



Benchmark Retail Cost Index 2009/10 Interim Consultation Notice

AGL submission to the Queensland Competition Authority
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1. Executive Summary

AGL welcomes the opportunity to comment on the QCA's Draft Decision on the Benchmark Retail Cost Index (**BRCI**). AGL is looking forward to working closely with the QCA and its consultants, Charles River Associates (**CRA**) in determining the final 2009/10 BRCI.

AGL supports the intent of the BRCI, which is to capture the rate of change in a Queensland retailer's cost structure year on year. As has been previously noted in AGL's submissions to the QCA, if these costs are not properly assessed and allowed for, there is likely to be a detrimental impact on the level of competition in the retail market and investment in the energy market in Queensland.

AGL does not believe that the QCA properly assessed the costs of a retailer operating in Queensland in its Final Determination of the 2008/09 BRCI (**2008/09 Determination**). AGL has identified a number of significant issues with the 2008/09 Determination and CRA's Calculation of the Benchmark Retail Cost Index for 2007/8 and 2008/09 (**CRA Final Report**). Further, a number of these decisions of the QCA and CRA in respect of the 2008/09 BRCI will, if applied, have significant impacts on the 2009/10 BRCI Determination. These errors include, but are not limited to:

- › Failure to provide information to stakeholders as required under the *Electricity Act 2006 (the Legislation)* and as required to enable a fair and reasonable consultation process as required under the principles of natural justice;
- › Failure to take account of the direction from the Minister for Energy in the Delegation to the QCA to ensure 'competitive headroom remains relatively stable';
- › Failure to take account of the clear direction in the Energy Regulations 2006 (**Regulations**) to use the same data in any recalculation of the 'base year' as was used in the previous BRCI Determination. The QCA is adopting an approach of forecasting 'conservatively', thereby incorrectly suppressing the BRCI in one year, and then substituting the actual data for the forecast data in the subsequent year's determination, thereby guaranteeing a margin erosion.
- › Ignoring the clear and unambiguous direction in the Legislation and Regulation to calculate the wholesale costs on the basis of the NEM Load.

The QCA's erroneous approach of considering any change in methodology as permitting a substitution of previous forecasts with actual data not only has significant impacts on retailer headroom, but also deters stakeholders from advocating any improvement to flawed methodologies used in the previous BRCI Determination. In order for the BRCI to be 'self correcting' over the years, the QCA must continue to use the data as forecast previously. However, the QCA has clearly signalled that it will not permit this process of self-correction if there is to be any change to any aspect of any methodology used to calculate any component of the BRCI. This approach places retailers in the invidious position of attempting to predict whether allowing a flawed methodology to continue to be applied, or permitting the QCA to substitute forecast data with actual data, will have the most significant impact on the BRCI's ability to accurately track a retailer's costs.

AGL is firmly of the view that the QCA should take the following approach in calculating the 2009/10 BRCI:



1.1. Provision of model, input assumptions and modelling results

The QCA and its consultants, CRA, must provide as a matter of urgency the models, the input assumptions and the results of the modelling on which the 2008/09 BRCI was based. In the absence of this information, AGL is precluded from properly commenting on the methodologies adopted by the QCA and CRA.

1.2. Wholesale costs

AGL does not support any substitution of forecast data with actual data in any circumstances, irrespective of any change in methodology.

If, after fully informed consultation with retailers on the methodology used in 2008/09, the QCA does not significantly change the methodology, but the QCA do comply with the legislative requirement to use the NEM load rather than the entire Queensland load, the QCA should calculate the wholesale costs for 2009/10 by:

- › using the LRMC and energy purchase costs calculated by CRA on the basis of the NEM Load for the purposes of the 2008/09 BRCI as the 'base year' costs for the 2009/10 BRCI – ie the QCA does not need to recalculate the 2008/09 costs;
- › calculate the 2009/10 LRMC using the most up to date input costs, including updated generation capital costs. AGL will be commissioning ACIL Tasman to compile these numbers in accordance with its 2007 Report and 2008 Report.

While AGL is suggesting there are better methodologies to capture the actual costs of meeting the Mandatory Renewable Energy Target (*MRET*), AGL is not suggesting that this should be considered as having any implications on the broader wholesale cost methodology.

1.3. Network Cost

In calculating the network cost component, the QCA should;

- › consult in an open and transparent basis on the methodology that is to be used to estimate the TUOS costs for 2009/10, and consider the significant detrimental impact on retailer margin if the TUOS costs are underestimated, particularly in light of the fact that the actual distribution costs that will be incurred in 2009/10 will be substantially greater than those captured in the BRCI (due to the impact of 'averaging' of Ergon and Energex's AARR and the ability of Energex to rebalance its tariffs);
- › publicly commit to using the TUOS costs it forecasts for 2009/10 for the subsequent BRCI process;
- › provide stakeholders with a clear and transparent reconciliation of the network costs included in the BRCI over the period from 2006/07 through to 2009/10.



1.4. Retail Operating Costs

In calculating the retail operating costs, the QCA should:

- > continue to use the 'benchmarking' approach;
- > forecast the churn rate for 2009/10 in line with the churn observed in functioning competitive markets such as South Australia and Victoria;
- > ensure that the acquisition costs calculated for the purpose of the 2008/09 BRCI for the year 2008/09 are used in determining the 2009/10 BRCI – ie are not recalculated; and
- > make sufficient provision for the increased cost of capital in the retail operating costs.

1.5. NEM Load

Where the electricity load is in any way relevant, the QCA should use the one consistent calculation of load, being the NEM Load calculated in accordance with legislative and regulatory requirements. Further, any inaccuracies in the estimation of the relevant load for the 2009/10 tariff year should be permitted to be self-correcting – ie not updated to reflect actual outcomes in subsequent years.



2. General Comments on QCA Process

2.1. Time constraints

AGL is very concerned by Queensland Government's decision to bring forward, and truncate, the consultation and determination of the 2009/10 BRCI (2009/10 Determination). AGL's concerns focus on:

- › The QCA will need to use at least 6 months of forecast data, if not more, in order to make the 2009/10 determination. This clearly erodes the confidence that stakeholders can have in the determination. Further, given the QCA's demonstrated proclivity to make more conservative forecasts than those which eventuate (detailed further below), AGL is concerned that in pulling the determination for 2009/10 forward, the step change between 2009/10 and 2010/11 will be greater;
- › The shortened consultation timeframe will not permit sufficient time for stakeholders to properly interrogate and analyse the draft reports of the consultants and the draft report of the QCA. AGL is of the view that the truncated consultation time will preclude the opportunity of a full and fair consultation as provided for under section 99 of the Regulation and as required under the principles of natural justice.

AGL is encouraging the government to extend the time frame for consultation so as to permit the 2009/10 Determination to be made by May 2009.

2.2. Provision of information necessary for fair and reasonable consultation process

AGL is pleased to note that the QCA has included in the consultation process an opportunity for stakeholders to comment on CRA's draft report prior to the QCA's release of its Draft Decision. AGL is hopeful that this will present an opportunity for stakeholders to participate in a fair and reasonable consultation process.

However, AGL remains firmly of the view that unless the consultants are required to provide their model, methodology, inputs and the results of their modelling, stakeholders will not be provided with a fair and reasonable opportunity to analyse and comment on the consultant's work, which forms the basis of the QCA's decision. AGL does not believe that the QCA's 2008/09 consultation was conducted in accordance with the Regulations, which require the QCA to provide the 'methodology and reasons' for the draft decision, nor in accordance with the principles of procedural fairness under the general law.

Further, it has become evident that CRA's internal processes are not robust, and require detailed stakeholder oversight. CRA publicly recognised two basic computational and input errors in its modelling work, one of which was only made known to stakeholders in the Final Report and QCA 2008/09 Determination. Given the total lack of transparency of the modelling work performed by CRA underpinning the 2008/09 Determination, stakeholders can have no confidence that there are not in fact other errors in the CRA work. Putting to one side the clear implications as to the validity of the 2008/09 Determination, these errors have eroded any faith stakeholders can have in the process without involvement and oversight of the modelling work. It is completely unreasonable in these circumstances to permit a regulatory pricing process to continue without requiring its consultants to make all of their inputs, models and results available.



AGL notes in this context that it is regulatory best practice to provide stakeholders with direct access to the model and modelling of consultants engaged by regulators. AGL draws the QCA's attention to the practice adopted by the Australian Competition and Consumer Commission (**ACCC**) in 2007 in developing the regulated price for Mobile Termination Access charged by Telstra, Vodafone and Optus. In that matter, interested parties were provided with direct access to the model developed by the economic consultants and the inputs used by those consultants. AGL understands that pricing models often comprise intellectual property but believes that the legitimate interests of consultants are appropriately protected by providing that parties who have access to the models enter into confidentiality deeds.

2.3. Direction to substantially maintain headroom

The QCA is subject to a direction under the Delegation from the Minister for Energy dated 13 March 2008 (**Amended Delegation**) that the QCA must have regard to the following policy objectives in determining the BRCI:

“(a) the annual indexation of electricity tariffs by the index should ensure that existing retail headroom in the tariffs at the date of this delegation (as modified by condition 2 below) remains relatively stable, although not necessarily the same from year to year

“(b) the policy of enabling small market customers to revert to notified prices should not result in a retail entity providing customer retail services to non-market customers at a loss”.

The genesis of this direction was a letter from the Queensland Government to prospective bidders for the retail businesses, dated 1 November 2007, which stated that:

The overall policy intent of the annual indexation of tariffs by the benchmark retail cost index is to ensure that the actual increases in (the total) electricity costs are reflected in the level of tariff increases. This approach will, amongst other things, ensure that the competitive headroom in Queensland remains relatively stable. Additionally, the intent is to ensure that the reversion policy does not result in retailers providing services at a loss to customers

As such, it is incumbent on the QCA to approach its determination of the BRCI with a view to ensuring that the difference between a retailer's costs and retailer revenue is not significantly eroded.

The QCA stated in the 2008/09 Determination that it believed it was incapable of giving any effect to this statement in the absence of retailers providing the QCA with details of their wholesale position, stating in the 2008/09 Final Determination, at page 53:

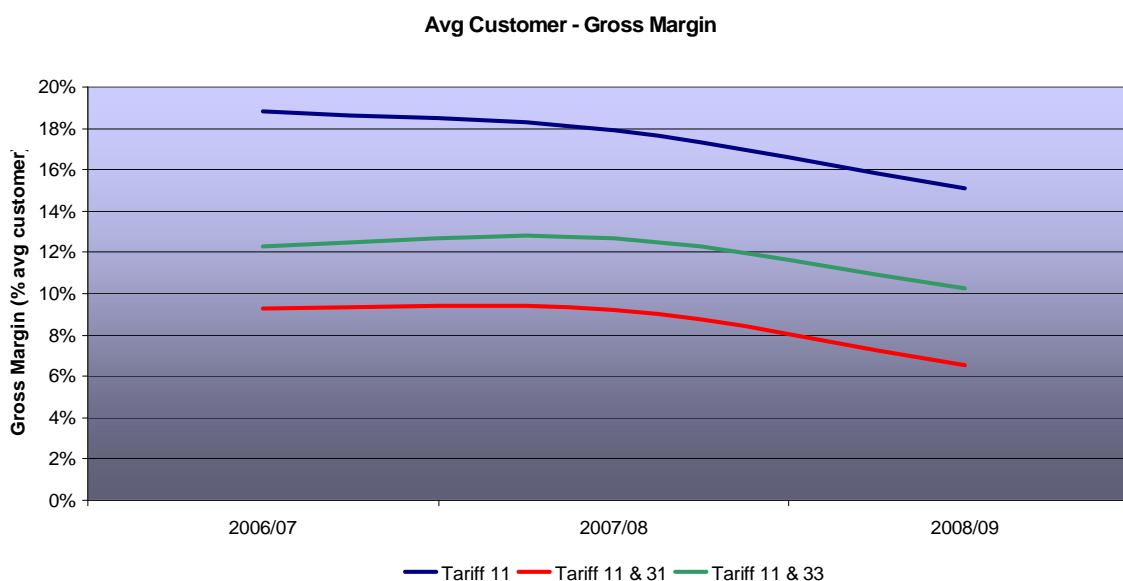
The Authority has considered whether the requirement of the Delegation to ensure that existing retail headroom in the tariffs remains relatively stable has been met. The Authority does not have actual information on retailers' margins or the existing headroom and is therefore unable to undertake an actual comparison between years. However, the Authority believes the BRCI has been designed with a view to main this headroom. As the Authority considers that all sources of change have, within the limits of the Electricity Act, Regulations and the delegation, been specifically addressed in this Final decision, it considers that the headroom available as at the date of the Delegation will have been maintained.

Further, no evidence was provided in submissions to demonstrate that headroom was likely to deteriorate in 2008-09.

AGL does not accept that the QCA are unable to properly give effect to this direction in the absence of 'actual retailer's margins' or existing headroom. Further, it is patently obvious from the approach taken by the QCA on a number of determinative points, that the QCA has not given any weight to the cumulative impact of its decision on retailer margins. This is evidenced by the following:

- > A simple analysis of the impact of the increasing distribution costs on a retailer's gross margin, using the regulated WEC and the regulated tariffs, clearly demonstrates that retailer headroom has not been maintained. This clearly demonstrated in Figure 1 below, and in confidential Annexures 1 and 2. AGL can only assume that the QCA did not perform this simple analysis when it was 'considering whether the requirement of the Delegation to ensure that existing retail headroom in the tariffs remains relatively stable has been met'.

Figure 1: Change to gross margin (ie excluding operating costs) using regulated tariffs, regulated wholesale costs and actual distribution tariffs on average customers on Tariff 11, Tariff 11 and 31 and Tariff 11 and 33



- > Notwithstanding the direction in the Delegation, and the obvious impact on retailer headroom of the Amended Delegation and the increasing distribution costs, the QCA adopted a 'limited' approach on a number of matters throughout its 2008/09 Determination which had the clear cumulative effect of suppressing the BRCI. This is evident from the CRA Report, particularly Table 25 and Table 26 at pages 55 to 58 of that report, which sets out clearly the impact of the QCA's decisions in respect of the relevant load, the substitution of the forecast data used with the actual data, and the choice of 'trended' LRMC costs over actual 2008 costs. Not only were a number of these approaches questionable in the context of a direction to maintain headroom, but were also in direct conflict with the clear and natural meaning which should be attributed to legislative and regulatory provisions discussed in further detail below.



- › Further, and of most concern, the approach of the QCA to ‘recalculating’ the BRCI, effectively ensures that not only will ‘conservative’ forecasting impact on a retailer’s margin in the determination of the BRCI in that year, but the substitution of that forecast data with ‘actual’ data in the following year will inevitably have a negative impact in that subsequent year. The compounding, negative effect of this clearly erroneous approach on retailer headroom is detailed further below.

2.4. Substitution of data used in previous BRCI with actual data not available at the relevant time

AGL is deeply concerned by the QCA’s disregard of the clear and natural meaning of the Energy Regulation in adopting an approach of forecasting and then substituting with actual data in the following year on the basis of a methodology change. AGL remains of the view that there is no legislative, regulatory, rational nor defensible basis on which to use the actual costs rather than the costs that were estimated and used at the time of determining the previous BRCI. Such an approach is neither in accordance with the legislation and regulation, nor in any way compatible with a purported purpose of ensuring a retailer’s costs are assessed so as to substantially maintain the existing headroom.

2.4.1. Impact on retailer headroom

The impact of this approach on retailer headroom is set out below:

Acquisition costs

In the 2008/09 Determination, the QCA used the CRA ‘alternative’ calculations using actual churn data for 2007/08 in preference to the churn forecast by the QCA and CRA for the purposes of the 2007/08 BRCI.

- › In the 2007/08 Determination, the QCA assumed that the churn between 2006/07 and 2007/08 would be 5%, notwithstanding stakeholders submissions that this was a very low estimate of the expected churn. The actual churn between 2006/07 and 2007/08 was 17%.
- › For the purposes of the 2008/09 BRCI, the QCA have estimated that the churn between the years 2007/08 and 2008/09 will be 10%.
- › In calculating the rate of change between 2007/08 and 2008/09 in acquisition costs, the QCA has not used the costs based on their forecast, and therefore the costs retailers have actually recovered, but have used the costs a retailer has actually incurred, being those based on actual churn figures of 17%. On this reasoning, the retailer’s costs have actually decreased, as the churn is decreasing from 17% to 10%, completely ignoring that the retailer’s tariffs were determined on the basis of a churn rate of 5%.
- › In choosing to use the ‘actual’ churn of 17%, rather than the forecast churn of 5%, the QCA has incorrectly lowered the 2008/09 BRCI by 1%. The impact of using a lower churn rate of 5% in the 2007/08 BRCI rather than a higher churn rate (as suggested by retailers at the time) is depicted below in Figure 2. The impact of then using the actual rate of 17% in the 2008/09 BRCI rather than the forecast churn rate of 5% is depicted in Figure 3.

Figure 2: Impact on 2007/08 BRCI of using churn rate of 5%

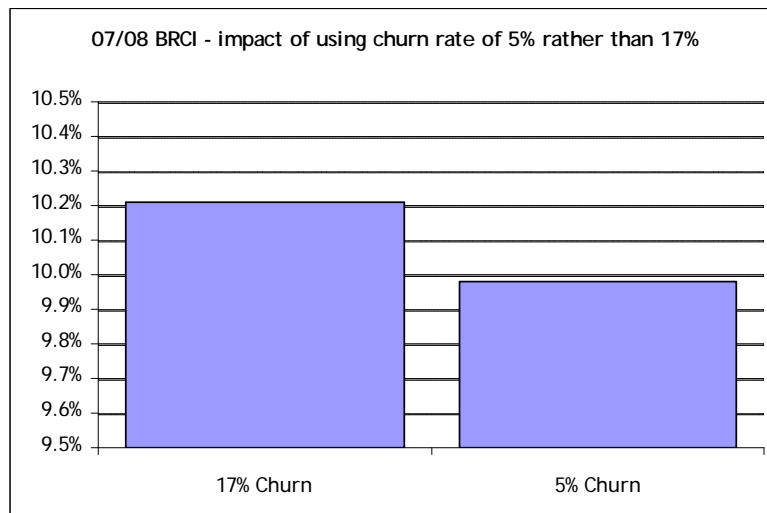
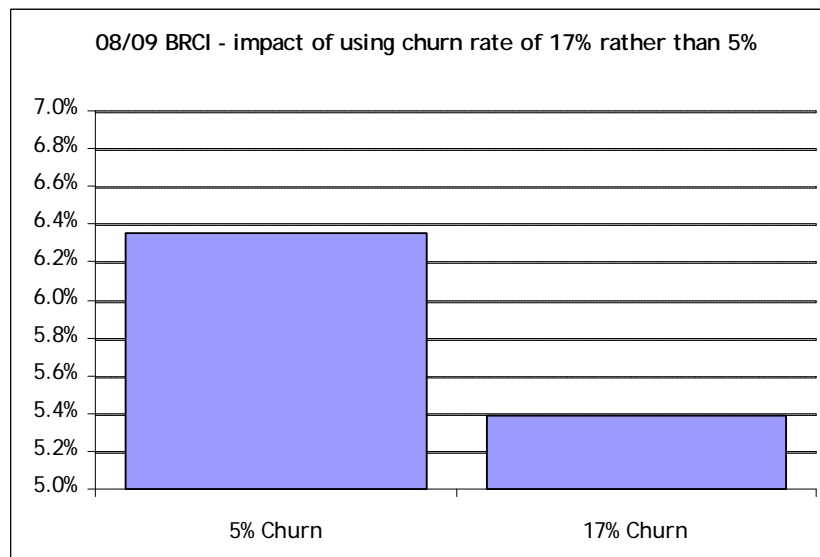


Figure 3: Impact on 2008/09 BRCI of using churn rate of 17% rather than 5%



Energy Purchase Costs

Similarly, the QCA's updating of contract data had a significant impact on retailer margin.

Figure 4: Forecast contract prices vs actual contract prices observed

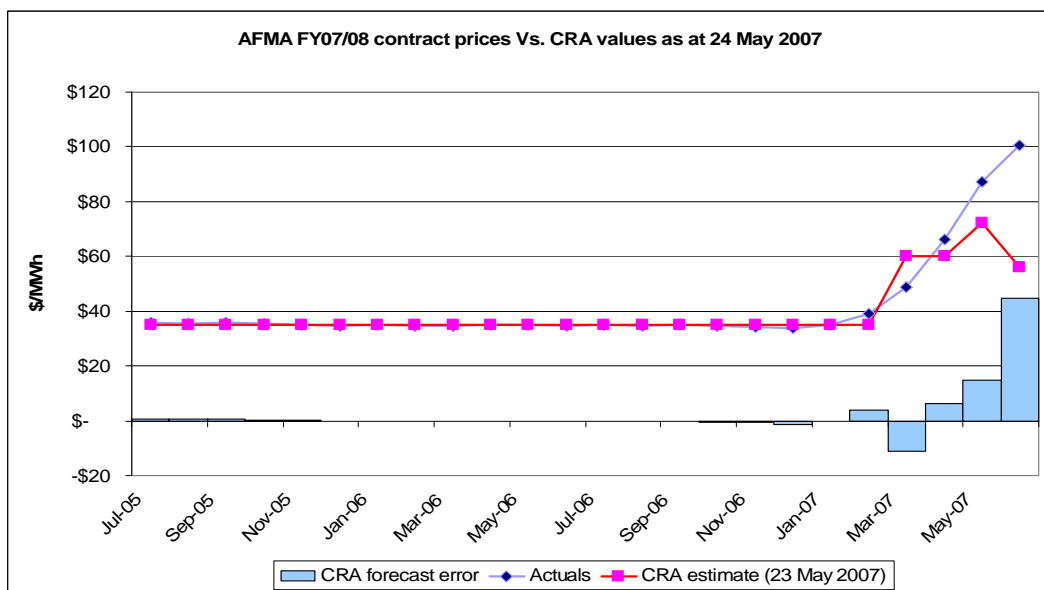
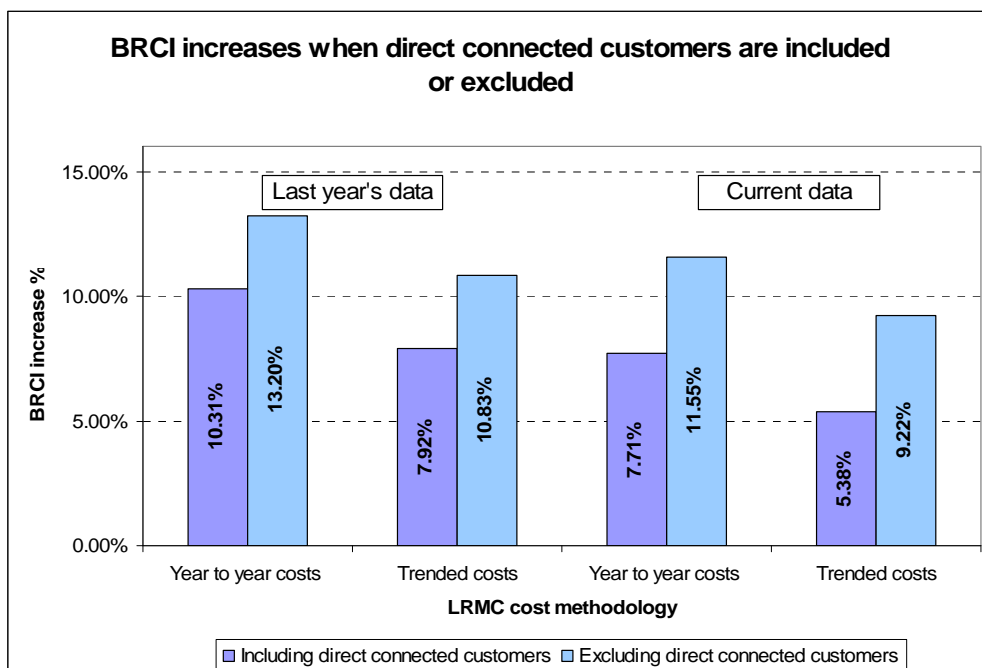


Figure 5: Impact of updating data on 2008/09 BRCI





2.5. Appropriate load to be used in WEC calculation

AGL does not accept that the appropriate load to be used in determining the wholesale cost is the entire Queensland load. As noted in AGL's submission to the QCA dated 4 April 2008, there is no legislative nor regulatory basis to support such an interpretation:

AGL does not believe there is any basis to use the total Queensland system load in determining the LRMC or the energy purchase costs – neither the Legislation nor the Regulation support such an interpretation:

- › *Section 92 of the Act clearly states that the relevant cost of energy is that to supply the NEM load, with particular reference in section 92(3) to the LRMC of the 'NEM load';*
- › *Section 105(c) of the Regulations states that the LRMC should be calculated to meet the demand profile, referred to as the NEM load shape, formed over each half hour trading period;*
- › *Section 106 stipulates that ancillary services necessary to meet the NEM load for the State must also be taken into account.*

It is AGL's firm view that the QCA have ignored a clear legislative and regulatory direction and stakeholder submissions in its 2008/09 Determination, using instead the entire Queensland load in determining the LRMC and energy purchase costs.

Further, AGL does not believe that the reasons put forward by the QCA as justifying the inclusion of direct connect customers are valid. AGL notes that the QCA did not at any time consult with stakeholders on the assumptions it was making in this respect, thereby denying stakeholders the opportunity to correct the QCA's erroneous assumptions, discussed below:

2.5.1. NEM load and energy purchase costs

As was evident from the Final CRA Report, there is a significant impact on the BRCI from using the entire Queensland load rather than the NEM load. AGL makes the following comments on the QCA's justification for this approach:

- › The QCA have premised their decision to use the entire Queensland load on the basis that a retailer providing services the entire range of customers, including direct connect customers, will be able to smear the cost of hedging across those customers, stating that:

the costs and prices associated with meeting the NEM load are those determined in the context of the actual market supplying the total load of the State, rather than those that might prevail in a non-existent smaller market.

Retailers servicing large 'direct connect' customers and smaller customers do not achieve any 'scale advantage' which can be factored into pricing for small customers. In suggesting that these 'scale benefits' exist, the QCA is suggesting that a retailer operating in a fully competitive market will be able to cross-subsidise the cost of hedging smaller customers from the lower costs of hedging the large direct connect customers. This does not accord with any economic theory or observation of functioning, competitive markets:



- » Any retailer using its lower hedging costs on large customers to subsidise lower prices for smaller customers will very quickly lose its large customers to competitors who do not service smaller customers;
 - » A pricing strategy which relies on the retention of large, direct connect customers is not sustainable – this would mean that the loss of a single customer could render all smaller customers unprofitable.
- › In seeking to justify the decision to use the entire Queensland load, the QCA also reference CRA's preference for this approach on the basis of 'significantly more robust data' being available – ie CRA had load data up until 31 December only. AGL notes in this respect that:
- » AGL understood from Regulation 105 that the NEM load and NEM load shape is calculated with reference to load data from the previous calendar year – ie the relevant data for 2007/08 would have been the data from 1 January 2007 through to 31 December 2007;
 - » If data beyond 31 December 2007 is considered relevant, it is AGL's understanding that the NEM load data would in fact have been readily available from NEMMCO. In fact, AGL had understood from communications with the QCA that it had in fact sourced this data. AGL can only assume that the reason the 'more robust data' was not available is because neither the QCA nor CRA actually asked for this data.
 - » Irrespective of the availability or otherwise of this data beyond 31 December 2007, it is a simple task to model a direct connect load – it is big, flat and stable. In circumstances where CRA is prepared to make forecasts of system loads 20 years into the future, it seems inconceivable that CRA have concerns over their ability to model the removal of such a load from the entire Queensland load.

2.5.2. NEM Load and LRMC

With respect to LRMC, the QCA accepted CRA's view that this was appropriate 'because the generation system that the LRMC estimate is seeking to capture would be built to service the entire Queensland load, not just loads supplied through the distribution networks'. This is a theoretical exercise – many other aspects of the calculation of LRMC and BRCI are theoretical with no nexus to the existing circumstances in the market.

2.5.3. NEM Load in 2009/10 BRCI

AGL is very firmly of the view that the wholesale energy costs for the 2009/10 BRCI should be calculated with reference to the NEM load, and not with reference to the entire Queensland load.

AGL notes that, notwithstanding the purported difficulties in identifying the relevant load data, CRA have in fact calculated the wholesale energy costs for 2008/09 using the NEM Load. The 'base year' calculation of the wholesale energy costs (ie the LRMC and energy purchase costs for 2008/09) for the 2009/10 BRCI has been done, and should not be re-calculated. Therefore, if the QCA do not make any other changes to the methodology but do comply with the legal requirements to use the NEM load, **the QCA does not need to perform any re-calculation of the base year** – it can simply perform its 2009/10 calculation with reference to the NEM Load.



2.6. Calculation of input assumptions for LRMC

The QCA's 2008/09 Determination did not reflect the step change in LRMC costs clearly evidenced in submissions provided by AGL and other stakeholders. The QCA calculated the LRMC input assumptions for the 2008/09 BRCI on the basis that:

- › A 'trended cost' analysis should be adopted, which extrapolates the 15 year 'historical trend' in capital costs, derived from a regression analysis; and
- › The costs identified in the updated ACIL 2008 Report should not be considered when conducting this trended analysis. That is, the QCA ignored the ACIL 2008 Report data altogether, and conducted its regression analysis on the basis of the ACIL 2007 Report.¹

The QCA has stated in its Issues Paper that 'where possible, short-term energy-cost influences should be confined to the purchase cost calculation and that long-run aspects should drive the LRMC calculation'. The Authority has stated that it believes this is 'in keeping with the intent of the legislation', although it does not provide any evidence to support the suggestion that this was the intent of the legislation.

AGL fundamentally disagrees with the analysis performed by the QCA and CRA and makes the following submissions:

2.6.1. Year on year vs trended costs

AGL notes that:

- › The QCA appears to be of the view that 'short term energy-cost influences should be restricted to the purchase cost calculation and that long-run aspects should drive the LRMC calculation' and that 'this is more in keeping with the intent of the legislation and the different focus of these two elements'. The QCA does not provide any evidence to support its assertion that this is the 'intent' of the legislation. The QCA are imputing this intent into the legislation without any basis for doing so. In AGL's view, if one examines the Legislation and Regulation, which requires the QCA to determine the 'likely total of the costs' for the 'relevant tariff year', this focus on a single year could equally be indicative of an intent to ensure the year on year costs are assessed and included into the BRCI.
- › A year on year analysis is necessary in order to reflect the actual costs of constructing a power plant. A trend analysis is only appropriate in circumstances where there is no fundamental step change in the market. CRA recognises this in its 2008 Final Report, in noting that the trend approach will 'lag and dampen any consistent changes' in the costs and 'in the near term essentially miss the impact that rising iron and steel prices are having globally at present on power plant costs' (see page 16).

¹ AGL notes that the trended gas costs for CCGT were not referenced to either the ACIL 2007 Report, nor the ACIL 2008 Report. Essentially the year on year change for CCGT gas prices was considered to be the trended Victorian spot price, minus 2.5%.



- › The QCA has ignored all evidence of this step change (except as discussed below) on the basis that:
 - » the ACIL 2008 Report was based on ‘a small sample of generation plant which may or may not be representative of costs’. This ignores that ACIL Tasman did not only reference specific projects, but also references third party reports as providing evidence of a global shift in capital costs. Further, the QCA does not appear to have attached any weight to submissions made by other stakeholders, most specifically Origin Energy, which provided clear, incontrovertible evidence of this fundamental shift.
 - » the costs found by ACIL Tasman in its recent reports diverge from those observed in a previous study. The QCA do not appear to have considered that a divergence from observed trends is the very definition of a step change – ie such changes are proof of a step change, rather than evidence against such a finding.
- › The QCA and CRA have not consistently rejected the use of the year on year analysis, and in fact have adopted the ACIL 2008 Report in respect of the availability factor of OCGT plant – substituting the CRA draft availability of 71.7% with an availability factor of 97%. The QCA state that ‘this reflects the replacement of several old and under-performing OCGT generators with new plant that would have much higher availability’. In essence, what the QCA have done is take advantage of the availability factors of plant as evidenced by the ‘small sample of generation plant’, while refusing to acknowledge the costs incurred in building that new, more reliable plant.

2.6.2. Failure to use updated data in trended cost

Even if a trended cost analysis could be preferred in the circumstances, there can be no justification for refusing to use updated ACIL Tasman data in a trend analysis. As noted by ACIL Tasman in the ACIL 2008 Report, the methodology used by ACIL Tasman in compiling the ACIL 2008 Report was the same used in compiling the ACIL 2007 Report.

AGL will be requesting ACIL Tasman to compile a report similar to that compiled for the purposes of the 2008/09 Determination which will outline the relevant LRMC of energy for 2009/10.



3. Cost of Energy

3.1. Long Run Marginal Cost

3.1.1. 2008/09 LRMC cost in calculating 2009/10 BRCI

AGL does not support the substitution of forecast data with actual data in any circumstances. Further, if the QCA were to accept the legislative direction to use the NEM load, rather than the entire Queensland load, there would still not be any needs to re-calculate the LRMC energy cost for 2008/09 in determining the 2009/10 BRCI. CRA have already done the calculation of the LRMC on the basis of the NEM Load, which should be considered the appropriate cost for the base year of 2008/9. In these circumstances, the QCA could:

- › accept the 2008/09 'base' LRMC energy cost as that calculated on the NEM Load and trended cost; and
- › calculate the 2009/10 LRMC energy with reference to the NEM load and the actual year on year cost as will be set out in the ACIL 2009 Report.

For the avoidance of doubt, AGL does not believe this would constitute a change in methodology, and therefore there could not be any recalculation nor 'reopening' of the input assumptions used in respect of the 2008/09 costs in determining the 2008/09 BRCI.

3.1.2. Appropriate inflation rate

AGL does not agree with the QCA's use of 'trended' inflation rates. National inflation for 2007/08 is 4.2, and Queensland inflation is 4.8%. These inflation rates should be the basis of the LRMC.

3.2. Energy Purchase Costs

As noted above, AGL does not believe that stakeholders have been provided with sufficient data to enable proper analysis or comment on the methodology employed in determining the energy purchase costs. AGL make this point repeatedly throughout the consultation on the 2008/09 BRCI. AGL requests as a matter of urgency being provided with access to the QCA and CRA's models, input assumptions and modelling results which formed the basis of the 2008/09 BRCI. In the absence of this information, AGL will not have been provided with sufficient opportunity to comment on the methodology. AGL therefore reserves its right to comment on the methodology until this information has been provided.

AGL does not support a substitution of the data forecast for the purposes of the 2008/09 BRCI with actual data, irrespective of its availability. To be clear, under no circumstances should the QCA 'update' the forecast contract prices or the theoretical retailer's hedge position – both sets of data should remain as they were for the purposes of the 2008/09 BRCI.



In the event there are no other significant changes to the methodology, a decision by the QCA to use the NEM Load would not require a re-calculation of the 2008/09 energy purchase costs to determine 2009/10 BRCI. CRA have already done the calculation of the energy purchase costs on the basis of the NEM Load, which should be considered the appropriate cost for the base year of 2008/9. In these circumstances, the QCA should:

- › accept the 2008/09 'base' energy purchase cost as being that calculated on the basis of the NEM Load for the purposes of the 2008/09 BRCI; and
- › calculate the 2009/10 energy purchase costs with reference to the NEM load.

3.3. Other costs

AGL continues to be of the view that the methodology adopted by the QCA does not properly assess the costs to retailers of compliance with the Mandatory Renewable Energy Target scheme (*MRET*). Accordingly, AGL suggests the following:

- › The QCA should consider calculating MRET costs with reference to the long run marginal cost of renewable plant. As noted in previous submissions, the 'market cost' indicated by d-cypha transactions underestimates the true cost to retailers. There is a lack of liquidity in the REC market, and retailers of any significant size are not able to buy the volumes of RECs necessary at the 'market cost', but need to enter into contracts with renewable projects to underwrite the development of plant. AGL suggests that the same approach to RECs should be adopted as the QCA has adopted with other wholesale energy costs, namely 'weighting' the LRMC against the REC purchase costs. AGL is of the view that if there was such a change in methodology:
 - » the forecasts adopted by the QCA in respect of the market price of RECS for 2008/09 should be used, rather than any 'updated' actual data;
 - » as the change in methodology would relate to the calculation of the REC component of the wholesale cost only, there would be no grounds on which to 'open up' the calculation of other components.
- › In the alternative, AGL suggests that the REC component of the 2009/10 BRCI should be calculated with reference to a single year contracting time frame. This was specifically suggested by AGL in its submission dated 4 April 2008 in respect of the 2008/09 BRCI. For the avoidance of doubt, AGL does not believe that this would constitute any change to methodology, and the REC cost forecast for 2008/09 should be used without any 're-calculation' or substitution of actual data for forecast data.

3.4. Appropriate Weighting

AGL reiterates that the QCA approach in fact builds in several 'smoothing' processes, which means a weighting of 50:50 between LRMC and actual purchase costs in no way reflects the actual change in costs incurred by a retailer in servicing a regulated retail load.

AGL accepts a methodology of 'layering in' hedges over 2 years, and is not suggesting any change to the methodology for calculating the energy purchase costs on this basis. However, AGL maintains that given the 'long term' smoothing this builds into the energy purchase costs, the appropriate weighting should in fact be 75% energy purchase costs and 25% LRMC.



4. Networks

AGL considers it essential that the QCA provide stakeholders with a transparent and clearly articulated explanation of:

- › the approach it has taken in respect of the treatment of all capital expenditure and unders and overs in the BRCI calculations over the previous BRCI processes; and
- › the approach it intends to take in respect of the 2009/10 BRCI process.

AGL recognises that the calculation of these costs is a complex matter, and is concerned to ensure that all stakeholders have an accurate understanding of the QCA's approach.

4.1. Estimating TUOS costs

AGL is very concerned by the prospect that under the amended timeframe imposed by the government, the QCA will be required to forecast the TUOS costs for 2009/10.

AGL considers the method suggested by the QCA, whereby the percentage share of Powerlink's 2008/09 revenue cap accounted for by Energex's and Ergon Energy's 2008/09 transmission charges to Powerlink's 2009/10 revenue cap could form the basis of the estimate. However, AGL is also of the view that the estimation must take account of the fact that retailer margins will be significantly eroded in 2009/10 due to the impact of the Amended Delegation and the ability of Energex to significantly rebalance into its small customer base. In these circumstances it is imperative that the QCA accommodate the need to ensure the TUOS costs for retailers in 2009/10 are not underestimated.

Further, AGL seeks a clear undertaking from the QCA that whatever estimates are used in determining the 2009/10 BRCI will be used in any subsequent BRCI determination – ie it will not be 'updated' to reflect actual TUOS costs.

4.2. Re-smoothing of Energex DUOS costs

AGL remains of the view that the QCA should re-smooth the Energex AARR in order to account for the fact that the initial smoothing was done without removing the over-recovered revenue.



5. Retail Operation Costs

AGL continues to support the 'benchmarking' approach taken by the QCA in respect of the calculation of retail costs in 2008/09.

AGL notes the significant impact the QCA's erroneous decision to substitute forecast data with 'updated data' had on the retail operating costs component of the 2008/09 BRCI. The QCA chose to use CRA's 'alternative' calculations on the basis of data that was not available in respect of both the inflation rates to be applied, and the rate of churn on which the acquisition costs should be premised. The irrationality of the QCA's substitution of the assumed churn figure used in the 2007/08 BRCI calculation (5%) with the actual churn figure in 2008/09 (17%) is clearly demonstrated above.

AGL is very firmly of the view that, irrespective of any purported 'change to methodology' the QCA must use the same churn assumptions for 2008/09 as they were determined for the purpose of the 2008/09 Determination.

5.1. Acquisition costs

A number of stakeholders suggested that the churn figures for 2008/09 as estimated by the QCA were too low. AGL maintains the view that if the QCA properly assessing retailer costs so that retailer margin were being maintained at a relatively stable level, churn would be significantly higher than 10% for 2008/09 and even greater in 2009/10.

For the purpose of determining the acquisition costs for 2009/10 BRCI, AGL is of the view that the QCA:

- › should not recalculate the acquisition costs for 2008/09, but should accept the calculation it performed for the purposes of the 2008/09 Determination; and
- › should base churn assumptions for 2009/10 on the basis that it has complied with the condition in the delegation to maintain retailer margin. This would suggest a significantly higher level of churn should be anticipated in 2009/10 than the 10% in 2008/09, as has been evidenced in the South Australian and Victorian markets.

AGL was exceedingly surprised to see in the 2008/09 Determination a significant shift in approach to the calculation of acquisition costs from that proposed in the Draft Determination. The new approach is premised on the assumption that retailer acquisition costs are significantly less when customers are transferred from a regulated contract to a market contract, rather than between retailers. Further, the QCA and CRA made the following assumptions without any reference to stakeholders:

- › That the number of customers switching to a market contract from a regulated contract to be 82.1% in the first year of FRC, and 56.1% of the number of customers switching in the second year of FRC. This was based on an analysis of data published in South Australia, as there is no Queensland data on this point. AGL again notes the QCA and CRA's willingness to make assumptions in the absence of data on some issues, while professing a reluctance to do so in others;



- › That the costs of transferring from a regulated contract to a market contract with the same retailer would be \$100 in 2007/08. This estimate was based on 'a CRA survey of retailers not operating in Queensland – on the basis of telesales to sell a market contract to an existing customer, rather than door-knocking to win a new customer'.

Again, the lack of fair and reasonable consultation on these significant issues is exceedingly troubling to AGL. Notwithstanding this lack of process in respect of the 2008/09 Determination aside, AGL remains of the view that the QCA should not update the forecasted churn results or cost assessments for 2008/09 in determining the 2009/10 BRCI.

5.2. Allowance for increased risk

Despite acknowledging in a previous workshop that the higher costs of capital require either a higher allowance for margin, or a higher increase in operating costs and wholesale energy costs, the QCA did not make sufficient allowance in the 2008/09 Determination. AGL does not accept that the methodology adopted by the QCA in respect of wholesale costs does properly allow for the volume and price risk inherent in the market.

AGL remains of the view that the higher capital costs that are clearly observable in the market place must be taken account of in determining the benchmark retail operating costs.

6. NEM Load

As recognised by the QCA in its Issues Paper, the amended timeframe will require the QCA to forecast the NEM load for a significant period. Again AGL notes that an inaccurate estimate of this NEM Load will have significant impacts on retailer margin in circumstances where this margin is already being clearly eroded due to the increase in distribution costs which will not be captured under the BRCI due to the Amended Delegation.

AGL is very firmly of the view that:

- › the same NEM Load calculation should be used in respect of any component of the BRCI where load is relevant; and
- › any forecast of NEM Load for 2009/10 must be permitted to be self-correcting – ie must be used in any subsequent BRCI determination.

AGL suggests that the NEM Load could be forecast by:

- › scaling the total Queensland load by using NEMMCO 2008 Statement of Opportunities Demand projects (released recently); and
- › removing actual transmission connected load by extrapolating from existing data. As noted above, direct connect load is extremely flat and stable, and relatively simple to forecast. Clearly such modelling work should be performed in consultation with stakeholders. The only significant change to direct connect load would occur if there were new industrial or mine loads commencing in the relevant period. Any such projects and their forecast load would be available from NEMMCO, Powerlink and/or the Department of Mines and Energy.