

Issues Paper

**Inquiry into Full Retail Contestability
for Electricity in the ACT**

January 2002

The Independent Competition and Regulatory Commission (ICRC) is 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 the determination of 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.

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For further information on this inquiry or any other matters of concern to the Commission please contact Ian Primrose, Chief Executive Officer on 62050779.

Foreword

The Treasurer has issued a reference to the Independent Competition and Regulatory Commission to inquire into and advise the Government on the costs and benefits of introducing full retail contestability (FRC) for electricity in the ACT for consumers using less than 100 Megawatt/hours (MWh) of electricity a year. [cf p 7].

As the reference was issued under sections 15 and 16 of the Act the Commission is required to publish a draft report and, after consultation, a final report providing advice and recommendations for the Government to consider.

Timetable for the inquiry

Issues Paper released	8 January 2002
Submissions on the Issues Paper close	8 February 2002
Draft Report	22 February 2002
Submissions on the draft report close	25 March 2002
Possible Public hearing/s	Between 2 March and 28 March 2002
Conclusion of the investigation	31 March 2002
Release of the Final Report	As soon as possible after 31 March 2002

The reference requires the Commission to consider a range of matters and report to Government by the end of March 2002. The Commission intends to investigate by seeking public input into the issues raised by the inquiry and by undertaking its own independent analysis. The Issues Paper provides an overview of the effects to be canvassed by the Inquiry although not all aspects are covered in this paper. Omission of reference to any issue in this Issues Paper should not reduce the matters being considered by the inquiry provided they are relevant to the terms of reference. The Commission will be seeking views from as wide a range of people and groups as possible through the Issues Paper, the Draft Report and possible public hearing/s.

Full retail contestability is a significant issue that potentially affects all users of electricity in the ACT. In the past only larger customers have been able to choose their retail supplier of electricity. Benefits have been delivered to those users in terms of greater choice of product packages, service levels and prices. However, it is not clear that full retail contestability will deliver those benefits to all consumers, particularly small consumers. The Commission has been asked to advise government about the costs and benefits associated with introducing full retail contestability for small customers, particularly residential and small business customers. The Commission will be considering whether all customers will benefit or whether the Government may need to provide some level of protection in future for some members of the community. Some people, such as the elderly, persons with relevant disability, or the socially or economically disadvantaged may not benefit from an open market. Their needs may require ongoing protection.

The Commission is seeking views and data from all interested parties to this inquiry, and particularly from those organisations or groups representing the interests of those who will be affected by the possible opening of the market but who are not in a position effectively to manage the new demands that will be put upon consumers to

act in their own interest. The Issues Paper provides the initial opportunity for making submissions to the Commission. The Commission will accept submissions in writing, oral submissions and submissions transmitted by post or electronically.

People intending to make a submission should be aware that the Commission publishes all submissions made to its inquiries unless there is a specific claim for information to be treated as confidential and the Commission agrees with that claim. Submissions are published on the Commission's website and are available for scrutiny at the Commission's offices.

For further information about making a submission or about the inquiry in general please contact the Chief Executive Officer of the Commission, Ian Primrose, on 62050779 or by fax on 62075887.

Paul Baxter
Senior Commissioner
8 January 2002

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Background

In 1995 the ACT Government, together with other Australian Governments, signed three agreements which constitute the National Competition Policy.

A major commitment in the National Competition Policy was to undertake development of a competitive national electricity market delivering benefits to the economy and consumers. It was agreed that the national electricity market would be facilitated by separating the generation, transmission, distribution and retail supply sectors, establishing a central management body for the national grid and creating an independent but consistent approach to the establishment of regulated prices.

The market was to be developed gradually with targets for the structural separation of transmission, distribution and retail services being met by 1996 and the opening of the east coast grid incorporating Queensland, New South Wales, ACT, Victoria and South Australia by the end of 1997. Governments also agreed to a phased opening of the retail market to competition in accord with the assessed benefits to be derived by each jurisdiction.

In the ACT, only large volume consumers above 160 Megawatt/hour (MWh) per year were initially made contestable from 1998. The threshold was lowered to 100MWh effective from July 2001. The ACT market was to be fully opened to retail competition by making consumers below the 100MWh (essentially households and small businesses) threshold contestable from 1 January 2002, in line with Victoria and New South Wales.

Victoria and New South Wales made their markets fully contestable from that date, but a decision in the ACT has been delayed by the processes of the Legislative Assembly. The ACT Legislative Assembly Standing Committee on the Urban Services Portfolio commenced an inquiry into whether there would be a net benefit to the community in exposing consumers using less than 100 MWh of electricity a year to competition. The Committee could not complete its inquiry before the Legislative Assembly rose for the election in October 2001. In its interim recommendations to the incoming government the Committee suggested that a new Standing Committee should take up consideration of the net benefit of full retail contestability to small customers.

The Treasurer subsequently issued a reference to the Independent Competition and Regulatory Commission on 18 December 2002 to conduct an inquiry into full retail contestability in electricity for consumers using less than 100MWh of electricity per year.

The terms of the reference

The reference, issued under section 15 of the *Independent Competition and Regulatory Commission Act 1997* (ICRC Act), is for an 'investigation into the public benefit of the extension of full retail contestability for electricity in the ACT'.

The reference has specific requirements, established under section 16 of the ICRC Act, to be met in the course of the investigation. The Commission is required to have regard to the following matters in its investigation:

1. The costs and benefits of the implementation of full retail contestability for electricity for the ACT, taking into account the Territory's obligations under the Council of Australian Governments (COAG) and National Competition Agreements. The review should include options for the ACT in relation to :
 - a. proceeding as soon as management and administrative systems allow; and
 - b. not proceeding at this time.
2. Identifying and describing the electricity market participants using 100 MWh pa or less;

Identifying and quantifying the costs and benefits (financial and non-financial) flowing from the extension of full retail contestability for electricity in the ACT to customers using 100MWh pa or less. This should include the effect of possible changes in electricity prices for different categories of customers, including those who may be socially disadvantaged;

3. The means and costs of avoiding or mitigating any adverse impacts on consumers, particularly those socially disadvantaged;
4. Whether or not the ACT should adopt deemed profiling of customer usage and the desirability or otherwise of moving to full metering;
5. An assessment of studies and/or experience in other jurisdictions with the implementation of FRC for the different classes of small business and residential users; and
6. Any other related matters.

In undertaking the investigation the Commission is required to consult widely, including key stakeholders such as consumer groups, small business representatives, social welfare groups and electricity suppliers and retailers.

The Commission is to conclude its investigation by 31 March 2002 and 'report as soon as possible thereafter'.

Issues

Costs and Benefits of Full Retail Contestability (FRC)

The National Competition Policy Agreements presumed that there would be net benefits arising from an open and free market. Ideally a competitive market would provide consumers with benefits such as lower prices; greater choice of products and improved service quality than would be available in a monopoly or near monopoly market. There are a number of issues that may influence the benefits that might be delivered to consumers in the ACT.

For example, in disaggregating the industry into its major components of generation, transmission, distribution and retailing, there have already been a number of benefits by way of cost reductions delivered to consumers in the ACT. Regulation of transmission and distribution activities has seen costs for these services reduce over time. Consumers have benefited from these cost reductions and the regulation of future prices, albeit at levels which still allow service providers to recover costs and earn an appropriate return on their investment in infrastructure. However, there are some indications that the cost of implementing full contestability may lead to price increases as retailers seek to recover their set up costs. There are also questions about whether small customers have sufficient market power to take advantage of the benefits that FRC may bring, particularly at a time when there has been high volatility in electrical generation prices.

The Commission will be seeking information from stakeholders about the balance of costs and benefits that may occur as a result of the market becoming contestable. While the costs of the market becoming contestable may be easy to quantify the benefits are usually more difficult to determine. The Commission will be seeking information not only on those costs and benefits which are readily quantifiable, but also those that may be more readily expressed in qualitative terms.

Prices for Electricity in the ACT

At the present time ACT consumers in the 100MWh pa or less group are residential or small business customers supplied by the incumbent retailer ActewAGL under regulated retail prices determined by the Commission. Those prices are lower generally than prices being paid elsewhere in the national market. Those benefits may be lost and prices may rise if (FRC) were introduced. The Commission will need to determine whether prices would rise or fall as a result of the introduction of FRC or whether prices may rise in any event as a result of other factors independently of FRC.

If prices were to rise the impact of those rises on various groups in the community need to be understood. For example, those on low incomes may not be able readily to afford electricity supply in a competitive environment if prices were to rise. In that case the cost of continuing supply of what is regarded as an essential service may fall upon the community at large in the form of increased government assistance. The cost of assisting these consumers through the processes of the Essential Services Consumer Council or some other mechanism will also have to be considered. Similarly the subsidies provided currently for the aged or socially disadvantaged may need to be reviewed at a potential cost to the Budget.

Determining what level of cost and social or economic impact of price movements the community regards as acceptable is a question on which the Commission will seek advice from the community and other stakeholders. Prior to the recent regulatory reforms, larger users have cross-subsidised residential and other smaller users. Cross-subsidies in the distribution charges have largely been removed since the 1999 Price Determination. However, an unregulated market may act to the disadvantage of smaller customers. Larger consumers with greater market power attract retail discounts while smaller users who do not have such market power are unable to command such discounts.

FRC itself may produce costs that are currently avoided. For example, costs arising from the process of handling the 'churn' of customers (that is, customers moving from one retail supplier to another). Experience with the opening of the telecommunications market has shown that with a large number of retailers competing for customers there are a significant number of customers willing to change retailers to gain greater advantage. That volatility, while healthy from a contestability perspective, produces costs which to the extent that the market allows these to be recovered, can increase the retail price, especially to small consumers. Volatility itself may be a significant factor in determining whether ultimately any benefit is delivered to consumers.

Do Consumers have Sufficient Market Power to Ensure a Workable Market

The tranche of customers in the 100MWH pa includes all residential customers and most small businesses. The Commission will seek views on whether those customers have sufficient knowledge of the market or market power to ensure that the market works effectively in their interest. For competition to provide the maximum benefits to consumers they must be aware of how the market operates and be able to compare the costs and benefits offered by competing retailers.

Informed awareness about consumers rights and obligations under supply contracts with retailers and the financial and service issues that are behind those conditions is an important issue in determining how successful the market is likely to be in supplying the services customers expect. There is a body of opinion which suggests that consumers are at a significant disadvantage in these matters and that consequently in an open market they will not receive the benefits that ideally they should.

Would a Competitive Market provide Appropriate Signals about Energy Use and Environmental Sustainability?

The Commission will need to consider a range of social and environmental issues in the course of the investigation. The Commission will benefit from information about the likely movement in aggregate demand for electricity and any signals that might send about the need or opportunity for future investment in infrastructure. Movements in demand will also affect the prospects of retailers and other market participants outside the ACT. It may also send signals about the worth of alternate sources of electrical energy that might be developed in the ACT. The ICRC Act requires that the Commission have due regard to the impact of FRC matters on ecological sustainability.

The Benefits of Observing FRC in Other Jurisdictions

In completing its investigation the Commission will need to consider the experience with full retail competition. Not only of Victoria and New South Wales but also internationally the UK and the USA have significant experience of open markets and the kinds of risks and benefits that are involved. There is a substantial body of evidence from those jurisdictions that will assist in determining the existence of a net benefit.

Metering and Other Technical Issues

The Commission has been asked to consider a range of technical issues as well as the broader social, economic and environmental ones. The issue of whether an open market in the ACT would need to have full metering for FRC to be effective is one such issue. The alternative to full metering is use of some form of profiling in conjunction with existing metering technology. Profiling is in use in Victoria in conjunction with existing metering equipment as an alternative to installing new meters that read consumption continuously rather than accumulating data over a period of several months. The profiling issue is about how quickly the competitive market can operate effectively.

Metering is not only about the means of collecting information about energy consumption, it also involves questions about who might own meters. Private ownership of meters, rather than reliance on retailers or network operators owning metering equipment raises a number of questions, not least being questions of access, how transfers occur, how connections occur, and the interface between the private equipment owners and retailers and network operators systems.

Terms of Reference

INDUSTRY REFERENCE FOR INVESTIGATION INTO FULL RETAIL CONTESTABILITY FOR ELECTRICITY

Disallowable instrument DI2001-346

made under the
**INDEPENDENT COMPETITION AND REGULATORY COMMISSION ACT
1997,**
**Section 15 (Nature of industry references) and Section 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 matter of an investigation into the public benefit of the extension of full retail contestability for electricity in the ACT.

Specified 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:

The Commission is to have regard to the following in its investigation:

1. The costs and benefits of the implementation of full retail contestability (FRC) for electricity for the ACT, taking into account the Territory’s obligations under the Council of Australian Governments (COAG) and National Competition Agreements. The review should include options for the ACT in relation to:
 - a. proceeding as soon as management and administrative systems allow; and
 - b. not proceeding at this time.
1. Identifying and describing the electricity market participants using 100 Megawatt/hours per annum (MWh pa) or less;
2. Identifying and quantifying the costs and benefits (financial and non-financial) flowing from the extension of full retail competition for electricity in the ACT to customers using 100 MWh pa or less. This should include the effect of possible changes in electricity prices for different categories of customers, including those who may be socially disadvantaged;
3. The means and costs of avoiding or mitigating any adverse impacts on consumers, particularly those socially disadvantaged;
4. Whether or not the ACT should adopt deemed profiling of customer usage and the desirability or otherwise of moving to full metering;

5. An assessment of studies and/or experience in other jurisdictions with the implementation of FRC for the different classes of small business and residential users; and
6. any other related matters.

In undertaking the investigation, the Commission is to:

- (i) canvass the views of key stakeholders including, consumer groups, small business representatives, social welfare groups and electricity suppliers and retailers; and
- (ii) conclude the investigation by 31 March 2002 and report as soon as practicable thereafter.

Dated this 18th day of December 2001

TED QUINLAN
TREASURER