ICRC

independent competition and regulatory commission

Draft Decision

Retail Prices for Non-contestable Electricity Customers

Report 2 of 2006
February 2006

The Independent Competition and Regulatory Commission (the Commission) was established by the *Independent Competition and Regulatory Commission Act 1997* (ICRC Act) to determine prices for regulated industries, advise government about industry matters, advise on access to infrastructure and determine access disputes. The Commission also has responsibilities under the Act for determining competitive neutrality complaints and providing advice about other government-regulated activities.

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For further information on this investigation or any other matters of concern to the Commission, please contact Ian Primrose, Chief Executive Officer, on 6205 0779.

Foreword

The Treasurer has made a reference to the Independent Competition and Regulatory Commission (the Commission) to review the competitive state of the market for the supply of electricity to franchise customers as the basis for determining whether there is a continuing need for a price direction in relation to those customers, and, if the need for such a direction exists, to provide a direction to operate from the expiration of the current price direction on 30 June 2006. The Treasurer's reference is made under s. 15 and s. 16 of the *Independent Competition and Regulatory Commission Act 1997* (ICRC Act).

In the Australian Capital Territory (ACT), the retailing of electricity to customers consuming more than 160 megawatt hours per year (MWh/yr) was made contestable from 1998.[1] The electricity supply industry in the ACT was opened to retail competition for customers consuming more than 100 MWh/yr from 1 July 2001.[2] Following the recommendation that full retail contestability (FRC) be introduced for all customers in the ACT, the government opened the market for customers using less than 100 MWh/yr to competition from 1 July 2003.[3]

While the government decided to open the market to all customers, certain transitional arrangements were maintained. These were intended to ensure that customers were able to remain on non-negotiated contracts with the incumbent retailer. A regulated maximum tariff was applicable to such customers for a period of three years. During the designated transitional period, the government undertook to consider whether these arrangements would need to be extended for an additional period.

In this investigation, the Treasurer has sought advice from the Commission on the need for the transitional arrangements to continue and, if so, the form and duration of price protection that should apply to franchise contracts in future.

In reaching its determination, the Commission is required to have regard to a number of matters, including:

- the potential effect of the new national energy regulatory environment
- arrangements for retailer of last resort
- retail prices charged by ActewAGL Retail (ActewAGL) in other jurisdictions
- retail prices charged by other incumbent retailers in other jurisdictions.

The investigation is also to have regard to the terms of s. 20 of the ICRC Act.

The Commission released an issues paper in November 2005 and has considered the submissions made in response to that paper in reaching this draft decision.

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[1] *Utilities Act 2000* (Utilities Act).
[2] Disallowable Instrument 2001–93.
[3] Independent Competition and Regulatory Commission (ICRC), *Final report: Full retail contestability in electricity in the ACT*, July 2002. Disallowable Instrument 2003–20.

The following timetable for the remainder of this inquiry is proposed.

Event	Date
Close of submissions on draft decision	3 March 2006
Release of final decision	7 April 2006

The Commission welcomes submissions on this draft decision. For further information about this draft decision or the inquiry process, interested parties are invited to contact the Commission.

Paul Baxter
Senior Commissioner
February 2006

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Executive summary

In 2005, the ACT Government sought the Commission's advice on whether the transitional franchise tariff (TFT) should be continued beyond June 2006 and, if so, at what level. In addressing this issue the Commission was required to examine:

- the competitive state of the market for electricity supplies to franchise customers in the ACT, as the basis for determining the need for a continuation of the TFT
- if a further period for the TFT is necessary, at what level the tariff should be set and for how long.

The Commission has also considered a range of other legal and administrative matters that are relevant to any decision on the future of a TFT, and the steps that would be required to implement a decision to move to unregulated retail pricing of electricity in accordance with the nationally endorsed competition policy objectives.

Competitive state of the ACT market

The Commission has examined the competitiveness of the electricity market in the ACT from a number of perspectives.

It is generally acknowledged that there is no one single characteristic of 'competitiveness', and that it is necessary to look at a number of characteristics of competitive behaviour in a market to form a view as to the competitive state of that market. It is also acknowledged that any market is dynamic in its behaviour, and evolves and changes in response to external factors and factors inherent in the market itself.

Characteristics of a competitive market are:

- the existence of a number of competing retailers and/or the imminent potential entry of new competitors
- actual and/or potential competition between these retailers
- innovation in the products and services offered to consumers by active retailers.

Draft conclusions

Having considered the evidence available, the Commission has drawn the following draft conclusions about the competitiveness of the ACT electricity market in terms of the of the three defining characteristics of competitiveness:

- The existence of a number of competing retailers and/or the imminent potential entry of new competitors
  - Currently there are three retailers operating in the ACT market, all of which are active in other states and able to compete within the retail profit margin currently applying to the TFT.
  - There is the imminent possibility of entry by Aurora Energy, offering a prepayment meter service.

  - Other retailers currently operating in other states have also been licensed in the ACT and, despite the strong market presence of the incumbent supplier, ActewAGL Retail (ActewAGL), does not regard the barriers to entry into the ACT market as insurmountable.
- Actual and/or potential competition between these retailers
  - Discounts on the TFT of up to 10% are now on offer in the ACT, whereas previously there was no discounting of this type.
  - Customer churn is still relatively low, although showing signs of increasing.
  - The incumbent supplier has been active and successful in promoting both its brand name and the benefits of remaining with that supplier rather than moving to competitors that are active in the marketplace.
  - There is widespread advertising in the print media and electronic media, particularly by the incumbent supplier.
  - There is a need to extend the existing consumer awareness of the options that are available for the supply of electricity from competing retailers, and to help improve consumers' ability to make informed judgements on the offers available.
- Innovation in the products and services offered to consumers by active retailers
  - A range of service options are available in the ACT market, similar in style to those offered in other states.
  - These service options were not previously available in the ACT, and have been developed in response to the competitive market.
  - The options currently available involve some form of bundling of several services (usually at least electricity and gas services).
  - There is the imminent possibility of the introduction of a new prepayment metering service that will be offered in competition with existing services.

On balance, the Commission believes that there is sufficient evidence to conclude that the market in the ACT is competitive.

Draft recommendation

Based on its assessment of the ACT electricity market, the Commission believes that the removal of the TFT will assist in providing further opportunity for competition to evolve and deliver wider benefits across the ACT market.

Therefore, the Commission proposes to recommend that the TFT be discontinued.

Consumer impact

The Commission recognises that there is a need to provide further public education on the availability of competitive tariff offers for electricity supply in the ACT, and to assist consumers in their interpretation and assessment of these offers. To this end, the Commission will undertake an ongoing market awareness program during 2006 (to be reviewed at the end of the year), with a focus upon the dissemination of information on the merits of competitive pricing, and the interpretation of the relative value of the competitive offers.

In some submissions to this inquiry, it was argued that a regulated tariff is required as a safety net for vulnerable consumers. To interpret the TFT in this way is to misunderstand the nature of the TFT and the method by which it has been determined. The TFT was introduced as a transitional arrangement in the process of moving towards full retail contestability (FRC) in the supply of electricity to household and smaller business customers. The actual value of the TFT has been calculated on a cost-reflective basis, and has not been based on maintaining a rate that more vulnerable customers might be able to afford.

The appropriate way to provide assistance to more vulnerable consumers is by targeted support programs of the type already available in the ACT. The Commission fully supports and endorses the continued use and development of such targeted assistance packages to support customers experiencing payment difficulties.

The Commission notes that the continuation of the support programs currently offered in the ACT, especially those delivered through the Essential Services Consumer Council (ESCC), is currently funded in part by licence fees paid by the electricity distributor and retailers. With the emergence of new, national regulatory arrangements at the end of 2006, this source of funding will no longer be available. Accordingly, the Commission highlights this as an area requiring government attention to preserve the support mechanisms currently in operation in the ACT.

Implementation

The Commission's draft decision to recommend that the TFT be discontinued cannot be applied without consideration of other related matters. In particular, the removal of the regulated tariff for electricity supply has implications in terms of the current arrangements that exist under the *Utilities Act 2000* (Utilities Act) and the Consumer Protection Code (the Code). The Utilities Act and the Code will need to be amended, regardless of when the TFT is discontinued, in order to address issues relating to the application of the standard customer contract, and the link between the application of the standard customer contract and the existence of franchise tariff customers.

It is expected that these amendments could be made during 2006 as part of the process of amending the Utilities Act in anticipation of the transfer of regulatory responsibility for electricity to the new Australian Energy Regulator at the end of 2006. As these amendments will not be made prior to 1 July 2006, when the current TFT arrangements expire, the Commission will recommend that the TFT remain in operation for a further 12-month period (until 30 June 2007) and be discontinued from 1 July 2007.

As an interim arrangement for the 2006–07 year, the Commission proposes to apply a consumer price index (CPI)-related price adjustment to the current TFT such that the TFT for the 12 months from 1 July 2006 will increase from its current rate by the movement in the CPI for the 12-month period ended 31 March 2006. Provision will be made in this adjustment process for ActewAGL (as the default electricity service provider) to bring forward a proposal for any increase greater than the CPI, if necessary, where exceptional circumstances occur. The Commission would need to consider and agree to any proposal made under the 'exceptional circumstances' arrangements.

From 1 July 2007, all customers would become either contestable contract customers or 'deemed contract' customers under the proposed amendments to the Utilities Act. The market would determine prices, although there would continue to be a 'retailer of last resort' facility, which in the ACT would be provided by ActewAGL.

ActewAGL would still be required to offer a default tariff to customers who did not want to accept any of the competitive service offers available, and this default tariff would be provided under the deemed contract arrangements. ActewAGL would set the default tariff but, as set out in the proposal submitted by ActewAGL to this inquiry, the Commission would continue to have a role in vetting this default tariff. This role would be to consider the reasonableness of any increase in the default tariff greater than the movement in the CPI. Furthermore, the ACT Government would retain the right to refer to the Commission terms of reference for an inquiry into retail electricity prices in the ACT if it were perceived that ActewAGL was misusing any market power it held as the incumbent retailer, or that the competitive market was not functioning.

1 Introduction

1.1 Background to the inquiry

One of the ACT's major commitments in the National Competition Policy, signed in 1995, was an undertaking to develop a national electricity market (NEM) delivering benefits of integration and competition to the economy and consumers. Together with the other jurisdictions in the NEM, the ACT effectively entered into the national market arrangements at the end of 1997. Among the policy commitments made by the governments was an agreement to a phased opening of the retail electricity market to full retail contestability (FRC), which enables retailers other than the incumbent to enter the market. Customers are then able to select the retailer that they consider provides the most appropriate price and service packages. Each jurisdiction was responsible for determining when it would open its retail electricity markets to competition by rolling back the monopoly supply arrangements of the incumbent retailers. Those decisions were to be guided by reviews of the costs and benefits of opening retail markets in each jurisdiction.

In the ACT, customers whose electricity consumption is above 160 megawatt hours per year (MWh/yr) were made contestable from 1998. The threshold was lowered to 100 MWh/yr from July 2001.[4] From 1 July 2003, customers below the 100 MWh/yr threshold (essentially, households and small businesses) were made contestable, opening the ACT market fully to retail competition.[5] This enabled all customers to enter into negotiated contracts with ActewAGL or other retailers. The government's decision was made, consistent with the Independent Competition and Regulatory Commission's (the Commission's) advice that a small net benefit existed in favour of contestability, subject to certain transitional arrangements intended to ease customers' entry to a contestable market for electricity supply. Those transitional arrangements were to have effect for three years, ending on 30 June 2006.[6]

Included in the transitional arrangements was the implementation of a regulated tariff, referred to as the 'transitional franchise tariff' (TFT). The TFT, which is offered by ActewAGL Retail (ActewAGL) as part of the standard customer contract, sets a maximum price that initially applied to all franchise customers. A franchise customer is any customer who consumes less than 100 MWh/yr and who remains on the standard customer contract offered by ActewAGL.[7]

From 1 July 2003, franchise customers became free to enter into negotiated contracts with ActewAGL, or other retailers, and pay alternative prices. These 'non-franchise' customers are no longer on the standard customer contract and therefore do not receive the regulated TFT. For ease of reference in this report, customers consuming less than 100 MWh/yr (whether they are paying

[4] Disallowable Instrument 2001–93.
[5] Disallowable Instrument 2003–20.
[6] ICRC, *Final determination: Investigation into retail prices for non-contestable electricity customers in the ACT*, Report 5 of 2003, May 2003.
[7] Franchise customers are defined under the Utilities Act and subsequent declaration (Disallowable Instrument 2003–20) as those customers who are not non-franchise customers. Non-franchise customers are customers who consume more than 100 MWh/yr or who have elected to enter a negotiated contract.

the regulated TFT under a standard customer contract, or a competitive tariff under a market contract) are termed 'small customers'.

The transitional arrangements also included an undertaking that the government would review the arrangements before the transitional period expired, to determine whether the arrangements were any longer required.

On 22 September 2005, the Treasurer issued a reference to the Commission to investigate whether there was a need for the transitional arrangements to continue and, if so, what form and duration of price protection should apply to franchise contracts in future. The full text of the reference is given in Appendix 1.

As the first step in addressing the terms of reference, an issues paper was released in November 2005. Appendix 2 of this draft decision contains a summary of the submissions made in response to the issues paper.

1.2 Commission's approach to addressing the terms of reference

The Commission has interpreted the terms of reference to require the Commission to consider two distinct issues.[8] First, the Commission is asked 'to consider the competitive state of the market for the supply of electricity to franchise customers as the basis for determining the continuing need for a price direction'. If it is found that there is sufficient competition in the retail electricity market in the ACT, it may be concluded that there is no need for the continued existence of a regulated franchise tariff. However, if this is the conclusion, it becomes necessary to investigate the administrative and legal implications of removing the regulated tariff.

Alternatively, if it is concluded that the market is not sufficiently competitive, the Commission must consider the second distinct issue identified in the terms of reference. That is, 'the Commission shall provide a price direction and recommend the duration of any price direction to operate from 1 July 2006, following the expiration of the current price direction on 30 June 2006'.

In undertaking this review, the Commission has taken into account the matters included under s. 2 of the terms of reference: the new national electricity regulatory environment, applicable requirements of the National Electricity Law and the National Electricity Code; arrangements for a retailer of last resort; the retail prices charged by ActewAGL in other jurisdictions; and the retail prices charged by incumbent retailers in other jurisdictions.

In addition, the Commission has also taken into account the requirements of s. 20 of the ICRC Act, which states that the Commission must have regard to:

(a) the protection of consumers from abuses of monopoly power in terms of prices, pricing policies (including policies relating to the level or structure of prices for services) and standard of regulated services

(b) standards of quality, reliability and safety of the regulated services

[8] The terms of reference are provided in Appendix 1.

(c) the need for greater efficiency in the provision of regulated services to reduce costs to consumers and taxpayers

(d) an appropriate rate of return on any investment in the regulated industry

(e) the cost of providing the regulated services

(f) the principles of ecologically sustainable development mentioned in s. 20(5)

(g) the social impacts of the decision

(h) considerations of demand management and least cost planning

(i) the borrowing, capital and cash flow requirements of persons providing regulated services and the need to renew or increase relevant assets in the regulated industry

(j) the effect on general price inflation over the medium term

(k) any arrangements that a person providing regulated services has entered into for the exercise of its functions by some other person.

The Commission must indicate to what extent it has had regard to these factors.

1.3 Structure of the draft decision

Chapter 2 of this draft decision outlines the regulatory context within which this review is being conducted and describes the Australian electricity market, including a discussion of the market structure in the ACT. Chapter 3 outlines the characteristics of competitive markets, and the indicators of competitiveness in the ACT market, which the Commission applies to assess the competitive state of the ACT market for the supply of electricity to small customers. Chapter 4 sets out the Commission's draft recommendation, in the context of the broader issues the Commission has considered, and proposes an approach to implement the recommendation.

An overview of submissions made in response to the issues paper is provided in Appendix 2. Appendix 3 discusses how discontinuing the regulated tariff could affect the standard contract for franchise customers, in the absence of other regulatory changes, and suggests solutions. Appendix 4 summarises the Commission's review of the issues listed in s. 20 of the ICRC Act. Appendix 5 outlines experiences with FRC and competitive markets in other Australian and international jurisdictions.

1.4 Call for submissions

The Commission invites interested parties to make submissions to the inquiry in response to this draft decision. The Commission proposes to adopt the following timeframes for the remainder of the inquiry:

- submissions on draft decision due to be made by 3 March 2006
- final decision due to be released on 7 April 2006.

Submissions, correspondence or other enquiries may be directed to the Commission at the addresses below:

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2 Overview of the ACT market in the national context

2.1 National regulatory framework

In examining the competitive state of the electricity market in the ACT, and how it relates to the continuing need for a regulated tariff for retail customers, it is necessary to be conscious of the regulatory context within which these considerations take place. In addition, s. 2(a) of the terms of reference specifically requires the Commission to consider the new national electricity regulatory environment and any applicable requirements of the National Electricity Law and the National Electricity Code.

The Ministerial Council on Energy (MCE) is the national body responsible for energy policy, and comprises the Australian and state and territory energy ministers. The MCE has confirmed that, in accordance with the Australian Energy Market Agreement, specific retail and distribution functions will be transferred from the jurisdictions to a national regulatory framework by 1 January 2007.

A communiqué from the most recent MCE meeting stated that ministers had agreed, subject to cabinet approval, to:

> a clear framework for the transfer of specified retail and distribution functions to national regulatory arrangements, with enabling legislation by the end of 2006 and the transfer of economic regulation of distribution networks to the national regime by 1 January 2007.[9]

Once these functions have been transferred, they will become subject to regulation by the Australian Energy Market Commission (AEMC) and the Australian Energy Regulator (AER), although decisions about retail pricing are to remain with the jurisdictions.[10]

While the jurisdictions will retain retail pricing functions, the MCE has noted the role that retail price regulation has in the achievement of a competitive market. In a discussion paper on improving user participation in the Australian energy market, the MCE concluded that:[11]

> In effect, they [regulated retail tariffs] are used to protect consumers from the possible exercise of retailer market power and to achieve a measure of price equality between various customer groups.
>
> In the absence of fully effective retail competition, regulated energy pricing should seek to balance the provision of commercial viability for retailers with consumer protection goals. This is a legitimate and ongoing role for government.
>
> However, regulated energy price setting has the potential to conflict with, and impede efficient market outcomes if prices are not set at cost reflective levels. Predictable and transparent government interventions would assist to achieve efficient outcomes while still facilitating legitimate social objectives.

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[9] Ministerial Council on Energy (MCE), Communiqué Hobart, 4 November 2005.
[10] Australian Energy Market Agreement, s. 8.1(c).
[11] MCE Standing Committee of Officials, *Improving user participation in the Australian energy market—discussion paper,* March 2004, p. 17.

The MCE goes on to state that it:

> acknowledges the important transitional role performed by retail price regulation but is concerned that inappropriate or entrenched regulation may negatively impact on retail market development.

The MCE notes some specific problems with retail regulation, including:

- inappropriately regulated prices that can dampen the development of a fully competitive market by making it less attractive for competing companies to provide innovative products to consumers
- possible discouragement of elements of investment or innovation due to market uncertainty over future price regulation
- price regulation for franchised load customers that reduces the opportunity for consumers to access products and/or market signals that could lead to load reductions at peak times
- continued adjustment and long-term use of price regulation, which may entrench perceptions of the need for price regulation in a number of customer market segments.

In addition to the issues raised by the MCE, the Productivity Commission recently conducted an inquiry into improving energy efficiency.[12] Finding 14.2 of the inquiry was that:

> Removing retail price caps (as soon as effective competition has been established), and exploring opportunities to improve the efficacy of price setting arrangements for network operators will improve the economic efficiency of electricity markets.

2.2 Electricity market segments

The electricity market is generally characterised as comprising four segments: generation, transmission, distribution and retail.

Within the ACT, the retail component contributes approximately 9% of an average residential customer's bill, with generation contributing 46%, transmission contributing 8% and distribution accounting for the remaining 37%.[13]

2.2.1 Generation

Electricity is produced by generation businesses and sold into the NEM, which is managed by the National Electricity Market Management Company (NEMMCO). The NEM includes the electricity markets of Queensland, New South Wales, Victoria, South Australia and the ACT. Generators operating in the NEM submit bids to supply electricity, which NEMMCO matches with requests for electricity from retailers.

Electricity is generated by privately-owned businesses and corporatised, government-owned businesses. The market for electricity generation is competitive. There is no regulation of the prices at which generators offer to supply electricity. Retailers can 'forward buy' their anticipated electricity requirements and/or purchase electricity on the 'spot market' operated through the NEM.

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[12] Productivity Commission, *The private cost effectiveness of improving energy efficiency,* 31 August 2005.
[13] ICRC, *Issues paper: Investigation into prices for electricity services in the ACT*, Report 6 of 2003, July 2003, p. 6.

2.2.2 Transmission

Transmission networks transport high-voltage electricity between the generation and distribution businesses. The prices charged by the transmission network businesses are regulated. The regulation of the transmission network was undertaken by the Australian Competition and Consumer Commission (ACCC) until recently, when this function was transferred to the AER.

2.2.3 Distribution

The distribution network conveys electricity, at a lower voltage than the transmission network, from the edge of the transmission network (typically at the fringes of urban areas) to the premises of individuals, businesses and other organisations. The jurisdictional regulators currently regulate the prices charged by distribution businesses, although this function is due to be transferred to the AER by 1 January 2007.

2.2.4 Retail

Retailers purchase electricity through the NEM and sell this electricity to customers. The price charged by the retailer includes the cost of the electricity purchased from generators through the NEM, the transmission and distribution charges associated with transporting the electricity, and the cost of retailing the electricity.

2.3 ACT retail electricity market

The following sections describe the current retail electricity market in the ACT, in terms of the customers, retailers, customer awareness, tariff offers and customer churn. These key market elements inform the Commission's assessment of the market's competitiveness, as discussed in more detail in Section 3.2.

2.3.1 Customers

The ACT market consists of approximately 145,000 electricity customers. A typical residential customer in the ACT, using 7,500 kilowatt hours per year (kWh/yr) under the TFT, will face a yearly bill of approximately $971.

In terms of customer numbers, the ACT market is relatively small in comparison with markets in other jurisdictions. The 2004–05 ACT customer base of 145,000 compares with approximately 2.6 million in New South Wales, 2.25 million in Victoria, 1.7 million in Queensland, 740,000 in South Australia and 255,000 in Tasmania.[14]

However, while the ACT market is small in customer numbers compared with most other Australian markets, it is a geographically highly concentrated pool of customers with relatively

[14] ICRC, Annual Report 2004–05, pp. 34–35; MMA, *Demand forecasts for distribution network services in Queensland,* July 2004, pp. iv–v; Aurora Energy, *Quarterly Electricity network performance report 1st April 2005—30th June 2005,* July 2005, p. 3.

high energy requirements. Also, the state markets are not perceived as single markets in themselves, but as collections of regional markets (for example, the Sydney–Newcastle–Wollongong market, or the Brisbane–Gold Coast–Sunshine Coast market). These regional markets are still relatively large in terms of customer numbers, and extend over large areas.

2.3.2 Retailers

Before the introduction of FRC, ActewAGL was the only electricity retailer in the ACT. This situation differed from that in other jurisdictions, where there were typically a number of incumbent retailers operating in geographically defined areas. In the ACT, the introduction of FRC for customers of particular sizes from 1998, which culminated with the introduction of FRC for all customers on 1 July 2003, provided the first opportunity for alternative retailers to enter the ACT market.

There are currently 15 licensed retailers in the ACT market:

- ActewAGL Retail
- AGL Electricity
- AGL Victoria
- Aurora Energy
- Country Energy
- Energex
- EnergyAustralia
- EnergyOne Proprietary Limited
- Ergon Energy Proprietary Limited
- Integral Energy
- Origin Energy Electricity Limited
- Powerdirect
- Red Energy
- TRUenergy Proprietary Limited
- TRUenergy Yallourn Proprietary Limited.

While 15 retailers now hold licences in the ACT, not all are currently active in the residential market. Only ActewAGL, EnergyAustralia and Country Energy are currently active in the residential market in the ACT.

Ten of the 14 retailers other than ActewAGL licensed in the ACT (AGL Electricity, AGL Victoria, Aurora Energy, Country Energy, Energex, EnergyAustralia, Ergon Energy Proprietary Limited, Integral Energy, Origin Energy Electricity Limited and TRUenergy Proprietary Limited) are incumbent operators in their respective jurisdictions.

The number of licensed retailers in the ACT is comparable to the number of retailers licensed in New South Wales, Victoria and South Australia, the other jurisdictions to have introduced FRC.

2.3.3 Consumer awareness activities

Of the 145,000 electricity customers in the ACT, approximately 130,000 are small customers consuming less than 100 MWh/yr. Since 1 July 2003, all small customers have had the opportunity to either remain as franchise customers on the TFT or elect to become non-franchise customers and select a competitive market tariff offered by either the incumbent retailer or an alternative retailer. However, for a small customer to take advantage of competitive market offers, it is necessary for the customer to be aware that a competitive market exists.

To coincide with the introduction of FRC the Commission released a pamphlet, entitled 'Informed choice: Which electricity retailer is best for me?', aimed at increasing the level of awareness within the community of the opportunities available under FRC. In addition, the Commission established a reference point on its website to provide information on FRC. Further information on FRC and various competitive market offers can also be found on the websites of the ACT Government and energy retailers. Furthermore, several of the retailers operating in the ACT regularly advertise in local newspapers and on radio and television. EnergyAustralia is undertaking a doorknocking marketing campaign across all suburbs of Canberra.

2.3.4 Tariff offers

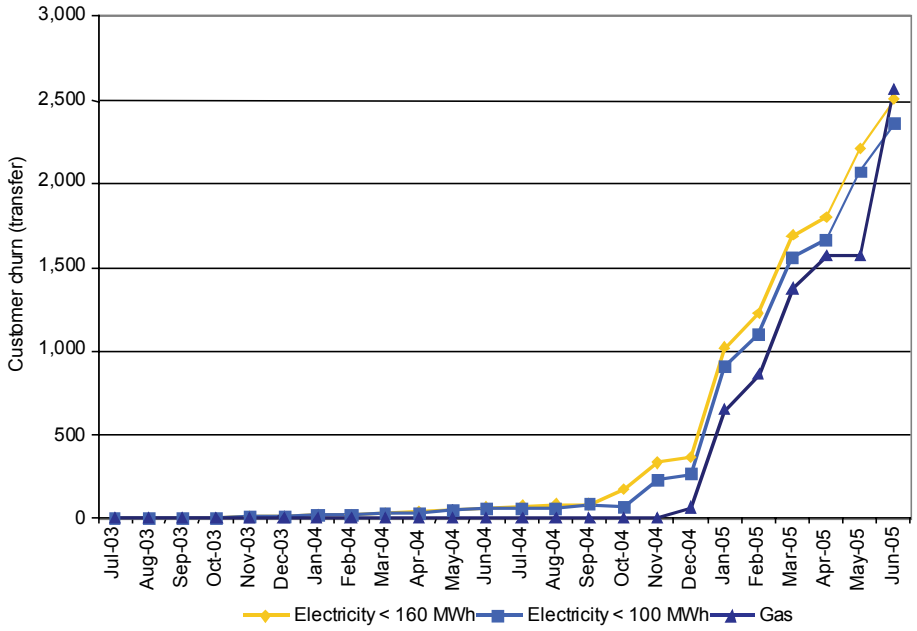
The majority of additional tariff offers available since the introduction of FRC are in the form of bundle offers. ActewAGL offers a customer who bundles four services with ActewAGL (retail electricity, retail gas, internet service provision and telecommunications services) a discount of 10% on their electricity account relative to the TFT. Under another ActewAGL offer, customers who bundle three of the above services (including electricity) receive a 5% discount plus other rewards.

Similarly, EnergyAustralia offers the option of three bundle packages with discounts of up to 8%, while Country Energy offers discounts of between 3% and 5%.

2.3.5 Customer churn

In the issues paper, the Commission noted that approximately 15,500 residential customers had elected to enter into negotiated contracts with ActewAGL to June 2005. In addition, approximately 2,500 residential customers had elected to enter into negotiated contracts with other electricity retailers to June 2005. The progression of this churn to alternative retailers in the ACT is shown in Figure 2.1.

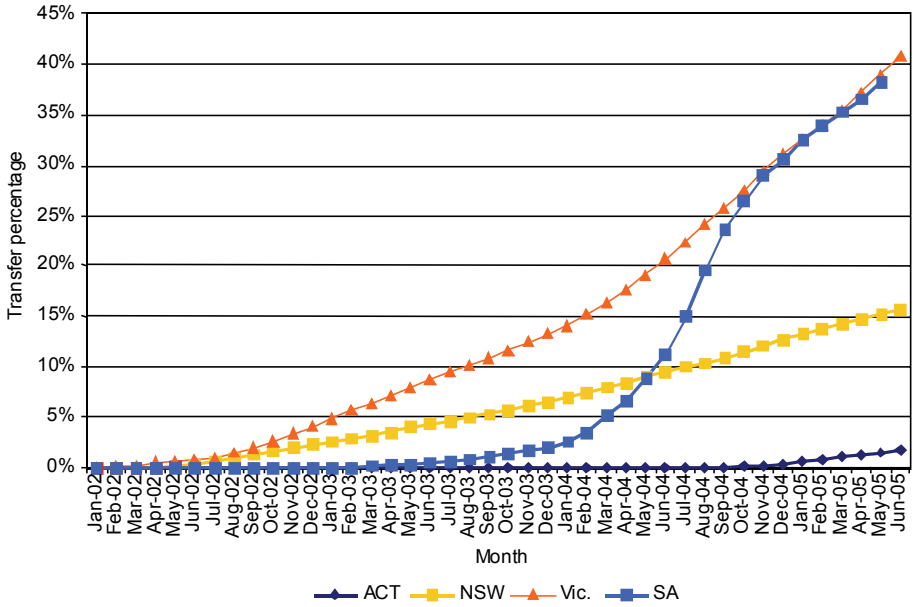
Figure 2.1 ACT customer churn, electricity and gas



The Commission understands that, in the months since June 2005, this churn to alternative retailers has continued at a similar rate to that experienced in the first half of 2005. This means that approximately 20,000 customers have entered into negotiated contracts with ActewAGL and approximately 4,300 customers have now entered into negotiated contracts with other electricity retailers. These numbers represent approximately 14% and 3% of the total customer base.

A comparison of the level of churn in the ACT to levels in Victoria, New South Wales and South Australia, the other jurisdictions with FRC, is shown in Figure 2.2.

Figure 2.2 Electricity churn in jurisdictions with FRC



3 Assessment of the competitiveness of the ACT market

3.1 Competitive market characteristics

In addressing the terms of reference—specifically, that the Commission 'consider the competitive state of the market for the supply of electricity to franchise customers as the basis for determining the continuing need for a price direction'—the Commission considers it necessary to outline the characteristics of a competitive market. The Commission uses these characteristics as a basis against which to assess the competitive state of the market in the ACT.

In the electricity retail market, the Commission considers that a competitive market will be characterised by:

- the existence of a number of competing retailers and/or the imminent potential entry of new competitors
- actual and/or potential competition between these retailers
- innovation in the products and services offered to consumers by active retailers.

Competition, or potential competition, between retailers forces each to produce at least cost, charge customers cost-reflective prices and continually seek efficiencies in production. A failure by a retailer on any of these counts will result in reduced market share and a subsequent reduction in profits. The Commission considers that competition, or potential competition, between retailers is an efficient means of protecting customers from potential abuses of market power, and that customers will benefit from competition in the form of cost-reflective prices and new products and services offered by the competing firms.

3.1.1 Number of competing retailers and/or potential competitors

The submissions provided to the Commission suggested various ways in which the Commission could assess the competitive state of the market and the role of competing retailers. These suggestions included frameworks based on customer knowledge of FRC and of the availability of offers, as developed by KPMG.[15] Alternative methodologies suggested included attempting to identify market failures and the level of barriers to entry in the market.

These proposals contain the main elements necessary to assess the competitive state of the market. However, the Commission believes that a more all-embracing test, which incorporates a number of the suggestions made in submissions, is required. To this end, the Commission considers that the most appropriate way to assess the impact of competing retailers is through an investigation of potential competition. Potential increases in competitive activity come from two sources: the

[15] KPMG, *The Effectiveness of Competition and Retail Energy Price Regulation*, December 2003.

entry of new firms, and the increased activity of firms already in the market but with small market shares.

For example, consider a market with one dominant firm. If the dominant firm attempts to increase prices, it creates an opportunity for other firms to enter the market and capture market share, or for existing firms to rapidly increase their efforts to attract customers and capture market share, thus making the price increase untenable. The potential competition from the threat of entry or the expansion of existing firms constrains the actions of the incumbent firm.

The extent to which potential competition constrains the actions of the dominant firm depends on barriers to entry. If significant barriers exist, they may reduce the ability of alternative firms to enter the market and subsequently reduce the constraint on the dominant firm.

The likely behaviour of competing retailers (either currently operating in the market or sitting on the sidelines) influences the competitiveness of the market. Generally, competitive markets are characterised by a large number of competing suppliers, but a market with a small number of firms may be considered competitive if there is significant competition between those firms. For example, two retailers may be sufficient for a competitive market if there is strong competition between them. Indeed, in some circumstances a dominant firm may be constrained by potential entry alone, in that the dominant firm may maintain prices near competitive levels to deter entry or expansion by potential rivals.

The Commission notes the recent decision by the Australian Competition Tribunal on Qantas Airways Limited. As part of the hearings, the tribunal agreed with comments made by Professor Ordover, an expert for Qantas, who argued as follows:

- Competitive constraints occur at the margin, and impact on the marginal passenger. Rivals or potential competitors do not need to appeal to all of the incumbent's passengers to exercise a competitive constraint on them. Rather, it is necessary only that enough customers are affected at the margin to make any increase in fares by the incumbents unprofitable.
- Constraints imposed by entrants do not depend on an immediate ability to increase capacity, but on their ability to implement a sound business plan over a well-defined period of time.
- Incumbents will be constrained from charging supra-competitive fares not by the threat of entry on a particular route, but by the potential for new entrants to enter trans-Tasman routes [the market] and gain profitable market share.[16]

The Commission considers these comments to be relevant to the electricity retail market in the ACT.

[16] *Qantas Airways Limited* [2004], ACompT 9 (Qantas).

Furthermore, the Commission notes the comments from the Essential Services Commission (ESC) of Victoria that:

> even where a large percentage of the market is concentrated in the hands of a small number of (incumbent) local retailers, they may be constrained ultimately by the threat of entry from other competitors, perhaps already operating in similar markets, or from smaller rivals who may have an incentive to expand within the market if there are profitable opportunities.[17]

The Commission considers that the findings of the tribunal, the arguments of Professor Ordover and the conclusions of the ESC support the argument that it is appropriate to consider potential competition as well as actual competition when assessing the competitive state of the market. The principles outlined by Professor Ordover can be readily applied to an investigation of the operation of the electricity market in the ACT, and serve as a guide to the Commission in considering the competitive state of that market.

3.1.2 Actual and/or potential competition between retailers

The Commission considers active actual competition between retailers to be a characteristic of a competitive market. Such competition is often observed through the offering of a range of products and services to customers, but active competition requires that customers participate in the market and make choices about the goods and services they buy. Those customers who choose not to participate in the market are likely to be passing up opportunities to access a wider variety of products and possibly to reduce their expenditure.

To participate in the market, customers must be aware that a competitive market exists, and adequate information must be available for them to make informed decisions. In the electricity market, the existence of a competitive market could be demonstrated through an awareness by customers of the retailers from which they may choose, the ease with which information about the products and services offered by those retailers can be obtained, and the level of advertising by the retailers.

In addition to customers' awareness, their willingness to participate in the market influences the competitiveness of the market. Given that average expenditure on energy (which includes both electricity and gas) in the ACT is $31.70 per week (approximately $1,650 per year), there should be sufficient incentive for customers to seek the most appropriate offers from retailers.[18] Currently, discounts of up to 10% are offered in the ACT market for those who choose to enter into negotiated contracts. Therefore, savings of approximately $150 per year are potentially achievable by the average 'bundled' customer.

As noted in Section 3.1.1 above, potential competition can also act as a constraint upon the behaviour of existing retailers. In their marketing behaviour existing retailers will have regard to the possibility of new entrants identifying market opportunities and will attempt to set prices and meet service standards such that the opportunity for such new entry is minimised.

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[17] Essential Services Commission (ESC), *Final report to minister: Special investigation—Review of effectiveness of retail competition and consumer safety net in gas and electricity, Background report*, June 2004, p. 24.
[18] Australian Bureau of Statistics (ABS), *2003–04 Household Expenditure Survey—summary of results*, ABS Publication 6530.0, Table 3.

3.1.3 Innovative product and service offers

The Commission envisages that competition between firms will result in a range of innovative product and service offers. In the electricity retail market, the Commission expects that these will include such options as time-of-use tariffs targeted to specific customer groups; alternative methods of bill payment, such as prepayment meters; and increased opportunities for bundling of services, such as electricity, gas and telecommunications services. Some of these have already been introduced in the ACT, with the introduction of bundling arrangements; a process to develop a prepayment metering code has begun, as part of a move towards allowing the introduction of prepayment meters.

3.2 Indicators of competitiveness in the ACT retail electricity market

In order to assess how the ACT retail electricity market is performing in relation to the characteristics of a competitive market (as defined in Section 3.1), the Commission has examined the following aspects of the market:

- the profile of the market, in terms of customers, retailers, customer awareness, tariff offers and customer churn (as described in Section 2.3)
- the level of retail margins in the ACT as compared to those in other jurisdictions
- barriers to entry to the market
- the use of electricity prices as a social policy instrument.

3.2.1 Customers

In the issues paper, the Commission sought views on how the size of the customer base in the ACT should be considered when assessing the continuing need for a regulated retail tariff. In its submission to this inquiry, the Essential Services Consumer Council (ESCC) argued that, based on the size of the market, there is little incentive for retailers to enter the ACT, and that this is the main barrier to competition. On the other hand, the submission received from EnergyAustralia stated that considerations of market size were not a major factor in its decision to enter the ACT market.

The Commission considers that the size of the ACT market does not adversely affect its competitiveness. In reaching this conclusion, the Commission is conscious that the ACT is a relatively small jurisdiction. However, the Commission notes the comments from EnergyAustralia and takes the view that particular characteristics of the market (the geographically highly concentrated pool of customers with relatively high energy requirements) are such that the ACT is an attractive market for retailers. In addition, the Commission notes that there are 15 licensed retailers in the ACT.

The size of the ACT market is not a good indicator of competitiveness, particularly where the service being offered by retailers has common characteristics with the service being offered by these retailers in other jurisdictions. As noted in Section 2.3.2, ten of the currently licensed retailers in the ACT other than ActewAGL are currently the incumbent retailers in their own 'home' markets and also are competitors in other parts of the country. These retailers are selling a product that is essentially the same across various parts of Australia, despite the different demand patterns, and therefore the marketing and customer support arrangements are in the main common across the jurisdictions.

However, while the absolute number of customers might not be a good indicator of competitiveness, it may play a role in determining the priority given to a particular location when retailers plan their marketing efforts. From discussions with retailers, the Commission has been able to confirm that they have had regard to the size of the ACT market when considering their marketing priorities. Nonetheless, they have also arranged to be licensed in the ACT at an annual cost for licence fees even though they currently have no customers in this market.

3.2.2 Retailers

There are 15 licensed retailers in the ACT electricity market, although only three, ActewAGL Retail, EnergyAustralia and Country Energy, are currently active in the household and small business market.

In the issues paper, the Commission sought views on how the number of licensed retailers should be assessed when investigating the competitiveness of the market. The issues paper also discussed whether actual competition between a number of competing retailers, or potential competition, should be considered in such an assessment.

The ACT Council of Social Service (ACTCOSS) argued that the number of (licensed) retailers is irrelevant, as only two are active (presumably referring to ActewAGL and EnergyAustralia) and one holds the vast majority of the small customer market.[19] ACTCOSS's submission also argued against the use of potential competition as the basis for assessing the competitive state of the market. ACTCOSS noted that it:

> rejects any assumption that, simply because the parameters for a market exist on paper, that a market will develop. The past three years have provided ample demonstration that retailers are not interested in competing for the under 100 MWh sector, despite the potential.[20]

Similarly, the ESCC submitted that, although there were 14 licensed retailers, only two of these were active in competing with the incumbent, and that those retailers were primarily involved with 'cherry picking' customer niches.[21] In addition, the ESCC submission argued that actual competition should be the primary measure in any assessment of the competitive state of the market, and that potential competition could be a back-up consideration. The submission argued that the level of actual competition for franchise customers in the ACT is low.

EnergyAustralia argued that, although not all of the retailers are active in the market, there is a constant threat that other licensed retailers will enter the market (the threat of potential competition) and that this threat acts as a downward influence on prices. The submission from TRUenergy also stated that potential competition should be taken into account, and that the threat of competitive entry is affecting the behaviour and pricing decisions of the incumbent retailer.

Submissions from other retailers, including AGL Retail and Origin Energy, and from the Energy Retailers Association of Australia (ERAA) argued that the Commission should focus on determining whether there is evidence of market failure or potential misuse of market power in the

[19] The Commission considers Country Energy to be active in the market, given the marketing and advertising Country Energy undertakes and the availability of its offers.
[20] ACT Council of Social Service (ACTCOSS) submission, p. 6.
[21] Red Energy has recently become licensed, bringing the total number of licensees to 15.

market structure, as opposed to focusing on market characteristics such as market size, number of retailers or churn rates. In addition, Origin Energy argued that the presence of potential competitors keeps incumbents attentive to pricing and mitigates the use of market power. It was argued that in these circumstances highly concentrated markets can be competitive if there are low barriers to entry and exit.

ActewAGL expressed a similar view, stating that it 'does not believe that a market needs a particular number of active retailers to prove effective competition'.[22] The submission cited a paper by the ESC of Victoria, which stated that:

> even where a large percentage of the market is concentrated in the hands of a small number of (incumbent) local retailers, they may be constrained ultimately by the threat of entry from other competitors … or from smaller rivals who may have an incentive to expand within the market if there are profitable opportunities.[23]

When considering the number of inactive retailers in the small customer market, the Commission takes the view that inactive licensed retailers are not an indication of a non-competitive market. Rather, the Commission considers that the fact that these retailers have chosen to become licensed is an indication that they consider the ACT to be an attractive market and a potential source of customers. The Commission notes, for example, that all licensed retailers pay a licence fee, regardless of whether they exercise the right to supply electricity in the ACT, and that the decision to obtain a licence in the ACT is not taken lightly. This creates an ongoing situation in which there are potential new entrants who can quickly become active in the market.

In addition, the Commission notes that of the licensed retailers other than ActewAGL operating in the ACT, AGL Electricity, AGL Victoria, Aurora Energy, Country Energy, Energex, EnergyAustralia, Ergon Energy Proprietary Limited, Integral Energy, Origin Energy Electricity Limited and TRUenergy Proprietary Limited are all incumbent operators in their respective jurisdictions. As a result of being incumbent operators, these retailers have significant market shares in their original jurisdictions. The Commission considers that their presence in the market increases the implied threat of competition. The existence of these licensed retailers, and other retailers that are yet to seek ACT licences, would act to constrain the actions of ActewAGL should the regulated tariff be removed.

The Commission sought views from retailers who are licensed but inactive in the ACT on their intentions for active entry into the ACT market. Most retailers indicated that the ACT was an attractive market but was not high on the priority list. Most stated that they were becoming increasingly active in the markets in which they were incumbent, and seeking to take an increasing market share in the larger urban and semi-urban markets in New South Wales, Victoria and South Australia. However, these retailers are also constantly monitoring the market situation in the ACT and other locations to judge their best opportunities for entering new markets or expanding their existing market share. Issues such as the available margin in the market concerned are relevant to their consideration of opportunities and marketing options.

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[22] ActewAGL submission, p. 15.
[23] ActewAGL submission, p. 16, citing ESC, *Review of effectiveness of retail competition and consumer safety net in gas and electricity—Final report*, June 2004, p. 24.

The Commission notes that the submissions from ACTCOSS and the ESCC argue that the ACT market is currently not competitive. However, the Commission believes that it is not necessary for a large number of firms to be actively operating in the market for it to be competitive. The Commission takes the view that it is appropriate to consider potential competition as well as actual competition when assessing the competitive state of the market. On that basis, the Commission considers that the number of electricity retailers actively operating in the ACT, the number of currently inactive licensed retailers, and the actual and potential competition that exists between the active, inactive and as yet unlicensed retailers, constitute sufficient evidence of a competitive market.

3.2.3 Consumer awareness

The issues paper released by the Commission raised consumers' awareness of FRC as an issue and requested comments on the availability of information to customers.

In response to the issues paper, ActewAGL stated that the ACT community could be left in 'little doubt about their ability to switch retailers and the various discounts and incentive based offers available to them' because of the significant amount of information available on the websites of the Commission, the ACT Government and energy retailers; the extent of newspaper, radio and television advertising; and the level of door-to-door marketing across Canberra that has occurred.[24] In addition, the submission noted the release by the Commission of a pamphlet, entitled 'Informed choice: Which electricity retailer is best for me?', which coincided with the introduction of FRC in 2003 and was aimed at increasing the level of awareness within the community of the opportunities available under FRC.[25]

Similarly, AGL Retail submitted that the introduction of FRC in the ACT market was 'followed by significant communication campaigns by the local retailer and the Commission'.[26] In addition, the submission highlighted the availability of information on competition in the ACT energy market on the websites of retailers, the ACT Government and the Commission. Furthermore, Origin Energy, when referring to the ACT market, stated that 'customers are free to make adequately informed decisions about their choice of retailer'.[27]

However, EnergyAustralia stated that it considered that customers in the ACT have a lower awareness of FRC than customers in other jurisdictions, and called for the Commission to recirculate the pamphlets distributed at the time FRC was introduced. Similarly, the ESCC argued that 'the information which the industry provided to the community at the time FRC was introduced in the ACT is now largely forgotten'.[28]

The question of the degree of consumer awareness of the choices available is problematic. There will always be some consumers who are more or less informed of their choices than others in any market for any good or service. The question that must be considered by the Commission is: does continuing the TFT protect consumers from their lack of knowledge? Put another way, does

[24] ActewAGL submission, p. 13.
[25] ActewAGL submission, p. 14.
[26] AGL submission, p. 4.
[27] Origin Energy submission, p. 3.
[28] Essential Services Consumer Council submission (ESCC) submission, p. 1.

removing the need for choice reasonably improve the wellbeing of consumers? Effectively, the continuation of the TFT substitutes the Commission's decision in terms of the price for electricity for the consumer's own choice. Continuation of a TFT arrangement will not reasonably ensure optimal choice for each and every consumer and effectively does little to help all consumers become more informed as to the choices that are available.

The Commission has identified more appropriate ways to encourage and assist consumers to make informed choices. The Commission considers that the information campaigns that have been conducted to date have contributed to a wider understanding of the availability of choice in the market. For example, the Commission notes the comments from Country Energy's Retail Group General Manager, when referring to the ACT and Queanbeyan area, that 'customers are becoming more aware that there is a choice of retailers'.[29] However, the Commission believes that there will continue to be a need for the dissemination of further information. In the same way that the ACCC releases information publications on a wide range of consumer rights issues, there is a need for the Commission (and, in future, the AER) to continue to publish information that can be accessed by consumers that will help them in making choices on energy matters.

Based on the information campaigns undertaken to coincide with the introduction of FRC; the ongoing marketing conducted by retailers in the form of newspaper, radio, television and door-to-door advertising and selling; and the information available on the websites of retailers, the government and the Commission; the Commission considers that customers in the ACT have been made aware of their ability to select a market-based electricity offer. However, the Commission acknowledges that there is an ongoing role for the Commission to continue to make further information available to customers and raise the profile of the choices available under FRC.

To this end, the Commission will undertake a program of information dissemination on the existence of FRC from a domestic household's perspective during 2006. This campaign will be undertaken regardless of the government's decision on the continuation of the TFT, and will be targeted in a way to provide practical assistance to households in their consideration of the various competitive offers available in the market.

3.2.4 Tariff offers

In Section 2.3.4 the Commission noted the increase in the range of tariff offers in the form of bundled offers that have emerged since the introduction of FRC. Similarly, in its submission on the issues paper, the ERAA noted that competitive market-based offers are now the norm rather than the exception.

ActewAGL submitted that there is a significant amount of advertising and marketing of tariff offers by retailers in the ACT, and claimed that these have reached record levels in recent months. The submission noted advertising campaigns by Country Energy and ActewAGL using newspaper, television and radio advertisements, and doorknocking campaigns by EnergyAustralia. The submission argued that the increasing level of competition between retailers had not only increased the awareness of ACT customers but had brought about the emergence of a number of new dual-fuel, bundle and incentive-based tariff offers. ActewAGL claimed that its current bundle offers are a direct response to increasing pressure from competitors.

[29] *The Canberra Times*, 'Energy companies feel the heat', 10 December 2005, p. 25.

EnergyAustralia claimed that retailers are offering stronger discounts in the ACT than in New South Wales, indicating that the level of competition in the ACT is sufficient to maintain downward pressure on retail prices.

TRUenergy argued that an outcome of a competitive market is a focus by business on delivering services desired by customers, rather than on the provision of least-cost products that suit the retailers. The TRUenergy submission argued that the introduction of bundling offers was therefore an indication of a competitive market.

Care Financial Counselling Service submitted that existing choices (for example, bundling offers) are likely to be taken up by low-income consumers in much lower numbers, if at all, because of the nature of the products being bundled. The ESCC argued along similar lines, claiming that new tariff offers are limited and restricted to bundling offers for large customers, or result from ActewAGL attempting to build up its TransACT business. It was argued that the existence of bundling arrangements was therefore not an indication of a competitive market.

ACTCOSS stated that it considered that customers are not being offered new products, as was the case with the boom in the telecommunications market. The submission argued, that under the current bundling offers, 'the more you have the more you save.'[30] It also claimed that many low-income households are not in a position to take advantage of the bundled offers because they often have no internet access, computers, mobile phone services or gas heating or hot water services. In addition, ACTCOSS stated that it is important that product diversification does not include a downgrading of service, or enforced low-cost options that would further exacerbate hardship. ACTCOSS argued that entering into agreements to purchase differentiated products should be voluntary for all customers. The submission also expressed opposition to the use of service standards as a way of differentiating products, on the basis that because electricity is an essential service all customers deserve a reliable product.

The Commission notes that the main increase in customer choice since the move to FRC has been in bundled service packages incorporating at least some form of electricity service. In order to access these packages, customers are required to have gas and electricity (in the case of the Country Energy and EnergyAustralia options) or three or more services (in the case of ActewAGL bundles).

The Commission notes that electricity customers without the required additional services are currently limited in the negotiated contracts into which they can enter. However, the Commission is conscious of the recent licensing in the ACT of Aurora Energy, which is contemplating the introduction of prepayment meters for interested electricity customers. This service would be available to customers with only an electricity connection. The Commission takes the view that the licensing of Aurora Energy is an indication of heightening competition and product differentiation in the market. This will increase in the future, as competitors look for further market growth and extend their marketing to customers who are not able to benefit from the bundled services at present being offered.

[30] ACTCOSS submission, p. 11.

To the extent that the TFT price has become the de facto benchmark in the ACT (with all discounts offered as a percentage reduction of this price), the removal of this benchmark would provide greater incentive for retailers to set prices for individual products and services more reflective of their own cost structures and the market's demand patterns. It is anticipated that this would further contribute to the range of service offers available for all consumers.

A further issue raised by ACTCOSS was that there is a need to address the structure of the tariffs being offered and that reductions to the standing charges, coupled with inclining-block tariffs and robust rebates, concessions and community service obligations (CSOs), were needed to protect vulnerable customers. The Commission notes that many of the tariffs currently on offer exhibit the characteristics of inclining-block tariffs referenced by ACTCOSS, and that the Commission has been active in reducing the fixed standing charges that are associated with the electricity distribution charge which is passed through to customers by electricity retailers.

In addition to investigating the availability of competitive offers, the Commission considers it necessary to investigate whether the offers being made are too complex or misleading, as such offers may reduce the competitiveness of the market.

In its submission, ACTCOSS argued that information on tariff offers must be relevant and easily understood. The submission noted that ACTCOSS and other organisations have commented in previous consultations on the presentation of billing information, and acknowledged that in response ActewAGL has made some changes to the content included in bills. The ESCC noted that competitive market offers are relatively complex and that each offer would have to be specifically evaluated to check its suitability for a customer. The ESCC expressed concerns that, in general, only large customers have the capacity and interest to analyse their options effectively and make informed decisions.

The Commission is conscious of the arguments that some customers may have difficulties in interpreting competitive market offers. This supports the Commission's view that there is a need for a continuing education program to be conducted by the Commission to help consumers understand the options available to them. However, the Commission notes that approximately 17% of customers in the ACT have already entered into negotiated contracts, and that at least some proportion of those who have not done so have made an informed decision on this matter. Furthermore, the Commission notes the willingness of ActewAGL to alter published billing information and that each of the active retailers have means, including web pages and call centres, by which customers can access additional information if required. The Commission also considers that, over time, the level of information available and customers' knowledge of their options will increase. The Commission acknowledges its role in this education process and the need for a continuing program of information dissemination.

The Commission considers that the wide-ranging education and doorknocking campaigns underway are designed to inform customers of the range of service options available. The range of these options is expected to move away from the bundled service offers currently available as new entrants such as Aurora Energy commence their marketing activities. Overall, the Commission considers that there are numerous market offers available to ACT consumers that allow them to make a variety of choices about which product best suits their needs.

3.2.5 Customer churn

Customer churn is an outcome of the marketing and innovative service offers resulting from the opening of the market to competitors. The level of churn in the ACT market was described in Section 2.3.5. The Commission's issues paper sought comments on how customer churn rates should be interpreted. The submissions received from retailers expressed concern about interpreting specific market information when assessing the competitiveness of the market.

ActewAGL stated that it:

> considers customer churn a relatively poor measure of the effectiveness of competition. Churn does not appropriately take into account those customers who have considered other retailers' offers and have *chosen* to remain on the incumbent's standard contract, or to accept a contract with the incumbent retailer. Further, churn rates do not capture customers who, although aware of the choice available to them, *choose not to exercise their choice* because they are satisfied with current arrangements. [emphasis in original][31]

Origin Energy expressed the sentiment that customer churn is a poor indicator of the effectiveness of the market by stating:

> that while these factors [churn rates, pricing, and the emergence of new tariff offers] may be helpful in mapping the market and its characteristics, they are ultimately unhelpful as primary indicators of an effective market as *there is no clarity about what would adequately demonstrate an effective market.* [emphasis in original][32]

Similarly, the submission received from the ERAA argued that:

> it is difficult to get definitive evidence on the level of competition and the assessment of 'effective competition'.[33]

However, despite arguments being made about the inappropriateness of considering customer churn when addressing the competitiveness of the market, the Commission notes that the ACT market has experienced lower levels of churn than markets in other jurisdictions that have introduced FRC (see Figure 2.2).

ActewAGL argued that rates of churn may be low due to its 'impeccable level of customer service' and cited business awards it had received.[34] In addition, it was argued that the high standing that ActewAGL enjoys in the ACT community as a result of its level of community involvement has played a role in keeping ActewAGL customers from switching to other retailers.

The submission received from the ESCC argued that the low churn rates in the ACT are probably a reflection of a lack of interest in the market by alternative retailers, and that small customers may not have the interest, or necessary information, to seek offers. However, the submission noted that 11% (14% as of November 2005) of customers had entered into negotiated contracts with ActewAGL, probably because of its vigorous marketing campaign. Furthermore, it was argued by the ESCC that churn rates in other states suggest that the level of actual competition is the determining factor of effective retail competition and that the ACT is not expected to have this level of effective competition in the foreseeable future.

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[31] ActewAGL submission, pp. 16–17.
[32] Origin Energy submission, p. 2.
[33] Energy Retailers Association of Australia submission, p. 2.
[34] ActewAGL submission, p. 18.

ACTCOSS attributed the relatively low churn rate in the ACT to the lack of new products being offered. The submission stated that those customers who had adopted market contracts were mostly 'early adopters' who had enough services to bundle, combined with a few customers who felt they could benefit from the EnergyAustralia discount of 8%. It was argued that, from a retailer's perspective, the low level of churn indicated that the various regulatory requirements in licences, rules, codes and metrology procedures may be discouraging licence holders from undertaking expensive information technology upgrades to allow seamless business operations in the ACT, and that insufficient margins exist to provide an attractive environment for competing retailers. However, the submission states that ACTCOSS is against any approach to encourage greater churn by increasing the regulated tariff to allow more active competition from alternative retailers, as such an approach is to the disadvantage of low-income consumers.[35]

Alternatively, TRUenergy argued that:

> The information provided in the issues paper indicates a rapid increase in churn activity during 2005. While the data provided tends to indicate the ACT may have experienced a slower start than some other jurisdictions, our view is that once competitors have made the investment to enter that market, they will face strong incentives to rapidly build customer numbers in an attempt to recover fixed market entry costs. Our expectation would be that churn activity is likely to continue to escalate in the ACT, and may increase dramatically once consistent national regulations are put in place.[36]

The Commission considers that the ACT retail electricity market has characteristics different from those of markets in other jurisdictions, and that this may partly explain the differences in customer churn.

The Commission notes that the states with the highest churn rates are South Australia and Victoria. In South Australia, churn rates were relatively low until the introduction by the South Australian Government of a $50 electricity transfer rebate for concession card holders in March 2004, following a significant increase in the regulated electricity tariff rates.[37] However, no such incentive was offered by the Victorian Government to encourage customer switching in that state (nor was there a dramatic increase in regulated prices as occurred in South Australia).

When considering the switching rates of Victorian customers, the Commission is conscious of the historical differences between the Victorian and ACT markets and the impact this may have on current market characteristics. The Commission notes that before the Victorian Government privatised its electricity assets, customers were served by a single entity, the State Electricity Commission of Victoria (SECV). As part of the sale of the state's electricity assets, the retail and distribution network functions of that entity were split according to geographic boundaries, and different brand names were adopted by each new geographical entity. This may have resulted in a lower degree of brand recognition and customer loyalty to their incumbent retailer—factors advanced by ActewAGL to explain its high retention of customers and subsequent low churn rates in the ACT. In addition, the Commission considers that churn rates may initially have been higher in Victoria because five broadly equivalent businesses had been created and were ready to compete

[35] The Commission notes that the churn rate in South Australia increased significantly after a unprecedented increase in regulated electricity prices in that state.
[36] TRUenergy submission, p. 2
[37] The Commission understands that approximately 25% of South Australian electricity customers are eligible to receive concessions.

for new and existing customers from the commencement of retail contestability. This contrasts with the situation in the ACT, where there is a single incumbent operating in the market.

The Commission notes that there is likely to be an initial period after retailers enter the market during which they focus on gathering market information. Once retailers have sufficient information, their marketing activity can be expected to increase. The Commission considers that this may partly explain the apparent lack of activity in the ACT market in the initial years after FRC, and the recent increase in activity. Discussions held with some of those retailers who are licensed in the ACT but as yet inactive in terms of the small customer market, suggests that this 'market information gathering' stage may well be what has been seen over the initial period of FRC in the ACT.

EnergyAustralia argued that customer churn alone is not a good indicator of the effectiveness of competition, and that the number of customers who have accepted a market offer from the incumbent retailer must also be considered. The submission claimed that ACT churn rates were not unacceptably low, and noted that 'If you compare the churn rates between the first nine months of FRC in New South Wales with the first nine months since EnergyAustralia's market entry in the ACT, the churn rates are similar.'[38] In addition, the submission stated that most of the churn in New South Wales had occurred in the Sydney and Newcastle metropolitan regions, where customer densities are highest. The submission argued that the ACT is considerably smaller than those centres and more closely parallels a regional centre in Country Energy's area (which, despite good margins, has so far experienced a low churn). It was argued that competitors will increasingly look to other areas for growth opportunities as the metropolitan areas become saturated.

The Commission has considered the argument that customer churn rates in New South Wales are comparable to the proportion of customers in the ACT who have elected to enter into market contracts if those who remain with ActewAGL but enter contracts are included. However, the Commission does not have access to information from other jurisdictions on the extent to which small customers have entered into market contracts with incumbent retailers, so it cannot make a like-for-like comparison across jurisdictions on this basis. This limits the Commission's ability to draw meaningful conclusions from the above observation. The Commission also notes that there were several incumbents operating in the New South Wales market at the time FRC was introduced. However, the churn rates in New South Wales are approximately half those in Victoria. In this regard, the Commission notes that the businesses operating in Victoria are privately owned whereas those in New South Wales are government owned, and that this may have played a role in creating incentives to actively seek additional customers.

The Commission has analysed customer churn statistics for the ACT. In this analysis, the Commission has noted the difficulties associated with using the level of customer churn (or any other single indicator) to assess the competitiveness of the market. Customer churn is not necessarily a good indicator of the competitiveness of the market as customer churn can be influenced by other factors (such as the cash rebate that was offered to householders with concession entitlements in South Australia to encourage them to seek out a competitive market offer rather than stay with the franchise tariff, which had been increased significantly).

[38] EnergyAustralia submission, p. 3.

Also, customer churn can be influenced by how successful the incumbent has been in retaining customer loyalty despite alternate market offers from competitors. In the ACT, ActewAGL has been very successful to date in retaining customers on the franchise tariff, or converting them to its own contract customer tariff, despite EnergyAustralia offering discounts on electricity in some instances slightly higher than those offered by ActewAGL.

While the Commission acknowledges that specific indicators of competition may be difficult to interpret, it has noted the lower level of churn in the ACT compared to churn in the other jurisdictions discussed in this report. However, the Commission has also observed that the level of churn in the ACT has recently increased markedly, and that there has been a continuing increase in the number of customers adopting market contracts offered by ActewAGL.

3.2.6 Retail margins

The Commission is mindful that regulated prices set too close to efficient costs of supply will not provide an efficient and sustainable margin to retailers and could hinder the development of effective competition. Conversely, where prices are set too high there is a clear detriment to customers, and such a market outcome would be consistent with a monopolistic market rather than a competitive market. To determine whether the margins in the ACT are reasonable in terms of comparison to other states, the Commission has calculated the retail margins for each of the incumbent retail businesses in the ACT, New South Wales and Victoria. All of the data used to calculate margins for each retailer are available in publications produced by the relevant jurisdictional regulator.

Determination of margins

In evaluating whether prices in the market for electricity supply to small customers embody an efficient and sustainable margin and recover efficient costs of supply, the Commission has had to consider the retail prices charged by ActewAGL in other jurisdictions and the retail prices charged by incumbent retailers in other jurisdictions. These matters are also specific requirements of the current review, as set out in s. 2 of the terms of reference.

The Commission's consideration of these matters focuses mainly on the net margins available to retailers in supplying small electricity customers, given that a simple comparison of retail prices (that is, without considering the underlying cost differences between jurisdictions, particularly for network costs) would not indicate whether the prices in the ACT or in other jurisdictions provide evidence of the existence or absence of monopoly or market power.

In evaluating these matters, the Commission has sought to arrive only at indicative retail net margins. Margins calculated by the Commission for the purposes of this investigation are based on representative customer profiles and benchmark costs. The limitations of analysis based on such profiles and costs should be recognised. In particular, the costs and margins derived by the Commission for the purposes of this investigation should not be taken to provide an accurate estimate of actual retailer costs or margins by customer group or type. For example, the Commission's margin analysis focuses only on customers without an electricity off-peak service. In retail markets with a relatively high proportion of customers with an electricity off-peak service actual margins would be lower if this service option were factored into the analysis.

The Commission's analysis determines retailer initial net margins from regulated tariff revenue, less efficient costs of supply. Regulated tariff revenue is derived using the 2005 published

regulated prices for the relevant tariff classes in the relevant jurisdiction. The efficient costs of supply are determined on a similar basis to that used in the Commission's 2003 review.[39]

The Commission considers that a change to its retail operating cost per customer amount from the 2003 review ($85) is not warranted for the purposes of this investigation. While the amount of $85 per customer is higher than the $70 per customer allowance determined by the New South Wales Independent Pricing and Regulatory Tribunal (IPART) in its 2004 review,[40] it is consistent with the allowance used by the ESC in its 2004 review.[41] In the absence of evidence to the contrary, it appears that average retail costs per customer have not changed markedly since the Commission's 2003 review.

For the purposes of this draft report, as in the 2003 review, the Commission has applied the cost rate (as estimated for 2005) for a retailer purchasing energy on behalf of its customers. The cost rate used corresponds closely with that used by IPART in its 2004 review.

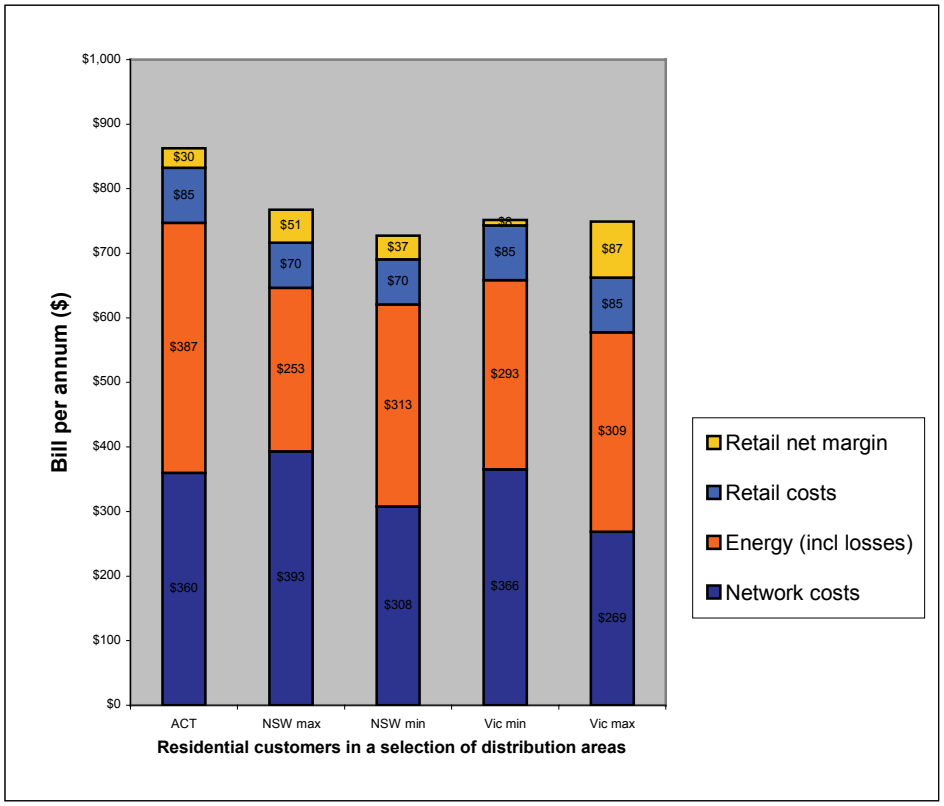
The network cost rates applied, in terms of transmission use of service (TUoS) charges, distribution use of service (DUoS) charges and allowances for competitive metering (where applicable), are the 2005 rates taken from the relevant regulator's published reports.

Commission's analysis

Figure 4.1 summarises the Commission's margin analysis. Results are shown for five retail areas, the ACT and the minimum and maximum margins in New South Wales and Victoria.

[39] ICRC, *Final determination: Investigation into retail prices for non-contestable electricity customers in the ACT*, Report 5 of 2003, May 2003.
[40] Independent Pricing and Regulatory Tribunal, *New South Wales Electricity regulated retail tariffs 2004–05 to 2006–07, Final report and determination*, 2004.
[41] ESC, *Final report to minister: Special investigation—Review of effectiveness of retail competition and consumer safety net in gas and electricity, Background report*, June 2004.

Figure 4.1: Components of residential customer bills



Inspection of Figure 4.1 reveals that the derived margins in the ACT lie between minimum and maximum in Victoria but below the minimum in New South Wales. However, if retail costs in New South Wales were set at $85 per customer as was used for the ACT and Victoria calculations, the ACT margin would be between the New South Wales minimum and maximum. This demonstrates that the TFT rate set by the Commission for the ACT has incorporated a retail margin that is not out of line with the retail margin set under the regulated prices operating in Victoria and New South Wales.

In the Commission's view, regulated TFT prices in the ACT appear to have produced an appropriate balance between providing an efficient and sustainable margin to retailers on the one hand, and a reasonable short-term to medium-term outcome for customers on the other. On the basis of the favourable comparisons with the margins in other states, the Commission also considers that the margin in the ACT does not appear to have been a constraint on the development of competition in the market for small customers. The Commission's views on these matters have been informed by the costs and margins applied in determining regulated tariffs in New South Wales and Victoria and also comments that the Commission has received from licensed active and inactive retailers.[42]

[42] The Commission notes that Country Energy has publicly said on a number of occasions that it would like the margin in the ACT to be greater than the Commission has allowed. This confirms that Country Energy may become more active in the ACT should ActewAGL seek to increase its margin if the TFT were withdrawn. It is a further example of the potential competition in the ACT market that acts as a constraint on the behaviour of the incumbent supplier.

The market offers made by ActewAGL in the ACT, and in the areas of New South Wales in which ActewAGL operates, are comparable to the market offers being made by competing retailers, and in particular to those being made by a retailer that is providing active competition in the ACT market. The fact that competitors to ActewAGL are able to make offers to ACT customers that are equivalent to those of ActewAGL provides evidence that ActewAGL does not have an anti-competitive cost or price advantage relative to its competitors in the ACT.

Nothing has come to the Commission's attention to indicate that retailers have focused their market offers on particular small customer classes to the exclusion of other small customer classes; that is, there appears to be no incentive for retailers to focus on 'cherry picking' particular customer classes. For example, the Commission notes that EnergyAustralia, as part of its doorknocking campaign, has marketed to all suburbs in Canberra. Instead, it appears that retailers in the ACT have marketed and made offers to small customers generally. The Commission acknowledges however, that in the marketing being undertaken, the current active competitors are offering a bundled service which requires that customers must have at least two services, electricity and gas, provided by that retailer to obtain a discount on the TFT rate for electricity. Nevertheless, with the impending arrival of Aurora Energy in the market and the offer of a prepayment meter with expected time-of-use tariff rates, further product offerings can be expected from the other competing retailers.[43]

The Commission therefore considers that the regulated margins that have been set in the ACT are not inconsistent with conditions required to allow the emergence of a competitive market. Furthermore, the margins and tariff offers that are applied by ActewAGL in the ACT are not inconsistent with the margins and tariff offers being applied in other markets where ActewAGL is an active competitor in the contestable market.

3.2.7 Barriers to entry

Barriers to entry may affect the competitiveness of the market, now and into the future. The existence of such barriers can result in potential entrants facing costs that existing firms do not face, perhaps to a level at which the costs prohibit the entry of additional firms. Barriers to entry enable firms already operating in the market to exert a degree of market power. If there are significant barriers to entry, it may be concluded that the market is not competitive.

Possible barriers to entry include:

- licensing costs
- existing regulatory arrangements
- the dominance of the incumbent retailer.

Licensing costs

The Commission is responsible for issuing licences to retailers in the ACT. Retailers wishing to be licensed are required to provide evidence to the Commission of their credit worthiness and compliance with other financial and economic regulatory requirements. In addition, once licensed,

[43] Both EnergyAustralia and Country Energy have a time-of-use tariff offering that is marketed in other jurisdictions.

retailers are required to submit annual licence fees to the Commission. The licence fees are determined for each utility based on an assessment of the costs to each of the Commission, the ESCC and the Technical Regulator of undertaking their functions related to the operation of the utility. The current annual licence fee for a retailer that has recently become licensed, or has little market share, is approximately $5,000.

EnergyAustralia stated in its submission that regulatory inconsistency among jurisdictions acts as a barrier to entry. The submission claimed that, in order to enter the ACT market, EnergyAustralia had to undertake modifications to its information technology and customer service operations in order to meet ACT-specific requirements. Similarly, TRUenergy argued that licensing conditions that differed between jurisdictions imposed a significant cost on retailers, but acknowledged that the MCE is currently working on ensuring consistency across the NEM and that this should reduce costs and enhance competitive outcomes for the ACT.

The Commission notes that, despite these 'barriers', both retailers have become licensed in the ACT and EnergyAustralia is active in the ACT market for smaller customers. The move toward national regulatory arrangements, which will become more pronounced later in 2006, will address these types of obstacles to the extent they exist.

Existing regulatory arrangements

The issues paper noted that setting the regulated retail tariff with insufficient retail margin above costs may create a barrier to entry for alternative retailers, as they would not be able to enter the market profitably.[44] To the extent that such a barrier exists, removal of the TFT arrangements would eliminate this factor as a barrier to entry. However, as noted above, the margin analysis undertaken by the Commission indicates that the regulated retail margin the ACT is comparable with that in Victoria and New South Wales.

Among regulatory arrangements, it is important to consider existing customer rights and customer protection provisions in the Consumer Protection Code in the ACT and in voluntary hardship measures adopted by retailers. This point was made by a number of submissions responding to the Commission's issues paper. ActewAGL identified the voluntary hardship measures which it operates, namely its 'Staying connected' policy and its 'Customer Council', and argued that these policies and programs assist customers who have difficulty paying their bills.[45]

Furthermore, ActewAGL stated that it intends 'to maintain a standard customer contract' regardless of the continuation of the TFT arrangements.[46] The implication of this is that removing the TFT would have no impact on the arrangements for retailer of last resort provisions or ActewAGL's obligation to supply.[47] A further implication is that customers would be able to opt in and out of the contract at any time, which would alleviate concerns that a lack of reversion arrangements could reduce customer switching levels.[48]

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[44] That is, the regulated tariff is set at a level which does not allow a competing retailer to offer a service at a competitive price below the TFT price and still earn a satisfactory margin on its activities.
[45] ActewAGL submission, p. 26.
[46] ActewAGL submission, p. 27.
[47] ActewAGL submission, p. 27.
[48] ActewAGL submission, p. 19.

It is noted that both EnergyAustralia and Country Energy are involved in the voluntary customer hardship programs operating in the ACT and have not indicated that these have been a major constraint on their entry into the market.

Dominance of the local retailer

ActewAGL is the incumbent retailer in the ACT and currently has over 95% of the small customer base. Market dominance by a single firm may appear to indicate that some form of barrier is restricting entry by rival firms. The issues paper questioned whether the size of ActewAGL relative to other retailers might act as such a barrier. This would be the case only if the continuing dominance of ActewAGL results either from it having an absolute cost advantage over its potential rivals, or from the existence of sufficient economies of scale (so that the least-cost means of servicing the market is available only to the incumbent retailer serving a large portion, or the entirety, of the market).[49]

In the absence of either an absolute cost advantage or economies of scale, the mere existence of a firm with a dominant market share is not evidence of a barrier to entry. ActewAGL's dominance in the small customer market is due to its having been the only retailer until FRC was introduced for this market segment in 2003.

Many of the current licensees in the ACT are also large retailers in other jurisdictions. As they are currently purchasing energy in the national market and have already developed the capability to retail to large numbers of small customers, it is highly unlikely that ActewAGL would have an absolute cost advantage over them.

Economies of scale exist in situations where the average cost of production decreases as the quantity produced increases. This enables firms producing large quantities of goods to offer lower per unit costs to customers. In the retail electricity market, retailers with significant market shares can achieve economies of scale. The retail electricity market can be characterised as having high fixed costs and a decreasing per unit cost for servicing customers. Economies of scale therefore exist in that market. Therefore, the existence in the ACT of few competing retailers with significant market shares is not an indication of an uncompetitive market. Rather, ACT retail market outcomes can be viewed as a consequence of the market exhibiting scale economy characteristics, with relatively high fixed costs and low per unit margins.

This would be a matter of concern from a competitive market perspective if the ACT market were viewed as being a single separate market. However, the ACT market is part of the wider national market from an energy generation perspective and is treated by retailers as being part of a wider market for energy supply.

Many of the other retailers licensed in the ACT are incumbents in their original jurisdictions. The Commission considers that those retailers are in a position to take advantage of scale economies at a national level when attempting to enter the ACT market. Therefore, the Commission takes the view that, while ActewAGL may be in a position to achieve economies of scale in the ACT, the potential for this to reduce competitiveness is mitigated by the ability of other retailers to access similar efficiencies.

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[49] There is a subtle distinction between these two cost-based potential barriers to entry. The first states that the incumbent firm has the ability to produce at a lower cost than its rivals. The second derives from the possibility that the average cost of production falls as output increases (economies of scale). Economies of scale do not preclude small and large firms from having the same cost structures, but do imply that one large firm has lower average costs than several smaller firms.

Thus, while the Commission acknowledges that economies of scale exist in the electricity retail market, it takes the view that these are not significantly affecting the competitiveness of the supply of electricity in the ACT market.

Conclusion

The Commission considers that, because 15 retailers are currently licensed in the ACT, the requirement to be licensed and pay the obligatory annual licence fee is not acting as a barrier to entry.

Further, to the extent that jurisdictional differences in licensing and other regulatory arrangements may be seen to present a barrier to entry, as noted by EnergyAustralia and TRUenergy in their submissions on the Commission's issues paper, work currently being undertaken by the MCE on ensuring consistency across the NEM, and the transfer of distribution and retail regulation (except retail pricing) to a common basis by 31 December 2006, should reduce costs and enhance competitive outcomes for the ACT. In addition, the Commission is conscious that both EnergyAustralia and TRUenergy have become licensed in the ACT despite these licensing and regulatory arrangements. EnergyAustralia is actively competing in this market.

The Commission considers that, in the absence of an ongoing franchise tariff set so low so that competition cannot flourish, there are no existing regulatory arrangements that would constitute a barrier to entry. As part of its proposal for the future setting of retail prices outside of a continuation of the TFT, ActewAGL has offered to maintain its existing customer contract provisions and obligation to supply. However, even this arrangement, should it be supported, would not represent a barrier to competition, particularly as the margin analysis supports the view that the TFT margin is comparable with that offered in other states where FRC is occurring.

Finally, the Commission has assessed that ActewAGL's current market position is not a barrier to entry; nor is it evidence that ActewAGL has a significant cost advantage or can take advantage of its economies of scale to deter entry in the market.

Therefore, the Commission concludes that there are no significant barriers to entry.

3.2.8 Issues related to the use of electricity prices as a social policy instrument

Arguments have been advanced to the Commission that a regulated retail tariff is required as a social policy instrument and a safety net for vulnerable consumers. ACTCOSS stated in its submission that it 'sees regulated pricing as an important safeguard'.[50] Similar sentiments have been expressed by the ESCC and Care Financial Counselling Service. However, the Commission notes that the current TFT arrangements were not implemented as a means of protecting vulnerable consumers. Rather, the TFT was introduced as a transitional measure to assist in the implementation of FRC in the ACT, and was calculated on a cost-reflective basis so that ActewAGL could recover the legitimate costs of supplying electricity.

[50] ACTCOSS submission, p. 9.

The issue of regulated tariffs acting as a safeguard for the vulnerable has been identified by the MCE, which states that:

> In effect, they [regulated retail tariffs] are used to protect consumers from the possible exercise of retailer market power and to achieve a measure of price equality between various customer groups.
>
> In the absence of fully effective retail competition, regulated energy pricing should seek to balance the provision of commercial viability for retailers with consumer protection goals. This is a legitimate and ongoing role for government.
>
> However, regulated energy price setting has the potential to conflict with and impede efficient market outcomes if prices are not set at cost reflective levels. Predictable and transparent government interventions would assist to achieve efficient outcomes while still facilitating legitimate social objectives.[51]

The Commission is conscious of the difficulties some customers have in meeting their energy bills. However, the Commission believes that restricting general retail tariffs via regulation is a poor means of addressing these issues. Rather, the Commission considers targeted assistance programs by government to be a more effective and equitable way to address customer difficulties.

The Commission also notes recommendation 10.5 of the recent Productivity Commission review of national competition policy, which stated that:

> In retail infrastructure markets, once effective competition has been established, regulatory constraints on prices should be removed. Ensuring that disadvantaged groups continue to have adequate access to services at affordable prices should be pursued through adequate, well targeted and transparent community service obligations (or other appropriate mechanisms), that are monitored regularly for effectiveness.[52]

The value of CSOs, concessions and rebates was highlighted in the submissions from ACTCOSS and Care Financial Counselling Service. The Commission supports the continued use and development of such targeted assistance packages to support customers experiencing payment difficulties.

A broader issue raised in submissions was the continuation of safeguards. ACTCOSS called for a commitment to safeguards, such as the ESCC. The Commission supports the work of the ESCC and notes that it is often considered a benchmark for the work of other assistance organisations nationally. However, the Commission is also conscious that the issues of the continued role and funding of the ESCC, which are especially relevant given the imminent shift to a national regulatory framework, are outside the scope of this review.

The Commission expresses its support for the continued operation of the ESCC, and raises the matter of its funding, which currently relies heavily on licence fees collected from companies whose regulation will be transferred to the national regulator, as an issue that government must address.

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[51] MCE Standing Committee of Officials, *Improving user participation in the Australian energy market—discussion paper,* March 2004, p. 17.
[52] Productivity Commission, *Review of National Competition Policy Reforms*, 2005, recommendation 10.5.

3.3 Draft conclusions

The ACT is one of four jurisdictions in the NEM to have introduced FRC for retail electricity supply. The decision by the ACT Government to introduce FRC was a strong commitment to allowing the introduction of competitive forces in the retail electricity market. Over the past three years, these competitive forces have led to benefits to customers in the form of new products and services offered by the competing retailers operating in the ACT and the ability for customers to access tariffs as part of bundled packages that are below the regulated tariff. The Commission envisages that these offers will only increase over coming years.

Having considered the evidence available, the Commission has drawn the following draft conclusions in terms of the of the three characteristics of competitiveness identified above:

- The existence of a number of competing retailers and/or the imminent potential entry of new competitors
  - The Commission has concluded that the size of the retail market in the ACT does not adversely impact on the competitiveness of that market. In practice, the number of electricity retailers in the ACT, actively and imminently operating, is sufficient to ensure a competitive market.
  - The investigation of barriers to entry determined that there were no barriers impacting upon the competitive state of the market. The Commission has found that retailers currently operating in other states have also been licensed in the ACT and, despite the strong market presence of the incumbent supplier, ActewAGL, do not regard the barriers to entry into the ACT market insurmountable.

- Actual and/or potential competition between these retailers
  - The level of customer awareness is such that customers are generally aware of FRC, although the Commission has determined that during 2006 it will undertake a major program to further promote the availability of competing electricity supply arrangements for small consumers, and provide advice on how to interpret supply offers made by competing electricity retailers.
  - There has been widespread advertising in the print and electronic media about the availability of contestable electricity supply offers, and one supplier has undertaken an extensive door-to-door campaign seeking to sign up customers for its services. In response, the incumbent supplier has been active in promoting of both its brand name and the benefits of remaining with that supplier rather than moving to competitors that are active in the marketplace. The Commission has concluded there is no evidence of any non-competitive behaviour in that process.
  - Discounts on the TFT of up to 10% are now on offer in the ACT, where previously there was no discounting of electricity supplies for household consumers other than for off-peak electricity.
  - The Commission has concluded that, while there are difficulties in assessing the competitive state of the market based on a single indicator, the customer churn level in the ACT is consistent with that of a competitive market and is showing signs of increasing.
  - The Commission has also analysed retail margins and found that margins are sufficient in the ACT to elicit competition and that there is no evidence that retailers are focusing their attention on specific classes of small customers to the exclusion of others.

- Innovation in the products and services offered to consumers by active retailers
  - The Commission has found that there is a range of price and service options available in the ACT market, similar in style to those offered in other parts of Australia. These offers were not previously available in the ACT, and have been developed in response to the competitive market. The offers currently available involve some form of bundling of services (usually at least electricity and gas services).
  - There is the imminent possibility of the introduction of a prepayment metering service that will be available as a competitive option for consumers and is expected to incorporate a new time-of-use tariff option.

On balance, the Commission believes that there is sufficient evidence to conclude that the market in the ACT is competitive and that, therefore, there is no longer a 'continuing need for a price direction'.

4 Draft decision

4.1 Recommendation to discontinue the TFT

The Commission notes the original reason for implementing the TFT was to guard against the possible abuse of market power by ActewAGL. Given the Commission's conclusion that the market exhibits the characteristics of a competitive market, the Commission believes that the role of the TFT is this capacity is now redundant, and the market will ensure that ActewAGL is not able to abuse its market power.

Furthermore, the Commission is conscious of the inherent difficulties of setting a regulated tariff. The Commission has noted the consequences of setting the tariff too high or too low and the impact this may have on competition in the market and the welfare of consumers.

The Commission believes that, in these circumstances, the removal of the TFT will assist in providing further opportunity for competition to evolve and deliver wider benefits across the ACT market.

In arriving at the decision to recommend that the TFT be discontinued, the Commission has considered a range of important social and practical implications of such a decision. The following sections set out the Commission's proposed advice on those matters.

4.2 Consumer protection issues

The Commission has considered the arguments in favour of the TFT being retained as a form of safety net or social policy instrument to protect more vulnerable consumers. However, the Commission notes that the TFT was never designed to meet this objective, not was its calculation based on principles other than ensuring an efficient cost-reflective pricing of electricity which sought to balance the interests of the supplier and consumers in general. There are other more appropriate and targeted tools that governments have for meeting social policy objectives. These need to be maintained and reinforced within the ACT, particularly at a time when there is a move toward national regulation of the electricity sector.

To this end, the Commission notes that the continuation of the support programs currently offered in the ACT, especially those provided through ESCC, is currently funded in part by licence fees charged on the activities of the electricity distributor and retailers. With the emergence of the national regulatory arrangements at the end of 2006, this source of funding will no longer be available. Accordingly, the Commission highlights this as an area requiring government attention to preserve the support mechanisms currently in operation in the ACT.

The Commission recognises that there is a need to provide further public education on the availability of competitive tariff offers for electricity supply in the ACT, and to assist consumers in their interpretation and assessment of these offers. To this end, the Commission will undertake an ongoing market awareness program during 2006 (to be reviewed at the end of the year), with a focus upon the dissemination of information on the merits of competitive pricing, and the interpretation of the relative value of the competitive offers.

4.3 ICRC Act considerations

The Commission also considered the implications of the proposed withdrawal of the TFT in terms of the requirements of s. 20 of the *Independent Competition and Regulatory Commission Act 1997* (ICRC Act). Under this section of the Act, the Commission is required to consider a wide range of matters relating to the impact of its decisions on consumers and service providers. The Commission has examined each of these issues (see Appendix 4) and is of the view that all the requirements of s. 20 have been met by the draft conclusions and recommendation contained in this report.

4.4 'Retailer of last resort' provisions

The draft decision to recommend that the TFT be discontinued will not alter the arrangements whereby ActewAGL will remain the retailer of last resort. ActewAGL has stated in its public submission to this inquiry that it intends to continue to provide this facility, thereby providing a fallback supply option for any consumer unable to obtain supply from any other retailer in the ACT.

4.5 Role of the default tariff in the regulatory framework

The Commission is conscious of the role the TFT plays as a 'default' tariff for customers on standard customer contracts (as discussed in more detail in Appendix 3).

To summarise, under the current arrangements, the retail supply of electricity is provided by a utility under either a negotiated customer contract or a standard customer contract. The standard customer contract is currently issued under the provisions of the *Utilities Act 2000* (Utilities Act) and the *Consumer Protection Code* (Code). The standard customer contract essentially is legislated to act as a 'default' contract where a customer applies to a utility for an electricity supply but does not enter into a negotiated customer contract. The obligation to supply electricity to a customer is only relevant when that customer is on a standard customer contract.[53]

ActewAGL has submitted that it intends 'to maintain a standard customer contract with no fixed term, and customers would be able to opt in or opt out of it at any time' even if the Commission decides a price direction is not required.[54] However, by definition, a standard customer contract is only one that is approved by the Commission, and the Commission can only approve the standard customer contract or any variation to that contract if it is satisfied the terms meet specified criteria.[55] If the TFT were discontinued, the Commission would effectively cease to approve the contract offered by ActewAGL. As a result, the standard customer contract would effectively become a negotiated customer contract.

If the Commission did not issue a new TFT price direction, before 30 June 2006 ActewAGL would be required to contact each of the customers with whom it currently has standard customer contracts and ask them to agree a negotiated customer contract that meets the requirements of the Code.

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[53] Utilities Act, s. 80. The obligation to supply does not apply to a customer on a negotiated customer contract.
[54] ActewAGL submission, p. 27.
[55] Utilities Act, s. 89.

However, the Commission considers that there is insufficient time before 1 July 2006 in which to achieve the objective of transferring all customers onto a negotiated customer contract. This could be addressed by amending the Code to allow a few months grace before the requirements of the Code apply to those contracts remaining to be transferred. However, the removal of the standard customer contract also has the potential to remove any default tariff role it may play for vulnerable customers.

Further, an addition problem is that ActewAGL would likely encounter customers who would be reluctant to sign a negotiated customer contract. In the absence of any alternative, and given the requirements of the Code, ActewAGL would be supplying electricity to those customers under a contract that would be in breach of the Code.

Therefore, to ensure vulnerable customers interests are protected and ActewAGL is not compelled to supply electricity in breach of the Code, the Commission proposes that the Utilities Act be amended to legislate for a 'deemed contract' in certain circumstances. An amendment along these lines would be required regardless of when the TFT was discontinued.

This proposal, and alternative solutions, are explored in greater depth in Appendix 3 of this draft decision.

4.6 Proposed implementation regime

The Commission considers there to be insufficient time for the amendment of the Utilities Act to address the issue of standard contracts to occur before 1 July 2006, when the current TFT arrangements expire.[56] Therefore, the Commission considers it appropriate to impose a price direction or TFT for a period of 12 months from 1 July 2006 to 30 June 2007 as an interim measure to allow time for the amendment of the Utilities Act and ultimate withdrawal of the TFT arrangement from 1 July 2007. This interim measure presumes the Utilities Act is amended by 30 June 2007.

To this end, the Commission considers it appropriate to apply a CPI-related price adjustment regime to the regulation of the retail electricity tariff from 1 July 2006 to 30 June 2007 based on the price adjustment proposal submitted by ActewAGL.

The Commission considers the following scheme to be appropriate for the period from 1 July 2006 to 30 June 2007:

- Default retail tariffs will be available to all tariff customers whose consumption is below 100 MWh/yr.
- Customers consuming less than 100 MWh/yr may return to default retail tariffs at any time.
- Default retail tariffs should be broadly reflective of published industry benchmarks.
- ActewAGL will advise the Commission of proposed increases to default retail prices at least 40 days before the date of effect.

[56] The Commission notes that the ACT Government, as part of its commitments to its MCE obligations will be required to make a number of amendments to the Utilities Act later in 2006, and that the amendments proposed by the Commission could also be made at that time.

- Where the Commission determines that a proposed price increase is at the CPI or less than the CPI, the Commission will conduct no further review.
- In the event that the Commission determines that a pricing proposal involves an average increase to retail prices greater than the CPI ('CPI plus proposal'), the Commission will determine whether the proposed increase is reasonable.
- The Commission will receive advice from ActewAGL as to the basis of any CPI plus claim.
- Where the Commission determines that a CPI plus proposal is reasonable, based on ActewAGL's explanation, the Commission will conduct no further review.
- The Commission will not review a CPI plus proposal where ActewAGL demonstrates that this is the result of one or more cost pass-through events or other relevant market factors. Cost pass-through events are changes in: wholesale market conditions; the form of market arrangements adopted in the ACT market; NEMMCO fees and charges; MRET/greenhouse levies; network tariff variations; and other fees, taxes and imposts.
- In the event that the Commission seeks to conduct a review of the CPI plus proposal, the Commission may undertake a review of the relevant components, taking into account published industry benchmarks, and prepare a final report on ActewAGL's proposal no later than 20 days before the day on which the proposal is to take effect.
- The Commission will apply the movement in the CPI for the ACT for the 12-month period to 31 December 2005 over the previous 12-month period to 31 December 2004 in assessing the CPI based price adjustment to take effect from 1 July 2006.

ActewAGL would continue to the retailer of last resort under this arrangement. This role would not be affected by the implementation of the proposal to discontinue the TFT from 1 July 2007.

4.7 Future price regulation

The Commission considers that, should the ACT Government require it to determine a regulated tariff for a period of time beyond 30 June 2007, a similar approach to that outlined above would be appropriate. The Commission will present further details on this approach in its final report into this inquiry. This arrangement will include provisions for customers to return to the deemed default tariff as proposed by ActewAGL.

The Commission notes that, even with cessation of the TFT arrangement from 1 July 2007 as proposed, the ACT Government would retain the power to issue a reference to the Commission should, after 30 June 2007, the Commission conclude that the de facto default tariff offered by ActewAGL exhibits monopoly pricing characteristics.

The Commission is also favourably disposed to the proposal made by ActewAGL that, even under a post-TFT arrangement, ActewAGL would still advise the Commission in advance of its proposed annual price adjustment for its 'default' tariff, and that similar adjustment rules based on movement in the CPI as outlined above for the 2006–07 year would apply. The Commission will make a final decision on this proposal as part of its final report.

Appendix 1 Terms of reference

Australian Capital Territory

Independent Competition and Regulatory Commission (Reference for Investigation) Determination 2005 (No 1)

Disallowable instrument DI2005–218

made under the *Independent Competition and Regulatory Commission Act 1997*, s. 15 (Nature of industry reference) and s. 16 (Terms of industry references)

Reference for investigation under s. 15

Pursuant to s. 15(1) of the Act, I refer to the Independent Competition and Regulatory Commission (the 'Commission') the provision of a price direction for the supply of electricity to franchise customers for a period to operate from the expiration of the current price direction on 30 June 2006.

Reference for requirements in relation to investigation under s. 16

Pursuant to s. 16(1) of the Act, I specify the following requirements in relation to the conduct of the investigation:

1. The Commission is to consider the competitive state of the market for the supply of electricity to franchise customers as the basis for determining the continuing need for a price direction. If such a need exists, the Commission shall provide a price direction and recommend the duration of any price direction to operate from 1 July 2006, following the expiration of the current price direction on 30 June 2006.

2. In undertaking the review, the report should have regard to the requirements of s. 20 of the Act, as well as the following:

   (a) while having regard to the new national electricity regulatory environment, any applicable requirements of the National Electricity Law and the National Electricity Code;

   (b) the arrangements for Retailer of Last Resort;

   (c) the retail prices charged by ActewAGL in other jurisdictions; and

   (d) the retail prices charged by incumbent retailers in other jurisdictions.

3. The Commission must produce its final report in time sufficient to allow ActewAGL Retail to make any necessary administrative changes to its billing system and to provide information on any new tariff to customers.

Ted Quinlan MLA
Treasurer

22 September 2005

Appendix 2 Overview of submissions

The Commission received submissions from a variety of retailers and consumer advocacy groups. This section briefly summarises the submissions. Copies of the submissions can be found on the Commission's website, www.icrc.act.gov.au.

ACT Council of Social Service

The ACT Council of Social Service (ACTCOSS) stated that it was opposed to the removal of a regulated tariff. ACTCOSS argued that it will be many years before the ACT develops into a mature market with a competitive retail segment and that the transitional arrangements should be retained until this occurs.[57]

The submission argued that the size of the ACT market (145,000 customers and, at the time, 14 licensed retailers) is irrelevant, and stated that only two retailers are active in the market and that the incumbent retailer retains 98% of the small customer base.[58] In addition, the submission argued against the use of potential competition as the basis for assessing the competitive state of the market:

> [ACTCOSS] rejects any assumption that, simply because the parameters for a market exist on paper, that a market will develop. The past three years have provided ample demonstration that retailers are not interested in competing for the under 100 MWh sector, despite the potential.[59]

It was argued that customers must be provided with relevant and easily understood information. The submission stated that the breakdown of the full cost of electricity is not clear and transparent, but acknowledged that, for most consumers, understanding their utilities bills is not a high priority. The submission supported the introduction of a community-based advocacy and information service to provide information on utility services.[60]

The submission provided little comment on barriers to further competition but claimed that none of the potential benefits of competition, such as retailer choice, lower prices and better products, have yet been realised.[61]

ACTCOSS sees the ACT's low churn rates relative to those in other jurisdictions as a result of the lack of new products being offered. The submission stated that those customers who had adopted market contracts were mostly 'early adopters' who had enough services to bundle, combined with a few customers who felt they could benefit from the EnergyAustralia discount of 8%.

It was argued that, from a retailer's perspective, the low level of churn indicated that the various regulatory requirements in licences, rules, codes and metrology procedures might be impeding licence holders who would otherwise undertake expensive information technology upgrades to allow seamless business operations in the ACT, and that insufficient 'headroom' exists to provide

[57] ACTCOSS submission, p. 4.
[58] ACTCOSS submission, p. 5.
[59] ACTCOSS submission, p. 6.
[60] ACTCOSS submission, p. 6.
[61] ACTCOSS submission, p. 7.

an attractive environment for competing retailers.[62] However, the submission stated that ACTCOSS is against the 'headroom approach' (which presumably involves increasing the regulated tariff to encourage more active competition from alternative retailers), as such an approach disadvantages low-income consumers.[63]

ACTCOSS argued that there is a need to address the structure of the tariffs being offered, and that reductions to the standing charges, coupled with inclining-block tariffs and robust rebates, concessions and community service obligation (CSOs), would protect vulnerable customers. The submission stated that regulated pricing was an important safeguard in the transition to a competitive market.[64]

The submission stated that it is important that product diversification does not include a downgrading of service or enforced low-cost options that would exacerbate hardship, and expressed concern about the introduction in other jurisdictions of tariffs that include demand management options such as 'time off the grid' and 'brown out' provisions for residential customers. ACTCOSS argued that entering into differentiated products should be voluntary for all customers, but opposed the use of service standards as a way of differentiating products, on the basis that because electricity is an essential service all customers deserve a reliable product.[65]

ACTCOSS argued that there will always be a need for a basic, low-cost, safety net scheme and that such a scheme must be available universally. ACTCOSS argued that, under the current bundling offers, 'the more you have the more you save'.[66] In addition, it claimed that many low-income households were not in a position to take advantage of bundling offers because many did not have internet access, computers, mobile phones, or gas heating or hot water. It argued that these customers were often on the highest tariffs because no-one had made them an offer, and that a safeguard tariff must take into account the needs of such households.[67] Furthermore, ACTCOSS submitted that there is a need for a commitment to other safeguards, such as the Essential Services Consumer Council (ESCC), and asked the Commission to ensure that any proposed changes do not reduce the ESCC's ability to assist vulnerable customers.[68]

The submission argued that an increase in churn would leave the first tier-retailer with less profitable customers, which in turn would lead to pressure to increase prices due to the high cost of servicing those customers, who the second-tier retailer does not see as profitable.[69]

The submission from ACTCOSS provided no direct comments on whether the market has changed sufficiently in the past three years to warrant a change in the approach used to calculate a further transitional tariff. However, ACTCOSS asked that any change in the methodology for determining

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[62] 'Headroom' refers to the margin between the price at which a retailer buys electricity from a generator and the price that the retailer receives for that electricity from a final customer, less appropriate regulated distribution and transmission charges.
[63] ACTCOSS submission, p. 8.
[64] ACTCOSS submission, p. 9.
[65] ACTCOSS submission, p. 10.
[66] ACTCOSS submission, p. 11
[67] ACTCOSS submission, p. 11.
[68] ACTCOSS submission, p. 12.
[69] ACTCOSS submission, p. 11.

the transitional franchise tariff (TFT) keep in perspective the impact of pricing decisions on the lowest income households.[70]

ACTCOSS argued that benefits could be achieved through the restructuring of tariffs. It claimed that environmental goals could be achieved by sending better price signals to mid-range and high energy-use consumers who do not monitor their usage. This, combined with a baseline, cheap allowance of electricity would provide households with enough electricity to meet health and safety needs, with use over and above that amount being truly discretionary.[71]

ActewAGL Retail

ActewAGL's submission stated that competition in the ACT retail electricity market was effective and that retail price regulation should be removed. However, the submission also stated ActewAGL's preferred approach to price regulation, should the government decide to continue regulation.

The submission set out ActewAGL's:

- justification for the removal of retail price regulation
- arguments as to the effectiveness of competition in the ACT electricity market, and concerns about the Commission's criteria for assessing the effectiveness of the market
- consideration of consumer protection issues, including arrangements for retailer of last resort and obligation to supply
- discussion of regulatory frameworks adopted in other jurisdictions
- preferred approach to regulation, should it be decided that a regulated retail tariff is required.

Justification for the removal of retail price regulation

ActewAGL argued that there is no longer a need for retail price regulation in the ACT, due to the existence of effective competition in the retail electricity market. The submission stated that the combination of the threat of new entry and consumer protection provisions provided an adequate safety net for ACT consumers. In addition, the submission noted that there was an ongoing threat of re-regulation.[72]

The submission claimed that maintaining retail price regulation has the potential to create distortions in the electricity market and deny consumers the benefits that flow from a truly competitive market.[73] The submission pointed to reviews by the Productivity Commission and the Energy Retailers Association of Australia (ERAA) that highlighted potential costs and distortions associated with inaccurately setting the default retail tariff. The difficulties associated with setting a regulated 'competitive' price were also raised.

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[70] ACTCOSS submission, pp. 12 and 13.
[71] ACTCOSS submission, p. 13.
[72] ActewAGL submission, p. 6.
[73] ActewAGL submission, pp. 6 and 7.

Benefits from the removal of a regulated tariff identified by the ERAA included increases in the overall efficiency of the market, more cost-reflective pricing, promotion of investment in supply and demand initiatives, removal of barriers to second-tier retailers, avoided future price increases to facilitate future infrastructure investment, reduced regulatory costs, and increased incentive to implement more targeted and effective mechanisms for assisting vulnerable customers.

In addition, the submission discussed the national regulatory framework. ActewAGL cited the Productivity Commission finding that, once effective competition had been established, there was no good reason to continue retail price regulation.[74]

Effectiveness of competition in the ACT

ActewAGL argued that competition in the ACT retail market is effective. It cited as evidence the existence at that time of 14 licensed retailers, two of which are actively competing against ActewAGL in the market, and a significant number of competitive offers. The submission argued that the current level of actual and potential competition is sufficient to warrant the removal of retail price regulation.

The submission provided an alternative approach to considering 'the competitive state of the market' as the basis for determining the continuing need for a price direction. ActewAGL suggested that, rather than focusing on whether the market is competitive, attention should focus on identifying and removing factors that are leading to market failures. The submission identified price regulation as a source of market failure.

ActewAGL expressed concern with the market characteristics of size, number of retailers and churn identified in the issues paper as potential guides to the effectiveness of competition. The submission cited a report from KPMG, which stated that, in determining the effectiveness of competition, attention should be paid to the following three questions:

- Are customers aware that they have a choice?
- Do customers know how to exercise choice and is it easy to do?
- Are choices (that is, offers) being made available to them?[75]

Based on these criteria, ActewAGL argued that the market is effective.

The submission claimed that relying heavily on the number of retailers in the market and customer churn figures could prove misleading in attempts to assess the competitiveness of the market.[76] In addition, it argued that there are no significant barriers to entry in the market as a result of the dominance of ActewAGL. This was argued on the grounds that alternative retailers are entering the market and are vigorously pursuing ActewAGL customers.[77]

In the issues paper, the Commission sought views on whether the current state of the electricity market was sufficient to guard against price rises that were not cost based. ActewAGL submitted

[74] ActewAGL submission, p. 9.
[75] ActewAGL submission, pp. 12 and 13.
[76] ActewAGL submission, pp. 15–19.
[77] ActewAGL submission, p. 19.

that the existence of actual and potential competition in the market will ensure that the removal of regulation will not lead to such price rises. The submission cited the deregulation of natural gas prices as further evidence in support of this view.[78]

The submission noted that, since the deregulation of gas prices on 1 July 2004, price rises have been linked to movements in the consumer price index (CPI). In relation to this pricing arrangement, ActewAGL stated that, should price regulation be removed for electricity, it 'proposes to increase [its] default retail tariff by CPI on average on 1 July 2006.'[79] ActewAGL stated that this would provide a degree of certainty for decision makers and ensure price stability for customers while allowing ActewAGL to manage its cost recovery with a longer term perspective. The submission argued that the proposed average price increase of CPI from 1 July 2006 is comparable to planned movements in regulated default tariffs in other jurisdictions, and provided information on tariffs in Victoria, New South Wales and South Australia in support of this contention.[80]

ActewAGL claimed that ActewAGL's tariffs in the ACT are the lowest in Australia, with an average customer using 7,500 kWh/yr receiving an annual bill of $971. The submission stated that a similar customer would receive a bill 67% higher in South Australia, 38% higher in Victoria, 17% higher in Western Australia, 11% higher in Queensland and between 4% and 36% higher in New South Wales.[81]

Consumer protection issues

ActewAGL restated its view that competitive pressures and the threat of re-regulation were sufficient to insure against price increases that are not cost based. In addition, it argued that specific social equity and affordability issues should be addressed through direct government payments, not through price controls.[82] The submission pointed to the existence of the Consumer Protection Code, and ActewAGL's 'Staying connected' policy and 'Customer Council', and argued that these policies and programs assist customers who have difficulties paying their bills.[83]

Furthermore, ActewAGL stated that it was its intention 'to maintain a standard customer contract' beyond 30 June 2006 even if the TFT was no longer to apply.[84] The implication of this is that removing the TFT would have no impact on arrangements for the retailer of last resort or ActewAGL's obligation to supply.[85] A further implication is that customers would be able to opt in and out of the contract at any time, which would alleviate concerns that a lack of reversion arrangements may reduce customer switching levels.[86]

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[78] ActewAGL submission, p. 20.
[79] ActewAGL submission, p. 20.
[80] ActewAGL submission, pp. 21–23.
[81] ActewAGL submission, p. 23.
[82] ActewAGL submission, p. 25.
[83] ActewAGL submission, p. 26.
[84] ActewAGL submission, p. 27.
[85] ActewAGL submission, p. 27.
[86] ActewAGL submission, p. 19.

Regulatory frameworks in other jurisdictions and preferred approach to regulation

The ActewAGL submission concluded by restating the position that price regulation is unnecessary. However, the submission provided a proposed light-handed approach to regulation, based on experiences in other jurisdictions, should the government decide that price regulation is to continue.[87]

The ActewAGL approach consisted of 11 points:[88]

- Default retail tariffs will be available to all tariff customers whose consumption is below 100 MWh/yr.
- Customers consuming less than 100 MWh/yr may return to default retail tariffs at any time.
- Default retail tariffs should be broadly reflective of published industry benchmarks.
- ActewAGL will advise the Commission of proposed increases to default retail prices at least 40 days before the date of effect.
- Where the Commission determines that a proposed price increase is at the CPI or less than the CPI, the Commission will conduct no further review.
- In the event that the Commission determines that a pricing proposal involves an average increase to retail prices greater than the CPI ('CPI plus proposal'), the Commission is to determine whether the proposed increase is reasonable.
- The Commission will receive advice from ActewAGL as to the basis of the CPI plus claim.
- Where the Commission determines that a CPI plus proposal is reasonable based on ActewAGL's explanation, the Commission will conduct no further review.
- The Commission will not review a CPI plus proposal where ActewAGL demonstrates that this is the result of one or more cost pass-through events or other relevant market factors.
- Cost pass-through events include changes in wholesale market conditions, the form of market arrangements adopted in the ACT market, National Electricity Market Management Company (NEMMCO) fees and charges, Mandatory Renewable Energy Targets/greenhouse levies, network tariff variations, and other fees, taxes and imposts.
- In the event that the Commission seeks to conduct a review of the CPI plus proposal, the Commission may undertake a review of the relevant components, taking into account published industry benchmarks, and prepare a final report on ActewAGL's proposal no later than 20 days before the day on which the proposal is to take effect.

AGL Retail

AGL Retail submitted that competition in the ACT electricity market is sufficiently effective to enable the removal of price controls from July 2006 and that the minister has the power to issue a reference for the Commission to review prices in the future, should it prove necessary.[89] In assessing the competitiveness of the market, the submission referred to the framework developed

[87] ActewAGL submission, pp. 28–30.
[88] ActewAGL submission, p. 33.
[89] AGL Retail submission, p. 1.

by KPMG, which was also referred to in the ActewAGL submission. Based on the evaluation criteria in the KPMG framework (whether customers are aware that they have a choice, know how to exercise choice, and know of the offers being made available to them), AGL Retail submitted that further regulation of retail prices was not warranted.[90]

In addition, the submission argued that the Commission should focus on attempting to identify market failures or barriers to competition (as opposed to proving that competition is effective), and where such failings are identified establish a program to correct or remove them.[91] The submission stated that, in AGL Retail's opinion, no apparent barriers to competition exist.[92]

However, the submission stated that should the Commission determine that competition is not yet effective, a light-handed approach should be adopted that would expedite the transition to market-based prices and the removal of the regulation of prices.[93] A Voluntary Transitional Pricing Agreement, such as that implemented in the New South Wales gas market, was suggested.[94]

AGL Retail stated that issues of financial hardship are not effectively addressed by regulating energy prices. Rather, price regulation and assistance to customers in financial hardship should be managed as two separate issues. The submission cited recommendation 10.5 of the Productivity Commission's *Review of National Competition Policy Reforms*, which recommends that once effective competition has been established regulatory constraints should be removed, and that ensuring that disadvantaged groups receive adequate services at affordable prices should be pursued through CSOs (or other appropriate mechanisms).[95] In addition, the submission claimed that the removal of a regulated tariff would have no impact on customer rights or on customer protection available under the Consumer Protection Code and through voluntary hardship measures adopted by retailers. The submission noted that gas prices have not been regulated since July 2004.[96]

Care Financial Counselling Service

Care Financial Counselling Service (Care) stated it was pleased that the Commission had made specific reference in the issues paper to the potential impact of its decision on low-income consumers.[97] The Care submission addressed some of the specific matters raised in the issues paper relating to the possible impact on low-income consumers if a regulated retail tariff were removed.

The submission stated that the needs of customers experiencing difficulties with energy bills are handled in conjunction with the ESCC. The submission highlighted the importance of the CSO regime funded by the ACT Government in assisting these consumers. However, Care argued that

[90] AGL Retail submission, p. 4.
[91] AGL Retail submission, p. 2.
[92] AGL Retail submission, p. 4.
[93] AGL Retail submission, pp. 2–3.
[94] AGL Retail submission, p. 5.
[95] AGL Retail submission, p. 2, citing Productivity Commission, *Review of National Competition Policy Reforms*, 2005, recommendation 10.5.
[96] AGL Retail submission, p. 5.
[97] Care Financial Counselling Service (Care) submission, p. 1.

the existence of community support agencies and the CSO regime was insufficient to address issues such as insufficient income or inappropriate or energy-inefficient rental properties.[98]

Care stated that such choices as exist in the ACT market appear to target consumers other than its clients. The submission argued that product bundling offers currently available from competing retailers are unlikely to be taken up by low-income consumers, given the nature of the products being offered. The submission claimed that the only activity in the market that appears to take into account the needs of low-income consumers is the use of prepayment meters, under which consumers are likely to pay more for their usage.[99]

EnergyAustralia

EnergyAustralia submitted that it does not see any link between the size of the ACT market and the future of regulated tariffs, and stated that market size was not a major factor in its decision to enter the ACT market.[100] The submission noted that there were 14 licensed retailers in the ACT and that while only two were currently active in the residential market, the constant threat of competition from other retailers ensured the market's competitiveness.[101]

In relation to the availability of information to customers, EnergyAustralia stated that it considered this to be one of the most significant factors affecting the effectiveness of competition, and that it was its impression that ACT energy consumers have a lower awareness of FRC than have consumers in other jurisdictions. The submission noted that before the introduction of FRC in New South Wales the government had required all four standard electricity retailers to insert promotional information in customer bills, and that a media campaign was conducted. The submission stated that it may therefore be appropriate for the Commission to recirculate the information pamphlet distributed at the time FRC was introduced in the ACT.[102]

The submission argued that regulatory inconsistency between jurisdictions acts as a barrier to entry and claimed that, in order to enter the ACT market, it was necessary to undertake ACT-specific modifications to information technology and customer service operations. Licence conditions that differed between jurisdictions were also raised as an issue.[103]

EnergyAustralia argued that customer churn alone is not a good indicator of the effectiveness of competition, and that the number of customers who have accepted a market offer from the incumbent retailer must also be considered. The submission claimed that ACT churn rates were not unacceptably low and noted that 'If you compare the churn rates between the first nine months of FRC in New South Wales with the first nine months since EnergyAustralia's market entry in the ACT, the churn rates are similar.'[104] In addition, the submission stated that the majority of churn in New South Wales had occurred in the Sydney and Newcastle metropolitan regions, where customer densities are highest. The submission argued that the ACT is considerably smaller than these centres and more closely parallels a regional centre in Country Energy's area, and that

[98] Care submission, p. 2.
[99] Care submission, p. 3.
[100] EnergyAustralia submission, p. 1.
[101] EnergyAustralia submission, p. 1.
[102] EnergyAustralia submission, pp. 1–2.
[103] EnergyAustralia submission, p. 2.
[104] EnergyAustralia submission, p. 3.

despite good margins in that area the churn there has so far been low. It was argued that competitors will increasingly look to other areas for growth opportunities as the metropolitan areas become saturated.[105]

The submission stated that retailers are currently offering stronger (double) discounts in the ACT than are generally offered in New South Wales, indicating that the level of competition in the ACT is sufficient to maintain significant downward pressure on retail prices within commercial parameters. In addition, EnergyAustralia noted that its current offers are well below the TFT, that gas pricing in the ACT is unregulated, and that gas offers are attractive.[106]

The submission argued that the TFT creates a benchmark for product structure and therefore inhibits the development of new products, and that even ActewAGL's bundled product is based on the TFT. Furthermore, in later discussions, EnergyAustralia indicated that, while margins currently available under the TFT are adequate, a greater margin would likely increase the level of competition.

In relation to safeguard arrangements, the submission stated that there had been limited hardship cases; only two EnergyAustralia customers had entered into the ESCC's hardship management program. It also claimed that EnergyAustralia provides a range of payment assistance alternatives for disadvantaged customers; customers with longer term hardship issues are offered assistance under its EnergyAssist hardship case management program to keep them connected, and this would not be changed if regulated prices were removed or phased out.[107]

The submission argued that New South Wales regulations restrict product innovation, and that the recent prevalence of time-of-use tariffs is a result of a relaxation of these restrictions, although some still exist.[108] The submission concluded by noting that, in the current Ministerial Council on Energy (MCE) process dealing with national regulatory reforms, the Australian Government has requested that the jurisdictions commit to the removal of retail price caps over time.[109]

Energy Retailers Association of Australia

The ERAA submitted that it supports the removal of retail price controls in the energy sector. The submission noted that, since the introduction of FRC in the ACT, a number of new retailers have entered the market and that competitive market-based offers are now the norm rather than the exception.

The submission argued that, in assessing the effectiveness of competition, the Commission should focus on identifying market failures and removing barriers to competition, and claimed that attempting to measure the effectiveness of competition can be imprecise and somewhat arbitrary. The ERAA argued that the presence of customer choice, and the assurance that customers are aware that they have a choice, are characteristics of a market that protects customers over the longer term.

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[105] EnergyAustralia submission, p. 3.
[106] EnergyAustralia submission, p. 3.
[107] EnergyAustralia submission, p. 4.
[108] EnergyAustralia submission, p. 5.
[109] EnergyAustralia submission, p. 5.

In addition, the submission referred to the Productivity Commission's final report on National Competition Policy, which recommended that price constraints should be removed once effective competition has been established, and that servicing disadvantaged customers adequately at affordable prices should be pursued through targeted CSOs.

Essential Services Consumer Council

The ESCC argued that because of the ACT market's small size there is little incentive for retailers to enter the market, and that this is the main barrier to effective competition.[110] The submission argued that the ACT market is not sufficiently competitive to protect franchise customers from price rises that are not cost based, and that because the ACT population is unlikely to increase beyond 500,000 this situation could persist for many years. The ESCC also argued that, even though there were 14 licensed retailers, only two of those were active, and that those retailers were primarily involved with 'cherry picking' customer niches.[111]

The ESCC stated that, based on its dealings with ACT electricity customers, the information provided to the market at the time of the introduction of FRC is now largely forgotten. In addition, it claimed that a significant number of its franchise-customer clients had not attempted to access this information, and that the information available on competitive offers was relatively complex.[112] The submission argued that the level and nature of the information available on FRC was not adequate for customers to make informed decisions and that, in general, only large customers have the capacity and interest to analyse their options effectively and make informed decisions.[113]

The submission stated that churn rates of less than 2% are very small, and that this may indicate that small customers have little interest in pursuing, or lack the necessary information to pursue, competitive offers. However, the submission noted that 11% of customers had entered into negotiated contracts with ActewAGL, which probably reflects its vigorous marketing campaign. The submission argued that the churn rates in other jurisdictions suggest that it is the level of actual retail competition in the market that is the determining factor, and that the ACT does not have, and is not expected to have, that level of effective retail competition in the foreseeable future. The submission stated that the ESCC could only see that prices would increase if the TFT were removed.[114]

In relation to the Commission's request for comments on the emergence of new tariff offerings, the ESCC argued that their emergence is very limited and is restricted to bundling offers from alternative retailers for large customers or as a result of ActewAGL trying to build up its TransACT business. The submission argued that the existence of these bundling arrangements does not mean that the market is truly competitive.[115]

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[110] ESCC submission, p. 2.
[111] ESCC submission, p. 1.
[112] ESCC submission, p. 1.
[113] ESCC submission, p. 2.
[114] ESCC submission, p. 2.
[115] ESCC submission, p. 2.

The ESCC argued that there is a continuing need for the Commission to regulate the fees charged by the electricity distribution business as a safeguard for franchise customers.[116]

The submission argued that actual competition should be the primary measure in any assessment of the competitive state of the market and that potential competition can be a back-up consideration, but that there is a need for some analysis of the real interest of alternative competitors. It was argued that the level of actual competition in the ACT market for franchise customers is low.

The ESCC submitted that the deregulation of the retail market in other jurisdictions has resulted in increased consumer difficulties. It was claimed that in Victoria the government has reintroduced price subsidies for rural consumers and that the level of disconnections had forced the establishment of a Committee of Inquiry into Electricity Hardship. It was argued that retail prices in South Australia have escalated greatly since the introduction of FRC. However, the submission noted that the increases could generally be attributed to other factors, including generation costs and increased consumption.[117]

The submission stated that the ESCC could see no reason to alter the current approach to regulation and that the TFT should be specified for a further three years from 1 July 2006 to 30 June 2009. The submission also claimed that there should always be a retailer of last resort and that, for practical reasons, this function should remain with ActewAGL, regardless of any decision about the continuation of a regulated tariff.[118]

The submission concluded by stating that if, contrary to the submission, the regulated tariff were to be removed, code changes would be required in order to protect small customers, and that the ESCC would wish to be consulted on the form those amendments might take.[119]

Origin Energy

Origin Energy stated that the Commission should focus its attention on assessing whether the structure of the market provides for competition and specifically whether there is any evidence of a capacity for misuse of market power to charge monopoly rents or restrict entry.[120] The submission claimed that an effective market without significantly unbalanced market power does not require many sellers. Rather, highly concentrated markets can be competitive if barriers to entry and exit are low. In addition, the submission stated that the presence of potential competitors keeps incumbents attentive to pricing and mitigates the use of market power.[121]

The submission argued that while factors such as churn rates, pricing and the emergence of new tariff offerings may be helpful in mapping the market, they provide little guidance on whether the market is effective, as there is no agreement on the levels of these indicators needed to

[116] ESCC submission, p. 3
[117] ESCC submission, p. 4.
[118] ESCC submission, p. 4.
[119] ESCC submission, p. 5.
[120] Origin Energy submission, p. 1.
[121] Origin Energy submission, p. 2.

demonstrate the existence of a competitive market.[122] The submission argued that it may be incorrect to interpret the low level of customer churn in the ACT market as a demonstration of the lack of a competitive market. Instead, it may be an indication that prices are not yet at a level to encourage market involvement by competing retailers or consumers, which may be the result of effective market forces.[123]

Origin Energy argued that, if there are no significant barriers to entry and customers are free to make adequately informed decisions about their choice of retailer, price regulation should be left to the market. However, the submission noted that this may be supplemented with monitoring and intervention rights, which should be based on agreed and transparent criteria.[124] Origin Energy expressed concerns about regulators incorrectly setting prices, stating that the market is the most efficient way to determine prices because only the market can take into account all the necessary information.[125]

TRUenergy

TRUenergy expressed its support for a price monitoring approach, as opposed to an extension of the TFT, in a transition from a fully regulated price cap to deregulation.[126] It argued that price monitoring, combined with the threat of re-regulation, would ensure that prices remain at competitive levels.[127] TRUenergy preferred monitoring to either of the benchmarking methods raised in the issues paper, as these would necessarily involve translations between benchmark bases and would result in an arrangement similar to the current cost build-up approach.[128] However, should it be concluded that a further TFT is required, TRUenergy supports using cost build-up on the grounds that it is well understood by industry participants.[129] In addition, the submission argued that any extension to the TFT should end in 2007 to allow possible alignment of retail pricing policy with other jurisdictions.[130]

The submission provided feedback on several of the matters raised in the issues paper. It argued that a barrier to market entry exists in the form of licensing requirements that differ between jurisdictions, and that this imposes a significant cost on retailers. However, the submission acknowledged that current work by the MCE towards ensuring consistency across the national electricity market, and the transfer of distribution and retail (except retail pricing) to a common basis by 31 December 2006, should reduce costs and enhance competitive outcomes for the ACT.[131]

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[122] Origin Energy submission, p. 2.
[123] Origin Energy submission, p. 3.
[124] Origin Energy submission, p. 3.
[125] Origin Energy submission, p. 3.
[126] TRUenergy submission, p. 1.
[127] TRUenergy submission, p. 3.
[128] TRUenergy submission, p. 3.
[129] TRUenergy submission, p. 3.
[130] TRUenergy submission, p. 1.
[131] TRUenergy submission, pp. 1–2.

In response to the Commission's comments in the issues paper on the availability of information to customers, the submission stated that regulating for information provision had had little practical effect in other jurisdictions and had simply increased the regulatory barriers to entry.[132]

The submission argued that the information on customer churn in the ACT indicated a rapid increase in churn activity during 2005 and that, while the ACT may have experienced a slower start than other jurisdictions, TRUenergy expected that churn rates would continue to escalate.[133]

TRUenergy argued that a key outcome of a free and competitive market is that such a market forces businesses to focus on delivering services desired by customers, rather than on providing least-cost products that suit the retailer. The submission argued that, in this light, the introduction of bundling offers is a positive indicator of competitive pressures.[134]

The submission claimed that the Commission should consider potential competition (compared to actual competition, as discussed in the issues paper) when considering the competitive state of the market, and that bundling offers, even while churn rates remain modest, are an indication of the threat of competition.[135]

[132] TRUenergy submission, p. 2.
[133] TRUenergy submission, p. 2.
[134] TRUenergy submission, p. 2.
[135] TRUenergy submission, pp. 2–3.

Appendix 3 Standard customer contract issues

Implications of discontinuing the price direction for the standard customer contract

ActewAGL has submitted that it intends 'to maintain a standard customer contract with no fixed term, and customers would be able to opt in or opt out of it at any time' even if the Commission decides a price direction is not required.[136] It was anticipated this would alleviate concerns that a lack of reversion arrangements could reduce customer switching levels.[137]

Under the *Utilities Act 2000* (Utilities Act), a utility may provide a utility service to a person under either a negotiated customer contract or a standard customer contract.[138] The standard customer contract essentially is legislated to act as a 'default contract' where a customer applies to a utility for an electricity supply but does not choose to enter into a negotiated customer contract or where a utility provides a service to a person who has not applied for that service. In addition, the obligation to supply electricity to a customer is only relevant when that customer is on a standard customer contract.[139]

A customer contract is a standard customer contract for the purposes of the Utilities Act only if the Commission approves the terms of that contract.[140] The Commission can approve the terms of a standard customer contract only if it is satisfied the terms are consistent with specified criteria when the standard customer contract is in force.[141] These criteria include that charges payable under the contract would be consistent with the relevant price direction made by the Commission.[142] The Commission also must be satisfied these criteria are met in approving any variation of the terms of a standard customer contract.[143]

Thus, a decision not to issue a new transitional franchise tariff (TFT) price direction from 1 July 2006 would have the unintended consequence of invalidating the status of the standard customer contract. This is because the Commission could no longer be satisfied that the terms of the contract were consistent with a key criterion: namely, that charges payable under the contract would be consistent with the relevant price direction made by the Commission.

In terms of the current situation, the Commission has already approved ActewAGL's standard customer contract, and did so when a relevant price direction was put into place. This applied from 1 July 2003. However, if a price direction were no longer in place, ActewAGL would be free to set its own prices. To do so means varying the standard customer contract. With no price direction operating, the Commission has no power to approve or refuse to approve any proposed variation to the standard customer contract.

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[136] ActewAGL submission, p. 27.
[137] ActewAGL submission, p. 19.
[138] Utilities Act, s. 92. For the limited exceptions to this requirement see s. 96 of the Utilities Act.
[139] Utilities Act, s. 80. The obligation to supply does not apply to a customer on a negotiated customer contract.
[140] Utilities Act, s. 87.
[141] Utilities Act, s. 89.
[142] Utilities Act, s. 89(2)(b).
[143] Utilities Act, s. 93.

The Utilities Act is silent on the status of a standard customer contract approved under a price direction once a price direction ceases to apply, whether that occurs on 1 July 2006 or any date thereafter. However, in the absence of a price direction there is doubt that the standard customer contract remains a standard customer contract for the purposes of the Utilities Act, particularly once ActewAGL varies that contract.[144]

Under the Utilities Act if a contract is not a standard customer contract it can only be a negotiated customer contract. There is no other alternative. Accordingly, in the event the Commission does not issue a price direction, it is arguable that each and every standard customer contract agreed between ActewAGL and a customer pursuant to the Utilities Act becomes a negotiated customer contract once ActewAGL varies any part of the standard customer contract after 1 July 2006.

Effect on customers

If the Commission does not issue a new TFT price direction, from 1 July 2006 or, more likely, the date on which ActewAGL varies the standard customer contract—whichever is the later—the standard customer contract that ActewAGL currently has in place with most ACT electricity customers will cease to exist. Instead, every agreement between ActewAGL and its customer would be categorised as a negotiated customer contract.

This categorisation would apply to any 'standard customer contract' that ActewAGL maintained in the absence of a price direction. In effect, such contract could only be a 'standard' negotiated customer contract. For the purposes of the Utilities Act as currently drafted, ActewAGL's offer of to retain a standard tariff contract, and to allow customers to opt in and out of that contract, is a voluntary offer that has no regulatory enforcement.

The threat of re-regulation is likely to constrain ActewAGL's pricing and service conduct. The Commission notes that the potential for re-regulation can be activated through the Commission obtaining price direction terms of reference from the Treasurer pursuant to which it can decide on a new level of electricity retail prices for franchise customers.

Any negotiated customer contract (including ActewAGL's proposed 'standard' negotiated customer contract) must meet all relevant requirements of the Consumer Protection Code (Code) and other consumer protection legislation. This means it must contain provisions that allow for a cooling-off period of ten business days and allow for the contract to be rescinded within six months of the date of commencement.[145] An electricity retailer supplying electricity to a customer under a negotiated customer contract must also give at least four weeks notice of when the contract period is due to expire, and meet obligations relevant to the disconnection of supply, the repayment of any security deposits and the making available of such a contract to the customer.[146]

In most cases customers can easily transfer to and maintain supply under negotiated customer contracts. However, in the absence of a statutorily endorsed standard customer contract, there is no

[144] See also Utilities Act, s. 92(3)(c), which provides that the standard customer contract is unenforceable by the relevant utility to the extent to which it does not comply with the requirements set out in s. 89(2)(a) and s. 89(2)(b).
[145] Consumer Protection Code, clauses 24 and 25.
[146] Consumer Protection Code, clauses 26, 23, 27 and 28.

alternative under which a customer can be supplied electricity. Further, there is no obligation to supply. This means the most vulnerable customers are left with no 'safety net'. Thus, to ensure the most vulnerable customers are protected requires that the Utilities Act be amended to legislate for a 'deemed contract' in certain circumstances. This is discussed in more detail below.

Effect on ActewAGL

In the absence of other regulatory changes, if the Commission decided not to issue a new TFT price direction, ActewAGL would be required (before 30 June 2006) to contact all the customers with whom it currently has standard customer contracts and ask them to agree to negotiated customer contracts (the proposed 'standard' negotiated customer contracts or others) that meet the requirements of the Code. While this would be a costly and time-consuming exercise for ActewAGL to undertake, the Commission notes that the exercise also could stimulate competition. This is because the exercise is likely to encourage consumers to consider the range of options and deals offered by all electricity retailers operating in the ACT, including ActewAGL, before entering into a negotiated customer contract.

It is arguable there is insufficient time in which to achieve the objective of transferring all customers onto negotiated customer contracts that meet the requirements of the Code. This could be addressed by amending the Code to allow a few months grace before the requirements of the Code apply to those contracts remaining to be transferred.

A problem that would remain, however, is that ActewAGL would likely encounter some customers who would refuse to sign a negotiated customer contract. In the absence of any alternative, given the requirements of the Code, ActewAGL would in effect be supplying electricity to those customers under a contract that was in breach of the Code.

Solutions

In the absence of a new price direction, to ensure that ActewAGL is not compelled to supply electricity in breach of the Code requires that the Utilities Act be amended to legislate for a 'deemed contract' to apply in certain circumstances. The Commission recommends this course of action.

However, it is arguable that there is not enough time to make the necessary legislative amendments before the current price direction expires. Therefore, the Commission proposes to make a temporary new price direction to maintain the status of the standard customer contract until new requirements are in place.

Alternatively, should the government reject the approach of amending the Utilities Act, the Commission could continue to regularly issue price directions in order to maintain the standard customer contract. In this case, the Commission would propose to narrowly limit the application of the price direction such that it could achieve that objective for customers who require it, with minimal impact on competitive pricing overall.

The following sections discuss these options in more detail.

Amendments to the Utilities Act

As already noted, in order to ensure the most vulnerable customers are protected and ActewAGL is not compelled to supply electricity in breach of the Code, the Commission recommends that the Utilities Act be amended. By way of example, Division 6.2 of the Utilities Act, which currently sets out the requirements for standard customer contracts, could be amended by:

- replacing references to 'standard customer contracts' with 'deemed contracts'
- deleting the requirement that any charges payable under the contract would be consistent with the relevant price direction (s. 89(2)(b))
- amending s. 92(1)(b) to ensure the deemed contract applies only in very specific circumstances, such as applying only to those customers:
  - who have not agreed to a negotiated customer contract prior to the date from which a price direction ceases to apply
  - whose existing negotiated customer contract has expired without them agreeing to a new one
  - who have moved into a premises and commenced consuming electricity without first agreeing to a negotiated customer contract with the retailer

    or
  - who have otherwise been disconnected from supply.

References to 'standard customer contract' elsewhere in the Utilities Act, such as in s. 80, the obligation to supply provision, also would need to be replaced with 'deemed customer contract'..

Assuming the Utilities Act was amended as suggested and the Commission decided not to issue a new TFT price direction from 1 July 2006, all those customers who had not agreed a negotiated customer contract by 30 June 2006 would thereafter default to the deemed contract. This would remove any need to amend the Code.

Temporary new price direction

The Commission is aware of the difficulties that may arise in any attempt to amend legislation within a tight timeframe. It is also aware that the government will have to amend the Utilities Act during the course of 2006 in preparation for the transfer of responsibility for electricity distribution and retail regulation (except retail pricing) to the Australian Energy Regulator, due to occur by 1 January 2007.

An alternative is that the Commission issue a new TFT price direction to commence from 1 July 2006 that includes 'a reference to an event or events (price variation trigger) the occurrence of which would entitle the Commission to initiate a reference for an investigation into a variation of the direction'.[147] For example, the 'price variation trigger' may be the date on which the relevant amendments to the Utilities Act commence. This approach would provide sufficient flexibility to

[147] *Independent Competition and Regulatory Commission Act 1997*, s. 20A(3)(c).

the government, to enable it to enact the appropriate 'safety net' provisions, and to the Commission, to enable it to reconsider the need for a price direction in light of the move to national regulation and the amendments to the Utilities Act.

The Commission's suggested model for this approach is provided in Section 4.6 of the draft decision.

Limited new price direction

Should the government choose not to make the suggested amendments to the Utilities Act, an alternative, albeit a considerably less satisfactory one, would be for the Commission to issue a price direction and to suggest a means by which its application would be limited.

A price direction applies only to franchise customers. If the category of 'franchise customer' were more narrowly defined than at present it could limit the application of the standard customer contract. This could then encourage most customers to agree negotiated customer contracts while also providing a safety net for those customers who are most vulnerable and least able to agree a negotiated contract.

The wording of the Utilities Act means that to do this effectively requires a precise and skilful definition as to who is **not** a 'non-franchise customer'. The Utilities Act currently defines a franchise customer in relation to the supply of electricity, as someone who is a customer other than a non-franchise customer.[148]

A non-franchise customer is defined as being a person who:

- owns or occupies premises at which the consumption of electricity does not exceed 100 megawatt hours in a consumption period
- enters into a negotiated contract for the supply of electricity with the same or another electricity supplier on or after 1 July 2003.[149]

To limit the definition of franchise customer effectively requires this disallowable instrument to be replaced with another that would define who is a non-franchise customer more prescriptively, perhaps by reference to who it does not include.

The Commission has not explored this alternative in detail but raises it for the sake of completeness and to facilitate further discussion.

[148] Utilities Act, s. 17.
[149] Utilities Act, s. 18, and clause 3 of the Utilities (Non-franchise customers) Declaration 2003 (No 1), Disallowable Instrument 2003–20, made under s. 18 of the Utilities Act.

Appendix 4 ICRC Act considerations

When making any direction about prices in a regulated industry, the Commission is required to take into account a number of issues identified in s. 20 of the *Independent Competition and Regulatory Commission Act 1997* (ICRC Act). The Commission's conclusions on each of those matters, considered in regard to its draft decision on the transitional franchise tariff (TFT) for electricity, are summarised in the following table.

ICRC Act s. 20 issues	Commission conclusions
The protection of consumers from abuses of monopoly power in terms of prices, pricing policies (including policies relating to the level or structure of prices for services) and standard of regulated services	The Commission considers that competition, both current and imminent from existing and new entrants, will ensure appropriate efficient pricing of electricity and the provision of service options that will best meet the needs of consumers. It is proposed that the government will retain the ability to refer retail pricing of electricity to the Commission should there be evidence of market failure or abuse of market power at any time in the future.
Standards of quality, reliability and safety of the regulated services	Competitive market conditions will ensure service standards are met. The existing technical regulations relating to safety and quality of electricity provided will remain unchanged.
The need for greater efficiency in the provision of regulated services to reduce costs to consumers and taxpayers	Competition is acknowledged as the optimal method for ensuring efficient provision of services, and the Commission has concluded that existing and potential imminent competition will ensure the efficiency of the provision of electricity services to small consumers.
An appropriate rate of return on any investment in the regulated industry	The Commission's analysis of the retail margins currently included in the TFT applying in the ACT confirm that they are consistent with the margins included in regulated and contestable retail price offerings in other states.
The cost of providing the regulated services	The margin analysis undertaken by the Commission incorporates the full flow-on of network and generation costs. The margin analysis also demonstrates that retailers are able to recover their retailing costs in the current TFT tariffs, and decisions by retailers to discount below the TFT price indicate a further margin within which retailers are able to compete and remain viable in this market. Withdrawal of the TFT in a competitive market will still allow retailers to recover their costs.
The principles of ecologically sustainable development mentioned in s. 20(5) of the Act	Pricing of electricity to reflect its actual cost, including charges such as greenhouse gas emission costs, provides a clear signal to consumers of environmental and ecological sustainability issues and encourages best use of energy resources. The recommendation will not alter the pass through of these costs as is at present included in electricity prices.
The social impacts of the decision	The Commission has examined the social implications of the recommendation, and has highlighted the continuing need for funding of targeted assistance (including for the operation of the Essential Services Consumer Council) for vulnerable households.
Considerations of demand management and least cost planning	Greater opportunities for competition in the ACT market are expected to bring new service offers, including time-of-use tariffs, which will have a positive impact on better demand management.
The borrowing, capital and cash flow requirements of persons providing regulated services and the need to renew or increase relevant assets in the regulated industry	The Commission's margin analysis has confirmed that the margins allowed in the TFT are adequate to meet the financing needs of the electricity retailers, and the margins applying on discounted electricity offerings are consistent with margins offered by competitive retailers in other jurisdictions.
The effect on general price inflation over the medium term	There is not expected to be any significant impact on price inflation from this decision as retailers compete to maintain or expand their customer bases.
Any arrangements that a person providing regulated services has entered into for the exercise of its functions by some other person	Not applicable.

Appendix 5 Retail electricity pricing in other jurisdictions

Other Australian jurisdictions

The various state and territory jurisdictions of Australia have adopted differing approaches when dealing with retail tariffs. These range from Victoria's approach, whereby FRC was introduced in January 2002 and there is currently no regulated retail tariff, through to Tasmania's approach, whereby FRC for small customers is not expected to be introduced until 2010.

New South Wales

New South Wales introduced FRC in January 2002. The Independent Pricing and Regulatory Tribunal continues to regulate retail prices, which are available to customers who use less than 160 megawatt hours per year (MWh/yr) and who do not wish to enter into a negotiated contract.[150]

Victoria

Victoria introduced FRC in January 2002. While retail prices are not regulated, the Victorian Government has entered into an agreement with local electricity retailers that ensures that average tariffs will not rise in real terms between 2004 and 2007.[151] In addition, the government can review and amend prices if it considers that adequate competition has not developed and that prices are being set at unreasonable levels.[152]

Queensland

In Queensland, FRC is to be introduced from 1 July 2007 for customers using less than 100 MWh/yr.[153] The minister currently sets the retail tariff for non-contestable customers.

South Australia

South Australia, which introduced FRC in January 2003, continues to have a regulated retail tariff for customers who remain with the incumbent retailer.

Tasmania

FRC is due to be introduced in Tasmania from 1 July 2010.[154] Currently, all tariffs offered are approved by the Tasmanian Energy Regulator.

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[150] www.ipart.nsw.gov.au/electricity_details_02.asp
[151] ESC, *Special investigation: Review of effectiveness of retail competition and consumer safety net in gas and electricity, Overview report*, 22 June 2004, p. 18.
[152] www.esc.vic.gov.au/electricity139.html
[153] www.energy.qld.gov.au

International jurisdictions

United Kingdom

In the United Kingdom, retail competition for domestic electricity customers was phased in between September 1998 and May 1999.[155] In April 2000, price controls were lifted for customers on direct debit accounts, and all price controls on retail tariffs were lifted in April 2002.

These decisions to remove price controls were based on the rationale that:

> Ofgem believes that the competitive pressures exerted on gas and electricity suppliers are the best way to ensure that all groups of customers are protected. Ofgem's previous reviews have shown that competition is producing benefits for all customers and has become an even more powerful influence on companies' behaviour. In particular, the Occasional Paper and the Recent Developments document confirmed Ofgem's view that competition was sufficiently developed that the potential for regulatory distortions caused by continuing price controls of retail supply markets would be more harmful than helpful.[156]

New Zealand

Full retail competition was introduced for small customers—those using less than 500 MWh/yr—in 1993.[157] The remainder of the electricity market (those using more than 500 MWh/yr) was opened to competition in April 1994. Once competition was introduced, no price regulation existed, although the Ministry of Economic Development continues to monitor prices and publishes a comparison of prices offered around the country on a quarterly basis.[158]

United States

In the United States, retail competition has been introduced in such states as Massachusetts (introduced in 1998), New York (2001), New Jersey (1999), Maine (2000), Pennsylvania (2001), Ohio (2001) and Texas (2002).[159] These states have generally seen low levels of switching away from incumbent retailers (usually below 5%). Typically, regulated prices have been maintained; in some instances, these have been below the wholesale electricity market price, allowing little room for non-incumbent retailers to enter the market profitably.

Regulated retail tariffs have been identified as the major factor contributing to the rolling blackouts experienced in California during 2000–01.[160] At that time, the regulation of retail prices offered no opportunity for retailers to 'pass through' increased generation costs; they therefore elected not to supply high-cost electricity, which resulted in blackouts across the state.

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[154] www.energyregulator.tas.gov.au
[155] Ofgem (the Office of Gas and Electricity Markets), *Domestic Competitive Market Review 2004—A review document*, April 2004, p. 6.
[156] Ofgem, *Domestic Competitive Market Review 2004—A review document*, April 2004, p. 4.
[157] www.med.govt.nz/ers/electric.html#ref
[158] www.med.govt.nz/ers/inf_disc/prices/200508/index.html
[159] KPMG, *The effectiveness of Competition and Retail Energy Price Regulation,* December 2003.
[160] Productivity Commission, *Review of National Competition Policy Reforms,* February 2005, p. 197.

Glossary and abbreviations

ACCC	Australian Competition and Consumer Commission
ACT	Australian Capital Territory
ACTCOSS	ACT Council of Social Service
ActewAGL	ActewAGL Retail
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
Care	Care Financial Counselling Service
Commission, the	Independent Competition and Regulatory Commission
CPI	consumer price index
CSO	community service obligation
ERAA	Energy Retailers Association of Australia
ESCC	Essential Services Consumer Council
ESC	Essential Services Commission (Victoria)
FRC	full retail contestability
ICRC Act	*Independent Competition and Regulatory Commission Act 1997* (ACT)
IPART	Independent Pricing and Regulatory Tribunal (New South Wales)
kWh/yr	kilowatt hours per year
MRET	Mandatory Renewable Energy Target
MCE	Ministerial Council on Energy
MWh/yr	megawatt hours per year
NEM	national electricity market
NEMMCO	National Electricity Market Management Company
OFGEM	Office of Gas and Electricity Markets (United Kingdom)
TFT	transitional franchise tariff
Utilities Act	*Utilities Act 2000* (ACT)