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### **Draft Decision - Benchmark Retail Cost Index**

Thank you for the opportunity to comment upon the Authority's *Draft Decision on the Benchmark Retail Cost Index*.

TRUenergy acknowledges the work of the Authority in determining the benchmark retail cost index, particularly given the external time constraints imposed. However, due primarily to unprecedented high electricity contract prices over recent months, an index of 9.98% will not meet the Minister's objective "to ensure existing headroom remains relatively stable". Instead, margins will be substantially eroded, turning negative for some customers. This will diminish the level of competitive activity from the commencement of FRC.

#### *Actual Energy Purchase Costs*

CRA's approach to estimating energy purchase costs relies upon a hypothetical two-year hedging strategy of a prudent retailer. However, we query the relevance of such an approach, developed for benchmarking work in Victoria, as the decisions to introduce both retail contestability in Queensland and to sell the government-owned retail businesses were taken within that two year period. It would be appropriate to consider a more truncated hedging strategy.

In addition, CRA predicted that contract prices would fall in May and June to an average of \$47.50, the mid-point between prices in March (\$35/MWh) and April (\$60/MWh). However, three weeks into May it is now evident that contract prices will remain high for the remainder of the financial year, whereby the actual energy cost allowance for the final two months should be revised upwards.

Adopting a hedging strategy from May 2006, following the sale announcement, and adjusting prices for May and June 2007, results in an estimate of \$42/MWh, compared to the CRA estimate of \$38/MWh.

#### *LRMC of Energy*

As identified by CRA, there is a difficulty in estimating LRMC arising from methodological inconsistencies in the 2005 and 2007 ACIL Tasman reports. To rectify this CRA used data from the 2007 report to estimate costs for 2006/07.

The outcome is a 1.62% increase, from \$43.3/MWh to \$44.0/MWh. However, we are concerned that this value underestimates the LRMC increase.

An alternative approach is to consider the medium-term LRMC trend identified in the 2007 report, on the grounds that we would expect a similar increase in 2007/08. The ACIL Tasman estimates for 2007/08 to 2011/12 show a consistent increase in costs in the range of 2.0% to 2.5% per annum. There is no reason to suspect that the change in 2007/08 would vary from the medium-term trend, whereby the Authority should adopt an increase in LRMC of 2.25%, to \$44.38/MWh.

#### *FRC Operating Costs*

South Australia has been the only market that has facilitated a highly competitive market in the early stages of FRC, in part because of a realistic evaluation of retailer costs. ESCOSA also had the benefit of experiences in Victoria and New South Wales in establishing prudent cost benchmarks. It is for these reasons that we consider that the South Australian electricity FRC cost allowance is the only benchmark which should be considered. Adjusted for inflation, this provides an FRC allowance of \$11.30 per customer.

#### *Customer Acquisition Costs*

CRA are incorrect in their understanding of the IPART decision on customer acquisition costs, claiming that "*IPART was considering a new entrant, where all customers had to be acquired.*" In fact, IPART were considering a retailer the size of TRUenergy and other host retailers in Victoria that had already established a customer base in New South Wales. Nevertheless the full \$35 acquisition was applied, and not discounted on the basis of the level of customer churn. The same approach should be adopted for Queensland whereby a customer acquisition cost of \$35 is allowed.

With regard to the allowance for loss of scale, CRA used adjustments in the retail operating costs calculated by ESCOSA. However, the ESCOSA analysis was based upon an explicit assumption that electricity customer losses would be balanced by gas customer gains, providing a stable customer base. A more appropriate approach for Queensland is the alternative method described by CRA, based on the proportion of total costs that are fixed, adjusted for the rate of churn, providing an estimate of \$5.63. There is no indication from CRA as to why this would not be an accurate estimate of loss of scale costs.

Please contact me on (03) 8628 1122 if you require additional information.

Yours Sincerely,

**Graeme Hamilton**  
**Regulatory Manager**