Review of the Effectiveness of Competition in Electricity and Gas Markets in South Australia - Second Draft Report

JOHN TAMBLYN
CHAIRMAN
AUSTRALIAN ENERGY MARKET COMMISSION

ADELAIDE
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OVERVIEW

- Purpose of the Second Draft Report
- Background to the Commission’s draft advice
- The Commission’s draft advice
- Consultation process and next steps
- Specific issues for discussion
- Questions
Under the AEMA, the AEMC is required to:

- Assess whether competition is effective in electricity and gas retailing in South Australia
- If competition is effective, provide advice to the SA Government and Ministerial Council on Energy on ways to phase out retail price regulation
- If competition is not effective, provide advice identifying ways to develop effective competition
PURPOSE OF SECOND DRAFT REPORT

• The Commission's First Final Report was published on 19 September 2008

• First Final Report confirmed the Commission’s preliminary finding that competition is effective in electricity and gas retailing in South Australia, although relatively more intense in electricity than in gas

• Second Draft Report outlines the Commission’s draft advice on ways to phase out retail price regulation in South Australia
BACKGROUND TO DRAFT ADVICE

• First Final Report found that competitive has been effective in keeping prices in line with costs and margins at or below competitive levels

• Energy sector entering a period of transition:
  – tightening supply/demand balance in SA
  – increasing wholesale energy costs
  – introduction of new climate change policies

• This is likely to lead to increases in input costs and an erosion of retail margins

• Effective competition will continue so long as standing contract prices can adjust flexibly to provide competitive margins

• Price regulation is unnecessary and can impose costs where competition is effective

• With rising input costs, continuation of retail price regulation risks the viability of retailers and the supply reliability of consumers
COMMISSION’S DRAFT ADVICE: OVERVIEW

- Key recommendations
- Features of the Commission’s recommended price oversight framework
- Options for additional oversight of the regional gas supply
- Reasoning for the Commission’s draft advice
- Consequential amendments following the removal of retail price regulation
- South Australia’s compliance with the AEMA
KEY RECOMMENDATIONS

• The existing framework for regulating retail prices should be replaced by a transparent price monitoring framework

• Regulation of standing contract prices should cease by no later than the expiration of the current price determinations for electricity and gas

• Under the model recommended by the Commission:
  – cost-reflective prices will be set by the competitive retail market
  – ESCOSA will undertake transparent price monitoring and reporting
  – SA Government has a conditional reserve pricing power to re-impose price controls if competition deteriorates
  – non-price consumer protection arrangements continue

• The framework recommended by the Commission should be introduced for a period of at least three years following the removal of price regulation
FEATURES OF RECOMMENDED FRAMEWORK

• Standing Contract Prices
  – Obligations to agree to sell electricity and to sell and supply gas will apply to the FRMP for existing connections and to the standing contract retailer for new connections
  – All retailers set and amend own standing contract prices

• Price Disclosure Requirements
  – The Energy Price Disclosure Code will be extended to standing contracts and default contracts
  – Retailers must publish a notice in a local newspaper prior to changing their standing contract or default contract price
FEATURES OF RECOMMENDED FRAMEWORK cont’

• **Monitoring by ESCOSA**
  
  – ESCOSA monitors and publishes information about trends in standing contract and default contract prices
  
  – Options for additional oversight of regional gas supply

• **Price Monitoring Reports**
  
  – ESCOSA to publish half yearly price monitoring reports, outlining as a minimum:
    
    • Trends of each retailer’s standing contract and default contract prices
    • Changes in the pricing structure for standing contract and default contract prices
FEATURES OF RECOMMENDED FRAMEWORK cont’

• Reserve pricing power
  – Conditional statutory power that can be exercised by the SA Government to re-introduce retail price regulation should be included in the Electricity Act and Gas Act
  – Reserve pricing power can only be exercised if a review by the AEMC finds competition is not effective and price regulation is the appropriate policy response

• Additional AEMC Competition Reviews
  – Mechanism to enable the SA Government to request the AEMC to conduct an accelerated review of competition at short notice

• Periodic Review of Framework
  – AEMC to undertake review of price monitoring framework within three years of implementation
• **Structural limitations in regional gas supply**
  
  – First Final Report identified constraints in access to transmission haulage capacity that are affecting the ability of retailers to expand into regional areas
  
  – Some structural issues will be resolved in the short to medium term, with the expiry of Origin’s legacy contracts for firm transmission haulage on some MAPS laterals

• **Ensuring access to competitive offers**
  
  – Origin’s market offers available to regional customers currently provide the same level of discounting as Origin’s market offers available in Adelaide
  
  – However, additional oversight of the regional gas supply may ensure regional gas customers can continue to access competitively priced market offers
Options for additional oversight role

- ESCOSA could:
  - report on any price differences between comparable gas market contracts offered by Origin in regional SA and metropolitan Adelaide in its half-yearly price monitoring reports; and/or
  - require Origin to report on requests for access to the SESA Pipeline and the outcomes of those requests
REASONING FOR DRAFT ADVICE

• The proposed price monitoring regime allows the flexibility of market-determined prices whilst maintaining oversight of standing contract and default contract prices, and the ability to re-introduce retail price regulation if competition deteriorates

• **Competition is effective:** Effective competition has kept prices in line with costs and margins at or below competitive levels

• **Changes in costs/prices:** Prospective increases in costs/prices would be better handled by the competitive market than by a regulator

• **Price monitoring:** Monitoring provides a prudent transparent oversight of market pricing performance
• **Power to re-regulate:** Conditional reserve pricing power can be exercised by the SA Government if competition deteriorates, following a competition review by the AEMC

• **Retailers’ incentives:** Rivalry of competitors and threats of re-regulation provides incentives for retailers to price competitively

• **Viability of retail energy sector and supply reliability:** Cost reflective pricing necessary to ensure incentive to enter retail market is maintained in light of future cost pressures

• **Comprehensive consumer protection framework:** Will continue to apply under the Commission’s recommended price monitoring regime
The Commission has considered how the replacement of direct retail price regulation with a price monitoring framework will affect existing non-price protections for customers.

The Commission has made some proposals to allow non-price protections to better operate in an environment without direct retail price regulation.

These suggestions include:

- the obligation to agree to sell electricity and to sell and supply gas should apply to the FRMP for existing connections and to the standing contract retailer for new connections

- each retailer should determine its own default contract prices: default contract prices should not be fixed by ESCOSA or by the Electricity Pricing Order
RECOMMENDED CONSEQUENTIAL AMENDMENTS cont’

- a Retailer of Last Resort (RoLR) scheme for gas should be introduced at the earliest opportunity

- ESCOSA should consider whether the reference in the RoLR Guideline to linking the variable element of price should continue to refer to the standing contract price

- the SA Government could consider undertaking a consumer awareness and education campaign as part of the transition to phasing out retail price regulation
COMPLIANCE WITH THE AEMA

- The AEMA requires the Commission to assess whether community service obligations (CSOs) are transparently funded and do not materially impede competition.

- There are currently four CSO programs in place in SA:
  - a customer concession scheme for energy
  - the Emergency Electricity Payment Scheme
  - funding assistance
  - the Country Equalisation Scheme
COMPLIANCE WITH THE AEMA cont’

• The Commission found that SA’s CSOs are transparently funded.

• There is currently no evidence that SA’s CSOs have an anti-competitive effect on energy retailing, including the Country Equalisation Scheme.

• The Commission invites comments from stakeholders in their submission.
CONSULTATION & NEXT STEPS

Submissions on the Second Draft Report are due
4 pm, Monday 17 November 2008

• The Commission welcomes views on all matters relevant to its draft advice

• The Commission is also seeking views on a range of specific issues, which are outlined in the following slides

• Second Final Report will be published in mid-December 2008

• SA Government to consider and respond to the Commission’s final advice, to be published in the Second Final Report
SPECIFIC ISSUES FOR DISCUSSION

Stakeholder views are sought on the following issues:

• **Price oversight of default contracts**
  
  – What are the potential costs and benefits of monitoring default contract prices?
  
  – Do default contract prices need to be monitored, noting that these prices may be set by reference to retailers’ standing contract prices?
  
  – Are there any other comments on the price monitoring regime design or operation?
SPECIFIC ISSUES FOR DISCUSSION cont’

- Extension of the Energy Price Disclosure Code to standing contract and default contract prices
  - What are the potential costs and benefits of extending the Code to standing contract and default contract prices?
  - Should market contract prices remain subject to the Code during the initial three years of the framework?
  - Are there any other comments on the Commission’s price disclosure proposals?
SPECIFIC ISSUES FOR DISCUSSION cont’

• Proposal for ESCOSA to monitor and report on any price differences between comparable gas market contracts in regional SA and metropolitan Adelaide

  – What are the potential costs and benefits of this additional price monitoring role for regional gas market contracts?

  – Given that Origin’s regional gas market offers currently provide the same discounts as market offers available in Adelaide, is this additional pricing oversight necessary?
• Proposal for ESCOSA to establish and maintain a register of Origin’s negotiations for access to the SESA Pipeline

  – What are the potential costs and benefits of this register?

  – What type of information should be reported on by Origin under this register?

  – Should the information in the register be publicly available?

  – Should ESCOSA be required to report on the outcomes of requests for access in its half-yearly price monitoring reports?
SPECIFIC ISSUES FOR DISCUSSION cont’

• **Impact of the Country Equalisation Scheme on the development of retail electricity competition**
  
  – What are the costs and benefits of Scheme?
  
  – Given that competition is effective for electricity retailing, is the Scheme necessary?
QUESTIONS

- Questions from the floor