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

1 May 2007

Review of Regulated Retail Tariffs and Charges
for Electricity 2007 to 2010
Independent Pricing and Regulatory Tribunal
PO Box Q290
QVB Post Office NSW 1230

energyretail@ipart.nsw.gov.au

**Review of Regulated Retail Tariffs and Charges for Electricity 2007 to 2010 – Draft Determination**

Thank you for the opportunity to comment upon the Draft Report and Draft Determination on the *Review of Regulated Retail Tariffs and Charges for Electricity 2007 to 2010.*

TRUenergy welcomes and supports the draft determination on the grounds that it is more likely than current regulated tariff settings to provide the market signals required to facilitate a more competitive retail electricity market, and encourage investment in new generation capacity. However, the recent unprecedented increases in wholesale electricity costs will need to be monitored to ensure that the benchmarks established in the decision continue to send the appropriate price signals for the period of the determination.

*Form of Regulation*

TRUenergy supports the relaxation of cross-balancing constraints in the draft determination. This will assist standard retailers in accelerating the transition to cost reflective tariffs, and thereby the development of a competitive market. There is an inherent difficulty in a regulator attempting to set cost-reflective targets at the individual tariff-level, demonstrated by the adjustments still required to achieve cost-reflectivity on some tariffs six years after the commencement of FRC.

The proposal to not allow the aggregation of pass-through events in considering the 0.25% threshold appears harsh. It is possible that a number of events slightly below the threshold may occur within a 12 month period, the cumulative impact of which would be significant upon retailers.

*Energy Costs*

TRUenergy supports the adoption of the market price (conservative) energy costs in the draft determination. Based on our experience, the long-run marginal cost estimates are not realistic, and may reflect difficulty in gaining access to reliable data. With respect to the market price (elbow) estimates, the corresponding portfolio represents a position that would not be acceptable under a prudent retailer's allowable risk parameters.

The case for a conservative approach in estimating energy costs has been strengthened by the recent sharp increase in wholesale costs, which have flowed into the forward contract market. Consequently, the exposure risk assumed with the conservative model would have shown a corresponding increase since the completion of the consultant's report.

When considering the impact of recent wholesale market trends, the Tribunal must be mindful that the greater regulatory risk resides with an underestimation of energy costs rather than an overestimation. Underestimating costs will impede the development of competition and deny the appropriate price signals to facilitate future generation. By contrast, any overestimation of costs will be rapidly eroded through competitive activity.

*Operating costs*

TRUenergy supports the inclusion of customer acquisition costs, as reflecting actual costs incurred by new entrant retailers which the Tribunal is required to consider under the Terms of Reference. However, we remain concerned with the assumed customer retention rates. Providing the Tribunal establishes the correct retail price settings, there is no reason to expect that the annual customer transfer rates in New South Wales will differ from those currently operating in Victoria and South Australia at 20-25%.

The Tribunal has suggested four factors that may prevent the New South Wales churn rate reaching the level in other states. Two of those factors (incumbent dissatisfaction and the pensioner rebate scheme) are no longer relevant in South Australia and were never relevant in Victoria. Similarly, the ESCOSA price information service has had little patronage in South Australia in recent years, and there is no evidence that the Victorian scheme has had any impact on transfer rates. Finally, the fact that Victoria and South Australia are among the most active markets in the world is an indicator, not a cause, of competitive activity.

The Tribunal concedes that there is no evidence to suggest that customer transfer rates will differ between residential and business customers. Therefore, we recommend that the customer retention rate of 6 years be assumed for both customer classes. This is still below the level of other jurisdictions, thereby representing a conservative position, but recognises the impact that the determination in its current form would have in promoting competition.

We are also concerned that the Tribunal has maintained a $75 cost-to-serve estimate. This is well below the level of $90-100 allowed in other states, with no explanation provided as to why it should be established at a lower level in New South Wales.

*Retail Margin*

Based on experience in other jurisdictions, 5% retail margin is the minimum margin that should be allowed to facilitate a competitive retail market. However, this provides no allowance for regulatory error on the other cost components. Given the concerns that do exist in the current determination with respect to energy costs, retention rates, and operating costs, it would be more prudent to adopt a value between the mid point (5.4%) and upper-end (6.4%) of the expected returns approach.

*Timetable for Annual Pricing Proposal*

Current arrangements for the approval of the annual pricing approvals lack the transparency of other jurisdictions. New South Wales standard retailers generally publish their tariffs, in a local newspaper, only 1-2 days prior to commencement. This compares to requirements in Victoria to publish two months in advance, and South Australia to publish 10 business days in advance, in both cases in the government gazette. The shorter time frame in NSW means that second-tier retailers are unable to respond to the new tariffs on the date that they commence, and imposes greater implementation costs through the commercial need to respond to the new tariffs as soon as possible after their commencement.

TRUenergy recommends a requirement for standard retailers to publish, on their web-site and/or in the government gazette, their proposed tariffs within one business day of application, and their final tariffs within one business day of the Tribunal's approval.

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

Yours sincerely,

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