AGL Energy Limited
ABN: 74 115 061 375

Level 22, 101 Miller St
North Sydney NSW 2060

Locked Bag 1837
St Leonards NSW 2065

T: 02 9921 2999
F: 02 9921 2552
www.agl.com.au

Energy in action.®

28 March 2014

The Independent Competition and Regulatory Commission
GPO Box 296
CANBERRA CITY ACT

By email: icrc@act.gov.au

Dear Commissioners,

Draft Report – Standing offer prices for the supply of electricity to small customers, 1 July 2014 to 30 June 2017

AGL welcomes the opportunity to comment on the Independent Competition and Regulatory Commission (**ICRC**)'s Draft Report (the **Draft Report**) on *Standing offer prices for the supply of electricity to small customers from 1 July 2014 to 30 June 2017,* released in February 2014.

AGL is one of the leading energy retailers in Australian with about 3.9 million customers and is a joint venture partner in ActewAGL Retail.

AGL has provided a submission in response to the ICRC's Issues Paper in November 2013. AGL continues to maintain its views as outlined in that submission. In this submission, AGL provides comments on ICRC draft decisions on a number of points in the Draft Report. Rather than commenting on each key point, AGL has focussed on the areas where AGL has a significantly different view from the ICRC.

ICRC's Draft Report

In the Draft Report, the ICRC has generally maintained the approach it has adopted in past regulatory price reviews.

In relation to wholesale energy costs, the ICRC has continued to use its EPC model. Although AGL does not propose any changes to the use of this model, AGL remains of the view that the load ratio which measures the peakiness of the load is under-represented in the uplift factor.

The only material change in the Draft Report is to increase the retail operating cost allowance to better align with the benchmark used in NSW and QLD. Even so, AGL does not consider that this adjustment goes far enough.

In the following section, AGL concerns with the ICRC's approach on retail operating cost allowance, customer acquisition costs, retail margin and competition allowance are outlined.

Retail operating costs

NSW and QLD benchmarks

In the draft report, the ICRC has adjusted its benchmark for 2013-14 to $111.66 per customer. This is equivalent to $114.45 for 2014-15.

In the 2013 electricity review, IPART had set a benchmark retail operating cost of $110 per customer in 2012/13$. This is equivalent to $115.79 in 2014-15 (based on annual March 2013 CPI of 2.5% and the latest annual CPI (December 2013) of 2.7%).

In the Draft Determination released in December 2013, the QCA has set an allowance for retail operating cost of $119.56 per customer for 2014-15.

Therefore, the ICRC's adjusted benchmark for 2014-15 of $114.45 per customer remains below that of NSW and QLD despite the ACT being the smallest market in the National Electricity Market.

Economies of scale

In AGL's submission to the Issues Paper, AGL has pointed out that ActewAGL's customer base is less than a tenth of either of the two largest energy retailers in Australia. Despite this fact, the ICRC has made no allowance for economies of scale on the retail operating cost allowance for the incumbent retailer in the ACT.

When considering economies of scale, the ICRC has referred to a list of Victorian retailers and stated that:

> *"... there are a number of retailers that have a similar number of electricity customers as ActwAGL Retail, such as Australian Power & Gas and Simply Energy, which are successfully competing for customers in a deregulated market with much larger competitors. Indeed, the change in market share from 2011-12 is dominated by the smaller retailers at the expense of their larger competitors. This suggests that minimum efficient scale may be closer to ActewAGL Retail's customer numbers with a corresponding reduction in any potential cost disadvantage."*[1]

On this basis, the ICRC concluded that there should be no allowance for economies of scale for the incumbent retailer in the ACT. AGL strongly disagrees with this conclusion. The removal of price regulation in Victoria allows small retailers to set their retail prices at levels which reflect their own costs and risks. It is not a reflection of economies of scale. Other things being equal, the fact that few of the smaller retailers are actively competing for residential and small business customers in the ACT suggests that electricity prices in the ACT do not allow them to recover their costs.

More importantly, the ICRC has not specifically examined the small retailers' operating costs. There is some public information which is useful as a reference. On 15 June 2013, AGL announced a takeover offer for Australian Power and Gas (APG). In AGL's takeover announcement, AGL has stated that it has significant cost advantage over APG and that "... AGL's cost-to-serve is ~$130 per customer lower that APG"[2]. This is confirmed in APG's final full year annual results for the year ended 30 June 2013 which reported operating costs per customer of $252[3]. This evidence clearly shows that there are large differences in average operating costs of large and small retailers. The retail cost allowance of $115 per customer in the ICRC's draft report clearly fall short of the appropriate benchmark for the current incumbent retailer in the ACT.

Customer acquisition costs

In addition to the retail operating cost allowance mentioned above, IPART and the QCA have allowed customer acquisition costs. AGL notes that, in its submission to the Issues Paper, although the Government has specifically stated that it did not support a financial contribution to support for competition as recommended by the AEMC, it did not preclude customer acquisition costs.

The introduction of FRC would have required the incumbent retailer to incur additional costs which are necessary for a contestable market such as marketing, agency and contracting costs. The ICRC has made no allowance for these costs to be recovered.

---

[1] ICRC Draft Report, February 2014, page 76
[2] AGL's ASX & Media Release, 15 June 2013, Australian Power and Gas acquisition - presentation, page 3
[3] APG's Appendix 4E, page 7

In addition the retail operating cost allowance, IPART has added direct customer acquisition cost of $40 per customer in 2013 while the QCA has proposed an allowance for customer acquisition cost of $45 per customer for 2014-15.

Competition allowance

AGL notes the ACT Government's direction to exclude any competition allowance in setting regulated prices and the ICRC's support of this position. This position is unusual in comparison with the other jurisdictions in the NEM and in AGL's view, will continue to delay the development of competition in the market. Customers can avoid this allowance by entering into market contracts.

By encouraging the entry of new entrants, this allowance can be competed away and at the same time, reduce the regulatory risk of setting the price too low.

Retail margin

In AGL's submission to the Issues Paper, AGL had stated that in relation to the retail margin allowance, there is merit in maintaining consistency with regulatory benchmarks in NSW and QLD. However, given that the ICRC has not adopted benchmarks such as customer acquisition costs and competition allowance as in NSW and QLD, nor recognised any economies of scale, it is not appropriate to simply adopt the benchmark retail margin allowance set by IPART and QCA. A significantly higher retail margin allowance should be considered for the ACT market given the lack of margin for error in its benchmarks for retail costs.

Government's commitment

The ACT Government has stated in its submission to the Issues Paper that it "... remains committed to the retail electricity price deregulation, should effective competition emerge and be sustained ..." The Government has also mentioned its "...continuing commitment to promoting competition and price deregulation." In AGL's view, the ICRC has not outlined how its Draft Report will promote competition. It provides little incentive for new retailers to enter the ACT market and AGL is very concerned that this will result in a barrier to effective competition developing, and thereby preventing a move to deregulation in the ACT.

If you have any questions in relation to this submission, please contact me on (02) 9921 2221 or mgoh@agl.com.au.

Yours sincerely,

Meng Goh
Manager Regulated Pricing