

8th April 2008

Mr Brian Parmenter
Chairperson
Queensland Competition Authority
GPO Box 2257
Brisbane Queensland 4001

By email: electricity@qca.org.au

Dear Mr Parmenter,

Draft Decision Benchmark Retail Cost Index (BRIC) for Electricity 2008 to 09

Australian Power & Gas (APG) is writing to the Queensland Competition Authority (QCA) as a follow up to the recent consultation workshop held on the 27 March 2008. In particular APG wish to further highlight the discussions around the input assumptions used in calculating the Benchmark Retail Cost Index (BRIC).

APG wish to also inform the QCA of its support for the overall findings and recommendations of the ACIL report "*Energy costs for Queensland electricity tariffs in 2007/08 and 2008/09*". This is the report commissioned by AGL which has subsequently been publicly released.

APG are of the firm view that the QCA must use the updated input assumptions from the latest ACIL report when determining the BRIC. A failure to do so would have a detrimental impact on electricity retailers operating in the Queensland market.

In addition to the ACIL report APG believe the following components in the current BRIC are either unrealistic or have understated the cost to retailers:

1. Cost of wholesale energy – assumption that retailers get half of their funding at Long Run Marginal Costs (LRMC) at the \$40 mark is unrealistic given the current wholesale environment and is especially the case for new entrants who have only recently entered the market.
2. Inadequate costing of wholesale volatility premiums.
3. Using a whole of state load profile which includes transmission connected assets like smelters gives a false impression of flat loads when most NSLP/small customers have peakier profiles.
4. Cost of capital/funding to create and sustain a retailer in Qld – no mention of the WACC required to fund the business, the increase in funding costs this year (interest rates) or the cost of guarantees and NEMMCO prudential deposit costs. This cost of capital/ funding is

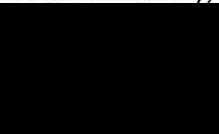
required at setup before a retailer signs a single customer, and continues through the life of the business. Even when a customer pays a bill a retailer still needs to generate a return to pay for the cost of equity or debt. Furthermore, WACC is required for the whole equity and debt base of the business, not just the working capital component.

5. Cost of bad debts – it is not clear if credit management costs incorporate this cost. Bad debts generally increase in an FRC environment as “some” customers attempt to avoid their financial responsibility by transferring between retailers.
6. Inadequate assumption of customer acquisition costs of \$18 per customer (\$28.47 in 2007/08) – modeled on incumbent retailer spending to acquire 10% of customer base to replenish 10% customer base losses due to competition. Again for a new start retailer this cost would be higher as the new entrant retailer is starting from nil having to build its customer base. Whilst we appreciate that the model only assumes an incumbent retailer with 0.5M customers, this assumption is incorrect even for an incumbent, as the market churn rate has been running higher (17% in 2007/08) than the 5% assumed when determining the BRCI in 2007/08. Using these understated assumptions equates to a substantial understatement of retention/acquisition costs.
7. Network cost increase does not take into account the effects of rebalancing in the Energex area where small customers may receive an increase of more than 9%

APG appreciates the tight timeframe the QCA is dealing with in finalising its decision; however APG believes it is crucial that the QCA use LRMC inputs that are representative of the current market environment and give due consideration to the above mentioned points.

Should you wish to discuss any aspect of our request please contact Mr Shaun Ruddy, Manager Regulatory & Compliance on (02) 8908 2714 or email sruddy@auspg.com.au

Yours Sincerely,



James Myatt
Chief Executive Officer
Australian Power & Gas