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The Independent Competition and Regulatory Commission
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Submission on the Investigation into Retal Electricity Prices – Issues Paper

TRUenergy welcomes the opportunity to participate in the Independent Competition and Regulatory Commission's ("the Commission's") investigation into regulated tariffs for franchise customers in the Australian Capital Territory ("ACT").

We are encouraged by the approach the Commission has proposed in it's issues paper to thoroughly examine the possibility of removing price regulation, explore intermediate approaches such to price monitoring, and only revert to the continued use of price caps if evidence suggests competition has yet to sufficiently establish itself.

We anticipate therefore that the Commission will thoroughly explore the option of adopting a price monitoring approach rather than extending the transitional franchise tariff. If the Commission concludes that an extension of the transitional tariff is required, we anticipate that the extension would end in 2007, to allow possible alignment of retail pricing policy with that of other Jurisdictions under a NEM wide framework.

In order to assist the Commission in it's review, we have compiled selected comments on key questions raised in the issues paper below.

Competitive State of the ACT Electricity Market

Size of the Market / Entry barriers

As identified by the Commission, the size of the ACT market is an important factor to be considered by retailers considering market entry. The ACT, under the Commission, has its own regulatory regime, which differs from regimes in other Australian Jurisdictions in a number of ways. Any retailer currently active in other Australian markets must therefore carefully review their processes and procedures and ensure measures are in place to meet ACT requirements before entering the market.

Our experience is that this task is significant and costly, and therefore can create a barrier to early entry for retailers – who must consider the comparative incremental costs of the functional requirements for entry to other larger markets than the ACT.

We acknowledge the work currently proceeding through the Ministerial Council of Energy, which is addressing the alignment of regulatory requirements for retailers and distributors operating across National Electricity Market ("NEM"), jurisdictions. As the Commission has noted in its issues paper, all distribution and retail market regulations (apart from retail pricing) are expected to transfer to a common basis by 31 December 2006. National consistency of these regulations should substantially reduce the incremental costs noted above and further enhance competitive outcomes for the ACT.

Information available to customers

Our experience in other jurisdictions that have regulated for various levels of information provision is that this has had little practical effect in assisting customers understand energy pricing better than under the general regime of the Trade Practices Law. The incidental impact has been to increase the regulatory barriers to entry arising in those jurisdictions, as discussed above.

Customer churn & product offerings

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.

One of the key outcomes of a free and competitive market, is that it forces retail businesses to focus on delivering services desired by customers rather than on least cost delivery of products that suit the retailer. This outcome incentivises, and rewards product innovation. The Commission notes that bundling of energy and other services has been introduced into the ACT market, which in our view is a positive indicator that competitive pressures are beginning to drive the behavior of retailers in that marketplace. We would expect other product structures and offerings to emerge as more retailers enter the market and target differing customer requirements.

Actual vs Potential Competition

Potential Competition can be a critical driver of competitive behavior by an incumbent retailer, and should be factored into the Commissions assessment of the competitive state of the ACT market. As discussed above, product innovation has commenced in the marketplace, even during a period in which churn statistics remained relatively modest. This is evidence that the threat of competitive entry is impacting on the behavior and offerings of the incumbent retailer.

Calculation of further transitional franchise tariff

Options for future regulation

We are encouraged by the approach the Commission is taking to thoroughly assess the competitive state of the market. In particular we are encouraged by the Commissions consideration of a price monitoring approach, as a transition path from fully regulated price caps to deregulation. Such an approach, backed up by the threat of re-regulation, would impose the necessary discipline on the incumbent retailer to ensure that prices remain at competitive levels, while reducing the regulatory risk profile of the ACT marketplace. It also provides a clear path to complete de-regulation once confidence in competitive market outcomes is firmly established. We support the consideration of this option by the Commission.

The other options canvassed by the Commission, such as benchmarking to other jurisdictions or to the wholesale price are in our experience problematic, as they will necessarily involve complex translations between benchmark bases, and may end up as little more than variations on the current benchmark cost build-up approach.

Methodology if Franchise Tariff is to be determined by the Commission

If after further examination of the development of competition, and assessment of the price monitoring approach, the Commission concludes a further Transitional Franchise Tariff is warranted, TRUenergy would support a cost build-up approach to establishing the tariff. This methodology is preferred as it is well understood by NEM participants, and it would seem inappropriate to develop a new approach for what will be short transition period (should a further transition be required at all).

Key principles supported by TRUenergy in a cost build-up approach to price determination are:

- If a multi-year tariff duration is to be established, then we support the use of a long-run marginal cost approach to energy pricing, on the basis that this more closely matches longer term costs and revenues. Under most conditions TRUenergy encourages multi-year tariff determinations on the basis they provide more price certainty to customers, and new entrant retailers;

- If a single-year tariff duration is to be established, then it may be acceptable to benchmark wholesale costs to retailer wholesale contract costs. This approach leads to more price volatility for customers due to frequent price reviews and pass through of wholesale market year by year volatility, and provides less certainty to new entrants about future market pricing increasing the risk of market entry. While this is not usually our preferred approach, it may be appropriate if a short transition is expected until the removal of price regulation or the transitional to a NEM wide pricing approach;

- Regulators should select a retail margin benchmark at the high end of the benchmark range they determine as efficient. We support this approach on the basis that the risk of setting the margin too high is self correcting in that competition will be encouraged ensuring market margins settle at competitive levels. On the other hand, setting margin too low can result in regulated prices becoming a barrier to the development of competition by making entry by competing retailers uneconomic.

Duration of price determination

Current regulated price paths in most Australian Jurisdictions are scheduled to end in either June or December 2007. We are also aware of efforts by the Federal government – through the MCE process – to transition retail price regulation to a national framework in the medium term. In order to allow policy in the ACT to align with that of other Jurisdictions, we suggest aligning the end date of any transitional tariff extension to conclude in 2007.

We look forward to participating further in the current price review. Please contact me on (03) 8628 1156, or Mark Frewin on (03) 8628 1130 to discuss our views further.

Your Sincerely,

David McAloon
Senior Regulatory Manager