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30 April 2017

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 supply of electricity to small electricity customers from 1 July 2017

AGL welcomes the opportunity to comment on the Independent Competition and Regulatory Commission ('**ICRC'**)'s Draft report, *Standing offer prices for the supply of electricity to small customers from 1 July 2017, Report 1 of 2017, March 2017 ('***Draft Report'***)*. AGL has provided a submission to the Issues Paper in relation to this review.

AGL is concerned with the ICRC's decisions in the Draft Report regarding some of the key elements in the cost build-up to establish the regulated prices from 1 July 2017 in the ACT. AGL's views are outlined below.

Wholesale energy cost (WEC)

The WEC methodology relies on about two years of historical ASX futures prices. Whilst this methodology has provided stability in the past, in the current environment of rapidly rising wholesale costs, this results in a significant lag and regulated prices are unlikely to reflect current market prices.

As illustrated in Figure 3.1 in the Draft Report[1], forward prices have more than doubled from less than $50/MWh to $110/MWh in less than 12 months. New entrant retailers or existing retailers seeking to win customers from the incumbent retailer will be unable to compete as they will need to procure energy at current costs of around $110/MWh whilst the regulated price or market cap is set based on $65/MWh in the Draft Report. Although the WEC in the Final Report will include more up to date ASX data, the gap between current market prices and the average of two year prices will remain significant.

Retail costs

The benchmark retail operating costs (ROC) in the Draft Report is a continuation of the benchmark set by IPART of $110 per customer ($2012/13) for the review of NSW retail electricity prices for 2013-16. ICRC claims that by adopting the IPART benchmark for retail operating costs, the ICRC is allowing for customer acquisition and retention costs (CARC)[2]. However, IPART's definition of retail operating costs (ROC) was distinctly separate from

[1] P 44
[2] P 32

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CARC[3]. The CARC allowance considered by IPART was considered separately from and was in addition to the ROC of $110 per customer.

IPART's 2013 benchmark was based predominantly on the retail costs of the NSW standard retailers which are several times larger than ActewAGL in terms of the number of customers. Retail operating costs are mostly fixed and retailers with larger customer bases are able to achieve efficiencies of scale to average these costs down. The ICRC has not made any allowance for the difference in the relative size of ActewAGL on ROC.

Recent changes to the National Energy Retail Rules require retailers to prepare for metering competition (Power of Choice) by 1 December 2017. There are significant costs to prepare for this as well as the ongoing costs. This requirement was not in place at the time when IPART was considering the benchmark for ROC and therefore, should be allowed for as an addition to the ROC.

Retail margin

The Draft Report has changed the approach to setting the retail margin allowance by fixing the retail margin on a $/MWh basis at 2016/17 levels in real terms. The current retail margin allowance is 6.04% of total costs or 5.7% of revenue. Given the significant increase in energy purchase costs, this will result in a reduction in the 2017/18 retail margin allowance by over 0.5% to 5.49% of total costs or 5.2% of revenue. If costs continue to rise, this retail margin in percentage terms will decrease further. The current benchmark is based on IPART's benchmark set in the 2013 review.

This approach results in a retail margin which is independent of the underlying costs. The National Electricity Market is the most volatile market in the world and this approach will increase the risk that regulated prices are set too low.

This change in setting the retail margin allowance diverges from the approach used by other regulators and even past ICRC decisions. It will result in a reduction in the retail margin in percentage terms in a market currently facing significant cost pressures and will ensure retail competition is limited in the ACT.

Discussion

AGL summary assessment of the ICRC 2017 Draft Report is that:

- WEC is set below market costs;
- retail cost allowance provided to the standard retailer is below cost;
- there is no cost allowance for customer acquisition and retention;
- there is no Headroom allowance to encourage competition; and
- the Retail margin provided is below all regulated and market benchmarks.

For each element in the Draft Report's cost build-up, the ICRC has set a low benchmark or provided no allowance. This results in regulated prices which are set below market costs, preventing new retailers from entering the market or existing retailers competing for new customers. In AGL's view, these price could be considered uncommercial and anti-competitive.

[3] Review of regulated retail prices and charges for electricity, From 1 July 2013 to 30 June 2016, IPART, p 97

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While the ICRC has adopted IPART's benchmark for retail operating costs and retail margin, albeit inadequately, the ICRC has decided to omit other key cost elements. In AGL's view, if the ICRC chooses to omit CARC and any competition allowance then it should re-examine whether the benchmarks for retail operating costs and retail margin are appropriate. Without these elements, it is highly likely that the ICRC's retail operating cost and retail margin allowances are significantly understated.

IPART recently made a comparison of retail electricity prices in NSW and ACT and found that:

> *"... customers that engage with the market in NSW can benefit from retail competition and find offers with lower retailer charges than in the regulated market in the ACT... [W]e also consider a greater range of prices (and products) available in the market is a sign of competition working, reflecting differences in the products being offered by retailers. In addition, when less price-sensitive customers remain on higher margin products, other customers are able to benefit from cheaper offerings."*
>
> *"We consider the findings by the ECA also support the benefits of retail competition in NSW. Customers gave positive ratings on key indicators in NSW and the ACT as follows:*
> - *Value for money: 52% in NSW compared with 48% in the ACT.*
> - *Customer service: 55% in NSW compared with 50% in the ACT.*
> - *Billing and account options: 62% in NSW compared with 56% in the ACT."*[4]

A key objective of the ICRC under the ICRC Act is to, "*promote effective competition in the interest of consumers*". The overarching objective, consistent with the National Electricity Objective, is to, "*promote the efficient investment in, and efficient operation and use of regulated services for the long term interests of consumers in relation to the price, quality, safety, reliability and security of the services.*"

These objectives do not require the lowest possible price to be set nor is price the only consideration. By setting the regulated price below market levels, the ICRC is preventing the development of effective competition and, in AGL's view, failing to meet its own objectives.

Should you have any questions in relation to the information provided, please contact Meng Goh, Manager Regulatory Strategy, at mgoh@agl.com.au or (02) 9921 2221.

Yours sincerely,

Elizabeth Molyneux
Head of Energy Market Regulation

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[4] Review of the performance and effectiveness of the retail electricity market in NSW, From 1 July 2015 to 30 June 2016, Energy – Final Report, November 2016, IPART, p 19