



1 February 2008

Australian Energy Market Commission
PO BOX A2449
Sydney South
NSW 1235

cc: submissions@aemc.gov.au

Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria – Second Draft Report

The Energy Supply Association of Australia (esaa) welcomes the opportunity to comment on the Australian Energy Market Commission's (AEMC) Second Draft Report on the review of the effectiveness of competition in electricity and gas retail markets in Victoria.

esaa is the peak industry body for the stationary energy sector in Australia and represents the policy positions of the Chief Executives of more than 40 electricity and downstream natural gas businesses, including energy businesses in Western Australia. esaa member businesses own and operate some \$110 billion in assets, employ over 40,000 people and contribute \$14.5 billion dollars directly to the nation's Gross Domestic Product.

esaa is pleased to note that the AEMC, through the publication of the First Final Report, has now confirmed the report's preliminary findings that competition in gas and electricity retailing in Victoria is effective. As highlighted in its previous response, esaa fully endorses these findings which are further supported by the recent report from the Essential Services Commission (ESC) indicating that Victorian electricity prices have fallen by around 21 per cent since the commencement of the competitive market¹.

esaa supports the proposed recommendations to phase out retail price regulation outlined in the draft report, given the proven competitive nature of the Victorian energy market and the significant benefits that have accrued to consumers to date. However, given the finding that the energy market is both competitive and contestable, it is difficult to understand the justification for introducing the proposed new regulatory measure to implement an industry specific price monitoring regime.

Comments on the Second Draft Report

The Second Draft Report has been released in conjunction with the First Final Report with the purpose of providing advice to the Ministerial Council on Energy (MCE) and

¹Energy Retail Businesses Comparative Performance Report 2006-07, December 2007. Essential Services Commission.

the Victorian Government on the ways to phase out retail price regulation in Victoria. The draft report makes several recommendations including:

- Phasing out price regulation by 1 January 2009 and allowing the Victorian Government's existing reserve price powers to lapse by the end of 2008.
- Retaining the obligation to supply but with a proposed Financially Responsible Market Participant model.
- Requiring retailers to determine and publish their standing offer prices.
- Implementing a price monitoring regime for standard offer prices.
- Introducing a consumer awareness and education programme.

esaa supports the recommendations and the proposed timeframe for the removal of price regulation and encourages the MCE and Victorian Government to commit to these dates in order to provide greater certainty to industry. However, it urges the AEMC to reconsider its proposal to introduce a price monitoring regime for the following reasons.

Price Monitoring Regime

The draft proposes a regime of annual monitoring and public reporting of standing offer prices from all retailers for an initial period of three years but with the option to continue monitoring at the regulator's discretion. Initially undertaken by the ESC, the intention is to transfer the monitoring regime to the Australian Energy Regulator (AER) once the national retail regulation framework replaces the existing State-based regulatory arrangements. The ESC (and later the AER) will have the power to recommend that the AEMC undertake another review of the effectiveness of competition if considered necessary. If the AEMC review concludes competition is no longer effective then the ESC/AER will have its powers to regulate prices reinstated.

The reasons presented in the Second Draft Report for price monitoring of standing offer prices include:

- customers on standing offer prices are the most exposed to the potential exercise of localised market power, particularly if they have never actively engaged in the market, and monitoring consequently will provide transparency for consumers and policy makers in relation to standing offer prices;
- a three year monitoring period will facilitate consumer confidence that retailers are being constrained by market competition under the new arrangements;

These reasons may be sufficient to justify monitoring absent effective competition in what may formerly have been a host retailer's monopoly area, and absent effective regulatory measures to compensate for information asymmetry for small residential customers.

However, in a market such as Victoria where the AEMC has reported that competition is fully effective, and where substantial transparency and consumer protection regulations apply, the addition of price monitoring seems to be addressing a risk of potential re-emergent market power that has already been adequately addressed, and thereby imposing unnecessary reporting obligations on retailers and monitoring costs on the regulator (at the taxpayer expense).

For example, effective competition and the rapidly decreasing occurrence of geographically defined areas for incumbent host retailers provides competitive tension for standing offers as well as market contracts. A retailer that maintains standing offer prices at levels well above cost will run a strong risk of losing a substantial proportion of its standing offer customer base to other retailers with more competitive prices for its standing offers. Given the importance of maintaining a large customer base to achieve economies of scale in retailing, other retailers will be strongly incentivised to poach customers on uncompetitive standing offer prices (without even having to offer the lower prices for market contracts).

In addition, regulation of the terms and conditions for standing offers and the related deemed contracts provide a substantial protection against the use of market power, particularly when, as is the case in Victoria (and presumably the forthcoming national retail regulation framework), any variation in standing offer tariffs and charges must be published in advance of the variation taking effect. Any number of regulators, community groups, Governments or any other party can compare and report on standing offers at any time.

In these circumstances, it is difficult to see how the proposed monitoring regime adds value to public confidence that retail competition is working given the presence of compulsory notification of standing tariffs and charges and the legal obligations contained in the consumer protection arrangements.

The implied threat of re-regulation associated with the recommended price monitoring regime may also reduce the level of benefits of competition by diverting retailers to dedicate some of their resources to the requirements of complying with the monitoring regime rather than increasing the competitive quality of service to their own and potential new customers, thereby reducing customer service developments and inhibiting product innovation. For example, the draft report proposes that as part of the price monitoring regime retailers should have to provide an 'explanation of the impact on bills by consumption level'. This reporting requirement could easily become a regulatory disincentive for retailers considering changes and reductions to their standing tariffs.

esaa understands the reasons for suggesting a monitoring regime, but believes they are misguided.

Such a regime may have a role in a retail market for an essential service in transition to effective competition, where monitoring can provide assurance that the standard consumer protection measures associated with competitive retail energy markets are working. However, the Victorian retail energy market is highly advanced and relatively sophisticated. Competition in the market as assessed by the AEMC is fully effective, and intensive retailer advertising and promotion has created a very high level of consumer awareness of energy products and retailer differentiation. A comprehensive retail regulation framework is in place, and the general powers of the Australian Competition and Consumer Commission are available to investigate and prosecute any anti-competitive practices or address any substantial lessening of competition. Price monitoring in these circumstances is superfluous, adds an unnecessary cost and potentially inhibits market and product development.

Obligation to Supply

The draft report also seeks comment on the recommendation to retain the obligation to offer to supply and sell energy, and the deemed supply arrangements. The AEMC's preferred approach is that the obligation should rest with the Financially Responsible Market Participant (FRMP) with new connections either being managed

by the host retailer in the area or through a competitive distributor tender process. esaa supports the FRMP model and agrees with the draft report that it would result in the obligation to supply being more closely aligned to any variations in a retailers' market share. esaa also notes that the FRMP model is also supported by the MCE's Retail Policy Working Group process.

In terms of the new connections, esaa agrees with the draft report that 'the concept of the host retailer is becoming increasingly irrelevant due to the amount of customer switching and changes in market share occurring in the Victorian retail energy sectors'. esaa has no in-principle objection to the proposal that the right to provide the New Connection Obligation is tendered out to retailers by the appropriate distributor with any resulting revenue accounted for during the distributor's pricing determination process. We understand there is likely to be an opportunity to consider this proposal in more detail in the consultation processes being undertaken as part of the development by the Ministerial Council on Energy (MCE) of the national distribution and retail regulation legislation.

The distribution tender model is reflective of a more flexible, market based approach which address the concerns of the static host retailer concept introduced prior to the commencement of the competitive market. The energy industry is characterised by rapid and constant changing market structure and introducing a competitive tender model will allow for the efficient development of the industry over time.

Consumer Assistance Measures

esaa in its response to the First Draft Report agreed that while there is clear need to support those customers that may not be able to access the full benefits of competition due, for example, to financial hardship, disability or location – retail price regulation was not the most appropriate mechanism to achieve this goal. esaa therefore strongly agrees with the findings in the draft report that:

'Where concerns arise regarding issues going beyond the operation and performance of the competitive energy market, such as the affordability of energy for low income households, these issues need to be addressed through appropriately targeted policies rather than by intervening to distort the efficient operation of the market.'

esaa further supports the AEMC's view that the current mechanisms to safeguard the interests of such consumers are adequate and that no fundamental change to the regulatory framework is required.

In summary, esaa welcomes the findings and recommendations contained within the Second Draft Report but encourages the AEMC to reconsider the need for the proposed price monitoring regime given that competition in Victoria has been proven effective, the presence of strong state consumer protection and national competition legislation, and the proposed measures for transparent and ongoing public notification of standing offer prices.

Yours sincerely



Brad Page
Chief Executive Officer