12 February 2011

Queensland Competition Authority
GPO Box 2257
Brisbane QLD 4001

By email: electricity@qca.org.au

Draft Decision Benchmark Retail Cost Index for Electricity 2011-12

Australian Power & Gas (APG) welcomes the opportunity to comment on the Queensland Competition Authority (QCA) draft decision on the Benchmark Retail Cost Index (BRCI) for electricity 2011-12. APG has limited its submission to high level comments on the review.

APG would reiterate its comments made in previous reviews that to further increase competition in the retail energy market and provide greater benefit to consumer's price regulation should be phased out in the Queensland energy market. The removal of price regulation will pave the way for market forces to set appropriate pricing which will provide greater benefits to consumers through increased competition.

However in the absence of price regulation being removed the QCA must ensure that prices for the supply of energy are se at cost reflective levels. Retail prices must be set at levels that allow for the full recovery of retailer operating costs, account for wholesale risk and contain sufficient headroom to encourage competition.

We provide the following comments in response to the draft decision. Should you wish to discuss our submission I may be contacted on (02) 8908 2714 or via email at sruddy@auspg.com.au

Yours Sincerely

Shaun Ruddy
Manager Regulatory & Compliance
Australian Power & Gas

Australian Power & Gas Pty Ltd
ABN 26 118 609 813

Level 9, 341 George Street
Sydney NSW 2000

Address all mail to:
Locked Bag 5004
Royal Exchange NSW 1225

Ph: 02 8908 2700
Fax: 02 8908 2701

www.australianpowerandgas.com.au

Benchmark Retail Cost Index for Electricity 2011-12

Need for Price Regulation:

As previously commented APG holds the view that price regulation should be phased out in Queensland and market forces used to set appropriate pricing. Where market forces are used to set pricing consumers will benefit through enhanced competition that will include new and innovative product offerings.

Lending support to the removal of price regulation is the QCA's own information from the draft decision on the level of competition in Queensland which comments that,

the Authority acknowledges that, as suggested in a number of (non-retailer) submissions, much has changed in the ensuing years with the rapid expansion of the level of competition from the initial staring position of two incumbent retailers covering the entire Queensland market. By way of comparison:

> *(a) as at November 2010, there were 12 retailers with small market customers operating in the state. Victoria, which has been fully deregulated since 1 January 2009, has a similar number of retailers (14);*
>
> *(b) as at November 2010, 55 different types of retail market offers were available to Queensland customers;*
>
> *(c) a substantial number of small customers in Queensland have moved to market contracts (41.7% as at September 2010). More importantly, the proportion of small customers on market contracts in the South East Queensland market now stands at 63.2%, comparable with that of the Victorian (60%) and South Australian (66%) markets at the time they were deemed to be competitive by the Australian Energy Market Commission. In comparison, 34% of NSW small customers were on market contracts as at December 2009 and 19% of small customers in the ACT were on market contracts as at June 2009; and*

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(d) the rate of customer switching, another indicator of market activity, is also high. For the 2009 calendar year, this was estimated to be 14.5% as a proportion of total Queensland customers and, as a proportion of South East Queensland customers, the switching rate was estimated to be 21.5%, exceeding that of NSW (13%) and South Australia (17%) and not far off the level of Victoria (26%).

We believe this information clearly supports the position for the removal of price regulation in Queensland.

Energy Purchase Costs:

In estimating the likely energy purchase costs the QCA comes to a view about the purchasing decisions that would be made by a prudent theoretical retailer operating in Queensland.

In making its assessment the QCA relies on a number of assumptions. A key assumption made by the QCA in its assessment of energy purchase costs / wholesale risk, is the availability of hedging products. It would appear the assumption made is that these products are generally availability for retailers to access to mitigate risk. In our experience this is far from being the case. A retailer's ability to negotiate and enter into appropriate contractual arrangements so as to mitigate wholesale risk can be impacted by a number of varying factors.

Whilst understanding the limitations faced by the QCA, we hold the view that the elements being used by the QCA in the methodology of assessing energy purchase costs / wholesale risk remain too broad. These elements should be reviewed in light of the diversification of retailers now operating in the Queensland market.

In addition, whilst not evident at the time of drafting this decision, the recent environmental conditions (QLD Flood) will have an impact on generation and subsequently impact the level of risk and cost faced by retailers.

The QCA needs to take these impacts into account in determining the energy purchase costs.

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Customer Acquisition & Retention Costs:

The QCA in its draft determination has chosen to combine and as a result reduce the costs associated with customer acquisition and retention. APG strongly disagree with this approach and the methodology adopted by the QCA in coming to this decision.

The QCA is basing its decision to combine the customer acquisition and retention costs on the basis of increased competition in the Queensland market. Whilst we agree on the point of increased competition in Queensland, we do not agree that this will result in reduced customer acquisition and retention costs.

We hold the firm view that a combined customer acquisition cost and retention cost (CARC) of $40.52 as proposed in the draft determination is a gross underestimate of the true costs of these services.

In its previous determination the QCA included customer acquisition and retention costs of $187.66 and $109.47 respectively. We fail to see how increased competition has resulted in such a reduction in these costs. Increased competition increases customer retention costs as retailers are required to do more to retain customers.

Operating Costs:

In the draft determination the QCA recognises the introduction of "Regulatory Service Fees" that are being imposed on retailers for the provision of regulatory services by the QCA.

However we note with concern that despite the fee being payable in both 2010-11 and 2011-12, the Authority has not adjusted the 2010-11 base for this year's BRCI calculation as the fee was not incorporated in the 2010-11 BRCI calculation.

Given the retrospective nature of the fee when it was introduced, the QCA must revise its decision and adjust the 2010-11 base and apply an escalation path for the fee and include this in the 2011-12 determination.

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Retail Margin:

The draft decision proposes the continuation of a 5% retail margin on the basis that this should provide a reasonable return to a retailer for the risk that it faces in operating in the Queensland market.

The QCA believes there is no evidence to support an increase in the retail margin. APG would argue that the proposed reduction in CARC should be offset by an adjustment to the allowable retail margin. Further as previously highlighted following recent environmental events in Queensland (Flood) generation and spot price increases are expected. Unless the QCA makes the appropriate adjustments to the energy purchase / wholesale costs used in the determination. These costs should be offset in an adjustment in the allowable retail margin.

APG hold the strong view that a 5% retail margin is not sufficient for the risk faced by a retailer operating in Queensland, and does not provide a reasonable rate of return that encourages further investment in the Queensland market.

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