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Retail Competition Review – First Draft Report, 4 October 2007

The Australian Energy Market Commission's (the Commission's) review is the third review of effectiveness on competition in the Victorian electricity and gas markets since the introduction of full retail contestability in 2002. The Essential Services Commission of Victoria (ESCV) undertook reviews in 2002 and in 2004. In 2004, the ESCV concluded that competition in the Victorian market was sufficient to discipline any exercise of market power and to enable considerations on the gradual roll back and potentially the elimination of retail price regulation. The ESCV noted that more could be done to enhance the level of competition and recommended a number of actions that have been implemented.

The energy market in Victoria is rated as the most active in the world.

It is therefore not a surprise that the Commission has found that competition is effective in Victoria for all customers, when measured against the indicators established by the Ministerial Council on Energy (MCE) and further developed and agreed to by all stakeholders through the Commission's public consultation process. We also note that the methodologies used for assessment, such as customer and retailer surveys, are consistent with the approach used in Victorian and South Australian reviews in the past. The review has found that retailers do not discriminate between customer classes. AGL Energy Limited¹ (AGL) is particularly pleased with the 'facts-based' approach used by the Commission to dispel misconceptions with respect to market performance and outcomes amongst certain stakeholders.

Under the Australian Energy Market Agreement (AEMA), the Commonwealth and the State and Territory governments have agreed to phase out the exercise of retail price regulation for electricity and natural gas where effective competition can be demonstrated. Clause 14.11 (a) of the AEMA states that the Commission will assess the effectiveness of competition for the purpose of retention, removal or reintroduction of retail energy price controls.

¹ AGL is one of Australia's leading integrated energy companies. Drawing on 170 years of experience, it includes retail and merchant energy businesses, power generation assets and an upstream gas portfolio. AGL has Australia's largest retail energy and dual fuel customer base. This includes customers supplied with gas and electricity through AGL's joint venture partnership with ActewAGL. AGL has a diverse power generation portfolio including base, peaking and intermediate generation plants, spread across traditional thermal generation as well as renewable sources including hydro, wind, landfill gas and biomass. One of Australia's largest renewable energy producers, AGL is looking to further expand this position by exploring a suite of low emission and renewable energy generation development opportunities.

Clause 14.11 (c) of the AEMA requires the Commission to publicly report on its assessments of effective competition in which it will provide advice on:

- (i) ways to phase out the exercise of retail price regulation if competition is determined to be effective, and an appropriate timeframe; or
- (ii) ways to promote the growth of effective competition for those users or areas of a jurisdiction which do not enjoy effective competition.

The rationale and pre-conditions for the phase out of retail price regulation have been discussed in the lead up to the agreement under the AEMA. The comprehensive assessment by the Commission and the ranking of Victoria as the most competitive energy market in the world by FirstData/VaasaEMG² leaves no doubt that competition in Victoria is effective.

The focus of the next stage of the Commission's considerations should be on transitional issues and timetable for the phase out of retail price regulation, such as:

- obligation to supply; and
- arrangements for price monitoring and reserve powers, if relevant.

It is important that the outcome following the implementation of the agreement under the AEMA, in particular with respect to customer protection, is clearly understood and communicated so as to ensure continued consumer confidence. There appears to be a view that the phase out of price controls will weaken customer protection generally and impact on arrangements for assisting the vulnerable customers (customers experiencing financial hardship).

This will not be the case. In our view the **only** difference to the current customer protection arrangements will be that efficient retail prices will be determined by market forces continuously, rather than by a regulator or government attempting to predict that outcome for several years out at a single point in time. If the incumbent or host retailers were to publish an unregulated 'default price' to replace the current standing offers, the existing customer protection arrangements would continue.

The removal of retail price regulation does not mean a diminishing of any of the existing customer protection arrangements such as obligation to supply, arrangements for customers in financial hardship, and community service obligations.

Furthermore, the AEMA provides for powers to monitor and intervene with respect to retail pricing should there be evidence that competition has ceased to be effective.

AGL accepts that current legislation and regulations need to be reviewed to clarify or define arrangements with respect to:

- Obligation to supply;
- Default prices;
- Price monitoring; and
- Reserve powers

² World Energy Market Rankings, Utility Customer Switching Research Project, Second Edition, June 2006, FirstData Utilities/VaasaEMG.

Each of these matters and options on the way forward are discussed below. AGL notes that the Standing Committee of Officials of the MCE is currently consulting on the development of a national regulatory framework for retail. Any substantive changes to the Victorian regulatory framework should be undertaken as part of that process. The existing non-price customer protection framework for customers in Victoria should be maintained in the meantime.

Obligation to supply

Incumbent or host retailers currently have the obligation to supply small retail customers in Victoria. This obligation is linked to the standard terms and conditions established in accordance with the Energy Retail Code. Standing offer tariffs are currently agreed with the Victorian government.

As discussed above, under a deregulated pricing regime the standard terms and conditions are not required to change except that any references to standing offer tariffs need to be changed to an alternative (unregulated) publicly available price ('default price'). The options of this are discussed in the next section below.

The options with respect to who has the obligation to supply include the:

- Incumbent (host) retailers as is the case at present; or
- Financially Responsible Market Participant (FRMP), as is the case for electricity in Queensland. The FRMP is the retailer who the market operator sees as the party responsible for supply to a site.

AGL supports the option of the FRMP having the obligation to supply for the following reasons:

- The energy market in Victoria has reached a level of maturity where the 'incumbent or host' concept is becoming increasingly less relevant. New entrant retailers now supply over 20% of electricity and over 12 percent of gas customers and there has been a significant redistribution of customers amongst the traditional host retailers;
- Obligation to supply can complement the deemed price provisions where customers move in and commence using energy without entering into an arrangement or where customers' contracts expire and have not been renewed;
- This arrangement ensures that retailers who market and have the service infrastructure in a particular geographic region carry the obligation;
- A FRMP can be more readily identified compared to alternative options;
- Avoids the customer having to transfer from the current FRMP to another retailer; and
- Avoids the administrative complexity of determining responsibility for wholesale market costs and subsequent adjustment processing.

AGL supports the retention of obligation to supply on the host retailers until the national regulatory framework for retail is delivered.

Default prices

Clearly, retailers will need to have published 'default prices' that will apply:

- in the event that a customer's contract expires and they have not made alternative arrangements;
- where a customer moves into a premise and commences to use energy without making arrangements with a retailer; or
- under the obligation to supply provisions.

In the first two cases the supply will come from the FRMP and customer will be deemed to have entered into an arrangement with the FRMP, at the FRMP's

published default price. Clearly, the FRMP having the obligation to supply would provide a consistent and sensible approach.

The FRMP should make the prices that will apply ('default prices'), in each of the circumstances above, publicly available. The 'default prices' may be published on the retailer's website, and may vary for each of the circumstances listed above.

The publication of the default prices ensures that customers are aware of the costs that they will incur when consuming energy. In addition, publication will also ensure that prices can be monitored under an appropriately designed price monitoring regime, if deemed necessary.

Default prices published in this manner together with a 'retailer of last resort fee' can also become the basis for the charges that may apply in the event of a retailer failure.

AGL notes the concerns that current market offers are generally with reference to the regulated standing offer tariff and that the absence of such a tariff will make it difficult for customers to assess the benefits under the market offers.

The publication of default prices by a FRMP will ensure that there is a 'reference price' against which customers may compare market offers. Since that 60% of customers are already on market contracts, offers that are with reference to a standing offer tariff can be misleading. In our view, comparisons should be against other market offers rather than to a 'reference price'.

Price monitoring

Clause 14.14 (c) of the AEMA states that transitional arrangements may involve oversight of retail prices under a deregulated pricing regime.

Energy is an essential service and AGL understands that the phase out of retail price regulation without any independent monitoring of prices will not be acceptable to some stakeholders, especially the consumers. Further, independent 'price monitoring' together with reserve price regulation powers will ensure that customers have confidence that price outcomes will remain efficient.

The Price Disclosure Guidelines in Victoria require retailers to publish generally available market offers to small retail customers on their websites. The current standing offer tariffs are published in the government gazette and websites.

AGL believes that the extension of the Price Disclosure Guidelines to include the publication of 'default prices' will ensure that retail prices are transparent and effectively communicated. In addition, since the Commission is responsible for the effectiveness of competition reviews for the retention, removal, or reintroduction of retail energy price controls under the AEMA, it would make sense for the Commission to also undertake 'price monitoring'.

It is important however, that 'price monitoring' remains non-interventionist and does not become a de facto retail price review, for example, in the form of a detailed cost build up exercise. AGL believes that 'price monitoring' should take the form of a 'state of the market' report that examines a number of factors such as number of retailers, availability of market offers and customer choice, and other market conditions to establish if competition has ceased to exist. The Commission should only take action where it can demonstrate that there is market failure.

Reserve powers

We note that under clause 14.14(c) of the AEMA, the phase out of retail price regulation does not prevent the exercise of a reserve power by the State or Territory where effective competition ceases. AGL supports such reserve power but considers that any such reserve power should only be exercised in accordance with a regulatory methodology promulgated by the Commission that ensures that any intervention by government may only occur where there is demonstrable evidence of market failure.

The Commission should undertake the assessment of market failure (competition has ceased to be effective) which may be triggered as a result of the Commission's ongoing price monitoring, or through a direction for an effectiveness of competition review from the MCE.

Protection of vulnerable customers

The Victorian government adopted the recommendations of its Committee of Inquiry into the Financial Hardship of Energy Consumers and passed legislative amendments to require retailers to publish hardship policies in 2006. The ESCV published a guideline for Energy Retailer's Financial Hardship Policies in April 2007 and the ESCV approved retailers' hardship policies in August 2007.

As outlined above, all arrangements with respect to assistance to vulnerable customers are expected to remain unchanged. Current arrangements for vulnerable customers address the process for identification and delivery of assistance to those customers who are not able to pay their bills through retailers, government and welfare organisations.

Clause 14.11 (b) of the AEMA states that social welfare and equity objectives will be met through clearly specified and transparently funded State or Territory community service obligations that do not materially impede competition. This agreement is consistent with the recommendations of the Productivity Commission³ following its review of Competition Policy Reforms in 2005.

Social programs in place in Victoria are being delivered under the current regulatory regime and agreements with the government. These will continue to be delivered when retail price regulation is phased out.

Way forward

There are two options for addressing the minor 'regulatory' changes that will be required to facilitate the removal of retail price regulation:

- Review existing 'regulatory' arrangements as a Victorian only review and make the necessary changes; or
- Implement the arrangements as part of the MCE process to establish a national regulatory framework for distribution and retail regulation.

³ "In retail infrastructure markets, once effective competition has been established, regulatory constraints on prices should be removed. Ensuring that disadvantaged groups continue to have adequate access to services at affordable prices should be pursued through adequate, well targeted and transparent community service obligations (or other appropriate mechanisms), that are monitored regularly for effectiveness." - Productivity Commission Inquiry Report: Review of Competition Policy Reforms, February 2005.

Given the pace and uncertainty of timing for the delivery of the national regulatory framework for retail, AGL strongly recommends that the Victorian regulatory changes be addressed as a separate exercise. Further, the regulatory changes should be limited to the administrative matters to facilitate the removal of price controls, for reasons cited above, rather than be a full review of customer protection arrangements. The latter is already part of the development of the national framework.

At its simplest, the regulated *standing offer tariff* may be replaced by an unregulated *published default price* with no other changes to regulatory arrangements. The recent changes to arrangements announced by the Victorian government, where the retail price regulation for small business customers will be removed provides useful guidance. We believe the necessary regulatory changes can be delivered within six months, well in advance of the expiry of the extended price path for the residential customers in Victoria in December 2008.

AGL looks forward to contributing to the development of the Commission's advice to the Victorian government and in assisting the Commission in addressing in any transitional matters that are identified. For any enquiries in relation to this submission please contact Kam Khelawan, Manager Policy & Strategy on (02) 9921 2611 or khelawan@agl.com.au.

Yours sincerely,

A handwritten signature in blue ink that reads "Sean Kelly". The signature is written in a cursive, flowing style.

Sean Kelly
General Manager Energy Regulation