



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

22 August 2008

Queensland Competition Authority  
GPO Box 2257  
Brisbane QLD 4001

electricity@qca.org.au

### **CRA First Report - Benchmark Retail Cost Index 2009/10**

Thank you for the opportunity to comment upon CRA's first report for the *Benchmark Retail Cost Index 2009/10*.

#### *Long-run marginal cost*

TRUenergy does not support the continued use of trend analysis from the 2007 ACIL Tasman report to calculate LRMC. Trend analysis is only appropriate if it is assumed that future variations around the forecast trend will be self-cancelling. It is not appropriate if there has been a step-change in costs, whereby future values will consistently exceed the previously identified trend.

The ACIL Tasman 2008 report indicates that a step-change in costs has occurred, given the magnitude of the increases identified. This is also consistent with the reports of industry participants, as well as recent increases in steel, construction and fuel costs, well above the 2007 report trends. To reverse the QCA's argument against the use of the 2008 report, there is no evidence to suggest that the costs identified in the 2007 report will be more representative of the future long-term trend than those identified in the 2008 report. Indeed, the fact that the 2008 report is based on the latest available evidence, an approach the QCA adopted for the 2008/09 BRCI final decision on a number of variables, suggests that they are more reliable.

Even if the QCA does not accept the step-change argument, at the very least the trend analysis should be updated to include the most recent data available. As a long-term solution we recommend that the QCA themselves commission ACIL Tasman, or another consultant, to update the 2007 report in response to recent evidence, and do so on a regular basis. It is unacceptable to continue to rely upon an historical report, the continued relevance of which has been seriously questioned by both industry participants and its own authors.

#### *Energy Purchase Costs*

Whilst TRUenergy generally supports CRA's method of calculating energy purchase costs, it is unreasonable to make a final decision on those costs six months prior to the commencement of the pricing period. Such an approach bases more than one-quarter of the retailer's hedge, in a highly volatile trading

market, on a predicted price. Furthermore, there is no reason to expect the predictive errors to be self-cancelling over time, but in fact could contribute to a long-term divergence between allowed and incurred costs.

We appreciate that the current timetable is outside the control of the QCA. Nevertheless, given the increased risk that the timing constraint places upon the final estimate, we recommend that the QCA commit to a true-up of that estimate for the 2010/11 BRCI calculation. This would not involve a recalculation of the base, but rather a cost adjustment recognising the variation between the actual and predicted price for the forward estimate months.

With regard to forecasting from the data-cut off date to the commencement of the pricing period, we recommend a reduction from 2 months to 2-4 weeks in the data used for that forecast. Notwithstanding an exceptional one or two day event, the more recent the price the more likely it represents a prudent estimate of future prices. An extension to two months of back data is highly questionable, with a greater potential for the older data not to reflect more recent market understandings.

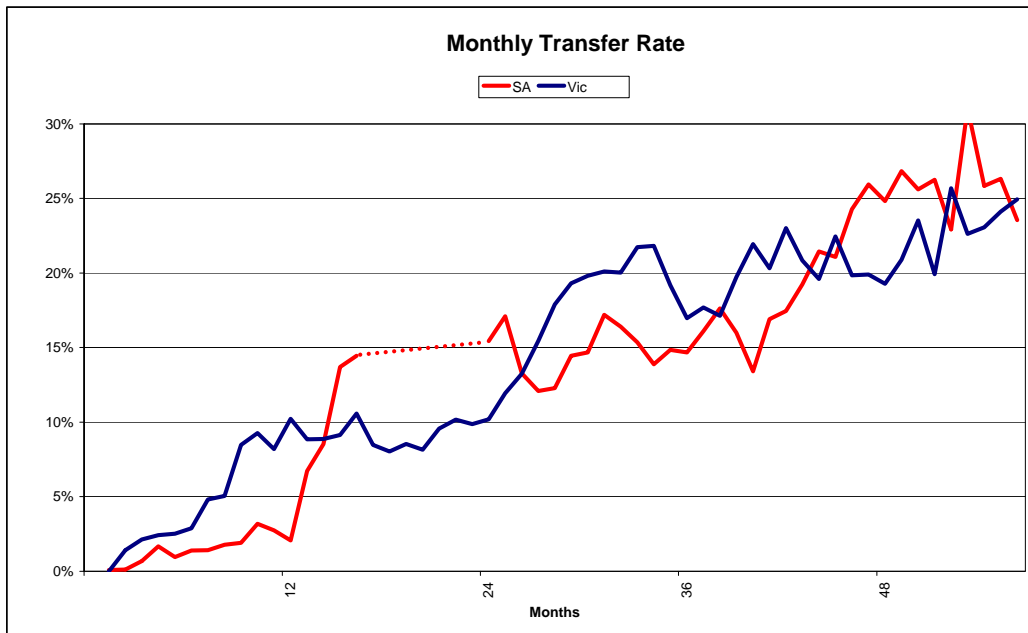
#### *Customer Acquisition Costs*

In general, TRUenergy has supported CRA's method of measuring customer acquisition costs. However, this is subject to two important exceptions:

- o We did not support the inclusion of intra-retailer transfers in the 2008/09 final report, on the grounds that the South Australian data only included standard-market transfers (which will decline over time) and not market-market transfers (which will increase over-time). This error arose due to an absence of consultation and has not been explained or defended in the current paper.
- o We did not support the updating of estimated with actual data for the base year calculation in the 2008/09 decision. As a lower estimated transfer rate was replaced with a higher actual rate, this lowered the BRCI and ensured that retailers were not able to recover the higher costs incurred as a result of the underestimated transfer rate in the base year.

To resolve these ongoing issues, and concerns regarding the customer transfer statistics in Queensland, TRUenergy recommends that the QCA base its calculations on the observed escalation of customer transfer rates in effectively competitive markets in other jurisdictions.

Evidence from Victoria and South Australia has demonstrated that customer transfer activity escalates over the first five years of full retail contestability to reach a potential long-term equilibrium of approximately 25%. There are of course variations around this trend, most noticeably when the South Australian government offered the Pensioner Transfer Rebate (replaced by a dotted line in the graph below). Rates have also fallen in recent months, as the price cap has squeezed margins following wholesale price increases. Nevertheless they are indicative of the transition path for a market to achieve effective competition.



Customer acquisition costs are driven by the level of competitive activity, which in turn is largely determined by the extent to which regulated prices are set by regulators at market-based levels. The clearest evidence of this is in New South Wales, where the transfer rate is well below that of Victoria and South Australia, and the regulator has acknowledged that many tariffs remain below market based levels.

Thus it would be reasonable assume that, providing the QCA meets the requirement of a consistent headroom over-time, the customer transfer rate should increase by approximately 5% each year, to an equilibrium of 25% after five years.

It is important to note that the base of the calculation is the total number of customers in that month. Therefore, even if the proportion of customer transfers remains stable, the actual number of customer transfers would have increased over the period due to the expanding customer base. This is in contrast to the CRA report which has assumed a constant number of customer transfers, but which represents an actual decline in the customer transfer rate. As argued above, the only circumstances in which this would occur is if the QCA failed in its requirement to maintain retailer headroom over-time.

#### *NEM Load*

TRUenergy does not support the inclusion of direct connect customers in the Queensland load calculations:

- o Section 92 of the Act explicitly requires the cost of energy to be calculated for the "NEM load".
- o The denominator is calculated with reference to the NEM load.

- No other jurisdiction includes direct customers in their energy cost estimates.
- LRMC is a theoretical construct. The fact that plant is not built to alone supply the NEM load is irrelevant. Neither is all plant constructed anew each year. If the BRCI were to rely on market realities, only the market purchase costs of the retailer would be considered.
- Retailers, assuming they supply any direct connect customers, cannot use these customers to cross-subsidise distribution network customers. Attempting to do so would ensure the retailer was uncompetitive in the direct connect customer market.

In summary, TRUenergy recommends the QCA:

- Commission a regularly-updated LRMC analysis, using more recent data than the ACIL 2007 report. In the short-term, accept the ACIL 2008 findings or, at the very least, include them in the long-term trend analysis.
- Commit to a true-up process in subsequent BRCI calculations to allow for predictive errors resulting from a requirement to estimate energy purchase costs more than six-months prior to the pricing period.
- Base acquisition costs on the observed growth in customer transfer rates in effectively competitive markets.
- Remove direct connect customers from Queensland load calculations.

Yours sincerely,

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