



independent competition and regulatory commission

Issues Paper
**Retail Prices
for Non-contestable
Electricity Customers**

**Report 12 of 2005
November 2005**

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.

The Commission has three Commissioners:

Paul Baxter, Senior Commissioner
Robin Creyke, Commissioner
Peter McGhie, Commissioner.

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

The Independent Competition and Regulatory Commission
PO Box 975
CIVIC SQUARE ACT 2608

Level 7 Eclipse House
197 London Circuit
CIVIC ACT

The secretariat may be contacted at the above addresses, by telephone on 6205 0799, or by fax on 6207 5887. The Commission's website is at www.icrc.act.gov.au, and its email address is icrc@act.gov.au or ian.primrose@act.gov.au.

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 referred 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’ to the Independent Competition and Regulatory Commission (the Commission). The reference is made under sections 15 and 16 of the *Independent Competition and Regulatory Commission Act 2000* (ICRC Act).

In the ACT, the retailing of electricity to customers consuming more than 160 Megawatt hours (MWh) per year was made contestable from 1998.¹ The electricity supply industry in the ACT was opened for retail competition to customers consuming more than 100 MWh per annum 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 per annum 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 of price protection that should apply to franchise contracts in future and the duration of such protection. In reaching its determination, the Commission is required to have regard to a number of matters:

- 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 section 20 of the ICRC Act. The Commission is releasing this issues paper to initiate the investigation and to canvass issues that will be included in the review. The paper does not seek to cover all the potential issues that the community may wish to have examined. The Commission relies upon submissions on the issues raised in this paper to bring forward other related concerns about the continuation of the transitional arrangements, particularly any issues that are pertinent to a reasoned decision on whether the arrangements should continue and on the means that the Commission might use to determine an appropriate retail price.

Paul Baxter

Senior Commissioner

November 2005

¹ *Utilities Act 2000*.

² Disallowable Instrument 2001–93.

³ Independent Competition and Regulatory Commission, Final report: Full retail contestability in electricity in the ACT, July 2002. Disallowable Instrument 2003–20.

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1 Introduction

1.1 Background

One of the ACT's major commitments in the National Competition Policy, signed in 1995, was an undertaking to develop a competitive national electricity market delivering benefits to the economy and consumers. Together with the other jurisdictions in the National Electricity Market (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). FRC enables retailers other than the incumbent to enter the market. Customers are then able to select the retailer they consider provides the most appropriate price and service offerings. 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, large-volume customers—that is, those customers whose electricity consumption is above 160 megawatt hours (MWh) per year—were made contestable from 1998. The threshold was lowered to 100 MWh/year from July 2001.⁴ The ACT market was fully opened to retail competition, by making customers below the 100 MWh/year threshold (essentially, households and small businesses) contestable from 1 July 2003.⁵ 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.

Included in the transitional arrangements was the implementation of a regulated tariff, referred to as the 'transitional franchise tariff' (TFT). The TFT was offered by ActewAGL Retail (ActewAGL) as part of the standard customer contract, and set a maximum price that initially applied to all franchise customers. Customers who elected to remain with ActewAGL on the standard customer contract continued to receive the regulated TFT.

However, franchise customers became free to enter into negotiated contracts with ActewAGL, or other retailers, and pay alternative prices. Those customers who did so would no longer be regarded as franchise customers; they were no longer on the standard customer contract and therefore do not receive the regulated TFT. 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 the need for the transitional arrangements to continue and, if so, the form of price protection that should apply to franchise contracts in future and the duration of such protection. The full text of the reference is given in Section 1.2.

⁴ Disallowable Instrument 2001–93.

⁵ Disallowable Instrument 2003–20.

1.2 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 section 15

Pursuant to subsection 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 section 16

Pursuant to subsection 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 section 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

1.3 Commission's approach to addressing the terms of reference

The Commission interprets the terms of reference to be requiring the Commission to consider two distinct issues.

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'.

A franchise customer is any customer who consumes less than 100 MWh of electricity per year and who remains on the standard customer contract offered by ActewAGL.⁶ In addressing the issue of a continuing need for a price direction for these franchise customers, the Commission will consider whether the market is sufficient to provide protection against the possible exercise of market power by ActewAGL, if such market power is found to exist.

If, after considering these and other issues raised in submissions to the Commission, it is found that there is sufficient competition in the electricity retail market in the ACT, it may be concluded that there is no need for the continued existence of a regulated franchise tariff.

However, 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.' Possible approaches that could be adopted to calculate a regulated retail price to continue after the current TFT expires are discussed in Section 3 of this issues paper.

In these considerations, the Commission will have regard to the requirements of section 20 of the ICRC Act and the other specified matters set out in Section 2 of the reference.

⁶ Franchise customers are defined under the *Utilities Act 2000* 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/year or who have elected to enter a negotiated contract.

2 Whether the transitional franchise tariff should continue

2.1 Objectives of the transitional franchise tariff

In 2002, the Commission was issued with a reference from the ACT Treasurer to provide a price direction for the supply of electricity to franchise customers. The price direction was calculated for a period of three years, to coincide with the introduction of FRC from 1 July 2003.

The objective of implementing a regulated tariff (the TFT) was to allay concerns about the opening of the market and allow newly contestable customers a period in which they could become familiar with the new retail electricity market arrangements. In addition, the existence of the regulated tariff effectively provided a price cap and therefore guarded against potential price shocks. It also encouraged competition from alternative retailers, as it provided a set price against which retailers could compete. Furthermore, the application of a three-year regulated retail tariff provided an opportunity to review the effectiveness of opening the market to competition before fully removing all safeguards.

2.2 Competitive state of the market

In considering the state of the market to determine whether it is sufficiently competitive to no longer require the existence of a regulated tariff for franchise customers, the Commission will review and seek comment on the following market characteristics:

- the size of the market
- the entry of new retailers
- information available to customers
- barriers to further competition
- churn rates
- pricing
- the emergence of new tariff options
- safeguards.

In addition, the Commission will seek comments on whether actual or potential competition should be the basis for any decision on whether there is a need for the continuation of a regulated franchise tariff.

2.2.1 Market conditions

Size of the market

The ACT market is relatively small in comparison with other jurisdictions. In 2004–05, there were approximately 145,000 electricity customers in the ACT.⁷ This 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.⁸

The relative size of the ACT market may make it less attractive to alternative retailers, particularly when there are other, larger markets in New South Wales and Victoria. However, the ACT offers the potential for a highly concentrated catchment of potential customers with relatively high energy requirements in comparison with other major cities.

The Commission seeks views on how the size of the ACT market should influence considerations of the competitive state of the market and how this relates to a continuing need for a regulated tariff.

The number and scope of electricity retailers

The ACT currently has 14 licensed electricity retailers, although not all are currently active in the market. This is comparable to the number of licensed retailers that operate in New South Wales, Victoria and South Australia, the other jurisdictions to have introduced FRC. FRC is to be introduced for customers using less than 100 MWh/year in Queensland from 1 July 2007 and may be introduced for small customers in Tasmania from 1 July 2010.⁹

Of the 13 licensed retailers other than ActewAGL, Country Energy and Energy Australia are the most active in the ACT retail market. A number of licensed retailers in the ACT are the incumbent retailers in their original geographical areas and have significant market shares in other markets.

The Commission seeks views on how the number of licensed retailers should be taken into account when investigating the competitiveness of the market and how this relates to a continuing need for a regulated tariff.

Information available to customers

One issue raised by the Commission in its investigation into the introduction of FRC was the availability of information to customers. To increase the awareness of the community about the

⁷ ICRC 2004, *Final decision: Investigation into process for electricity distribution services in the ACT*. Report 6 of 2004, March 2004, p. 26.

⁸ 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.

⁹ <http://www.energy.qld.gov.au> and <http://www.energyregulator.tas.gov.au>

introduction of FRC, the Commission released a pamphlet outlining the changes.¹⁰ However, the availability of information is an issue that may still need to be resolved.

The evidence available to the Commission indicates that the information required to be provided to customers by retailers under the Consumer Protection Code and other instruments should be sufficient to enable informed consent and meaningful comparisons between offerings. However, the Commission recognises that some customers may find comparisons between offerings confusing—offers can be difficult to decipher, making it difficult to determine what is actually being compared. This is a difficulty that also exists in other product markets.

The Commission seeks views on the amount of information available to customers and whether it is sufficient for customers to make informed decisions about the services they require and to make comparisons between the costs of alternative services offered.

Barriers to further competition

In determining whether the conditions exist for a contestable market to sustain itself in the ACT, the Commission will need to consider whether there are substantial barriers to further competition within the ACT retail electricity market and what they might be. Barriers may exist for some parts of the market, particularly for small customers. These barriers may derive from the market power and scale of the incumbent and the operation of the transitional tariff.

A number of licensees have stated that one reason for not being more active in seeking to contract with small customers in the ACT is, in their view, the dominance of the incumbent retailer, ActewAGL. The price of servicing and marketing to small customers may be too high for such retailers to be competitive against ActewAGL. This may be overcome by increasing the transitional tariff to provide a more attractive margin to competing retailers. However, any adverse price consequences for customers under such an initiative may not be outweighed by the benefits of additional competition.

The existence of a transitional tariff provides customers with an easy option in relation to the choice of retailer. It may act to discourage the emergence of other competitors by making it easy for customers to adopt a ‘no choice’ strategy and still be assured of a reasonable price for electricity as set by the regulator.

The Commission seeks views on any barriers to further competition that exist, and the extent of those barriers.

Customer churn

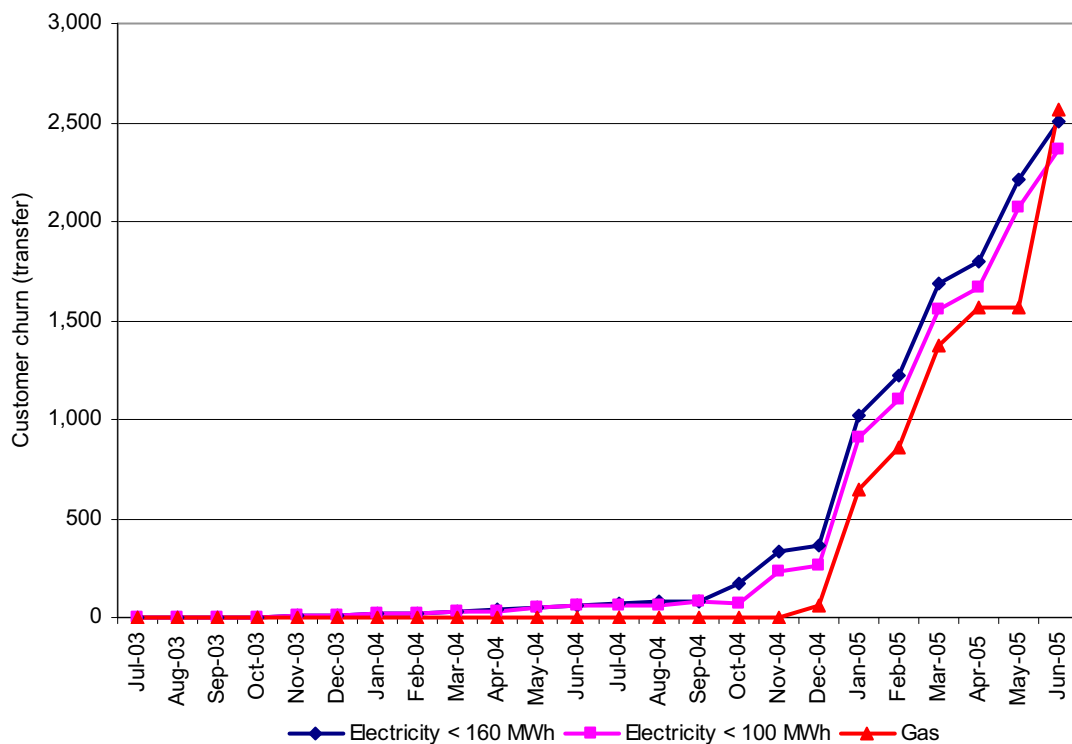
‘Customer churn’ is the number of customers who have switched retailers. In the first two years since FRC was introduced in the ACT, approximately 2,500 small customers elected to change to a

¹⁰ <http://www.icrc.act.gov.au/energy/electricity.html>

retailer other than ActewAGL. This represents less than 2% of the electricity retail market. This is despite a strong marketing campaign by Energy Australia and to a lesser extent by Country Energy. However, approximately 15,500 residential customers (about 11% of all ACT electricity consumers) have switched from the standard customer contract to a negotiated contract with ActewAGL.

Figure 1 shows the numbers of customers who changed their electricity retailers between the introduction of FRC and June 2005. Customers who elected to remain with ActewAGL on a negotiated contract are not included. Gas transfers are included for comparison. Approximately 2,500 gas customers out of the total market of about 94,000 have changed retailers since FRC was introduced on 1 January 2002. There are currently five gas retailers in the ACT market.

Figure 1 ACT customer churn, electricity and gas



The Commission seeks views on how customer churn can be interpreted when examining the competitive state of the market and how this relates to a continuing need for a regulated tariff.

The Commission seeks views on whether there are unique: (i) cost factors; (ii) regulatory requirements; (iii) market characteristics; (iv) historical factors; or (v) other factors in the ACT that explain the extent of customer churn in the ACT relative to churn rates in other jurisdictions (see Section 2.3 of this paper).

Pricing

Several pricing issues may be relevant when considering the possible removal of the TFT.

First, there may be an impact on pricing from the removal of the regulated tariff. The existence of a regulated tariff may protect customers from price rises that are not cost-based. That is, without a

regulated tariff, it may be possible for the incumbent retailer, ActewAGL, to increase prices in an attempt to increase profits. However, while increasing prices in the short term may temporarily increase ActewAGL's profits, it is likely that profits would fall in the long run because the company's market share would be reduced by competition.

Second, if the Commission were to determine a regulated tariff that is either too high or too low, there may be impacts on the competitiveness of the market. For example, if the Commission were to calculate a regulated tariff below the 'competitive' rate, this may act as a deterrent to other retailers entering the market and limit the introduction of alternative pricing arrangements. Conversely, if the regulated tariff were set above the 'competitive' rate, while this may provide an opportunity for other retailers to enter the market, there could be a detriment to customers (at least in the short term) through them having to pay a higher tariff. However, it is recognised that the TFT is effectively a maximum price—there is nothing to stop ActewAGL reducing tariffs below the regulated rate, or offering a range of alternative tariffs, which is what currently occurs.

Another pricing issue raised in the terms of reference requires the Commission to have regard to the retail prices charged by ActewAGL in other jurisdictions.

The Commission seeks views on whether the current state of the market in the ACT is sufficient to guard against price rises that are not cost-based, should the TFT be removed.

The Commission seeks views on the likely impact on prices if the TFT were removed.

The Commission seeks views on the possible implications of inaccurately setting the TFT.

The Commission seeks information on the retail prices charged by ActewAGL in other jurisdictions and how these compare to those offered in the ACT.

The emergence of new tariff offerings

The Commission is aware of the introduction of offers of 'bundling' arrangements some retailers. Under these arrangements, customers can elect to bundle more than one service with the same provider in order to receive a discount.

For example, if a customer bundles four services with ActewAGL (retail electricity, retail gas, internet service provision and telecommunications services) the customer receives a discount of 10% on their electricity account relative to the TFT. Energy Australia offers discounts of 8% relative to the TFT if a customer is willing to bundle electricity and gas. Typically, customers must sign on for a fixed period in order to receive the discount, with penalties applying for early termination of the bundling arrangement.

The Commission seeks comments on whether the emergence of tariff offerings are an indication of a competitive market and how this relates to a continuing need for a regulated tariff.

The Commission seeks comments on new products and offerings that it has not yet identified.

Safeguards

The Commission is conscious of the role played in supporting consumers by organisations such as the Essential Services Consumer Council (ESCC), the Consumer Law Centre, Care Financial Services and the ACT Council of Social Services.

The current TFT may play a part in guarding against price rises that are not cost-based. An argument may be made that the TFT provides protection for customers who are unable to take advantage of, or make informed decisions on, alternative tariff offerings. However, the Commission notes that there is no TFT or equivalent for the supply of natural gas by ActewAGL, and that customers with genuine financial hardship can receive assistance from the ESCC.

The existence of reversion arrangements may also have acted as a safeguard for customers. Under these arrangements, customers can seek negotiated contracts with competing electricity suppliers, with the knowledge that they can revert to the standard customer contract at any time (although switching back before the end of the negotiated contract may incur a penalty). In theory, the existence of the reversion arrangements might increase the willingness of a customer to switch; removing them may create a disincentive for customers to consider alternative pricing offers being promoted by competing suppliers in the ACT market, acting as a barrier to competition.

The Commission seeks views on the role the TFT may play in protecting the interests of consumers and how the interests of consumers may be affected by the removal of a regulated tariff.

The Commission seeks views on the role agencies such as the ESCC, Care Financial Services, the Consumer Law Centre and the ACT Council of Social Services play in providing assistance to disadvantaged consumers and how this role may be affected by the removal of the TFT.

Specifically:

- How are the needs of electricity customers experiencing difficulty with bills addressed?
- How are the needs of gas customers experiencing difficulty with bills addressed?
- How are such needs of customers of alternative retailers addressed?

2.2.2 Actual or potential competition

The government's reference requires the Commission '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'. The Commission has interpreted this as requiring it to investigate the electricity retail market in the ACT and to determine whether it is sufficiently competitive to no longer require the existence of a regulated tariff for franchise customers. It is therefore necessary to establish a way to judge the competitiveness of the market. Is a market competitive when actual competition is observed, or is potential competition sufficient to produce the benefits of competition?

Actual competition

Actual competition could be measured through observing the number of competitors active in the market, the market share of each competitor, the relationship between price and marginal cost, or a combination of these and alternative approaches.

Potential competition

Potential competition in a market may reduce the need for regulation if potential competitors constrain the actions of those already in the market. For example, when regulation is removed from a previously regulated market with a single firm pricing at an efficient level, the firm may consider increasing prices. However, if the firm believes that, as a consequence, other retailers will enter the market, undercut its prices and lure away customers, it may continue to price at the efficient level. In this scenario, the threat of competition is sufficient to guard against the potential abuse of market power by the single firm.

The Commission seeks views on whether actual or potential competition should be considered by the Commission when it is considering the ‘competitive state of the market’.

If it is believed that actual competition should be considered, how should it be measured and is the market currently sufficiently competitive?

If it is believed that potential competition should be considered, how should it be measured and is the market currently sufficiently competitive?

2.3 Experience in other jurisdictions

The Commission considers that experiences in other jurisdictions may prove instructive, especially those in New South Wales, Victoria and South Australia, where FRC has been introduced.

New South Wales, where FRC was introduced in January 2002, has approximately 20 licensed electricity retailers. The Independent Pricing and Regulatory Tribunal continues to regulate retail prices, which are available to customers who use less than 160 MWh/year and who do not wish to enter into a negotiated contract.¹¹

Victoria introduced FRC in January 2002, and now has about 20 retailers. While retail prices are not regulated, the Victorian Government has the ability to review and amend prices if it considers that adequate competition has not developed and that prices are being set at unreasonable levels.¹²

South Australia, which introduced FRC in January 2003, has approximately 12 retailers and a regulated retail tariff for customers who remain with the incumbent retailer.

Figure 2 shows retail customer churn to June 2005 in these markets as compared to the ACT. In New South Wales, 400,000 small customers (about 15%) have changed retailers since the introduction of FRC.¹³ In Victoria, 900,000 small customers (40%) have changed retailers.¹⁴ In South Australia, about 295,000 (40%) have changed.¹⁵ It should be noted that the large increase in South Australian transfers from March 2004 reflects the impact of the South Australian Government’s \$50 electricity transfer rebate for eligible concession card holders. The rebate expired on 13 August 2004.

¹¹ http://www.ipart.nsw.gov.au/electricity_details_02.asp

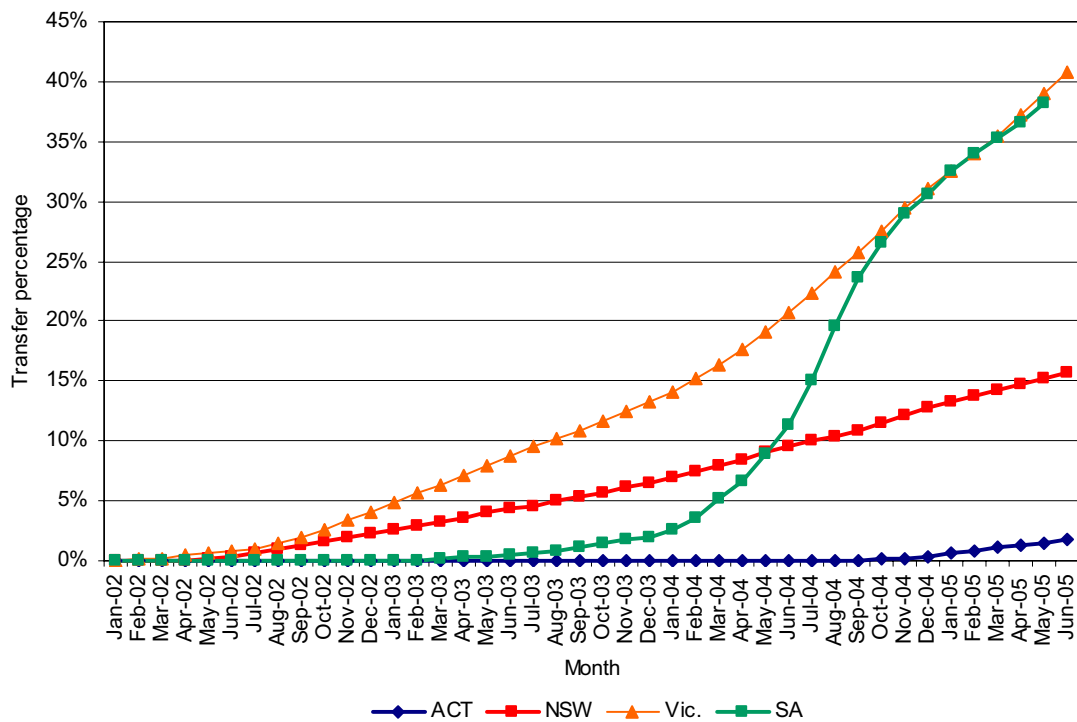
¹² <http://www.esc.vic.gov.au/electricity139.html>

¹³ http://www.nemmco.com.au/data/ret_transfer_datafiles/330-0452.pdf

¹⁴ http://www.nemmco.com.au/data/ret_transfer_datafiles/330-0454.pdf

¹⁵ <http://www.escosa.sa.gov.au/webdata/resources/files/051012-D-FRCTransfSchedOct05.pdf>

Figure 2 Electricity transfers



The Commission seeks views on the ACT’s experience of FRC compared with that of other jurisdictions, and on how it relates to this inquiry.

Since the introduction of FRC in other jurisdictions, there has been an increase in the tariff options offered by electricity retailers to small customers. For example, Country Energy and Energy Australia offer time-of-use tariffs in New South Wales; these apply different rates for electricity consumption depending on when electricity is consumed. Aurora Energy is currently offering prepayment meters in Tasmania and is in the process of introducing them in South Australia.

The Commission seeks views on whether the existence of a regulated tariff has any impact on the competitiveness of the market and the ability of retailers to introduce alternative products and services.

2.4 Regulatory context

The Australian Energy Market Commission has recently been established to perform energy rule-making functions in conjunction with the Australian Energy Regulator, which has been established to undertake regulatory functions. These organisations, which report to the Ministerial Council on Energy, are expected to assume responsibility for the regulation of energy distribution networks and retail markets from the various state regulatory agencies by 31 December 2006. However, the regulation of retail pricing is to remain with the jurisdictions.¹⁶

The Commission seeks views on how the possible introduction of the national regulatory framework may affect considerations about the maintenance of a regulated retail tariff.

¹⁶ Australian Energy Market Agreement, Section 8.1(c).

3 Calculation of a further transitional franchise tariff

The reference from the Treasurer sets out a two-step process for the Commission to follow. If it were found that there is a need for the TFT to continue, the next step would be to determine how the transitional tariff should be calculated. Closely related to this is the question of the duration of the TFT. This section explores these issues.

3.1 The Commission's approach in 2003

The Commission's determination of March 2003 considered how the regulated tariff should be calculated. The Commission's investigation included an analysis of which costs should be included in the tariff—that is, how electricity tariffs are generally structured to recover only legitimate costs. In the 2003 determination the Commission adopted the following cost components:

- retail costs, including:
 - customer care and call centre costs
 - billing costs
 - sales and marketing costs
 - collection and default costs
 - administration costs (business overheads, such as finance, human resource management, and regulatory administration)
 - retail costs associated with transfers and operating in a contestable market
 - a retailer margin, or a return to the shareholder commensurate with the level of risk and investment required for the business
- energy costs (the costs of purchasing energy in the market on behalf of customers), including:
 - costs of energy purchases in the NEM
 - costs of purchasing energy under contracts with generators
 - costs of hedging exposure to price and quantity fluctuations
 - NEMMCO fees and ancillary service charges
 - allowances for renewable energy costs
 - the effect of network losses in the ACT (both transmission and distribution).

3.2 Options for future regulation

In the current price direction, the Commission set the prices by means of the cost build-up approach described above. Ultimately, this was translated into a ‘CPI +/- X’ framework, whereby prices adjust every year by the consumer price index plus or minus an ‘X factor’ on 1 July. The level of the X factor was set for three years in the Commission’s determination. Under the determination, ActewAGL is responsible for developing proposed new prices in accordance with the predetermined price path. The Commission’s role is to approve the prices to ensure that they comply with the price path.¹⁷ The Commission believes that it is possible to use this approach for setting the TFT, if it is determined that the TFT needs to continue.

If the Commission were to maintain the current cost build-up approach, it would be required to forecast the costs of electricity retailing and the wholesale price of electricity—as well as forecast demand—in order to determine a price path that recovers efficient costs.

Alternatively, the Commission could adopt an approach to the determination of retail electricity prices based on benchmarking or monitoring. Examples of this approach include benchmarking against competitive prices elsewhere, linking price changes to changes in the wholesale price of electricity, or implementing a price monitoring scheme whereby the Commission would seek to prescribe prices if the monitored prices appear to be unreasonable.

On the question of the most appropriate form of regulation, the Commission considers that, while a price determination would provide customers and retailers with greater certainty, it may impose additional constraints on the market. A benchmarking approach to the determination of the TFT may be more consistent with the goal of fostering competition in the market and encouraging customers to enter into negotiated contracts.

Have conditions in the market changed sufficiently in the past three years to warrant a change from the approach the Commission adopted in 2003?

3.2.1 Franchise tariffs determined by the Commission

If it were decided that the Commission should determine a franchise tariff, one option would be to maintain the current cost build-up approach to determining retail prices, including fixing the price path for a specified number of years. This would provide the market with a substantial level of certainty, in that the approach is already documented in the Commission’s 2003 final report. Costs used to build up total retail costs are listed in Section 3.1.

There is also the issue of allocating costs between customers on the TFT and those ActewAGL customers on negotiated contracts.

The energy recovery charges are currently allocated to each customer segment. Given the experience of the past three years, there appears to be no reason to change the way those costs are allocated unless there has been substantial customer churn. As more customers switch to negotiated contracts, cost allocations may become incorrect.

¹⁷ The price adjustment process also allowed for a pass-through of distribution and transmission price changes.

The Commission seeks views on whether a cost build-up approach to regulation, such as a tariff determined by the Commission, is appropriate for the regulation of retail tariffs in the ACT.

Given the list of costs in Section 3.1, the Commission seeks comment on the following:

- Are these costs still sufficiently comprehensive, or should other costs also be considered?
- What costs identified above are not relevant to TFT customers? Why?
- How should the Commission approach the cost allocation problem?

3.2.2 Alternative regulatory options

If it is decided that a cost build-up approach is inappropriate, various other methodologies could be used to determine a regulated tariff. A benchmarking or monitoring approach, as well as being in closer harmony with the goal of ensuring market competition, would reduce the regulatory burden and would allow more flexibility in the development of a procedure for eventually removing the regulated tariff. However, there may be important interactions between the duration of a regulated tariff and the method used to determine a regulated tariff.

The Commission has identified three alternative regulatory options:

- Retail price changes could be benchmarked relative to changes in competitive prices in other jurisdictions.
- Retail price changes could be benchmarked relative to changes in the wholesale price of electricity.
- A price monitoring approach could be adopted whereby the Commission monitors the basic tariff offered by ActewAGL and, if it considers a future tariff to be inappropriate, could seek to re-regulate the tariff.

In either of the benchmarking cases, the Commission envisages that prices would adjust once a year in response to changes in the benchmark. The two most obvious benchmarks are considered to be retail prices in other jurisdictions and wholesale costs. Neither should impose a significant information burden on the market, and both have specific advantages and disadvantages. Benchmarking against competitive price changes elsewhere ensures that prices in the ACT do not move out of line with prices in other jurisdictions, while benchmarking against wholesale prices ensures that prices move in tandem with the primary cost of retail electricity (that is, electricity generation costs). While benchmarking is a less intrusive form of regulation than a form using a predetermined price path, it removes the certainty associated with predetermined price path adjustments.

The price monitoring approach would entail the Commission allowing ActewAGL, as the retailer to franchise customers, to set prices on a yearly basis. The Commission would monitor prices and, if it considered the tariff to be inappropriate, it would seek to re-regulate the tariff.

The Commission seeks views on the appropriateness of benchmarking and monitoring approaches to the regulation of retail tariffs in the ACT.

The Commission seeks views on the most appropriate benchmarking or monitoring approach to apply to the regulation of retail tariffs in the ACT.

3.3 Duration of price determination

The reference received from the Treasurer requires the Commission, if it finds a continuing need for a price direction, to ‘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’. The duration of any price direction depends heavily on the form of regulation adopted.

For example, if a cost build-up approach were adopted, the certainty of forward projections for such variables as generation costs and the size of the franchise customer base would affect the duration of the determination. The TFT originally determined by the Commission using a building-block approach was for a period of three years.

Alternatively, if the Commission were to adopt either a benchmarking or a monitoring approach to regulation, as discussed above, there may be a need to review the operation of the determination only as it becomes necessary. It would also be possible to build in a ‘trigger event’, which would signal that the regulated tariff should cease. For example, achievement of a predetermined market share by firms other than the incumbent could be one possible trigger.

The Commission seeks views on the duration of any price direction and on appropriate trigger mechanisms.

3.4 Retailer supplier of last resort

The ‘retailer of last resort’ (RoLR) is the retailer who becomes responsible for the provision of electricity to the customers of a failed retailer. RoLR arrangements differ from the obligation to supply requirements and consumer protections that exist under the Utilities Act and Consumer Protection Code. A discussion of the obligation to supply follows this discussion of RoLR arrangements.

In the ACT, the RoLR is ActewAGL. Under ActewAGL’s current Utility Service Licence, it is required to:

sell electricity to a customer when a last resort event occurs in respect of the customer’s other supplier of electricity. This obligation ends after three months or when the customer advises the Licensee, in writing, that the sale of electricity is no longer required, whichever occurs first.¹⁸

These RoLR services must be supplied in accordance with the guidelines issued by the Commission in 2002.¹⁹ In those guidelines, the Commission’s focus was on ensuring that customers continue to be supplied with electricity if their retailer of choice ceases to provide services. The guidelines state:

The Retailer of Last Resort arrangements provide an effective means by which customers continue to be supplied with electricity while the retailer failure is managed. Customers are not required to do anything to ensure that there is continuity of supply; transfers will be made by NEMMCO and

¹⁸ ActewAGL Retail Utility Service Licence; see www.icrc.act.gov.au

¹⁹ ICRC, *Retailer of last resort guidelines*, December 2002.

the Retailer of Last Resort. Customers affected by the failure of [their chosen licensed ACT retailer] will be able to choose a new retailer of electricity at any time or otherwise remain with the Retailer of Last Resort for up to 3 months. Customers can expect to receive offerings from other electricity retailers licensed in the ACT.

Importantly, electricity customers should note that while considering offers from other retailers their electricity supply will continue at a regulated price under the Retailer of Last Resort arrangements. The regulated price will be higher than alternative prices available in the market.

Advice on choosing a new retailer, prices and other information to assist customers make new choices, and about the management of the market generally, will be published [shortly after the retailer of last resort process comes into effect].²⁰

The Commission seeks views on how the removal of a regulated tariff may affect the RoLR arrangements.

The RoLR arrangements differ from the obligation to supply customers. Section 80 of the Utilities Act states that:

- (1) An electricity supplier must, on application by a person, and in accordance with the supplier's standard customer contract, supply electricity to premises owned or occupied by the person.
- (2) This section does not apply to the supply of electricity to premises for a non-franchise customer.²¹

The requirement to supply applies only to franchise customers. Because ActewAGL is the only ACT retailer with franchise customers, it is the only retailer with an obligation to supply.

Part 3 of the Consumer Protection Code relates specifically to the protection of franchise customers and includes the requirements that the utility must meet in regard to connection and supply of electricity, disconnection arrangements, failure by customers to pay accounts, interruption of supply, and when requesting security deposits from customers.²²

The Commission notes that the Utilities Act and Consumer Protection Code, as well as other pieces of legislation, differentiate between 'franchise' and 'non-franchise' customers. Any decision that there is no longer a need for the TFT may necessitate the redefinition of these terms. Franchise customers are currently those who consume less than 100 MWh of electricity per year and who are on a standard customer contract. The characteristics of franchise customers are:

- Their supply is guaranteed by the incumbent supplier.
- Responsibilities and obligations of the supplier and customer are defined in the standard customer contract, which has been approved by the Commission.
- Protection is afforded by the Consumer Protection Code and provisions of the Utilities Act, especially the operation of the ESCC.²³

²⁰ Independent Competition and Regulatory Commission, *Retailer of last resort guidelines*, December 2002, p. 19. Available on the Commission's Webpage: <http://www.icrc.act.gov.au>

²¹ <http://www.legislation.act.gov.au>

²² Available on the Commission's website: <http://www.icrc.act.gov.au>

²³ These protections are also available to non-franchise customers.

These arrangements are based on the existence of franchise customers. The Commission notes that ActewAGL continues to offer a standard customer contract for natural gas, despite the lack of a regulated tariff and the fact that there are no longer any franchise natural gas customers.²⁴

The Commission seeks views on whether the current obligation to supply, and protections available under the Utilities Act and Consumer Protection Code, are sufficient.

The Commission seeks views from ActewAGL on whether it would continue to offer a standard customer contract if it were found that there is no need for a regulated retail tariff.

The Commission seeks views on how best to ensure that the obligation to supply and the protections available under the Utilities Act and Consumer Protection Code would continue to apply to customers if it were decided to remove the regulated tariff.

²⁴ Disallowable Instrument 2001–94.

4 Call for submissions

While the reference does not prescribe a date for completing the investigation, the Commission is aware that the process has a short timeline. The government will need to decide whether the transitional arrangements will be extended and, if so, the Commission will need to determine an appropriate price well in advance of the 30 June 2006 deadline for the existing arrangements.

The following is a summary of the timetable for the investigation.

Submissions on issues paper due	02 December 2005
Draft decision due for release	23 December 2005
Submissions on draft decision due	10 February 2006
Final decision due for release	24 March 2006

In the course of its inquiry, the Commission will be seeking public input and comment relating to the issues raised in this paper and subsequent reports. At this stage, the Commission welcomes information about the issues raised by the reference. The Commission will accept submissions in a number of media, for example in writing or electronically. The Commission is also open to meeting parties to the investigation to discuss issues where that is desired.

People intending to make a submission to this investigation should be aware that the Commission publishes all submissions made to its inquiries on its website, unless there is a specific claim for information to be treated as confidential. Submissions are also available for scrutiny at the Commission's offices, by arrangement through the office.

5 Glossary and abbreviations

ACT	Australian Capital Territory
ActewAGL	ActewAGL Retail
Commission	Independent Competition and Regulatory Commission
ESCC	Essential Services Consumer Council
FRC	full retail contestability
ICRC Act	<i>Independent Competition and Regulatory Commission Act 1997 (ACT)</i>
MWh	megawatt hours
NEM	national electricity market
Utilities Act	<i>Utilities Act 2000 (ACT)</i>