



15 November 2013

Independent Competition and Regulatory Commission  
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### **Retail Prices for Franchise Electricity Customers from 1 July 2014**

The Energy Supply Association of Australia (esaa) welcomes the opportunity to make a submission to the Independent Competition and Regulatory Commission's (the Commission) Retail Prices for Franchise Electricity Customers from 1 July 2014 Issues Paper.

The esaa is the peak industry body for the stationary energy sector in Australia and represents the policy positions of the Chief Executives of 36 electricity and downstream natural gas businesses. These businesses own and operate some \$120 billion in assets, employ more than 51,000 people and contribute \$16.5 billion directly to the nation's Gross Domestic Product.

The Commission has been tasked with determining retail prices for franchise customers from 1 July 2014. The key objective of the Issues Paper is to alert stakeholders of any issues arising from developments in the energy market and regulatory sector.

#### **Deregulation**

To improve the efficiency and competitiveness of its electricity market, the Australian Capital Territory (ACT) has undertaken significant reform over more than a decade. This includes the introduction of full retail contestability for all electricity customers and the development of a transparent and consultative process for deriving the transitional franchise tariff, conducted by the Commission. Despite these commendable achievements, however, the process of reform is not yet complete. Retail price deregulation remains the key outstanding reform preventing a genuinely competitive retail electricity market from flourishing in the ACT.

Cost-reflective retail tariffs allow businesses operating within the retail sector to recover the costs of electricity supply as well as an appropriate return on investment. Accordingly, where cost-reflectivity is achieved, appropriate market conditions should evolve such that potential new market entrants may welcome an opportunity to enter the retail market. Conversely, regulated retail tariffs set below the cost of supply inhibit full cost recovery, potentially compromising the financial viability of businesses operating within the retail sector, and by extension, the electricity supply industry.

Enabling a genuinely competitive market requires setting the regulated price at a commercial level that allows scope for retailers to compete to offer better deals. Retailers will need to recover the costs of competing in a competitive market, including an appropriate customer acquisition and retention cost allowance (CARC). A study undertaken by Allen Consulting Group to review the effectiveness of competition in the ACT electricity retail sector found that the absence of CARC resulted in very low retail margins for competing retailers<sup>1</sup>. If the incumbent retailer benchmarking approach continues to be utilised by the Commission, esaa believes ActewAGL should benefit from the same allowances as other benchmarked retailers.

### **Wholesale Energy**

The esaa acknowledges the difficulties associated with trying to estimate the wholesale energy cost (WEC) component of regulated tariffs. While the Commission's preference for applying a hedging-based approach is noted, the Association maintains the most appropriate approach is one that ensures the WEC component is not less than the long run marginal cost (LRMC) of electricity generation.

As discussed above, regulating prices in potentially competitive markets whereby regulated tariffs may be set below the cost of supply impedes the efficient operation of the market. It creates financial pressure for industry participants forced to absorb costs that cannot be passed on and removes incentives for energy companies to enter the market and compete for small-use customers. Conversely, in the event that prices are set above the cost of supply – including an appropriate retail margin – competition will erode margins back to efficient levels. The risks are thus asymmetric, with greater adverse consequences arising from setting the regulated price too low.

### **Carbon price uncertainty**

In contrast, an approach based purely on prevailing market data will result in greater price volatility flowing from spot and contract markets into the retail price path and ultimately, non-cost-reflective prices. There is a high degree of uncertainty associated with estimating the WEC, particularly given the potential for significant changes to carbon pricing policy following the September 2013 Federal election. Retailers use a wide range of options to manage these risks, including purchasing different types of hedging products, long-term power purchase agreements and investing in generation themselves. As such, an assessment of market based costs alone may not necessarily be reflective of the actual costs faced by the retail businesses, potentially exposing them to costs they cannot pass-on.

### **Retrospectivity in carbon policy**

The Government has stated that the carbon tax will end on 30 June 2014 regardless of when the legislation is passed. This stated intention to backdate repeal to 30 June 2014 does not mean that businesses can ignore the carbon tax while it remains law. All businesses including those in electricity and gas industries must comply with the Clean Energy Act and associated legislation until it is repealed.

The possibility of retrospective repeal, even for a short period, will create risk for all participants in the market and complicate the repeal process, if repeal cannot be secured well in advance of 30 June 2014.

Retailers in the ACT are bound by the National Energy Customer Framework (NECF) and so can only change standing offers once every six months. This means once carbon price is repealed, there may be a delay until standing offers can be changed.

The Commission will need to take these matters into account in determining its approach to the uncertainty over when the carbon price may be repealed.

Any questions about our submission should be addressed to Nicholas Cannard, by email to [nick.cannard@esaa.com.au](mailto:nick.cannard@esaa.com.au) or by telephone on (03) 9205 3111.

Yours sincerely



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<sup>i</sup> The Allen Consulting Group, *Effectiveness of electricity retail competition in the ACT - price and profit margins analysis*, 2010, p. 26.