



10 February 2012

Independent Competition and Regulatory Commission  
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Canberra ACT 2601

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### **Retail Prices for Non-contestable Electricity Customers – 2012-14**

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 Non-contestable Electricity Customers (2012-14) Issues Paper.

esaa is the peak industry body for the stationary energy sector in Australia and represents the policy positions of the Chief Executives of 38 electricity and downstream natural gas businesses. These businesses own and operate some \$120 billion in assets, employ more than 61,000 people and contribute \$19.3 billion directly to the nation's Gross Domestic Product.

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.

As outlined in the Issues Paper, the Commission advocated for the removal of retail price controls in April 2006 when the ACT Government sought the Commission's views on the need for continued price regulation. In particular, the Commission recommended that the price-setting arrangements be discontinued and a monitoring arrangement be put in place. The ACT Government chose not to accept the Commission's advice at that time and proceeded to issue further price directions.

Five years on, in March 2011 the Australian Energy Market Commission (AEMC) completed its review of the effectiveness of competition in the electricity retail market in the ACT. The message in the AEMC's Stage 2 Final Report was clear – retail price regulation is a direct barrier to competition. On this basis, the AEMC recommended the removal of the transitional franchise tariff as part of a package of reforms. These reforms are intended to empower customers to make efficient decisions and make it easier for retail businesses to enter the ACT market to offer choices to consumers. In particular, the Stage 2 Final Report noted that such reforms would remove regulatory

risk for retail businesses, thus facilitating the development of a competitive retail market and the provision of cost-reflective market offers.

Disappointingly, the ACT Government failed to heed the advice of Australia's independent energy expert, opting to issue terms of reference for the provision of regulated prices for a further two years. esaa considers this decision to be a missed opportunity for overdue reform, particularly given the Territory's commitments as a signatory to the Australian Energy Market Agreement. These commitments include phasing out retail price regulation and ensuring that any remaining price regulation does not hinder further development of competition.

Of additional concern, however, is that the Commission may have now moved away from its 2006 position. It appears that the Commission is concerned that the removal of regulated tariffs may see electricity prices rise for small customers without any overall benefit to the ACT community. Given that the best way to ensure that electricity prices remain as low as possible while allowing energy supply businesses to remain viable is to promote competition, the Association is particularly troubled by this view.

The Association has long supported the removal of retail price regulation where retail markets are contestable. Open, competitive energy markets free from distortions such as retail price regulation naturally encourage prices to be efficient through the development of competitive market offers. Competition in retail electricity markets, as in other sectors of the Australian economy, incentivises businesses to improve service. More specifically, businesses are incentivised to develop products that meet consumer needs, find ways to lower their costs and to pass these cost savings on to consumers. As a result, retail prices are set as low as sustainably possible while businesses can still make an appropriate return.

Retail price regulation in contestable electricity markets is an inherently fallible and risk-laden exercise that can be self-fulfilling. 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.

The task of setting appropriate retail prices that are competitive but still allow retail businesses to meet their costs and manage risks is becoming increasingly complicated. This is largely as a result of uncertainty surrounding:

- rising fuel costs;
- the costs of meeting federal and state government policies that mandate more expensive forms of renewable energy and;
- the impacts of the Federal Government's Clean Energy Future package.

It is known that the carbon price will be starting at \$23/tCO<sub>2</sub>e on 1 July 2012 and escalating at 2.5 per cent in real terms over the first three years of the scheme. However, the direct impact of the carbon pricing policy on wholesale energy costs over this period (and beyond) remains to be seen. Furthermore, this uncertainty is likely to be particularly acute until effective financial instruments to hedge carbon costs emerge, as evidenced by reduced forward contracting in electricity futures markets.

Given the asymmetric risk profile identified above, esaa considers that the risks to the electricity market from the under recovery of underlying costs far outweigh the risk of over recovery in a contestable electricity market. Accordingly, the Association considers that any price setting methodology considered by the Authority:

- should be sufficiently flexible such that any significant deviation in costs is able to be reflected in the level of regulated tariffs;
- be based on the efficient costs of a new entrant retailer (inclusive of customer acquisition and retention costs) and;
- include an appropriate retail margin commensurate with the risks that a retail business faces.

Furthermore, a mechanism allowing the cost of carbon to be passed on efficiently and promptly, during both the fixed price and subsequent floating price periods, should be implemented.

esaa considers that the ACT Government should remove electricity retail price regulation as per the AEMC's recommendation in 2011. However, where regulation continues to be administered, electricity tariffs must be derived in a way that ensures they are at least cost reflective throughout the review period.

Any questions about our submission should be addressed to Kieran Donoghue, by email to [kieran.donoghue@esaa.com.au](mailto:kieran.donoghue@esaa.com.au) or by telephone on (03) 9670 0188.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Matthew Warren', with a large, stylized loop at the end.

**Matthew Warren**  
Chief Executive Officer