



TRUenergy Australia Pty Ltd  
ABN 96 071 611 017  
Level 33, 385 Bourke Street  
Melbourne Victoria 3000

21 July 2008

Queensland Competition Authority  
GPO Box 2257  
Brisbane QLD 4001

electricity@qca.org.au

### **Interim Consultation Notice - Benchmark Retail Cost Index 2009/10**

Thank you for the opportunity to comment upon the Authority's *Interim Consultation Notice - Benchmark Retail Cost Index 2009/10*.

In the Authority's calculation of the 2008/09 BRCI, three decisions had a significant impact on the final decision:

- Calculating energy purchase costs on the entire Queensland load, rather than excluding direct connect customers;
- Updating data sources for the calculation of the 2007/08 base, rather than maintaining the data that was originally used; and
- Adopting a trended cost method of calculating energy purchase costs, rather than a year-to-year cost method.

Estimating the costs of energy retailing, including the cost of energy, is at best problematic. This is evidenced by the range of plausible outcomes identified by CRA for the 2008/09 BRCI, with a spread of 7.82%. Whilst assumptions and methods may be rationalised on a number of grounds, there is nevertheless a degree of arbitrariness in all decisions, with the contrary approach often supported by at least as substantive a case. Indeed, on the issues listed above TRUenergy considers the stronger case is contrary to the position adopted by the Authority:

- The benchmark retail cost index sets the price for electricity customers supplied on the standard tariff. It should reflect the costs of supplying these customers, or otherwise it will inevitably establish a cross-subsidy from one group of consumers to another. In this context, calculation of energy costs should exclude direct-connect customers, those with a measurable load furthest removed from the regulated customer base.
- In a market subject to accelerating cost increases, updated cost estimates for a specified time period will always exceed those originally calculated. This has occurred in the Queensland energy market for both energy and customer acquisition costs. In these circumstances it is unreasonable to recalculate, based on more recent data, a previous year's BRCI to establish the base BRCI for a subsequent year. Doing so ensures that,

whilst that regulatory framework remains, retailers will never be able to capture the additional revenue required to meet those additional costs.

- The sole exception to the “recent data” approach of the Commission is in response to the ACIL Tasman 2008 report, which the Authority disregarded on the grounds that the previous 15 year trend analysis should be relied upon. This ignores the reality of the step-change in energy costs that has recently occurred, which renders historical trends meaningless.

To the extent that there is conjecture on these issues, and to overcome uncertainty regarding assumptions and methods, regulators generally set cost components around the mid-point of the consultant’s analysis. TRUenergy has consistently argued the dangers of such an approach on the grounds that the greater market risk is underestimating rather than overestimating costs. If costs are overestimated, competition will ensure that any excess margins will be rapidly eroded within a national retail market in which new entrant retailers can rapidly respond to price signals. On the other hand, underestimating prices is unsustainable, potentially leading to retailer withdrawal or failure (as has already been evidenced) and the collapse of investment signals.

However, in this case, on each issue, the Authority chose to adopt not the mid-point, but the option with the lowest BRCI impact, whereby from a range identified by CRA of 5.38% to 13.2%, the final BRCI was 5.38%.

In addition, and without consultation, CRA adopted a significant change in the calculation of customer acquisition costs (CAC) which also had a downward impact on the BRCI. CRA argued that in addition to change of retailer transfers, retailers also incur CAC through customers transferring to a market contract with their existing retailer. This is true. However, the data published in South Australia, upon which the Queensland data was based, only measures the number of customers transferring from a standard contract to a market contract with the same retailer, and does not include the number of customers transferring from a market contract to another market contract with the same retailer.

Including only standard-market transfers, and not market-market transfers, will not only underestimate the total CAC, but will do so by an escalating amount over-time. This is because, as the proportion of customers on a standard contract inevitably declines, the number of standard-market transfers will decline. However, this will be compensated by a growth in market-market transfers (not measured by ESCOSA, and not included in the CRA analysis), which incur the same acquisition costs as the standard-market transfer. Either the number of market-market transfers must be included in the CAC estimate, or the QCA must simply rely on the transfer rate between retailers (on the assumption that the decline in standard-market transfers and the increase in market-market transfers will be self-cancelling).

The overall impact of the Authority’s decisions is a continued diminution of the retail margin in Queensland, beyond that which otherwise would have been adopted in other jurisdictions, and the failure of the process to meet the requirement to maintain retailer headroom. As a direct consequence TRUenergy

remains a passive participant in the Queensland retail market, to the detriment of Queensland consumers.

In consideration of the 2009/10 BRCI TRUenergy makes the following recommendations:

- Long-run marginal cost estimates should be based upon the 2008 ACIL report. The 2007 ACIL report is no longer relevant given the step change in construction and fuel costs that have occurred over recent years. At the very least a new method is required that captures these recent cost increases.
- Customer acquisition costs should only be calculated according to the number of transfers between retailers, and should not include standard-market transfers. The latter will inevitably decline over-time, but their cost impact will be replaced by a corresponding increase in market-market transfers, which are not measured. An adjustment will also be required to correct the 2007/08 error of only including standard-market transfers.

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

Yours sincerely,

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