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Simply smarter energy

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Review of Regulated Retail Electricity Tariffs & Charges
for Small Customers for 2007 to 2010
Independent Pricing & Regulatory Tribunal
PO Box Q290
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By email: energyretail@ipart.nsw.gov.au

Re: Draft Determination Review of Regulated Electricity Tariffs and Charges for Small Customers for 2007 to 2010

Australian Power & Gas (APG) welcomes the opportunity to provide comments on the Independent Pricing and Regulatory Tribunals (Tribunals) draft determination on the Review of Regulated Electricity Tariffs and Charges for small NSW customers.

APG as a new entrant energy retailer, supplying energy (electricity & gas) to small retail customers in NSW has a vested interest in the outcome of the review.

APG in general supports the Tribunals draft decision and that of the direction the Tribunal is taking in relation to ensuring cost reflective pricing for the supply of electricity is achieved.

However we would like to highlight the areas of the draft determination that are of concern;

- Energy purchase costs & the risk assessment of the volatility of wholesale electricity prices,
- The assessment of Retail Operating Costs for new entrant retailers & the assumption of the life of a customer,
- Retail margin,
- Time period for achieving cost reflective pricing.

Energy costs and the risk assessment of the volatility of wholesale electricity prices is a key issue. We understand the difficulty the Tribunal faces in making an accurate assessment of these costs now to apply at a future point in time. Our concern is that where this assessment is inaccurate it has the potential to impact the ongoing viability of second tier electricity suppliers. The fluctuation of a floating wholesale price against that of a non-cost reflective regulated tariff may have the potential to "squeeze out" second tier retail suppliers, especially as these suppliers do not have access to the current safety net provisions afforded to the standard electricity suppliers under the ETEF Scheme.

APG see this issue as a major concern that if not appropriately addresses has the potential to impact the level of competition in the NSW electricity market by limiting the ongoing viability of new entrant second tier electricity suppliers.

Furthermore the potential political and consumer confidence implication should not be overlooked. As if this issue is not appropriately addressed it may give rise to potential retailer failure necessitating the requirement to enact RoLR provisions.

Our view on how this and other issues may be addressed is detailed in our submission.

Should you require any additional information or wish to discuss any aspect of our submission I may be contacted on (02) 8908 2714 or email sruddy@auspg.com.au.

Yours sincerely

Shaun Ruddy
Manager Regulatory & Compliance
Australian Power & Gas

Draft Determination Review of Regulated Electricity Tariffs and Charges for Small Customers for 2007 to 2010

Australian Power & Gas (APG) wishes to provide the following detailed comments on the Independent Pricing & Regulatory Tribunals (Tribunal) draft determination on the review of regulated electricity tariffs.

Risk Assessment of the Volatility of Wholesale Electricity Prices

APG understands the difficulty the Tribunal faces in the accurate determination and setting of a regulated retail tariff that is to apply over the term of the determination period. A key issue in the view of APG is that of the accurate assessment of the costs used in determining the level of the regulated retail tariff. Of particular concern is the estimation of wholesale electricity costs and associated risk levels.

As the Tribunal would be aware the regulated retail tariff is generally viewed by both customers and second tier retailers as a benchmark tariff for the supply of electricity. This benchmark tariff is used by customers to assess the deal being offered to them by alternative retail suppliers and is used by these retail suppliers as the benchmark it needs to discount against in order to attract / acquire customers.

Of concern to APG is the consequence of having a regulated tariff that does not accurately reflect the risk from floating wholesale electricity prices. The potential ongoing upward movement of wholesale electricity prices (given current and future environmental constraints having an ongoing impact on the volatility of wholesale electricity prices) against a "fixed" regulated retail tariff against which second tier suppliers are discounting, has the potential to squeeze second tier retail suppliers out of the market.

That is, as the wholesale price increases the level of "headroom" against the regulated tariff decreases thereby limiting a retailer's ability to both acquire new customers and maintain their existing ones.

APG are of the view the determination should have a greater recognition of this risk and allow for the "re-opening" of the decision during the determination period where it is shown that the volatility in the wholesale electricity prices are impacting the viability of the market.

APG would welcome the opportunity to be engaged in detailed discussion with the Tribunal on how this would be best achieved.

Retail Operating Costs of New Entrant Retailers

APG notes the attempts made by the Tribunal to assess costs incurred by a new entrant retailers, APG supports and recognises the positive steps in including both Customer Acquisition Costs (CAC) and Retail Operating Costs (ROC) in the estimation of retailer costs.

APG as a new entrant retailer has concerns with the findings on the allowances for retail costs and retail margin. In our view these costs have been understated. For example,

- The ROC of $75 per customer is low in comparison to other jurisdictions, and in our view is not reflective of the costs incurred by a true new entrant retailer. We believe these costs to be between $85 - $90

- The ROC assessment has been formulated based on information provided by "Standard Retail Suppliers" which have previously been acknowledged by the consultants as "stable" retailers. These retailers are likely to have lower operating costs than that of a new entrant retailer, partly due to their close association with their related distribution entity. A true new entrant retailer starting from a nil base will incur significantly higher operating costs than that of either a standard retailer or an existing retailer who is entering the NSW electricity market. These costs need to be recognised and included as part of the assessment process so as to ensure a viable market exists for true new entrant retailers,

- The ROC over the determination period is flat / fixed with no allowances for increases to the cost components that makeup the operating costs. Increases relating to the cost of providing services, labour provisions etc, have in our view not been appropriately considered,

- Frontier Economics have recommended that total costs including CAC be amortised over the expectant number of years the customer will remain with the retailer. This has required the Tribunal to determine the average life expectancy / number of years that a customer will remain with the same retailer. The Tribunal has determined that a small retail customer will remain with the same retailer for an average of 8 years.

  APG does not support this assumption. Customer retention rates are linked to a number of factors, price and service being two. This current determination, with its proposed price increase may in itself have the potential to increase customer churn, thereby decreasing the number of years a customer will remain with the same retailer. Another factor to consider is that the average fixed term customer contract is for between 2-3 years, for a customer to remain with the same retailer for a period of up to 8 years they would be required to re-sign with the same retailer at least twice following the initial sign up.

  We consider that a customer re-signing this frequently would be the exception rather than the rule. This is based on the view that once a customer has exercised their right or opportunity to choose their retailer they are more comfortable with exercising this choice when future opportunities arise. In addition as more retailers offer no-fixed term contracts, a customer's ability to switch between retailers has significantly increased as they can switch at any time.

  Also when a customer is on a negotiated customer supply contract and their contracted period is coming to an end the retailer is required to provide notification of this, which includes providing information on other options available to the customer. This in itself is providing a prompt to the customer to look at other options available to them for the supply of their electricity. In affect promoting customer switch.

APG would point out that we are not adverse to customers exercising their right to change retailers and support customers have the availability of the required information with which to make an informed choice. We would suggest however the Tribunal consider the previous mentioned points when making its assessment of the life expectancy of a customer.

APG would suggest that a more accurate assessment of the life expectancy of a small retail customer to be in the vicinity of 5 years.

Retail Margin

APG hold the view that retail price caps should be removed and market forces relied upon to set cost reflective prices that account for the volatility of wholesale electricity prices. However within the current environment where retail price caps are to remain, retail margins must be set at levels that account for volatility in the wholesale market.

The Tribunal considers that a retail margin of 5% is appropriate for the determination period. APG does not support this view.

The 5% retail margin is based on the assumption that ROC & CAC have been accurately assessed. As previously stated it is our view that the risk and volatility associated with wholesale electricity prices and the accurate assessment of CAC (bearing in mind the issue around customer life expectancy), has not been adequately assessed given the current volatile wholesale environment.

Given this we would expect at a minimum that the retail margin be set at the high level of the spectrum recommended in the consultants report in an effort to account for the volatile wholesale market, this being 6.4%.

Time period for achieving cost reflective pricing

APG supports the Tribunal's decision for a move to cost reflective electricity prices. Under the determination price regulation will remain until 2010. This remains a significant period of time in which the reliance of second tier retail supplier viability will hinge on the Tribunals ability to accurately predict (taking into consideration risk and volatility of wholesale electricity prices) the appropriate "cost reflective" price for the supply of electricity.

APG recognises the difficult task the Tribunal has in making this assessment. However as previously stated it is our view that retail price caps should be removed. APG are of the strong opinion that the sooner the industry moves to remove retail price caps and impalements cost reflective pricing that is driven by market forces through competition the sooner benefits will flow through to customers in the form of more competitive offers.

This will also create the opportunity for a greater number of retailers to enter the NSW market, while also providing the incentive for increased market investment, including investment in items such as renewable generation.