



16 November 2015

Attention: Mr Kim Wood

Principal Commissioner
Queensland Productivity Commission
PO Box 12112
George St, QLD 4003

Submitted Electronically

Dear Mr Wood

Issues Paper: Electricity Pricing in Queensland

QEnergy is grateful for the opportunity to respond to the Queensland Productivity Commission's (QPC) Issues Paper on electricity pricing in Queensland. QEnergy is an established independent national electricity retailer based in Brisbane with customers in Queensland, New South Wales, Victoria, South Australia and the Northern Territory, specialising in providing retail electricity to small businesses. QEnergy's largest customer base is in Queensland and the business commenced our retailing activities in Queensland, so we are therefore acutely aware of the need for pricing reform in this market.

Using the Commission's headings, we make the following comments.

Productivity in the Electricity Supply Chain

As a pure play retailer QEnergy has experienced the impacts of sharp spikes in the wholesale spot market resulting from the bidding practices of Queensland based electricity generators. QEnergy does not believe that there should not be high-priced events in the market, since they are obviously a key part of the market design to support the delivery of generation investment as required. We do however consider that the late rebidding practices engaged in over the last year in Queensland have meant that other generation was unable to be dispatched in time, and consequently that prices were higher than they otherwise would have been had the market been functioning properly.

In a less concentrated market, QEnergy would be able to commercially mitigate the risk of these spikes through contracting for hedges with generators in the region. However, in Queensland, the two major generators – both owned by a single owner, the Queensland government – together control 81% of Queensland's base load generation and 91% of the state's main ramping assets, the intermediate units.

These two generators have remarkably onerous prudential requirements – many times that of other generators in more competitive regions – such that it is simply not economic for a small retailer to hedge all of their load with them. Therefore, the second-tier retailer's ability to protect itself from the impact of the exaggerated price spikes in Queensland is limited, a considerable barrier to interest in participation as a Queensland retailer.

QEnergy has observed that the incidences of late rebidding have been especially prevalent in Queensland since the consolidation of the original three government-owned generators into two corporations, with the attendant rebalancing of asset portfolios. In the context of recent price events and outcomes based on Stanwell and CS Energy's late rebidding strategies, QEnergy continues to be gravely concerned about the Queensland Government's current policy commitment to further consolidation of the two government owned generators into a single entity will further entrench the conditions that could result in higher prices for Queensland consumers.

Over the last quarter, the Queensland market has also experienced an increase in the forward contract market as a result of the price spikes¹. Along with the spot market volatility, this represents a significant financial impost on a retail only electricity business. This flows through in the cost of wholesale electricity, hedge contracts and the resultant prudential capital required to participate in these markets.

These mid-year increases in prices are particularly punitive for retailers given the Queensland Government's annual tariff setting prices which changes prices only once per year, whilst costs are rising consistently throughout the year. This makes Queensland the most punitive retail market in Australia. Sadly, Queensland's 'FRMP' model means that once won, Queensland customers are extremely difficult to shed.

A properly functioning and effective wholesale market for electricity is necessary to support competition at the retail level. Transparency, access to information and the capacity of participants to respond to changing external conditions are all fundamental to maximising productivity and efficiency in any trading market. These conditions do not currently exist in the Queensland electricity market.

For this reason the Australian Energy Market Commission (AEMC) is currently progressing a change to the National Electricity Rules specifically targeted at the practice of late re-bidding in the wholesale electricity market observed from Queensland generators². For more information on QEnergy's view of this matter, please see our submission to the AEMC in response to the work on late rebidding.

Emerging Technologies

The potential benefits from technologies such as battery storage, solar and advanced metering systems are significant in that, if managed effectively, there is the potential for consumers to gain significant control over their consumption and costs. These technologies have the potential to reduce demand from the parts of networks that are most expensive to maintain supply so have the potential to be complementary to existing

¹ See Ernst & Young, Impact of late rebidding on the contract market, 11 September 2015

² <http://www.aemc.gov.au/Rule-Changes/Bidding-in-Good-Faith>

technologies on the more expensive outer perimeters of networks such as that of Ergon Energy in rural Queensland.

However, as we have seen with the uptake of rooftop solar, the impact of these technologies on the need to maintain a network that services the whole of the population needs to be managed. Thus the key will be in balancing these benefits and threats to ensure the delivery of a net benefit.

In particular, there is a threat to the realisation of net benefits if government subsidies are used to stimulate a response or a particular industry. As has been the case with solar installations, this can create genuine economic distortions in the market which then threaten the viability of other technologies not supported by subsidies, in turn creating market failures or inefficiencies and the potential for cross-subsidies which do not reflect genuine economic needs.

Future of the Network Business Model

It is essential to the whole electricity supply chain that network businesses continue to drive efficiencies and innovation in the maintenance of transmission and distribution systems. In settling on the future of the network business model, however, regulators will need to be very clear on what the business of a network is.

Robust ring-fencing guidelines are a critical element in maintaining efficiency in energy markets in circumstances where there is a separation of natural monopolies and contestable services. This ensures the distribution business does not apply capital and resources acquired through its regulated monopoly function to competitive services to the detriment of independent businesses operating in those markets. It also ensures that monopoly businesses (and their customers) are quarantined from potential losses from riskier unregulated contestable activities.

In the United States it is accepted that the very fact of a network company being a monopoly creates a need for ring-fencing. Monopoly regulated companies should be protected from risk because they are the only operators in the service area able to provide these essential services³.

This is particularly important in the case of batteries, which can act as a peaking generator as well as a mechanism to manage network demand. Because of the implications for the contestable wholesale market, it will be imperative that these technologies are led by the market, with networks contracting for services rather than owning the assets themselves, and not included in network asset bases. This model would echo that being implemented for smart meter rollouts through the Power of Choice review.

³ Schwarcz, Steven L. Ring-Fencing, Southern California Law Review

Deregulation in South East Queensland

The experience of deregulation in other NEM jurisdictions has confirmed that it stimulates a competitive market and puts downward pressure on electricity prices. The risk of continued price regulation is an absence of competitiveness in the market and a reluctance of new entrants to participate. The model adopted in other States of deregulated pricing and monitoring and publication of retail price movements is preferable.

Regional Queensland

QEnergy is one of the few non-government owned retailers operating in the Ergon region. This experience has not been a positive one. As a market retailer and as a result of the uniform tariff policy, QEnergy cannot compete with Ergon Energy's prices in this region. Additionally, the non-reversion policy has compounded the problem as we have not been able to reduce our customer load in what has become a loss-making market. QEnergy therefore welcomes the Government's announcement that it will examine options to improve competition in regional areas. Our strong position is that this should include redirecting the Community Service Obligation to the network level.

Through this period, it is imperative that as a network business, Ergon Energy be bound by the same rules as all other such operators and not be able to provide competitive services in the retail market. However, to ensure that regional Queensland customers are provided with choice, QEnergy also strongly supports allowing customers to revert to Ergon Energy's retailer should they wish, and would recommend the passing of immediate legislation to ensure that this is able to occur.

Customer Participation and Support in the Electricity Market

Communicating with clarity and simplicity to consumers will be the key to the success of any new developments in the electricity market. The CSIRO concluded in a recent study that, "*meaningful demand-side participation by many millions of Australian consumers will be key to optimising an increasingly decentralised electricity system and stabilising real cost of electricity to consumers themselves.*"⁴ QEnergy's experience is that there is broad confusion from consumers on the function and role of network and retail businesses in the electricity supply chain. As a retailer, this creates operational difficulty when communicating with customers on matters that are network functions over which a retailer has very limited control.

Customer impacts of network tariff reform

QEnergy has observed that networks are not structured and resourced to deal with pricing queries from the general public. The industry structure is such that network bills appear on a retailer's invoices, thus queries on network billing are addressed by retailers, not the networks themselves. Most of the network's engagements on pricing are with market specialists within retailing businesses who in turn must communicate this

⁴ Stenner, Karen, Frederiks, Elisha, Hobman, Elizabeth V. and Meikle, Sarah CSIRO, Australian Consumers' Likely Response to Cost- Reflective Electricity Pricing July 2015 P. 4

information to customers. We recommend therefore that a central part of network tariff reform needs to be the network business applying resources towards communication training to enable appropriate information to be passed to consumers.

Conclusion

There are particular challenges with electricity pricing in Queensland both from existing conditions and future trends in electricity provision. Managing these challenges to the ultimate benefit of consumers should continue to be the focus of all participants in this market.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Kate Farrar', written in a cursive style.

Kate Farrar
Managing Director