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TF:JD

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Mr Chris Pattas
General Manager
Australian Energy Regulator
GPO Box 520
MELBOURNE VIC 3001

Dear Mr Pattas

Alternative approach to the recovery of the residual metering capital costs through an alternative control services annual charge

Ergon Energy Corporation Limited (Ergon Energy), in its capacity as a Distribution Network Service Provider (DNSP) in Queensland welcomes the opportunity to provide a submission to the Australian Energy Regulator (AER) on its *Alternative approach to the recovery of the residual metering capital costs through an alternative control services annual charge* Consultation Paper (the Consultation Paper).

Ergon Energy understands the issues raised by the AER in the Consultation Paper regarding the concern over barriers to entry raised by some stakeholders, and is keen to work with the AER to deliver an acceptable solution. However, Ergon Energy maintains its position outlined in its 2015-2020 Regulatory Proposal and in subsequent submissions to the AER that an exit fee is the most appropriate mechanism for the recovery of residual metering capital costs. An appropriately structured exit fee would deliver a cost signal to enable customers to make more informed decisions regarding their meter type.

Furthermore, Ergon Energy considers that an exit fee would deliver a more equitable user pays framework and notes that exit fees or termination fees are included in a wide range of consumer and service contracts, and are only one part of the switching costs that an end-user faces in moving to a new supplier¹.

Ergon Energy also notes the advice of regulators and others examining options for inclusion of termination/exit fees in consumer contracts that fair termination/exit fees in

¹ Klemperer, P. (1995) "Competition when consumers have switching costs: an overview with applications to industrial organization, macroeconomics and international trade", *Review of Economic Studies* 62, pp 515-539

consumer contracts will lower the cost of providing services in the long term and create a complementary increase in competition at the point where suppliers compete for new customers. Providers in certain industries are also willing to provide up-front investment in services and products to help facilitate customer switching. Research conducted by Consumer Affairs Victoria has indicated that on balance, consumer contracts that include fair termination fees provide benefits to consumers in the area of lower product prices, fierce competition at the point of competing for new customers and a wide variety of contract offerings that go towards the goal of freedom to contract².

Ergon Energy also understands that termination fees form part of the switching costs for various retail energy contracts³, and that it is not uncommon for gas metering providers to seek to impose termination fees or other pricing methods to ensure an adequate return when retailers switch metering providers and that such fees may not in themselves constitute a major barrier to market entry or competition among providers⁴.

That said, we note the AER has requested feedback as to which of the two options outlined in its paper Ergon Energy considers to be preferable. In this regard, Ergon Energy considers that of the options presented for feedback in the Consultation Paper, Option 1 is the preferred option if the AER is to select one of these options. However, we do have a number of concerns regarding the option, which are expressed in detail below. Although we acknowledge that some of these concerns may be able to be addressed, this is not clear from the information currently available.

In particular, the definition of the proposed service will be critical. The AER can only regulate *distribution services* which are those provided by means of or in conjunction with a distribution system. If the service is related to recovery of meters then this could logically be a distribution service. However, the costs associated with the provision of a distribution service can only be charged to people that have received the service. From discussions with the AER we understand the AER may be considering a proposal for the service to apply to all customers (including customers who move-in to a premise that doesn't have a current DNSP meter and to new connections). Noting the definition of a distribution service and who may be charged for the provision of that service, it is unclear to Ergon Energy how DNSPs would be able to charge new and move-in customers the metering recovery fee on the basis of them never having received a metering service, and therefore distribution service, from the DNSP to begin with. However, having said that, we note the complexity and confusion that may arise in having to distinguish between those customers that receive the charge and those that don't.

Furthermore, if as has been suggested, the AER frames the charge as a 'market facilitation fee', Ergon Energy is concerned that the service provided (a market facilitation service) could not reasonably be classified as a distribution service and as such

² Consumer Affairs Victoria, "Options for fair early termination fees in consumer contracts", Research paper, May 2010 C-76-01 at pp 15-18

³ IPART "Early termination Fees: Regulating the fees charges to small electricity customers in NSW" - Final report, December 2013

⁴ See for example Commerce Commission New Zealand Determination dated 26 April 2013, Project No 11.04/13917 Public Version, Vector Limited and Contact Energy Limited [2013]NZCC 9 at pp7, 15-18

distribution businesses such as Ergon Energy would have no ability to charge it, nor would the AER have the authority to regulate it.

Ergon Energy is also concerned about the likely public response to the imposition of a charge for a meter they don't have. In particular we would expect significant queries and complaints being lodged through various channels, including the media and industry Ministers. Consequently, it is essential that any charge defined and approved by the AER is robustly supported by the regulatory framework, such that distributors can confidently apply the charge in practice and there is no risk of the charge being challenged and found to be legally invalid.

In discussions with the AER it was noted that retailers may bundle the costs meaning they wouldn't be seen as a separate identifiable cost. Although this may be the case for a significant number of competitive market retailers, Ergon Energy notes that the retail arm of our business, Ergon Energy Queensland (EEQ) is a non-competing retailer bound by the *Electricity Act 1994* (Qld). As a consequence of the statutory restriction on competition, EEQ is only able to charge its customers Notified Prices and pass through Alternative Control Service charges directly. That is, EEQ is not allowed to bundle costs, meaning the proposed charge would be explicit on the bill for the vast majority of regional Queensland customers, for whom EEQ is the retailer.

The AER has also indicated in recent discussions that new meters would be classified as Quoted Services, such that the capex does not go into the Metering Asset Base (MAB). Ergon Energy is concerned by this proposal for the following reasons:

- In our regulatory proposal, Ergon Energy proposed that new and replacement meters form part of the MAB. Consequently our customers have been consulted on that arrangement and neither Ergon Energy nor the AER has consulted with customers on the proposal to charge upfront.
- The proposal to charge upfront represents a significant change to the existing arrangements in Queensland, under which new connections (excluding augmentation and extension) including metering are all provided at no upfront cost to the customer. For example, when a house is built, customers are likely to receive the bill directly from their distributor rather than the costs being bundled into the electrical contractor's bill.
- There are also issues around the application of the Uniform Tariff Policy in Queensland and implications associated with this change that require further consideration.

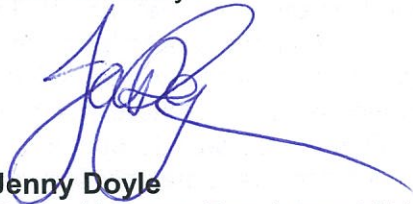
Finally, if the AER is to implement either of its proposed options, initial estimates suggest that Ergon Energy would need at least 12 months to implement the changes. This is mainly due to the requirement for system, auditing and process changes that would be necessary to ensure appropriate charges are applied to the correct customers. Given the AER has indicated it won't decide on the final approach until late April, there is clearly not enough time for these changes to be made by 1 July 2015.

An alternative that the AER may consider is adjusting depreciation rates. Specifically, if revenues are modelled using the Post Tax Revenue Model, a much easier option would be to adjust depreciation rates to allow for a higher capital return based on a churn rate. This approach would deliver the same outcome but using a much simpler pricing arrangement and removes the identified issues. However, the churn rate must be set high enough so that the likelihood of cross subsidy is extremely small. A low churn rate assumption with no exit fee will mean remaining customers pay more than they should in the long term. Although a high churn rate increases the risk that customers may pay a

higher charge than they otherwise could have, they would be no worse of in NPV terms. Furthermore, the cost under this arrangement would not serve as a barrier to entry into the contestable metering market upon commencement of the contestability in metering rule change, which was cited by the AER in the Consultation Paper as the underlying impetus for the proposed reclassification.

Should you require any additional information or wish to discuss any aspect of this submission, please do not hesitate to contact either myself on (07) 3851 6416 or Trudy Fraser on (07) 3851 6787.

Yours sincerely



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