Victoria and South Australia have all retained similar reserve powers.

Collectively, the Association considers these protections are adequate to support the transition to market deregulation. But it is noted the National Energy Retail Law also includes the following additional provisions:

- for the first year of deregulation, retailers would not be permitted to vary their standing offer prices for consumers on standard retail contracts, unless the variation is to reduce the price; and
- for the first two years of deregulation, retailers would not be permitted to include any new types of fees or charges in their standing offer prices that were not included in the regulatory price determination for the financial year immediately preceding deregulation.

Should the above provisions be implemented, it is important they are transitional only. Adopting the NECF reduces the regulatory burden of operating across multiple jurisdictions and lowers barriers to retail market entry. But overly prescriptive tariff requirements potentially expose retail businesses to costs they cannot pass on. This can potentially limit product differentiation and also increase the unit cost of electricity for all consumers as retail businesses are required to incorporate a risk premium into their pricing structures.

Retailer fees/charges are a feature of the current market and market offers can be revised to reflect changes in underlying costs (e.g. changes in network pricing or green scheme costs). A key benefit of retail price deregulation will be the evolution of a broader range of product offerings that better suit particular customer needs. This may include market offers that exclude exit fees entirely or provide price certainty over a longer time period. Further, customers will still have access to standard retail contracts that are bound by additional protections, such as a defined time for providing advanced notice of price changes.

To the extent any regulatory response is required, focusing on improving consumer engagement and ensuring concessions frameworks are appropriately targeted is likely the most appropriate action (these issues are discussed in further detail in *Section 4*). Further, consideration should be given to the applicability of the existing framework to new/alternate service providers. This work should be undertaken with a view to ensuring the current retail market framework provides a level playing field for all participants while also ensuring adequate consumer protections are retained.

### **3. Regional Queensland**

#### **Uniform Tariff Policy**

*Assistance measures should have a clear objective and be appropriately targeted*

Governments provide assistance with the aim of achieving a number of policy objectives. These include facilitating economic growth or employment, supporting regional development or improving social or environmental outcomes. Where appropriately targeted and defined,

assistance measures can effectively and efficiently meet overarching policy objectives and deliver economy-wide benefits.

But direct and indirect government assistance to industry and consumers has a significant effect on the structure of the economy and the incentives to invest, with delivered benefits generally coming at the expense of other industries, taxpayers and consumers. Accordingly, where assistance measures are considered, it is important the following three broad principles are taken into consideration.

- The objective should be well defined: Governments provide assistance for a range of economic, environmental, political and social reasons. The general aim of such assistance is to provide performance outcomes that are in addition to what would have occurred without the measure. To ensure assistance measures are appropriately targeted, the objective and economic rationale underpinning the market intervention must be clearly defined. This includes identifying the market failure and demonstrating that it is amenable to government intervention.
- The assistance measure should be designed to achieve the objective and minimise unintended outcomes: For a measure to be effective it should be designed so it is likely to meet its stated objectives while also minimising the unintended outcomes of the intervention. This includes displacement, substitution, leakage and/or adverse reactions with other policies.
- The measure should contribute to positive economic outcomes: Assistance can distort the efficient operation of an economy. The benefits of assistance must therefore be sufficient to outweigh the costs of achieving the desired outcome. Competition should not be impeded unless clearly demonstrated to be in the public interest.

The application of the states Uniform Tariff Policy (UTP) is highly relevant in this regard. The Association agrees that facilitating access to reliable energy supply is important from a social policy perspective. There are also broader economic benefits to be realised from doing so, including regional development. But the objective of the UTP is poorly defined. Further, there is a range of inefficiencies underpinning the way it is currently applied that likely diminishes its effectiveness and value more broadly.

*The Uniform Tariff Policy is poorly targeted and impedes electricity market development in regional Queensland*

Under the Queensland Government's UTP, non-market customers of the equivalent customer class are provided with access to the same retail prices (notified prices) irrespective of differences in the cost of supply. This is achieved by providing Ergon Energy (retail) with CSO payments to fund the difference between the costs of supplying customers within its distribution area (with controllable costs being benchmarked) and the amount that is recovered by Ergon Energy (retail) from regulated prices. As noted below, this has a number of negative impacts.

- Impeding the development of competition: Application of the CSO payment at the retail level effectively acts as a subsidy to Ergon Energy (retail) customers, precluding other retailers (forced to absorb additional costs) from competing. This is evidenced by the fact that less than one per cent of regional customers are supplied under a market contract in regional Queensland compared with more than 70 per cent in SEQ.<sup>xxiv</sup>

- Suppressing price signals for consumers: The UTP has delivered notified prices that are lower than the costs of supply for most regional customers. As a result, price signals are impeded and the ability of consumers to make rational decisions relating to energy consumption is diminished. Coupled with tariff structures that have historically been heavily biased toward high variable charges, this has implications for system utilisation and efficient investment in electricity supply infrastructure.
- Failing to target assistance to those in need: The scope of the UTP is too broad. It fails to provide targeted assistance to low income and disadvantaged customers, instead providing concessions to the wider regional customer base, including very large and commercial businesses as well as affluent households. As noted by the QPC, Queensland is the only state to provide very large business customers with access to uniform retail tariffs.
- Exposing the Queensland Government to a significant and variable financial liability: The adoption of the CSO at the retail level makes it less stable and more likely to lead to sudden increases in government expenditure. The CSO has blown out significantly in recent years, with the cost of the subsidy estimated to be \$432 million in 2013-14<sup>xxv</sup> and further increases anticipated. Without changes there is no reason to think it will be financially stable in the future.

*CSO payments should be applied in a way that facilitates competition and improves price signals in regional Queensland*

Transitioning electricity tariffs to cost-reflective levels (ideally through market deregulation) and implementing targeted assistance measures funded on budget, remains the most efficient means of delivering sustainable and competitive electricity supply in regional Queensland. Such an approach would ensure social welfare outcomes are met (i.e. those customers most in need of support receive it) and the inefficiencies associated with non-cost-reflective pricing are avoided.

Better defining the government's social and economic policy objectives and giving careful consideration to the eligibility criteria of targeted assistance measures is critical to this approach. This will ensure regional concessions (unrelated to welfare) continue to be made available where appropriate. While transitional arrangements for those customers deemed ineligible may also be required, these issues are not insurmountable.

To the extent the UTP is to be retained, it is important to ensure the associated subsidy arrangements are applied in a way that enables competition to flourish, while also delivering more cost-reflective price signals for consumers. Where this is not achieved, barriers to entry will continue to stymie the evolution of competitive retail markets in regional Queensland and the inefficiencies associated with holding electricity prices below cost will persist.

The Association considers applying CSO payments at the distribution level rather than the retail level is a sensible approach in this regard. It would remove a key barrier to competition in regional Queensland and enable retail businesses to compete for customers based on the competitiveness of their charges.

Given this approach would still prevent customers from facing cost-reflective retail prices, the esaa considers the approach to price setting should be based on the costs of supplying electricity to regional Queensland rather than SEQ. This would involve setting retail tariffs in

line with the lower of Ergon Energy's cost-reflective network charges initially and progressively transitioning all customers to fully cost-reflective levels over time. The key benefits to this approach are more efficient pricing outcomes and a sustained reduction in the Queensland Government's exposure to high and variable subsidy costs.

The Association maintains deregulating retail prices and implementing targeted concessions frameworks is the best way to deliver competitive and efficient electricity supply in regional Queensland, while also achieving social policy objectives. To this end, it is important that reforms to UTP arrangements are viewed as interim measures only and retail tariffs are transitioned to cost-reflective levels in a timely manner. This should occur in parallel with structural reforms to Ergon Energy (retail) that enable it to effectively compete in the retail market and the implementation of targeted concessions frameworks more broadly.

### **Role of local government**

*Local governments have an important role to play in the delivery of localised energy solutions*

Distributed generation and other localised energy supply solutions could feature prominently in the future of Australia's energy supply sector, particularly with respect to isolated networks in regional Queensland. While the norm within the industry has generally been for progressive expansion of the main grid to meet new demand and to interconnect existing isolated networks to the main regional grids, a report prepared for the esaa indicates there are situations where localised energy supply solutions and potentially moving customers(s) off-grid could deliver reliability improvements and lower network costs.<sup>xxvi</sup> Situations where an off-grid approach may be appropriate include where:

- reliability is low (e.g. due to single circuit supply prone to interruption and often requiring expenditure on temporary mobile generation during planned or extended forced outages);
- costs are high for both routine maintenance and activities such as pole replacement;
- there are location specific risks (e.g. high fires) that could possibly lead to switching off supply on high risk days; and
- distributed generation already exists or where fuel is readily available (e.g. a river hydro scheme, an untapped geothermal resource or other local resource).

Despite these benefits, the concept of disconnecting from the main grid may be seen as a retrograde step. In this respect, electricity network businesses are very much aware of the need to engage with customers, policy makers and the community in general. But there is also a clear role for local governments to assist network businesses with achieving social licence.

*Barriers to localised energy solutions must be addressed*

Outside of any social challenges, addressing the efficient deployment of distributed generation and localised energy solutions is very much predicated on the provision of transparent and cost-reflective price signals for electricity supply. The current application of the state's UTP is a clear impediment in this regard, as is the heavy reliance on flat tariff structures.

There are also likely to be other technical and regulatory considerations that may need to be overcome to allow off-grid solutions. In this respect, it would be useful to undertake a general review of state and national regulatory and legislative arrangements to identify potential barriers.

#### **4. Customer participation and support in the electricity market**

As discussed in *Section 2*, increasing competition rather than regulation is the most effective way to protect consumers' interests. In this respect, a key area of focus for SEQ is to drive consumer engagement and improve price signals for consumers. A targeted engagement strategy could help to improve customer awareness and understanding of the options available and provide the information and tools to help customers find a retailer and plan that suits their needs. Advanced metering and more cost-reflective electricity tariffs would also assist with providing more meaningful information relating to energy consumption.

To the extent there are concerns over the ability of vulnerable and disadvantaged customers to engage in the market and manage their energy bills, these issues are best addressed through robust concessions frameworks and should not be used as justification for intervention across the whole market.

##### **Driving customer engagement**

Consumer engagement and participation are important facets of a competitive market. A lack of awareness and understanding of the offers and products available can impede market engagement and ultimately result in consumers forgoing improved product choice, service quality and price discounts. This is particularly relevant in the context of the retail energy sector, where rapidly changing market dynamics have led to the emergence of new service providers and broader product offerings, including home energy management systems.

Advising consumers about changes in the market and raising awareness about how to change energy plans and where to access information to make informed decisions is therefore essential. In this respect, it should be noted that close to 90 per cent of SEQ consumers surveyed by the AEMC as part of their competition assessment were aware they could choose their electricity and gas retailers.<sup>xxvii</sup> Access to resources that enable switching does not appear to be an issue. There are several commercial switching businesses (including those that find offers for a range of services including insurance and telecommunications) that can be accessed via phone/internet and who advertise heavily on TV and other media. But the report also noted there is limited awareness of price comparator websites like the AER's Energy Made Easy website, which became available to Queensland consumers on 1 July 2015.<sup>xxviii</sup>

Both governments and retail businesses have an important role to play in increasing customer engagement and awareness. While retail businesses are heavily incentivised to increase consumer awareness of products and their benefits, the role of government is crucial during the transitional period to market deregulation in SEQ, as customers generally consider government advice to be impartial.

Implementing the Consumer Education Campaign Strategy previously developed by the Queensland Department of Energy and Water Supply, in partnership with energy retailers, industry bodies and consumer advocacy groups, could play an important role in facilitating

this engagement. Coupled with the additional information requirements imposed under the NECF, such an approach would ensure SEQ consumers have access to clear and relevant information relating to the changes underway and the tools available to maximise their engagement in the market.

### **Incentivising efficient energy use through more cost-reflective price signals**

The esaa supports greater efficiency and productivity across the Australian economy, including the use of the energy. Energy efficiency is not an end in itself, but is worthwhile when the costs to achieve lower energy use are lower than the costs to produce and transport the energy saved.

In general, the users of energy should be best-placed to make that trade-off. But there may be some barriers to their doing so, for example:

- static, inefficient and non-cost-reflective consumer pricing;
- information asymmetries in consumer education;
- capital constraints faced by financially vulnerable consumers;
- split incentives (landlord/tenant to install energy efficient products); and
- bounded rationality (limited understanding/interest dictating product purchase).

Cost-reflective pricing is the only price-based barrier to energy efficiency. With this in mind, any demand management and energy efficiency strategy should be based on enabling the industry to move towards offering more cost-reflective tariffs that will incentivise cost-effective demand response and ensure consumers have access to appropriate tools to manage their consumption effectively.

Empowering customers by providing them with more timely and meaningful information about their consumption allows for more efficient use of energy. Advanced metering and more flexible tariff structures can also deliver cost savings to consumers. These savings are achieved through more efficient network investment, the development of more innovative pricing offers that suit different patterns of consumption and a reduction in the level of cross-subsidisation inherent in current flat tariff structures. It will also add more value to storage devices, given batteries can assist with reducing a household's peak demand.

Despite these advantages, it must be acknowledged that more advanced metering infrastructure and flexible tariffs can also lead to bill increases in some situations (e.g. if demand is not moved out of peak pricing periods). But the AEMC's recent Distribution Network Pricing Arrangements Rule Change introduced a specified consumer impact principle and the requirement for businesses to describe how they have engaged with customers and retailers in developing their proposed Tariff Structure Statements. These principles place an explicit obligation on distribution businesses to consider the impacts of network tariff changes on consumers when determining how to transition consumers to more cost-reflective tariffs.

Encouraging the development of, and transition to, more cost-reflective tariff structures and enabling improvements in metering services is necessary to achieve this. Both government

and industry have a key role to play in facilitating this transition. There is likely to be a particular focus on the 'winners' and 'losers' of network tariff reform, so it will be important to communicate the need for, and benefits of network tariff reform more broadly.

### **Protecting vulnerable customers through targeted concessions frameworks**

Improved customer assistance measures should be a key priority for the Queensland Government. In its current form, the electricity rebate fails to appropriately identify and support those most in need. To provide more targeted and equitable assistance, the electricity rebate concessions framework should be amended to:

- incorporate some form of means testing for Queensland Seniors Card holders and provide eligible Health Care Card holders with access to the rebate, consistent with a number of other states; and
- transition the current flat rebate to an electricity cost-based rebate structure that delivers assistance in proportion to the size of an eligible customer's electricity bill.

To the extent the Queensland Government does pursue an aspirational solar PV target of 3,000MW, the Association would note there is merit in targeting solar PV incentives at vulnerable/hardship customers. There are a range of barriers that can limit vulnerable/hardship customer's access to solar PV, including limited access to capital (although emerging PPA business models provide a commercial solution to this) and reliance on rental accommodation. Further, such customers often have limited capacity to moderate their energy consumption. Overcoming these barriers would therefore assist with reducing the energy bills of vulnerable/hardship customers while also contributing to the Queensland Government's broader renewable energy policy objectives.

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<sup>i</sup> Energy Supply Association of Australia, 'Deregulation sparks energy price fall: CPI', online article, 31 October 2013.

<sup>ii</sup> Ibid.

<sup>iii</sup> Energy Supply Association of Australia, 'Household solar: Australia first, daylight second', online article, 14 May 2015.

<sup>iv</sup> Office of the Chief Economist, 'Data from: Australian Energy Statistics Tables, 2015 energy statistics data, Table B', accessed October 2015.

<sup>v</sup> Ibid.

<sup>vi</sup> Energy Supply Association of Australia, 'Household solar: Australia first, daylight second', online article, 14 May 2015.

<sup>vii</sup> Australian Energy Market Commission, 'Final Rule Determination – Potential Generator Market Power in the NEM', 26 April 2013.

<sup>viii</sup> Ibid.

<sup>ix</sup> Australian Energy Market Operator (AEMO), '2014 Electricity Statement of Opportunities', 7 August 2014.

<sup>x</sup> Ibid.

<sup>xi</sup> PricewaterhouseCoopers Australia, 'State of the Debt Markets for the Energy Supply Industry', report prepared for the esaa, December 2014.

<sup>xii</sup> Energy Supply Association of Australia, 'Energy and employment: The myth of 'green' jobs', online article, 4 June 2014.

<sup>xiii</sup> Australian Energy Market Commission, 'Rule Determination – National Electricity Amendment (Economic Regulation of Network Service Providers) Rule 2012', 29 November 2012.

<sup>xiv</sup> Australian Energy Market Commission, '2015 Retail Competition Review – Final Report', 30 June 2015.

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<sup>xv</sup> Energy Supply Association of Australia, 'Deregulation sparks energy price fall: CPI', online article, 31 October 2013.

<sup>xvi</sup> Ibid.

<sup>xvii</sup> Australian Energy Market Commission, '2015 Retail Competition Review – Final Report', 30 June 2015.

<sup>xviii</sup> Ibid.

<sup>xix</sup> Littlechild, Stephen., 'Regulation of Retail Energy Markets in the UK and Australia', report prepared for the esaa, October 2015.

<sup>xx</sup> Ibid.

<sup>xxi</sup> Littlechild, Stephen., 'Opening remarks to the Indepen Forum on 29 September 2015 – Snakes and Ladders: price controls and markets. What might the CMA's provisional findings mean for retail markets in utility services?', transcript.

<sup>xxii</sup> Littlechild, Stephen., 'Regulation of Retail Energy Markets in the UK and Australia', report prepared for the esaa, October 2015.

<sup>xxiii</sup> Ibid.

<sup>xxiv</sup> Queensland Productivity Commission. 'Electricity Pricing in Queensland – Issues Paper', October 2015.

<sup>xxv</sup> Ibid.

<sup>xxvi</sup> Oakley Greenwood, 'Assessment of edge of grid regulatory and policy framework', report prepared for the esaa, January 2015.

<sup>xxvii</sup> Australian Energy Market Commission, '2015 Retail Competition Review – Final Report', 30 June 2015.

<sup>xxviii</sup> Ibid.