REVIEW

Australian Energy Market Commission

STAGE 1 FINAL REPORT

Review of the effectiveness of competition in the electricity retail market of the ACT

Commissioners

Pierce
Henderson
Spalding

24 November 2010

Reference: EPR0017
Stage 1 Final Report

Inquiries

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

E: aemc@aemc.gov.au
T: (02) 8296 7800
F: (02) 8296 7899

Reference: EPR0017

Citation

AEMC, Review of the effectiveness of competition in the electricity retail market of the ACT, Stage 1 Final Report, 24 November 2010, Sydney.

About the AEMC

The Council of Australian Governments, through its Ministerial Council on Energy (MCE), established the Australian Energy Market Commission (AEMC) in July 2005 to be the rule maker for national energy markets. The AEMC is currently responsible for rules and providing advice to the MCE on matters relevant to the national energy markets. We are an independent, national body. Our key responsibilities are to consider rule change proposals, conduct energy market reviews and provide policy advice to the Ministerial Council as requested, or on AEMC initiative.

Summary

The AEMC's finding is that competition in the ACT electricity retail market for small customers is not effective. There are a number of inter-linking factors causing this:

- the weak presence of second tier retailers in the market reduces the overall level of awareness of full retail contestability (FRC), which is likely to make customers 'sticky' and therefore more difficult to attract away from ActewAGL Retail;
- this lack of awareness of FRC and ActewAGL Distribution's provision of distribution services could also give customers the perception that the product offered by ActewAGL Retail is more valuable than the product offered by other retailers (that is, there is a perceived product differentiation). This perception would increase the level of stickiness;
- the relatively small size of the market (approximately 150 000 customers) means that there are fewer customers over which to spread the fixed costs incurred to enter the ACT market. Therefore there is a risk to retailers that they may not capture a sufficient mass of customers to spread their upfront fixed costs over;
- the corporate structure of ActewAGL Retail and its economies of scale and scope are likely to provide it with cost advantages over a single fuel supply efficient new entrant; and
- the regulated price is based on the efficient costs of ActewAGL Retail rather than a new entrant retailer.

As a consequence, the actual margins available to second tier retailers may not be the same as those earned by ActewAGL Retail. Importantly, it appears that second tier retailers do not perceive the potential margins available to them to be a sufficient rate of return that is commensurate with the risks and uncertainties of operating in the market over the long-term. This perceived imbalance between the risk and reward of operating in the ACT has resulted in few retailers entering into (or expanding within) the market. Consequently, there has been very little retailer rivalry observed and there are currently limited offers available to small electricity customers in the market.

In reaching this finding, the AEMC has analysed electricity retail supply in the ACT as the relevant market with reference to the Ministerial Council on Energy criteria and the competition analysis framework of structure, conduct and performance. That is:

- market structure:
  - independent rivalry within the market; and
  - the ability of suppliers to enter the market.
- market conduct:
  - the exercise of market choice by customers; and

  - customer switching behaviour.

- market performance:
  - price and profit margins; and
  - differentiated products and services.

In considering the relevant MCE criteria, the AEMC has found that the market structure is not consistent with what would be expected in a market with effective competition. Although when looked in isolation certain characteristics of the ACT market appear to be attractive (for example, relatively high winter demand peaks), these features do not appear to outweigh the difficulties for second tier retailers to enter into and expand within the market.

In addition, the conduct of market participants (that is, retailers and customers) is not compatible with behaviour that would arise in an effectively competitive market. Rival behaviour between retailers has been limited. ActewAGL Retail has dominated the small customer market since FRC was introduced in July 2003, maintaining more than 90 per cent of the customer base throughout the period. Furthermore, the rate of consumer switching in the ACT (approximately 20 per cent of customers have switched) has been considerably less than what has been observed in other jurisdictions. Notwithstanding, ActewAGL Retail's 'win-back' campaign in response to the increased level of retailer rivalry in 2006-07 suggests that it responds well to competitive pressures.

Additionally, customers appear to be satisfied overall by the quality of service in the ACT. This suggests that despite ActewAGL Retail's dominance, competitive pressure (that is, the threat of entry or expansion) has encouraged it to maintain a high quality of service. This is one positive indicator of market performance. Therefore the evidence is that limited competition pressure exists, but increasing the level of competition will lead to benefits for consumers.

In addition to considering each of the MCE criteria, an assessment of the ACT's social welfare and equity objectives relating to the supply of electricity in accordance with the Australian Energy Market Agreement (AEMA) has been carried out. The AEMC's findings are that the various community service obligations operate in a manner that should not materially impede the effectiveness of competition in retail supply of electricity to small customers in the ACT.

Contents

1 Introduction

As requested by the Ministerial Council on Energy (MCE), the Australian Energy Market Commission (AEMC) is conducting a review into the effectiveness of competition in electricity retail market in the Australian Capital Territory (ACT Retail Review). The ACT Retail Review is to be completed by 31 December 2010.

1.1 Purpose of the Stage 1 Final Report

The purpose of the first stage of the ACT Retail Review is to address the question of whether competition in the ACT electricity retail market is effective. After considering submissions responding to the Stage 1 Draft Report[1], the AEMC maintains the view that competition in the electricity retail market of the ACT is not effective. This Stage 1 Final Report sets out the reasons for this conclusion.

With the publication of this Report, the ACT Retail Review now moves on to stage two, which provides advice on ways to promote competition in the ACT electricity retail market. The Stage 2 Draft Report has been published at the same time as this Stage 1 Final Report.

1.2 Structure of the Stage 1 Final Report

The remainder of this Stage 1 Final Report is structured as follows:

- **Chapter 2** summarises the AEMC's findings on the effectiveness of competition in the electricity retail market in the ACT;
- **Chapter 3** describes the analytical framework that has been utilised in the first stage of the ACT Retail Review;
- **Chapter 4** provides a definition of the market for which the effectiveness of competition is being assessed;
- **Chapter 5** assesses the effectiveness of competition in respect of the structure of the ACT electricity retail market;
- **Chapter 6** considers the effectiveness of competition with regard to the conduct of market participants in the ACT electricity retail market;
- **Chapter 7** analyses the effectiveness of competition in respect of the performance of the ACT electricity retail market;
- **Chapter 8** provides an assessment of the relevant social welfare and equity instruments available in the ACT;

---

1 AEMC, *First Draft Report: review of the effectiveness of competition in the electricity retail market in the ACT*, 30 July 2010.

- **Appendix A** summarises the consultation process for the ACT Retail Review; and

- **Appendix B** provides a summary of stakeholder issues in relation to the First Draft Report.

2 Findings on the effectiveness of competition

The AEMC's finding is that competition in the ACT electricity retail market for small customers is not effective. There are a number of inter-linking factors causing this:

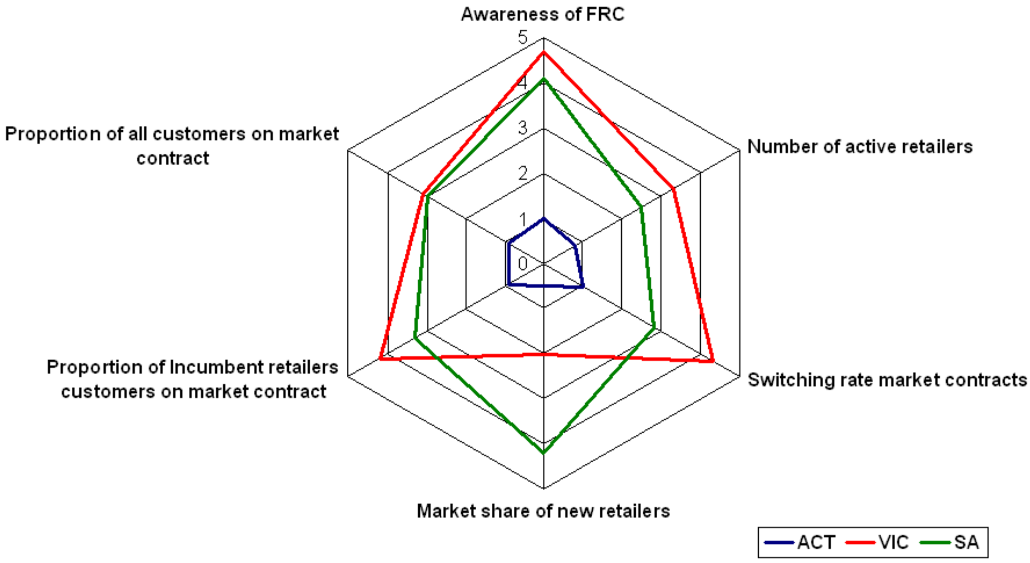
- the weak presence of second tier retailers in the market reduces the overall level of awareness of full retail contestability (FRC), which is likely to make customers 'sticky' and therefore more difficult to attract away from ActewAGL Retail;
- this lack of awareness of FRC and ActewAGL Distribution's provision of distribution services could also give customers the perception that the product offered by ActewAGL Retail is more valuable than the product offered by other retailers (that is, there is a perceived product differentiation). This perception would increase the level of stickiness;
- the relatively small size of the market (approximately 150 000 customers) means that there are fewer customers over which to spread the fixed costs incurred to enter the ACT market. Therefore there is a risk to retailers that they may not capture a sufficient mass of customers to spread their upfront fixed costs over;
- the corporate structure of ActewAGL Retail and its economies of scale and scope are likely to provide it with cost advantages over a single fuel supply efficient new entrant; and
- the regulated price is based on the efficient costs of ActewAGL Retail rather than a new entrant retailer.

As a consequence, the actual margins available to second tier retailers may not be the same as those earned by ActewAGL Retail. Importantly, it appears that second tier retailers do not perceive the potential margins available to them to be a sufficient rate of return that is commensurate with the risks and uncertainties of operating in the market over the long-term. This perceived imbalance between the risk and reward of operating in the ACT has resulted in few retailers entering into (or expanding within) the market. Consequently, there has been very little retailer rivalry observed and there are currently limited offers available to small electricity customers in the market.

In reaching this finding, the AEMC has analysed the electricity retail supply market in the ACT (the relevant market) with reference to the MCE criteria. A cross-jurisdictional comparison with Victoria and South Australia in accordance with key indicators from the MCE criteria is set out in Figure 2.1.[2]

2 Victoria and South Australia were both found to have effective competition by the AEMC. It was recommended that retail price regulation be removed in both jurisdictions.

Figure 2.1 Cross-jurisdictional comparison of competition indicators



Indicator	0	5	ACT	VIC	SA
Awareness of full retail contestability (FRC)	50%	100%	60%	94%	82%
Number of active retailers	0	20+	2	13	10
Switching rate market contract	0%	30% +	6%	26%	17%
Market share of new retailers	0%	50% +	5%	20%	42%
Proportion of incumbent retailers customers on market contracts	0%	60% +	11%	50%	40%
Proportion of all customers on market contracts	0%	100%	18%	62%	60%

Source: IPART, *Review of regulated retail tariffs and charges for electricity 2010-2013*, pp. 179-180. AEMC, *Review of the effectiveness of competition in electricity and gas retail markets in South Australia, First Final Report*, 19 September 2008. AEMC, *Review of the effectiveness of competition in electricity and gas retail markets in Victoria, First Final Report*, 19 December 2007.

Note: Importantly, barriers to entry and so the threat of new entry, are not included Figure 2.1. This was observed by ActewAGL Retail, who noted that barriers to entry were identified by the MCE as one of the six key indicators of the extent of competition in retail energy markets. The AEMC does not perceive an analysis of the barriers to entry to be a readily quantifiable measurement and therefore conducted a qualitative assessment in Chapter 5.4 of the Stage 1 Draft Report. ActewAGL Retail has suggested that the number of licensed retailers in each jurisdiction should have been included as an indication of the threat of entry. The AEMC does not agree that the number of licensed retailers provides an accurate indication of the barriers to entry that can be readily included in the diagram. However, if this were a measure, the analysis would suggest that the level of competition in the ACT lags behind Victoria and South Australia, with 19 licensed retailers in the ACT compared to 30 and 29 licensed retailers in Victoria and South Australia, respectively.

A summary of the AEMC's findings, covering each of the MCE criteria, is set out below. Stakeholder submissions in response to these draft findings have been considered in the preparation of this Stage 1 Final Report and are discussed within the relevant section of the following chapters (see also Appendix B).

2.1 Market structure

The market structure is not consistent with what would be expected in a market with effective competition, although certain demand-side characteristics of the market in themselves appear to be attractive to retailers. This finding is based on the following observations:

- although the ACT market is small, a number of characteristics such as, a relatively high average household consumption of energy (primarily as a result of the climatic conditions), winter peaking demand and high average incomes,[3] appear to make the market attractive to retailers;
- while there are 19 retailers licensed in the ACT, only four licensees have small customers, of which only two retailers are accepting new customers. Therefore, the ACT market is dominated by the incumbent retailer, which has maintained a total share of the market greater than 90 per cent since FRC was introduced;
- since full retail contestability (FRC) commenced, retailer rivalry has been limited and has weakened more recently. However, ActewAGL Retail's 'win-back' campaign in response to the increased level of retailer rivalry in 2006-07 suggests that it responds well to competitive pressures; and
- the unique characteristics of the market may make it difficult for second tier retailers to profitably enter into and expand within the market.

2.2 Market conduct

The conduct of retailer and consumer switching patterns are not consistent with a market that has effective competition. In considering the relevant MCE criteria, the AEMC has found that:

- there is little retailer rivalry, as evidenced by limited marketing, product offerings and price rivalry. The incumbent retailer is the only retailer marketing in traditional media, in addition to maintaining a significant amount of promotional activity;
- sixty per cent of surveyed consumers are aware that they can choose their retailer; however, this is low compared with both Victoria (94 per cent) and South Australia (82 per cent);
- there is a lack of awareness and understanding by customers of FRC; and
- customer switching from the incumbent to second tier retailers has decreased markedly since 2007 and remains low today.

2.3 Market performance

The performance of the ACT electricity market is not consistent with what would be expected to exist in a competitive market. Overall, however, customers appear to be satisfied with the retail services provided to them.

---

3 It is important to note that there are a significant number of low income households in the ACT.

In considering the relevant MCE criteria, the AEMC has found that:

- the actual margins available to second tier retailers may not be the same as those earned by ActewAGL Retail because of the unique characteristics of the market. Importantly, it appears that second tier retailers do not perceive the margins available to them to be sufficient to recover their costs and earn a rate of return that is commensurate with the risks and uncertainties of operating in the market over the long-term;

- the limited amount of retailer activity has resulted in a relatively low level of product innovation and offerings in the ACT retail electricity market, therefore, there is limited choice for customers; and

- customers appear to be satisfied overall by the quality of service in the ACT. This suggests that despite ActewAGL Retail's dominance, competitive pressure (that is, the threat of entry or expansion) has encouraged it to maintain a high quality of service. Additionally, most participants surveyed (in excess of 90 per cent) had never encountered any of the commonly identified retail problems, such as misleading marketing practices. However, there is a lack of awareness by consumers about the availability of independent assistance, should consumers have problems with their retailer. This is consistent with the number of complaints that the ACT Civil and Administrative Tribunal (ACAT) has received from non-hardship consumers, which has been low.

2.4 Compliance with social welfare and equity objectives

The AEMC has found that the social welfare and equity objectives relating to the supply of electricity in the ACT are clearly specified and are transparently funded. The various community service obligations operate in a manner that should not materially impede the effectiveness of competition in the retail supply of electricity to small customers in the ACT.

3 Framework for the analysis

This chapter summarises the policy and legislative framework that underpins the ACT Retail Review. It also sets out the indicators used in the analysis and their relevance to the MCE criteria in evaluating the effectiveness of competition.

3.1 Policy and legislative framework and the MCE criteria

Ongoing energy market reforms continue to introduce important changes to the structure and operation of Australian energy markets. The commitment of the Commonwealth, States and Territories to these reforms is reflected in the terms of the Australian Energy Market Agreement (AEMA).

One of the commitments made by each of the signatories to the AEMA is for the AEMC to assess the effectiveness of competition in the retail markets for electricity and gas for the purpose of retaining, removing or reintroducing retail price regulation. Where competition is found to be effective, the AEMC is to provide advice on ways to phase out retail price regulation.[4] Where competition is found not to be effective (as is the case in this Review), the advice must suggest ways to improve competition.

The reviews for Victoria (Victorian Review) and South Australia (South Australian Review) were completed in February 2008 and December 2008, respectively. On 10 July 2009, the MCE directed the AEMC to continue its program of reviews of the effectiveness of competition in the retail energy markets by considering the ACT in 2010, followed by New South Wales in 2011, Queensland in 2012 and then Tasmania in 2013 (if FRC has been implemented by that time).[5]

Each review is to follow the framework provided in clauses 14.10 to 14.16 of the AEMA. These clauses set out the structure that the AEMC must follow in reaching its conclusions. This requires, among other things, the AEMC to base its assessment of the effectiveness of competition on criteria developed through public consultation by the MCE.[6] The MCE criteria include:

- independent rivalry within the market;
- the ability of suppliers to enter the market;
- the exercise of market choice by customers;
- differentiated products and services;
- price and profit margins; and

4 AEMA, clause 14.11(a). The effectiveness of competition in Western Australia will be assessed by the Economic Regulation Authority.

5 MCE Communiqué, 10 July 2009.

6 AEMA, clause 14.11 (a)(i).

- customer switching behaviour.

On 16 December 2009, the MCE formally requested the AEMC to provide advice on the state of competition in, and retail price oversight for, electricity retailing in the ACT (Request for Advice). Consistent with the AEMA, the Request for Advice requires the AEMC to apply the MCE criteria in providing this advice. The Request for Advice is reproduced at Appendix B of the Issues Paper.[7]

The Request for Advice also requires the AEMC to use the methodology and approach detailed in chapters 2 and 3 of the Revised Statement of Approach (RSoA)[8] in conducting the retail competition reviews. The RSoA is outlined below.

3.2 Assessment framework in the Revised Statement of Approach

In order to assess the effectiveness of competition, the AEMC has to first determine an appropriate benchmark or reference point against which to assess the current and expected future state of competition. To undertake this assessment, the AEMC will have regard to the national electricity objective and the national gas objective where relevant. A range of market characteristics will also be considered, including: the extent to which market power is evident or not; the presence of co-ordinated conduct between rival firms; the quantity and quality of information disclosure; and the exercise of market choice by customers. As specified in the MCE criteria, these and other market characteristics will serve as important guides in determining the effectiveness of competition.

Market characteristics can be a useful indicator of the effectiveness of competition in a market. However, the conditions particular to an individual market may create circumstances where competition is effective outside a theoretical range. This view is reflected in the MCE criteria outlined above that the AEMC is required to consider in conducting this review. Accordingly, the AEMC will be guided by the market characteristics that are most likely to provide outcomes that are effective in delivering competitive markets. The AEMC is also mindful of the importance of incorporating quantitative and qualitative analysis into its assessment of competition. It is evident that there is no single criterion, nor pre-defined set of criteria, that can be applied to determine whether the level of competition within a market is effective. Understanding the level of competition in a market is dependent on the interaction of a number of interrelated factors.

Therefore, the AEMC has developed a series of quantitative and qualitative indicators that are based on the MCE criteria. It is against these criteria and indicators that the

7 AEMC, Review of the effectiveness of competition in the electricity retail market of the ACT - Issues Paper, 4 March 2010.

8 The AEMC prepared and published a Statement of Approach (April 2007), which was adopted for the Victoria Review and South Australia Review undertaken in 2008. Given the passage of time and developments that have since occurred, the Statement of Approach was updated for the forthcoming reviews. The RSoA (December 2009) is available from the AEMC's website.

AEMC will assess the degree to which the electricity retail market of the ACT is competitive.

While the AEMC has identified indicators that it will use to guide its analysis, it does not intend that the specific factors referred to in this RSoA amount to an exhaustive list of matters that it will have regard to for the purpose of these reviews. It is probable that each jurisdiction will have certain unique characteristics or trends that make relevant issues that are not referred to in the RSoA.

3.3 Relating the RSoA indicators with the MCE criteria

3.3.1 Market definition

In analysing the competitiveness of a market it is important to first define the relevant market. This sets the boundaries of the products that will be the focus of the review. The AEMC has defined the ACT market having regard to the following four dimensions: product; function; geographic; and temporal. These market definition dimensions will be considered at the commencement of the review for each jurisdiction.

3.3.2 Market structure

The market structure component of this review covers both the demand and supply-side aspects of the ACT electricity retail market. The following MCE criteria are considered in relation to market structure.

Consumer demand

This aspect of market structure focuses on consumer demand for electricity in the ACT. In particular, the demographics of small electricity consumers in the ACT market (that is, the number of households, temperature profiles in the ACT and seasonal aggregate demand) are considered. In doing so, the AEMC has had regard to the following indicators:

- the number, type and size of contestable customers, and changes in the number and size of those customers over time; and
- the seasonal demand patterns in the ACT.

Independent rivalry

Independent rivalry in the market looks at the number of electricity suppliers that are active in, or have been active in, the ACT market. The following indicators have been considered:

- the number, type and size of electricity suppliers, and changes in the number and size of electricity suppliers over time;
- market concentration indices; and
- the market shares of electricity suppliers, and changes to those shares over time.

Market barriers

In analysing market structure in relation to the ability of electricity suppliers to enter into and expand within the market, the AEMC has had regard to the following indicators:

- barriers to entry, including:
  - the extent and effect of economies of scale and scope;
  - access to the wholesale markets and risk management vehicles; and
  - the impact of regulated standing offer retail prices;
- barriers to expansion; and
- regulatory barriers.

3.3.3 Market conduct

Market conduct focuses on the behaviour of those individuals and entities participating in the market. As with market structure, both supply and demand-side aspects are considered. In doing so, the following MCE criteria are assessed.

Behaviour of electricity retailers

The behaviour of electricity retailers is an important measurement of rival conduct, that is, competition between electricity retailers in the ACT market. The behaviour of electricity retailers has been assessed with regard to the following indicators:

- marketing activities by electricity retailers within the market; and
- evidence of electricity retailers actively competing to obtain new and retain existing consumers.

The exercise of market choice by consumers

The demand-side aspect of market conduct will reflect how well consumers are placed to be active participants in the market. In considering market conduct in relation to the exercise of market choice by consumers, the AEMC has considered the following indicators, on which market research was conducted:

- consumer awareness of competition and choice; and
- the ease of obtaining, understanding and comparing information, including:
  - the extent and type of marketing activity undertaken by each electricity supplier; and
  - the extent of offers being sought and made by consumers.

Consumer switching behaviour

In addition to the amount of choices and information available to consumers, it is also important to consider the extent to which consumers act on that information and exhibit switching behaviour. In considering consumer switching behaviour, the following indicators from the RSoA have been considered:

- the number of consumers accepting market offers and/or switching retailers; and
- whether switches are by first tier (incumbent) or second tier (other) retailers.

3.3.4 Market performance

The performance of a market is a reflection of both its structure as well as the collective conduct of the participants acting in the market. Market performance has been assessed through the following MCE criteria.

Price and profit margins

An evaluation of market performance in relation to price and profit margins has also been considered. In doing so, the AEMC has evaluated the following indicators:

- evidence of changes in the retail price of electricity over time; and
- evidence of prices converging to an efficient long-term cost of supply.

Differentiated products and services

Another important component of market performance that the AEMC has evaluated includes:

- evidence that differentiated and innovative products and services are being offered to the market which meet customer preferences and needs.

Consumer satisfaction

In analysing the satisfaction of consumers in the ACT electricity retail market, the AEMC has had regard to the following indicators:

- the nature and frequency of customer complaints; and
- the nature of regulatory enforcement investigations.

3.3.5 Compliance with social welfare objectives

Clause 14.11(b) of the AEMA states that the AEMC must report on the social welfare and equity objectives available in the relevant jurisdiction. The AEMC has assessed whether these objectives are clearly specified and transparently funded by the ACT Government such that competition is not materially impeded.

4 Market definition

4.1 Introduction

In order to properly assess the effectiveness of competition in the ACT retail electricity market, it is first necessary to define the relevant market. The four key aspects to consider related to market definition include: product; function; geographic; and temporal.

This chapter summarises the analysis in the Stage 1 Draft Report related to these four aspects and the AEMC's findings based on that analysis. It then highlights the relevant submissions to the Stage 1 Draft Report in relation to market definition. Finally, the AEMC's final assessment on market definition is set out, taking into account the issues raised in the submissions.

4.2 Draft findings

The Stage 1 Draft Report provided an assessment on the definition of the market relevant to the ACT Retail Review using the framework utilised by the Australian Competition and Consumer Commission (ACCC) to evaluate the extent to which 'goods or services that are substitutable for, or otherwise competitive with, the goods or services under analysis'.[9] Specifically, four dimensions to the determination of product (a good or service) substitutability were assessed, which were: product; function; geographic; and temporal.

4.2.1 Product and function

Defining the relevant market for the ACT Retail Review required consideration of the product(s) that should be considered to be within the same market. From a consumer's perspective, this includes considering the substitutability and the functionality of the products. That is, whether the products can perform the same or similar functions and are consequently interchangeable.

Products are considered to be in the same market if sellers and buyers readily substitute between one product and another. While there may be some switching by consumers (buyers) from electricity to another energy source (such as gas) in response to price increases in the supply of electricity, the extent of this switching is rather limited. In terms of the functions and use of electricity for small end-users, there is no alternative product that is able to be a complete substitute for electricity supply.

The functional aspect of market definition has regard to the stages of production. In the electricity market there are several functional levels or stages of production the product (electricity) must go through before it reaches the end-user (for example, generation, transmission, distribution, and retail).

9 ACCC, *Merger guidelines*, November 2008, p. 15.

For the ACT Retail Review, the relevant stage of production is the retail supply of electricity to small end-users. The retail function is a distinct and different function from distribution, transmission and generation as it is able to be separated from the other functional levels in the supply chain.

4.2.2 Geographic

The geographic dimension of market definition is the physical area(s) over which the relevant product(s) are supplied and practically accessed by consumers.

The widest geographic area is the area covered by the National Electricity Market (NEM). However, a review of various retailer offers indicated that these are not NEM-wide. Instead, offers are particular to smaller geographic areas (often representing distribution network areas). One factor that may encourage this retailer behaviour is that each jurisdictional government requires retailers to obtain a licence to operate in that jurisdiction. In addition, certain legislative and regulatory requirements of a jurisdiction will result in suppliers of electricity offering certain products specific to that jurisdiction.

Additionally, discussions with retailers indicated that offers do not vary according to the geographic location of the end-user within the ACT. Nor did there appear to be any other differentiation of offers according to the demographic characteristics of small energy end-users.

Accordingly, the ACT Retail Review focuses on the geographic area of the ACT jurisdiction. It is within this area that retailers are required to comply with jurisdictional requirements that may influence the products on offer. It is also within this area that offers are made to all small electricity consumers and similarly, these end-users are confined to contracting with retailers licensed to operate within the ACT.

4.2.3 Temporal

The temporal dimension of market definition refers to the time over which suppliers and consumers of the relevant product(s) make substitution decisions.

To the extent that substitution can be made in response to a material increase in the price of electricity supply, the timing of these decisions for small electricity users is influenced by the need to replace relevant equipment (for example, the replacement of hot water heaters, cooking facilities and space heaters). As a consequence, in the short term, consumers may have a limited ability or interest to change from electricity to another form of energy.

However, in the long run, when energy consuming equipment can be changed, consumers have a greater capacity to respond to an increase in the price of electricity supply by switching energy sources. Notwithstanding the long run substitutability of energy sources such as gas for electricity supply, this substitutability is still weak and so small consumers will still require electricity. This suggests that even in the long run, alternative energy sources are not sufficiently close substitutes to widen the market definition beyond electricity supply.

Finally, the ability of consumers to change between electricity suppliers may be less restrictive. Small end-users that are supplied in accordance with the terms and conditions of the standing offer (regulated price) are able to select an alternative supplier fairly readily. Those end-users that have electricity services supplied via a negotiated or market contract may prefer to consider switching to an alternative supplier only when their contract expires. While this may mean waiting up to two years, it may be more preferable than paying exit fees to break a contract before its term ends. In this context, the temporal dimension of the market is the short to medium term as this is the likely time frame over which supplier substitution decisions can be made by small end-users.

Given the findings set out above, the AEMC concluded that the relevant market for the ACT Retail Review is the retail supply of electricity to small end-users within the ACT geographic area. This is relevant in both the short and long term.

4.3 Responses to draft findings

None of the submissions to the Stage 1 Draft Report raised any concerns regarding the AEMC's definition of the ACT electricity retail market.

4.4 Further analysis and conclusion

The AEMC has not undertaken any further analysis in relation to market definition.

Given that no stakeholders or other interested parties have expressed concern or made any recommendations regarding market definition, the AEMC maintains its draft finding that the relevant market for the ACT Retail Review is the retail supply of electricity to small end-users within the ACT geographic area (both in the short and long term).

5 Market structure

5.1 Introduction

An assessment of market structure requires consideration to be given to both the demand and supply-side aspects of the ACT electricity retail market. Specifically, the following MCE criteria related to market structure needs to be considered:

- consumer demand (including changes in consumer demand over time);
- independent supplier rivalry (including changes in the number of retailers operating in the market over time); and
- the ability of suppliers to enter and expand in the market (including an analysis of barriers to entry and expansion).

This chapter summarises the AEMC's assessment of these criteria in the Stage 1 Draft Report. Where relevant, submissions to the Stage 1 Draft Report are considered and then the AEMC provides its final findings on the structure of the market.

5.2 Market demand

The Stage 1 Draft Report started with an examination of the demand-side of the ACT electricity retail market by providing background on the number, type and size of contestable customers in this market and changes over time. In addition, variations in the effectiveness of competition for different customer segments in the market (for example, differences by geographic location, type or size of customers) were considered. This analysis is summarised below.

5.2.1 Draft findings

The ACT is a relatively small market given its comparably small population and number of potentially contestable electricity customers. As at September 2009, the ACT had just over 350 000 residents. This compares to approximately 7.2 million residents in NSW, 5.5 million in Victoria, 4.5 million in Queensland, 1.6 million in South Australia, and 500 000 in Tasmania.

Unlike other jurisdictions, the ACT is comprised almost entirely of urban customers. The ACT's 350 000 residents equate to approximately 150 000 small customers (comprising of households and small businesses) and approximately 1 500 large customers.[10]

10 In comparison, there are approximately 3.1 million small customers in NSW, 2.4 million in Victoria, 1.9 million in Queensland, 800 000 in South Australia, and 200 000 in Tasmania. Australian Energy Regulator (AER), *State of the energy market*, 8 December 2009, p. 194.

Similarly, the ACT is a relatively small market in terms of total electricity consumed when compared to other jurisdictions. In 2008-09, about 3 000 GWh of electricity was consumed in the ACT.[11] This compares to approximately 73 000 GWh in NSW, 47 000 GWh in Victoria, 50 000 GWh in Queensland, 14 000 GWh in South Australia, and 11 000 GWh in Tasmania.

While the ACT market is relatively small, it is a geographically concentrated pool of customers. In addition, the comparably high per customer electricity demand as a result of the relatively cold winters and warm summers could be considered attractive. Residential customers in the ACT typically consume about 8 000 kWh per year of electricity (up from 7 500 kWh in 2006) while the average small customer in NSW consumes approximately 7 000 kWh annually and the typical household in Victoria consumes about 6 500 kWh per year.[12]

Another potentially attractive characteristic of the ACT market is that the average weekly earnings are relatively high. As at February 2010, the seasonally adjusted average weekly earnings in the ACT was $1 177 per person compared to $983 in NSW and $922 in Victoria.[13] A relatively high average income could imply a greater propensity to consume electricity and possibly lower risk associated with bad debt. However, these market features are also dependent on the number of low income customers.[14]

Overall, several retailers indicated that the ACT is an attractive market because they consider that:[15]

- despite its relatively small size, there are enough customers to make entry viable and warrant competitive pursuit;
- there is particularly large energy demand during the winter;
- the geographic concentration of customers presents logistical benefits in terms of mobilising sales teams;
- the ability to provide electricity and possibly other services to politicians and government decision makers has the potential to increase their corporate profile; and

---

11 Australian Energy Market Operator (AEMO), *Electricity statement of opportunities*, August 2009, Appendix B. Note, AEMO published its 2010 Electricity Statement of Opportunities with revised data on 31 August 2010.

12 The annual consumption in NSW has been changed from the 5 600 listed in the Stage 1 Draft Report based on information provided in IPART's 2010 final determination. See: IPART, *Review of regulated retail tariffs and charges for electricity, 2010-13 - Final Report*, March 2010, p. 7.

13 ABS, *Average weekly earnings*, cat. no. 6302.0, 20 May 2010, table 12.

14 Importantly, the ACT also has over 22 000 households receiving the Energy Concession. This represents approximately 17% of all ACT households. Department of the Environment, Climate Change, Energy, and Water (DECCEW), *Draft sustainable energy policy 2010-2020*, December 2009, p. 19.

15 GA Research Retailer Interviews, pp. 34-35

- incomes are relatively high in the ACT which is seen to be beneficial both in terms of propensity to consume more energy and lower risk associated with credit issues.

Finally, the RSoA requires the AEMC to determine whether there are variations in the effectiveness of competition for different customer segments in the market (for example, differences by geographic location, type or size of customers). No differences between customer segments have been identified. Notably, there do not appear to be any differences in tariffs available to small customers.

The characteristics of the ACT which influence electricity demand are such that, in the absence of barriers, it is likely to be an attractive market for competitive retailers even though there are a relatively small number of customers.

5.2.2 Responses to draft findings

Care Inc, ACTCOSS and Uniting Care Australia (Consumer Agencies) questioned the AEMC's Stage 1 Draft finding that the ACT is an attractive electricity market for retailers. Specifically, the Consumer Agencies noted 'while average income in the ACT is high, living costs in the ACT are also high, and higher incomes are not evenly distributed, with a significant number of households being on low or modest income and unable to meet all living costs currently.'[16]

5.2.3 Further analysis and conclusions

The AEMC has considered the Consumer Agencies' comment that despite relatively high incomes in the ACT, there is still a significant number of low income households. However, as highlighted above, the relatively high incomes in the ACT was just one of the many factors driving the AEMC's finding that the demand characteristics of the ACT are likely to be attractive to retailers. Additionally, in section 8.2, the AEMC compares the Energy Concession available to low income consumers in the ACT to other jurisdictions and finds it to be more generous than a number of other jurisdictions, which should assist low income households to pay their electricity bills. On balance, the AEMC has found that if it were less difficult for second tier retailers to enter and expand within the market (for example, if customer stickiness were reduced), the market demand characteristics suggest that the ACT is likely to be an attractive market for retailers.

5.3 Market supply

This section summarises the discussion in the Stage 1 Draft Report pertaining to market supply and independent rivalry.

16 Consumer Agencies' submission, 27 September 2010, p. 6.

5.3.1 Draft findings

The Stage 1 Draft Report looked at the supply-side of the ACT market by focussing on the electricity retailers that are active in, or have been active in, the ACT since FRC was introduced for small customers. In addition, historical market shares and concentration indices were examined to assist in the evaluation of the effectiveness of retail competition. Each of these supply-side elements are summarised below.

Retailers in the ACT

The number of firms providing electricity retail services in the market is an important consideration for this Review. This is because it is generally true that a market comprising a larger number of suppliers (all other things being equal) is likely to be more competitive than a market with fewer suppliers. In 2003, there were 13 businesses licensed to provide electricity retail services.[17] Since that time, the number of firms holding retail licences in the ACT has increased to 19 (see Appendix C of the Stage 1 Draft Report for more information on these retailers).[18]

Despite the number of licence holders increasing overall since FRC commenced on 1 July 2003, the number of active retailers has actually fallen. In April 2006, ActewAGL Retail, Country Energy and EnergyAustralia were active in the residential market,[19] and by June 2008, TRUenergy had also started actively competing for customers.[20] However, by April 2009, Country Energy and EnergyAustralia were both no longer accepting new customers, although they have continued to provide retail services to their existing customers.[21] Currently, ActewAGL Retail and TRUenergy are the only two retailers in the ACT accepting new customers. However, TRUenergy has indicated that it has discontinued all proactive marketing activities to attract new customers and currently relies on passive marketing on the internet.[22]

Importantly, it appears that several inactive retailers maintain licences in the ACT to allow them to enter into the market quickly in the event that there is a significant change in the market environment.[23] Additionally, several of these retailers provide retail services to large customers in the ACT which necessitates a licence.

In summary, despite the number of licensees in the ACT, there are and have been limited supplier alternatives for small electricity customers.

---

17 ICRC, Annual Report 2003-04, September 2004, p. 23

18 It is important to note that all of these retailers are also licensed in other jurisdictions and that maintaining an ACT retail licence does not necessarily imply that the retailer is active in this market.

19 AER, *State of the energy market 2007*, 26 July 2007, p. 175.

20 AER, *State of the energy market 2008*, 20 November 2008, p. 174.

21 AER, *State of the energy market 2009*, 8 December 2009, p. 198.

22 TRUenergy submission, 9 April 2010, p. 3.

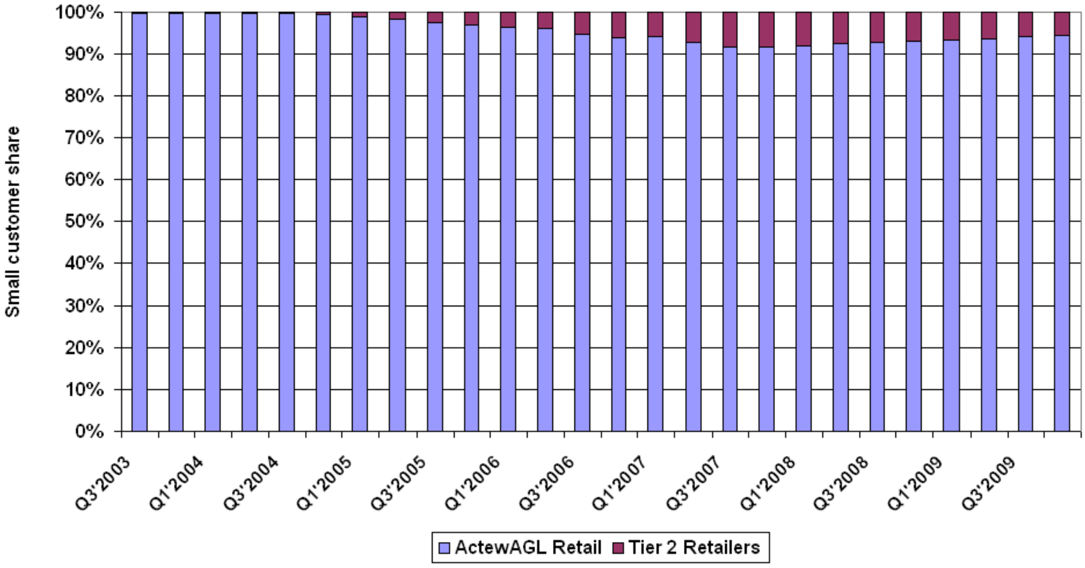
23 The AEMC also understands that the 2010-11 annual licence fee for retailers not supplying electricity in the ACT is $3 106. For more information see: http://www.icrc.act.gov.au/utilitieslicensing/licence_fees_and_energy_industry_levy.

Retailer customer shares

To help assess whether competition is effective, it is necessary to understand the extent to which new retailers have been able to attract customers to switch away from ActewAGL Retail since FRC commenced. The relative customer share of retailers operating in the ACT can significantly impact competitive outcomes since retailers with large customer shares may be able to maintain and attract customers better than a smaller new entrant.

As shown in Figure 5.1 below, during the period Q3'2003 to Q3'2007 ActewAGL Retail's share of the small customer segment steadily eroded. This was mostly as a result of EnergyAustralia's increased presence in the market. ActewAGL Retail's customer share reached its lowest point during Q3'2007 when it was providing electricity retail services to 91.6 per cent of the small customers in the market.[24] During that quarter, EnergyAustralia had 6.1 per cent of the market, TRUenergy had 1.8 per cent of the market, and the remaining retailers together held less than one per cent of the total.

Figure 5.1 Share of small customer market, 2003-2009



Source: AEMC calculations from AEMO MSATS data.

However, competitiveness in the small customer market did not continue to develop. From late 2007 until the present, TRUenergy has maintained its 1.8 per cent share while EnergyAustralia's customer share has steadily declined. As at Q4'2009, EnergyAustralia was providing electricity retail services to 3.6 per cent of the market, TRUenergy supplied 1.7 per cent of the small customers and the remaining tier two retailers continued to account for less than one per cent.[25]

24 A similar trend is also evident in the large customer segment outlined in Box 5.1 below.

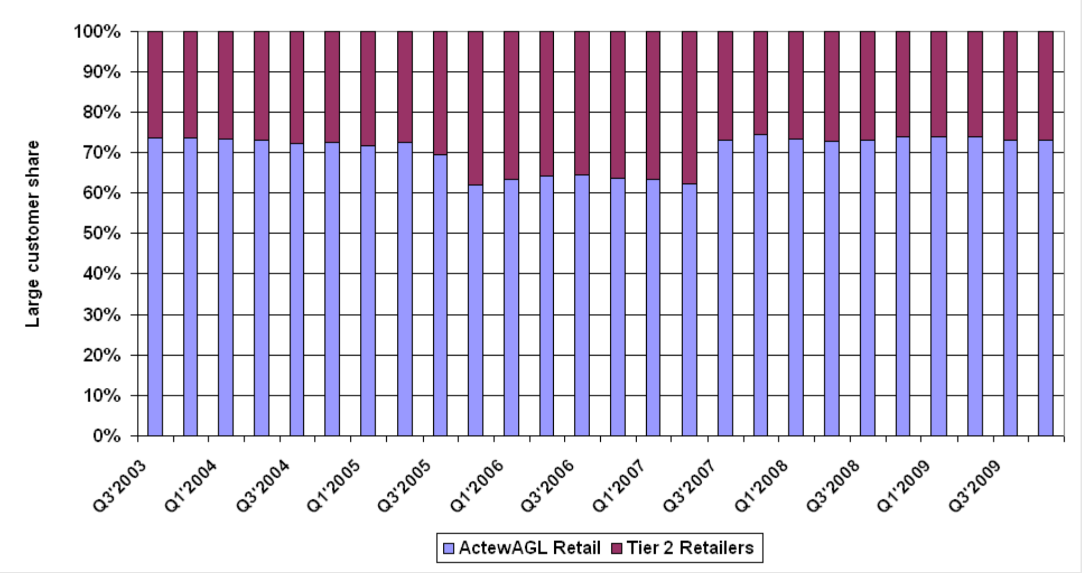
25 Country Energy, Integral Energy and the AGL businesses are the only other retailers that have had any noticeable presence in the small customer market. However, none of these firms have provided services to more than 0.3 per cent of the market in any given quarter since FRC.

This all suggests that rivalry among electricity retailers in the small customer market has been limited since the introduction of FRC and has weakened further since EnergyAustralia and Country Energy stopped accepting new customers and TRUenergy discontinued active marketing activities. This level of rivalry has not resulted in substantial reductions in the proportion of customers supplied by the host retailer, ActewAGL Retail. Notably, ActewAGL Retail's customer share has never fallen below 91.6 per cent since 2003.

Box 5.1: Large customer segment

While the scope of this Review does not require an analysis of the large customer segment of the electricity retail market, it is worth noting that tier two retailers have had much more success attracting customers away from ActewAGL Retail in this segment. As shown in Figure 5.2 below, ActewAGL Retail's large customer share has ranged between 61.9 per cent and 73.4 per cent during the period Q3'2003 to Q4'2009.

Figure 5.2 Share of large customer market, 2003-2009



Source: AEMC calculations from AEMO MSATS data.

By comparison, Integral Energy's quarterly share was negligible until Q3'2005 when its customer share jumped up to 5.7 per cent and then 12.6 per cent in the following quarter. Integral Energy continued to provide retail services to a significant number of large customers until Q3'2007 when it all but exited the market, its share dropping to approximately one per cent. In addition, the customer share of the AGL businesses, Origin Energy businesses and Country Energy have ranged between three per cent and eight per cent throughout this period. EnergyAustralia's share has been between 1.8 per cent and 6.2 per cent (the lowest occurring most recently), while TRUenergy's share has varied between 0.7 per cent and 4.6 per cent over the same period.

In summary, tier two retailers have had greater success in entering the large customer segment of the ACT electricity market. This could, in part, be due to the fact that all large customers are on negotiated contracts, some on a national basis, and as a result may be much more aware of the market offers available to them in comparison to small customers. However, the trend post 2007 is similar to that seen in the small customer segment.

Market concentration indices

There are several economic tools that can be used to assess the likely impact that the number of firms and their market shares have on the competitive nature of the market. The two most commonly accepted concentration measurements are the x-firm concentration ratio (CRx) and the Herfindahl Hirschman Index (HHI). These economic tools can provide an indication as to whether the market is concentrated. That is, the measures may suggest there are low levels of competition (if the majority of market share is held by a small number of firms). Alternatively, if the market is less concentrated, the measures may suggest higher levels of competition if the market is more equally divided between a large number of firms.

Since FRC was introduced, the three-firm concentration ratio (CR3) and four-firm concentration ratio (CR4) for the ACT small customer segment of the electricity supply market have not fallen below 99.5 per cent and 99.7 per cent respectively.[26] These extremely high ratios are the result of ActewAGL Retail's significant customer share, which has never fallen below 91.6 per cent, and that the other retailers have gained only a limited share of the market. These ratios suggest that the ACT retail market for small customers is extremely concentrated.

Like the CRx measures, the HHI[27] indicates that the ACT small customer electricity retail market is significantly concentrated with a minimum HHI of approximately 8 500 throughout the period Q3'2003 to Q4'2009 (the HHI can range between 0 and 10 000 depending on the number of firms operating in the market and their relative sizes). Following the pattern of ActewAGL Retail's customer share (as noted earlier), the HHI steadily declined until Q3'2007. The HHI then started to rise and as at Q4'2009, the HHI was approximately 8 925.[28]

In brief, retailer rivalry in the ACT electricity retail market has been limited in the past and could now be described as weak. An analysis of historical market shares and concentration indices has suggested that the ACT does not exhibit the characteristics of an effectively competitive market. Notwithstanding the above, tier two retailers have had greater success in entering the large customer segment of the ACT electricity market although it is still dominated by ActewAGL Retail.

---

26 The CR3 includes ActewAGL Retail, EnergyAustralia and TRUenergy. The CR4 also includes either Country Energy or the AGL businesses (depending on the quarter).

27 A measure of market concentration often used by the ACCC when assessing the potential impact a merger may have on the market. It will generally be less likely to identify competition concerns when the HHI is less than 2 000.

28 ACCC, *Merger guidelines*, November 2008, p. 37.

5.3.2 Responses to draft findings

The AEMC did not receive any submissions that explicitly commented on supply to the small customer segment, market share or concentration indices. However, the ICRC did comment on the observations made about the large customer segment. In particular, the ICRC suggested that the behaviour of ActewAGL Retail and tier two retailers in the unregulated large customer segment of the market should be further analysed by the AEMC. Primarily, the ICRC considered that as no regulated prices are set in the large customer segment, the 'apparent withdrawal of some of these larger retailers from the ACT market post 2007' should be addressed.[29] Furthermore, the ICRC queried 'what has caused this major change in approach, and to what extent were the factors that influenced these decisions by major retailers also reflected in their decisions in terms of the household market in the ACT?'.[30]

5.3.3 Further analysis and conclusions

No further analysis has been undertaken by the AEMC on market share or concentration in the small customer segment for the Stage 1 Final Report. However, the questions regarding the large customer segment raised by the ICRC have been considered. As noted in the Stage 1 Draft Report, second tier retailers may have been more successful in entering the large customer segment because all large customers are on negotiated contracts, some on a national basis, and therefore are likely to be more aware of market offers compared to the small customer segment.[31]

However, the pattern of second tier retailer market shares is similar in both the small and large customer segments. This suggests that there are common market constraints. For example, it is possible that ActewAGL Retail's economies of scale and scope as well as its historical presence as the incumbent retailer and distributor have made it difficult for second tier retailers to attract customers away from ActewAGL Retail in both segments of the market. Additionally, the size of the market is small so there is a limited number of customers over which fixed costs can be spread.[32] As a result, it could be that prior to the electricity price spike in mid-2007, the margins available to second tier retailers in the large customer segment of the ACT electricity market were already quite low (as a result of competing with ActewAGL Retail).

It is possible that after mid-2007, retailers such as Integral Energy and EnergyAustralia exited the large customer segment of the market because they no longer perceived the margins to be sufficient to account for the risks of supplying electricity (including the possibility of future price shocks), given their hedging and generation arrangements. Notably, AGL's generation assets may provide ActewAGL Retail with greater stability during price spikes than retailers that do not have a similar relationship (this could

29 ICRC submission, 31 August 2010, pp. 4-5.

30 ibid. p. 5.

31 See section 5.3.2 of the Stage 1 Draft Report for further information.

32 See section 5.4.3 for a more detailed discussion of the market constraints in the small customer segment.

include Integral Energy and EnergyAustralia). Additionally, it is possible that retailers with limited generation resources shifted into other markets where they believed higher returns were achievable.

Having said that, the risks of providing retail services in the unregulated large customer segment of the market are lower than those in the regulated small customer segment. This is because regulated prices will almost always be imperfect substitutes for prices determined by the competitive processes of a market. Notably, when setting prices, regulators are constrained by both imperfect information and the frequency in determinations. As a result, there is a regulatory risk in the small customer market that retailers get stuck (that is, having made investments to acquire customers) providing retail services to recover those investments at prices that do not accurately reflect their costs.

However, there is still a risk that prices do not accurately reflect costs in the large customer segment because costs could increase after the market prices have been set. Notwithstanding, there is greater flexibility in determining prices and so the prices are likely to be more responsive to changes in costs. As a result, retailers in both segments of the market consider future margins and risks when deciding whether to enter into or expand within a market. Having more control over prices and the overall higher level of consumer awareness of FRC in the large customer segment, are likely to be the reasons why second tier retailers have historically had more success entering into and expanding within the market.

Finally, even though NSW and the ACT are part of the same NEM market, it is possible that the margins Integral Energy and EnergyAustralia are able to achieve in the large customer portion of the ACT are lower than in the small customer portion of NSW where they are the incumbent retailers. Notably, in NSW these two retailers are protected from price increases through the Electricity Tariff Equalisation Fund (ETEF), which is designed to manage wholesale electricity pool purchase cost risk for government owned retailers that are required to supply electricity to small customers in NSW.[33]

In summary, there appear to be common market constraints in the small and large customer segments of the ACT electricity market, which could be limiting the margins available to second tier retailers. However, it appears that the margins were sufficient to attract entry and expansion (especially in the large customer segment where there are relatively lower risks because prices are not regulated) prior to the electricity price spike in 2007. However, since that time, it appears that the margins available to some second tier retailers (for example, Integral Energy and EnergyAustralia) are no longer sufficient to account for the risks of supplying electricity (including the possibility of future price shocks), given the unique characteristics of the market and their hedging and generation arrangements.

Nevertheless, the AEMC maintains its draft finding that supplier rivalry in the ACT electricity retail market for small customers has been limited in the past and could now

33 Frontier Economics, *Analysis of recent changes in NEM wholesale electricity prices*, May 2007, p. 2.

be described as weak. In addition, an analysis of historical market shares and concentration indices, especially post 2007, suggests that the ACT does not exhibit the market supply characteristics of an effectively competitive market.

5.4 Ability of suppliers to enter and expand in the market

The final segment on market structure in the Stage 1 Draft Report focussed on the ability of suppliers to enter into, and expand within, the ACT electricity retail market. This discussion is summarised below.

5.4.1 Draft findings

As discussed above, to date, entry into and expansion within the ACT electricity retail market for small customers have been limited as few retailers have actively participated in the market. In addition, those that have entered have had little success attracting customers away from ActewAGL Retail. It is therefore important to consider the barriers to entry into, and expansion within, the ACT electricity retail market that may be impeding competition.

The most commonly cited barrier to entry and expansion identified through interviews with retailers was the level at which the ICRC sets the regulated TFT. Several retailers stated that the TFT is set too low to allow sufficient returns to justify entering into and expanding within the market. There appear to be two main reasons for this view, namely:

- the cost build up of the TFT is based on the efficient costs of ActewAGL Retail and therefore does not include an allowance to recover the costs retailers incur to acquire new (and retain existing) customers; and
- the amount allocated to recover wholesale electricity costs has not been sufficient to account for the risks and uncertainties related to the wholesale electricity market.

These two potential barriers are examined in greater detail below.

The exclusion of customer acquisition (and retention) costs

The regulatory approaches used to determine an appropriate allowance for retailers to recover the cost of supplying customers vary between jurisdictions depending on the terms of reference and statutory requirements of each regulator.

Notably, the ICRC does not explicitly have a separate customer acquisition cost (CAC) or customer acquisition and retention cost (CARC) allowance in its cost build up of the retail operating costs (ROC).[34] A CAC allowance is intended to recover the costs associated with acquiring new customers in a competitive market, such as marketing costs and the costs of transferring customers. Similarly, a CARC allowance is to recover the costs of acquiring new customers and the retention of existing customers. All else being equal, CARC is lower than CAC.

Importantly, the ICRC's terms of reference require it to set prices to allow for the recovery of the efficient costs incurred by the incumbent retailer, ActewAGL Retail. Additionally, the terms of reference for the determination of the TFT focus on a combination of economic efficiency and equity objectives. Notably, the ICRC must have regard to s. 20 of the ICRC Act, which includes (among other things) the social impacts of the decision (s. 20(g)).[35]

The ICRC has considered whether or not to include a CAC or CARC allowance on several occasions. However, given its legislative requirements and its terms of reference, the ICRC has always decided to set a price based on ActewAGL Retail's costs (excluding CAC/CARC) rather than a price based on the costs that a new entrant and/or stand-alone retailer would likely incur.

Several retailers consider that the exclusion of a CAC/CARC allowance from the calculation of the TFT creates a barrier to entry and expansion within the ACT electricity retail market. An analysis undertaken by the Allen Consulting Group (ACG) suggested that the exclusion of an allowance for CAC/CARC in the TFT results in very low effective margins for tier two retailers (assuming that any offers they make are priced to compete with the regulated price). These low effective margins result in the ACT small customer retail electricity market appearing unattractive to enter into or expand within for these retailers.[36]

Wholesale electricity cost (WEC) allowance

The other major criticism of the TFT from retailers is that the WEC allowance in the TFT cost base is said not to be sufficient to account for the risks and uncertainties associated with purchasing wholesale electricity. Several retailers indicated that wholesale electricity prices increased substantially in mid-2007 and the WEC allowance did not accurately reflect the full electricity costs that retailers had to incur to participate in this market.[37]

Therefore, retailers are concerned about their ability to manage wholesale electricity costs. As a result of their concerns, the WEC allowance in the ACT may be influencing the behaviour of the retailers and could therefore be described as a barrier to entry.

---

34 Instead an allowance for sales and marketing costs to communicate the TFT arrangements, a component of CAC/CARC, has been included.

35 *Independent Competition and Regulatory Commission Act 1997* (ACT). See Chapter 8 for further discussion.

36 However, in the ICRC's submission to the Stage 1 Draft Report (p. 7), it commented that including a CAC/CARC allowance would be at the lower end of the range of price increases that retailers have identified as being required before they will enter into and expand within the market.

37 ACG, Price and Profit Margin Analysis Report, July 2010, p. 15.

Other potential barriers

Several other potential barriers to entry and expansion within the ACT electricity retail market were identified by stakeholders in the initial stages of the ACT Retail Review. These include:

- the relatively small size of the ACT market compared to other jurisdictions;
- ActewAGL Retail is dominant in the market as well as its bundling power across utilities;
- the inflexibility in how ActewAGL negotiates network use of system agreements;
- the credit requirements of ActewAGL Distribution;
- the obligation to supply customers;
- additional compliance and administrative costs in the ACT;
- the requirement to administer the feed-in tariff and its associated costs; and
- requirements to offer green products.

However, the relative importance placed on these potential barriers suggested that none of these other barriers were insurmountable and/or a problem limited to the ACT.

On balance, the Stage 1 Draft Report found that the barriers associated with the level of the TFT (including, the exclusion of an allowance for CAC/CARC and whether the WEC is calculated and structured to accommodate the risks and uncertainties in the wholesale electricity market) were the most significant for tier two retailers. The indications were that concerns surrounding these two barriers were influencing the behaviour of retailers to the extent that they were placing limited constraining factors on the behaviour of the incumbent retailer, ActewAGL Retail. That is, retailer concerns about the level of the TFT may be ultimately stifling the development of effective competition.

5.4.2 Responses to draft findings

This section provides a summary of the submissions to the Stage 1 Draft Report in relation to the ability of suppliers to enter and expand in the market. These submissions can be broadly grouped into two categories, including:

- the regulated price and the corresponding margins available in the market; and
- the unique characteristics of the ACT market (for example, customer stickiness and the ACT's feed-in tariff scheme).

The following submissions relate to the ACT's regulated prices and the corresponding margins.

Regulated price and the corresponding margins

Origin Energy agreed with the AEMC's conclusions that the 'ACT retail electricity market is subject to barriers to entry and that, primarily, the regulated tariff is set at a low level that has the effect of eliminating sufficient margins for a new entrant to recover its entry costs over a reasonable period of time'.[38]

Similarly, the Energy Retailers Association of Australia (ERAA) considered that the 'ACT's low regulated retail tariff is the single most significant barrier to developing effective competition'. Notably, the 'absence of customer acquisition and retention costs in the determination of the TFT does not allow sufficient head-room for competitors to enter the market and compete for customers in the ACT'.[39]

In addition, the Energy Supply Association of Australia (ESAA) stated that 'if retailers cannot be confident of recovering costs incurred in acquiring customers ... and making a commercial return, the incentive to enter markets and compete for customers is diminished'.[40] Origin Energy also observed that 'if the regulated retail price in the ACT does not reflect the marginal cost of customer acquisition, it will likely have a detrimental effect on competitiveness and consumer choice'.[41]

Finally, the ICRC noted that 'consideration should also be given to the actual dollar value of the ROC allowance made by the ICRC by comparison to other jurisdictions.[42]

Unique characteristics of the ACT market

There were also several submissions pertaining to the unique characteristics of the ACT retail electricity market. These are summarised below.

The ICRC stated that the AEMC 'does not appear to have critically analysed other possible factors influencing the decisions of retailers to enter or actively compete in the ACT market'.[43] Specifically, it commented that while a number of factors have been identified, these have been 'put aside as secondary to the CAC/CARC issue [and] in support of this view, the AEMC has relied heavily upon comments received in its retailer interviews undertaken by Roy Morgan [sic]'.[44]

TRUenergy stated that in relation to the dominant position of ActewAGL Retail, '[its] historical role, and continuing community support has resulted in a strong level of

38 Origin Energy submission, 27 August 2010, p. 1.

39 ERAA submission, 1 September 2010, p. 1.

40 ESAA submission, 27 August 2010, p. 3.

41 Origin Energy submission, 27 August 2010, p. 1.

42 ICRC submission, 31 August 2010, p. 5.

43 ibid, p. 3.

44 ibid.

brand loyalty, which while not anti-competitive in itself, does provide [an] incumbent advantage'.[45] In addition, Origin Energy noted that the 'structure of the ACT retail electricity market, with a single vertically integrated incumbent holding a dominant market share, is unique in Australia'. Therefore, Origin Energy has highlighted that the 'current ring-fencing arrangements in the ACT may require additional consideration in the context of facilitating effective competition'.[46]

While the removal of price regulation was seen as constructive in promoting a national electricity market, the ESAA considered that 'even without price regulation, a number of ACT specific factors will remain that retailers will have to accommodate, such as the feed-in tariff regime'.[47]

TRUenergy also considered the feed-in tariff scheme to be 'another disincentive for retailers to enter the ACT market'. Noting that the ACT scheme is more complex as it guarantees eligible customers a set feed-in rate (based on year of installation) for 20 years, which adds cost to retailers for any system changes and information to customers.[48]

5.4.3 Further analysis and conclusions

There was a significant amount of discussion in the Stage 1 Draft Report regarding barriers to entry and expansion without a clear definition of what these are. Therefore to provide clarity to stakeholders, this section begins with an economic definition of barriers to entry and expansion. Having said that, there is quite a bit of debate between economists over the correct definition. A reasonable definition is a 'set of structural, institutional and behavioural conditions that allow incumbent firms to earn economic profits for a significant length of time.'[49] Regardless of whether this definition is correct, the fact remains that more than seven years after FRC was introduced, retailer rivalry in the ACT electricity market is weak (as set out in Section 5.3). This suggests that there are market constraints limiting effective competition.

The Stage 1 Draft Report concluded that the level of the TFT (notably as a result of setting prices based on ActewAGL Retail's efficient costs and excluding an allowance for CAC/CARC) is the most significant barrier restricting effective competition in the ACT retail electricity market. As highlighted above, this conclusion was supported by several stakeholders in their submissions to the Stage 1 Draft Report. However, as pointed out by the ICRC, the AEMC's analysis in the Stage 1 Draft Report focussed heavily on the level of the TFT and the exclusion of CAC/CARC, while setting aside other factors (that is, the unique characteristics of the ACT market) that could be influencing whether or not second tier retailers decide to enter into and expand within the market.

45 TRUenergy submission, 3 September 2010, p. 2.

46 Origin Energy submission, 27 August 2010, p. 3.

47 ESAA submission, 27 August 2010, p. 4.

48 TRUenergy submission, 3 September 2010, p. 2.

49 The New Palgrave Dictionary of Economics Online, 2010, www.dictionaryofeconomics.com.

Upon further consideration, the AEMC has found the situation to be much more complicated than set out in the Stage 1 Draft Report. Notably, the AEMC has found that the actual margins available to second tier retailers may not be the same as those earned by ActewAGL Retail because of the unique characteristics of the ACT market (for example, customer stickiness).

Additionally, given that retailers are not entering into or expanding within the market, it appears that second tier retailers do not perceive the margins to be a sufficient rate of return that is commensurate with the risks and uncertainties of operating in the market over the long-term.

In response to the ICRC's comment, the purpose of this analysis is to explore the unique characteristics of the ACT retail electricity market in greater detail. In doing so, the AEMC investigates the reasons why the second tier retail margins are likely to be lower than the regulated margins set by the ICRC. This analysis begins with a comparison of the ACT's regulated price to other jurisdictions.

Regulated price comparison

The fact that the regulated price in the ACT is lower than any other jurisdiction is not sufficient to conclude that the TFT is set too low to encourage retailers to enter into and expand within the ACT retail electricity market. This is because the individual characteristics of each market are different. Importantly, the non-retail cost elements included in the regulated price (for example, network costs) vary significantly across jurisdictions (and even across distributors in the same jurisdiction).

For example, an independent cross-jurisdictional comparison of standard offer prices for small customers undertaken by the Office of the Tasmanian Economic Regulator (OTTER) shows that when the approximate network use of system (NUOS) charges are removed from the regulated prices, there is much greater harmonisation across jurisdictions in the portion of the prices remaining (especially between the jurisdictions in the NEM) - Table 5.1. This means that the ACT has relatively low NUOS charges.

Table 5.1 Comparison of prices available to residential customers on regulated tariffs or standing offer contracts

Jurisdiction	Price range at jurisdiction average consumption (c/kWh)	Approximate NUOS charge as a percentage of final customer bill (%)	Approximate NUOS charge (c/kWh)	Price range at jurisdiction average consumption excluding approximate NUOS charge (c/kWh)
ACT	16.3	44.9	7.3	9.0
Victoria	17.5 - 22.7	38.0	7.6	9.9 - 15.1
Tasmania	19.3 - 20.9	56.8	11.4	7.9 - 9.5
NSW	19.3 - 26.2	48.2	11.0	8.3 - 15.2
Queensland	19.5 - 20.6	48.8	9.8	9.3 - 10.4
South Australia	20.2 - 25.4	43.1	9.8	10.1 - 15.3
Northern Territory	20.8 - 21.0	30.0	6.3	14.5 - 14.7
Western Australia	21.7 - 23.0	34.2	7.7	14.0 - 15.3

Sources: OTTER, *Comparison of 2010 Australian standing offer energy prices*, Fact sheet - 9 September 2010, ESCOSA, *2010 Review of retail electricity standing contract price path - Draft inquiry report and draft price determination*, 6 September 2010 (ESCOSA Draft Pricing Determination 2010), IPART, *Final determination - Review of regulated retail tariffs and charges for electricity 2010-13*, 18 March 2010 (IPART Final Pricing Determination 2010), QCA, *Final decision - Benchmark retail cost index for electricity: 2010-11*, 28 May 2010 (QCA Final Pricing Determination 2010), ICRC, *Final report - Retail prices for non-contestable electricity customers 2010-12*, 11 June 2010 (ICRC Final Pricing Determination 2010) and AEMC calculations.

Note: This table should be used for illustrative purposes only. Notably, the network charges have been approximated. Additionally, the prices are unlikely to be equal to the total cost allowances set out in the 2010-11 pricing determinations in each jurisdiction. Instead, these are the prices for customers on standing offer contracts at the jurisdiction's average consumption. Customers are typically charged in the form of two-part tariffs including both a fixed (per day) and variable (per kWh) components and the prices shown above are the average prices per kWh. The AEMC understands that regulators ensure that these prices comply with their weighted average price cap formulas. This allows for some variation in the individual prices, provided that the weighted average is within the regulated cap.

While this table is useful for illustrative purposes, it is more relevant to compare the retail allowance (that is, the ROC allowance, CAC/CARC allowance and margin) available to retailers in the ACT to those in other jurisdictions (Tables 5.2 and 5.3 below). This is because, assuming the WEC allowance is an accurate reflection of actual wholesale electricity costs, the retail allowance is the amount that incumbent retailers receive for the provision of their services in the market (although certain risks are accounted for in the WEC allowance in some jurisdictions).

As a result, the retail allowance influences whether or not second tier retailers enter into and expand within a market because it needs to be sufficient (or perceived to be sufficient) for retailers to recover their costs and provide a return that is commensurate with the risks involved in supplying electricity in the market over the long-term (that is, the profit margins must adequately offset the risks).

There are several risks associated with the provision of retail services that need to be considered before retailers decide whether to enter into and expand within any regulated market, these include:

- regulatory risk (that is, the possibility that future prices will not accurately reflect costs);
- wholesale electricity price risk (that is, unexpected price shocks);
- forecast demand risk (that is, incorrectly forecasting the number of new customers and/or the costs incurred to enter or expand in the market); and
- other risks (such as, the financial risks).

Importantly, the retail margin needs to be sufficient to account for these risks both now and in the future. The regulators in each jurisdiction attempt to set the retail cost allowance to both cover retail operating costs and provide a margin that is sufficient for the incumbent retailers to account for these risks. However, as noted above, some of these risks are accounted for in the WEC allowance in some jurisdictions. Notwithstanding, as highlighted in the submissions above, there are several reasons why the actual margins available to second tier retailers in the ACT are likely to be lower than the regulated margins set by the ICRC. These reasons are explored further in the next section.

Actual second tier retail margins

Second tier retailers operating in any market typically need to either offer discounts or some other incentive (for example, a complimentary magazine subscription) to attract customers away from an incumbent retailer. This cuts into the margins available to second tier retailers. As a result, the margins available to second tier retailers in any market are likely to be lower than those set by the regulator. Additionally, as discussed in section 5.3.3, there is a risk that in the future prices will not accurately reflect costs. However, there appear to be two additional reasons why the second tier retail margins are likely to be lower than the regulated margins set by the ICRC and earned by ActewAGL Retail. These include:

- the ICRC's methodology for determining the retail cost allowance; and
- the unique characteristics of the ACT market.

These are discussed in greater detail below.

Retail cost allowance

As set out in the Stage 1 Draft Report, the ICRC sets regulated prices in the ACT based on the efficient costs of ActewAGL Retail. Additionally, the ICRC has not fully included an allowance for CAC/CARC (this is discussed further in section 7.2). Notwithstanding, the methodology used by regulators to determine the retail cost allowance differs between jurisdictions and this influences the allowed amount. These differences can be seen in Table 5.2, which briefly describes the methodology used in the 2010 determinations in the ACT, NSW, QLD, and SA.

Table 5.2 Comparison of the methodologies used to set retail allowances in 2010

Jurisdiction - regulator	Retail cost	CAC/CARC allowance	Retail margin
ACT - Independent Competition and Regulatory Commission (ICRC)	Based on ActewAGL Retail's estimate in 2003, benchmarked to other regulatory decisions and adjusted for the assumed CPI overtime. The allowance is set to recover the costs of billing services (including meter reading), call centre costs, customer information costs, and general operating overheads.	An allowance for CAC/CARC has been excluded; however an allowance for sales and marketing costs (a component of CAC/CARC) was included in the 2003 cost build-up and has been updated for inflation overtime. The exact amount included in 2003 is unknown.	The margin was set in line with IPART's 2010 determination and represents the return the incumbent retailer earns on the investment it must make to provide retail services.
NSW - Independent Pricing and Regulatory Tribunal (IPART)	The allowance is determined based on the efficient costs a standalone Standard Retailer (with economies of scale) is likely to incur in providing retail services. Specific cost items include: call centre costs, customer information costs, corporate overhead costs, administrative costs, billing and revenue collection costs, and the costs of bad and doubtful debt.	Based on a bottom-up analysis of CARC that includes the costs involved in acquiring new customers, transferring existing customers and retaining existing customers.	EBITDA margin because the retail operating cost allowance does not include amortisation and depreciation costs. The margin was set at a level sufficient to account for the systematic risks Standard retailers face in supplying electricity to small customers in the market (for example, variations in the load profile, electricity prices, and general business activities).
QLD - Queensland Competition Authority (QCA)	Based on the costs of a representative retailer, rather than an actual retailer, which has a significant share of the market, is efficient and has a customer base that is	An allowance for CARC is included and it is based on the costs of acquiring new customers, retaining existing customers and encouraging existing non-market customers to	The margin is set relative to the costs included in the Benchmark Retail Cost Index (that is, WEC, ROC and network costs).

Jurisdiction - regulator	Retail cost	CAC/CARC allowance	Retail margin
	representative of all customers in Queensland connected to the NEM. The costs items include: customer administration (including call centres), billing and revenue collection, IT systems and regulatory compliance and may also include costs associated with metering and data services that are not already included in distribution charges.	transfer to market contracts.	
SA (Draft) - Essential Service Commission of South Australia (ESCOSA)	The ROC allowance represents the costs that a new entrant retailer is likely to incur in meeting the responsibilities of standing contract supply to small customers in SA. The ROC is meant to recover the costs associated with the provision of retailer services, including: customer service, sales and marketing, revenue collection, management and support and the Residential Energy Efficiency Scheme (REES).	The exact CARC allowance is not separated from the ROC; however ESCOSA has given consideration to the extent that costs need to reflect those of a prudent new entrant retailer. Based on LECG's analysis, the CARC allowance is likely to be approximately $40 per customer.	The retail margin is set to cover a return on capital, depreciation, amortization, and taxes. The margin is based on a percentage of AGL SA's total controllable costs (that is, WEC and ROC).

Sources: ESCOSA Draft Pricing Determination 2010, IPART Final Pricing Determination 2010, QCA Final Pricing Determination 2010, and ICRC Final Pricing Determination 2010.

The AEMC does not have a preference nor has it attempted to form a view on whether one methodology is better than another as it is likely to depend on the individual characteristics of the market. However, this comparison highlights that differences do currently exist between jurisdictions and these differences, in combination with varying cost elements (for example, switching rates and load shapes), result in different levels of retail cost allowances - Table 5.3.

Table 5.3 2010-11 retail cost allowance comparison

Jurisdiction	Retail cost ($/customer) (a)	CARC ($/customer) (b)	ROC ($/customer) (c = a+b)	ROM ($/customer) (d)	Retail allowance ($/customer) (e = c+d)
ACT	104.90	Marketing and sales not specified	104.90	5.4% on NUOS, WEC & ROC	104.90 + ROM
NSW	77.11	37.68	114.79	5.4% on NUOS, WEC & ROC	114.79 + ROM
QLD	85.89	40.52	126.41	5.0% on NUOS, WEC & ROC	126.41 + ROM
SA	125.30	CARC not explicitly specified	125.30	10.0% on WEC & ROC	125.30 + ROM

Sources: ESCOSA Draft Pricing Determination 2010, IPART Final Pricing Determination 2010, QCA Final Pricing Determination 2010, and ICRC Final Pricing Determination 2010.

Notes:

The actual ROM amounts have not been included because there is not enough information provided in the determinations to make this calculation in all of the jurisdictions.

The SA retail cost allowance includes the Residential Energy Efficiency Scheme (REES) allowance ($10.30/customer).

The ICRC has included a marketing and sales component in its retail cost allowance; however the amount included is unknown.

In its 2010 draft decision, ESCOSA determined that LECG's analysis of the ROC (including CARC) demonstrates that AGL's proposed $115.00/customer is reasonable. LECG recommended that a ROC of $118.5/customer be adopted (base ROC of $76.50 and CARC of $41.90). However, ESCOSA's draft decision adopted AGL's recommended ROC of $115.00/customer. Therefore, the exact CARC allowance is unknown but is likely to be approximately $40.00/customer.

QLD allowances are for the period Jan-Jun 2011.

NSW allowances have been adjusted for inflation into 2010-11 dollars using 2.4 per cent, as forecasted in the IPART Final Pricing Determination 2010.

Importantly, regardless of whether the ACT's ROC allowance includes certain elements of CAC/CARC, the ROC and retail allowance under the TFT (including a retail operating margin) appear to be relatively low (although certain risks are accounted for in the WEC allowance in some jurisdictions).[50]

As discussed above, the retail allowance influences whether or not second tier retailers enter into and expand within a market because it needs to be sufficient (or perceived to be sufficient) for retailers to recover their costs and provide a return that is commensurate with the risks involved in supplying electricity in the market over the long-term (although this decision will also be influenced by the WEC allowance and the extent to which risks are included in it). This is based on the assumption that retailers will enter a market if they can earn a risk-adjusted profit (that is, retailers are assumed to be profit maximising firms).

However, this assumption could break down if a firm is resource constrained in the short-term. For example, if a retailer has a limited amount of generation assets or hedging contracts available, a profit maximising retailer will choose to operate in markets where it believes it can earn the highest rate of return (which may not include the ACT).

Additionally, while the ACT's retail allowance may be relatively low (although we note that some risk allowances are included in the ICRC WEC calculation in addition to the retail allowance), it is what second tier retailers forecast to be their actual margins which will influence their decision to enter into and expand within the market. For the reasons set out below, this is likely to be different from the margin included in the regulated allowance.

If the unique characteristics of the market are addressed to make it easier for second tier retailers to enter into and expand within the market then the current tariff levels could be adequate for retailers to earn sufficient profit. That is, prices do not need to increase to promote competition in the ACT electricity market. This is discussed further in the Stage 2 Draft Report.

Unique characteristics of the ACT market

There were several comments in the submissions related to the unique characteristics of the ACT retail electricity market that are likely to further restrict the margins available to second tier retailers.

Notably, the weak presence of second tier retailers in the market reduces the overall level of awareness of FRC, which is likely to make customers 'sticky' and therefore more difficult to attract away from ActewAGL Retail. This could further squeeze the second tier retail margins. This lack of awareness and ActewAGL Distribution's provision of distribution services could also give customers the perception that the product offered by ActewAGL Retail (that is, electricity) is more valuable than the product offered by other retailers (that is, there is a perceived product differentiation).

50 In addition, this disparity would likely increase if differences in economies of scale were considered (in line with the analysis undertaken by the ICRC in its 2010 final determination). See: ICRC, *Final Decision - Retail Prices for Non-contestable Electricity Customers - 2010-2012*, June 2010, pp. 39-40.

This perception may increase the level of customer stickiness. The level of awareness of FRC in the ACT is discussed further in section 6.3.

Customers also appear to be satisfied overall by the quality of service in the ACT (see section 7.4 for more detail). This suggests that despite ActewAGL Retail's dominance, competitive pressure (that is, the threat of entry or expansion) has encouraged it to maintain a high quality of service. This is one positive indicator of market performance. Therefore the evidence is that limited competition pressure exists, but increasing the level of competition will lead to benefits for consumers.

In addition, ActewAGL Retail may have slight cost advantages over second tier retailers that provide it with a greater actual margin. For example, ActewAGL Retail undertakes a number of activities on behalf of other Actew and ActewAGL business units, thereby, possibly benefiting from synergies across the business units. Some economies of scope would be expected to arise, bringing ActewAGL Retail some relative cost savings. The AEMC notes Origin Energy's comment that the ability of ActewAGL Retail to undertake activities on behalf of other Actew and ActewAGL business units may require additional consideration. This may require a review of ActewAGL Retail's current guidelines on cost allocation between its various business units.

The AEMC also notes that there is no evidence to suggest that the current level of the regulated price in the ACT does not allow ActewAGL Retail to recover its costs and earn a return for its stakeholders (including the ACT Government).[51]

Finally, both TRUenergy and the ESAA have noted that the ACT feed-in tariff scheme is a disincentive for market entry. As previously stated by the AEMC, jurisdictional specific requirements are not limited to the ACT. Retailers are required to manage jurisdictional specific requirements in each of the markets they operate in within Australia. The AEMC notes that it is anticipated that some differences across jurisdictions will diminish over time with the introduction of the National Energy Customer Framework. Notwithstanding, it is acknowledged that the cost per customer of managing these specific requirements may be heightened in the ACT as a result of the relatively low number of customers available to spread these costs, as compared to other jurisdictions.

Notably, the administrative and IT costs involved in managing these regulatory differences are largely upfront fixed costs. As a result, there is a risk to second tier retailers that these costs become sunk if they are unable to attract a sufficient number of customers to recover these fixed costs over time. Importantly, the fact that ActewAGL Retail services the majority of the customers in the ACT market provides it with a greater number of customers over which to spread its retail fixed costs. As a result, ActewAGL Retail is likely to have a lower average cost per customer than a

---

51 For example, in AGL Energy's 2008-09 Annual Report, it stated that ActewAGL Retail had returned $27.9 million for its joint venture in the business, which suggests that ActewAGL Retail is a profitable company. However, it is unclear how much of this profit is related to the provision of its essential services.

second tier retailer with significantly less customers.[52] Additionally, ActewAGL Retail's economies of scale and scope as a result of providing its essential services (for example, water services) may further reduce these costs.

It is difficult to quantify the costs second tier retailers incur to meet the ACT's specific regulatory requirements and whether these are greater than the amount allocated to ActewAGL Retail. For this reason, Table 5.4 sets out the regulatory requirements in the ACT and NSW to help develop a better understanding of the differences between the two jurisdictions, which are part of the same NEM region.

As highlighted by TRUenergy and the ESAA, the feed-in tariff scheme is the most significant difference between the two jurisdictions. Notably, the ACT market requires that the period of operation is 20 years from connection of the generator as opposed to seven years for NSW. In addition, the premium paid to customers is changed annually in the ACT whereas it is fixed in NSW. Finally, retailers in the ACT are required to report quarterly on a number of indicators, whereas in NSW all reporting obligations are on the distributor. The other two programs, the Greenhouse Gas Abatement Scheme (GGAS) and the GreenPower offer scheme appear to be essentially the same in both jurisdictions. The only difference in the GGAS between the two jurisdictions appears to be the timing of the scheme's ending.

In summary, there are mechanical differences in the feed-in tariff schemes in NSW and the ACT. These are the only real differences in the regulatory requirements in the two jurisdictions. While there are likely to be some upfront costs for the second tier retailers operating in NSW to enter into or expand within the ACT market, these are likely to be marginal. As a result, it is unlikely that the differences in the feed-in tariff schemes across jurisdictions (at least between NSW and the ACT) significantly influence whether or not second tier retailers enter into and expand within the market.

52 It is understood that retail costs are largely fixed and benefit from economies of scale. Frontier Economics, *Mass market new entrant retail costs and retail margin*, Report for IPART, March 2007.

Table 5.4 Comparison of the ACT and NSW regulatory requirements

Regulation/legislation	NSW	ACT
Greenhouse Gas Abatement Scheme (GGAS)	*Electricity Supply Act 1995* (NSW) Requirements include the licensee must comply with: 1. its greenhouse gas benchmarks; and 2. the *Electricity Supply Act 1995* (NSW) and statutory instruments in force under that Act, including *Electricity Supply (General) Regulation 2001* (NSW). Part 8A of the *Electricity Supply Act 1995* (NSW) sets a State greenhouse gas benchmark expressed in tonnes of carbon dioxide equivalent (tCO_2-e) per capita. The initial level in 2003 was set at 8.65 tCO_2-e and progressively dropped to 7.27 tCO_2-e in 2007 remaining at that level until 2012. This represents a reduction of 5% below the Kyoto Protocol baseline year of 1990.	*Electricity (Greenhouse Gas Emissions) Act 2004* (ACT) Requirements include the licensee must comply with: 1. its greenhouse gas benchmark; and 2. the *Electricity (Greenhouse Gas Emissions) Act 2004* (ACT) and statutory instruments in force under that Act. The licensee must also submit an audited Benchmark Statement to the ICRC annually by 1 March of the year following the compliance year. The Scheme sets a Territory greenhouse gas benchmark expressed in tonnes of carbon dioxide equivalent (tCO_2-e) per capita. The level set for 2005 was 7.96 tonnes per capita. The benchmark was progressively reduced. In 2007, the benchmark was 7.27 tonnes per capita. It will continue at this level until the Scheme ends in 2020. These benchmarks correspond to those adopted in NSW.
GreenPower	Requirements for licensed retailers are contained in the *Electricity Supply (General) Regulations 2001* (NSW) in clause 45B (1). That is:	GreenPower offer scheme From 1 April 2009, the Licensee must comply with

Regulation/legislation	NSW	ACT
	1. a supplier who offers to supply electricity to residential premises must: (a) offer (renewable energy sources offer) each potential new or moving customer the equivalent of a minimum 10% of the total electricity supplied from an accredited renewable energy source; 2. a renewable energy sources offer must state (i) whether the electricity to be supplied is under a standard form customer supply contract or negotiated customer supply contract (ii) tariffs/charges under the offer; and 3. a renewable energy sources offer must be a member of and comply with the requirements of an approved accreditation scheme.	the following requirements: 1. offer a GreenPower product to each new or re-connecting customer of the supplier; 2. at the same time as the GreenPower offer, make each potential new and reconnecting customer of the supplier aware that other products are available to them; 3. disclose all tariffs and charges associated with the GreenPower offer and all other products offered to each potential new and reconnecting customer of the supplier; 4. offer and make a GreenPower product available to all existing customers of the supplier at the existing customer's request; and 5. if a person being supplied a GreenPower product under a standard customer contract, permit the customer to revoke the supply agreement for the GreenPower product with the supplier without incurring any penalty or termination fee.
Feed-in tariff scheme	Regulatory framework of the Solar Bonus Scheme is set out in the Electricity Supply Act 1995 (NSW) and the Electricity Supply (General) Regulation 2001 (NSW). The licensee must comply with the Electricity Supply Act 1995 (NSW) and statutory instruments	Section 6 (3) of the *Electricity Feed-in (Renewable Energy Premium) Act 2008* (ACT) The licensee must comply with the *Electricity Feed-in (Renewable Energy Premium) Act 2008* (ACT) and statutory instruments in force under that Act.

Regulation/legislation	NSW	ACT
	in force under that Act. The main aspects of the scheme include: • period of operation is seven years from 1 January 2010; • legislation sets out how often the tariff is set; and • there are no reporting obligations for retailers under this scheme.	The major aspects of the scheme include: • period of operation is 20 years from connection of the generator; • the rate of the tariff is determined by the Minister for each financial year; and • retailers are required to report quarterly on the number of customers receiving the feed-in tariff and the total amount of the premium paid over this period.

In conclusion, the actual margins available to second tier retailers may not be the same as those earned by ActewAGL Retail for the following reasons:

- the ACT's 2010-11 retail cost allowance is relatively low compared to other jurisdictions;
- it could be difficult for second tier retailers to attract customers away from ActewAGL Retail because of:
  - the lack of customer awareness of FRC;
  - the possible perception of product differentiation in ActewAGL Retail's electricity service;
  - the high level of customer satisfaction;
- the corporate structure of ActewAGL Retail and its economies of scale and scope are likely to provide it with cost advantages over a single fuel supply efficient new entrant; and
- the relatively small size of the market means that there are fewer customers over which to spread the fixed costs incurred to enter the ACT market (for example, the costs associated with the ACT's feed-in tariff scheme).

Given that retailers are not entering into or expanding within the ACT retail electricity market, it appears that second tier retailers do not perceive the margins to be a sufficient rate of return that is commensurate with the risks and uncertainties of operating in the market over the long-term.

The AEMC intends to consider these issues further as part of its advice in the Stage 2 Draft Report on ways to improve the effectiveness of competition in the ACT electricity retail market. Notably, prices do not need to increase for the degree of competition to improve in the market. Instead, the unique characteristics of the market can be addressed to make it easier for second tier retailers to enter into and expand within the market.

6 Market conduct

6.1 Introduction

An analysis of market conduct also requires consideration of both supply and demand-side aspects. In doing so, the following MCE criteria are assessed:

- behaviour of electricity retailers (including retailer marketing activities over time and an assessment of retailers competing to attract new and retain existing customers);
- the exercise of market choice by consumers (including an analysis of consumer awareness of FRC and the ease of obtaining, understanding and comparing information);
- consumer switching behaviour (including customer switches and transfers over time).

This chapter summarises the AEMC's analysis of these elements set out in the Stage 1 Draft Report. Additionally, the relevant submissions to the Stage 1 Draft Report are considered and the AEMC's final findings on market conduct are set out.

6.2 Behaviour of electricity retailers

In the Stage 1 Draft Report this section described the conduct of electricity suppliers in the ACT electricity retail market. A summary of this discussion is provided below.

6.2.1 Draft findings

Independent rivalry between retailers in the ACT electricity retail market is an important aspect of effective competition. In an effectively competitive market, retailers will seek to retain or increase their market share by offering products that best meet the requirements of consumers in the market. Retailers achieve this by engaging in price and non-price rivalry with other retailers. Therefore, retailer rivalry can facilitate product innovation the delivery of those products most sought after by consumers and at prices that most accurately reflect the long-run efficient cost of supply.

Following the introduction of FRC in the ACT, two retailers - EnergyAustralia and TRUenergy - entered into the market to compete with ActewAGL Retail. EnergyAustralia undertook a door-knocking campaign from 2005 and was the first new entrant in the ACT market. Additionally, EnergyAustralia offered a dual fuel product. The price for electricity was generally offered at a discount to the published TFT.

TRUenergy entered the market in mid-2006 with a systematic door-knocking campaign to solicit customers. TRUenergy utilised both price and non-price rivalry, offering a discount to the published TFT for electricity and in some instances a sign-up gift.[53] Over this period, several other second tier retailers also acquired a small number of customers, but in each case their customer share was less than one per cent.

In response to the new entrants, ActewAGL Retail mounted a 'win-back' campaign and offered a discount from the TFT to its existing customers who entered into market contracts (internal switching).[54] This period (from mid-2006 to mid-2007) was by far the most rivalrous period between retailers in the ACT, as evidenced by the relatively high levels of customer switching (see section 6.4 below).

From mid-2007, following a steep increase in the wholesale market price, an inability of some retailers to obtain adequate forward contracts, coinciding with retailers' perception that the margins achievable under the TFT were too low, competition between retailers declined. Even though the NSW NEM region price has subsequently declined, competition between retailers in the ACT remains low today.

At the time that EnergyAustralia and TRUenergy were quite active in the ACT (for example, offering new products and undertaking marketing campaigns to attract customers), ActewAGL Retail was not offering many differentiated products and services, nor was it actively marketing to retain its customers. However, ActewAGL Retail is now regarded by other retailers as having a very active marketing approach to customer retention. ActewAGL Retail suggests that this is because it feels a real threat of entry and expansion by second tier retailers.

Notably, during the retailer interviews, most participants indicated that the most prominent electricity marketing activities in the ACT are currently being undertaken by ActewAGL Retail. This covers advertising on TV, radio, billboards and bus shelters, direct mail, as well as significant community and sports sponsorships, and education programs.

However, there is currently very little marketing being undertaken in the ACT aside from the bundling offers marketed by ActewAGL Retail and general promotional activity (for more information see section 7.3). Importantly, marketing by second tier retailers now appears to be completely passive, relying on the consumer to find offers (for example, through the internet).

In summary, while there was a relatively high level of rivalrous activity between retailers during the period from mid-2006 to mid-2007, since that time the level of activity has declined and remains low today. In addition, the amount of marketing by ActewAGL Retail and second tier retailers to promote their product offerings has declined since 2007. Currently, there is no active marketing by any retailer other than ActewAGL Retail.

---

53 ACAT submission, 9 April 2010, p. 3; TRUenergy submission, 9 April 2010, p. 2.

54 Internal switching is where a customer moves from the standing offer to a market contract with their current electricity supplier.

6.2.2 Responses to draft findings

The ESAA noted that 'a particular telling indictment of the deleterious effects of price regulation on the market is the fact that while there are 19 licensed retailers, only four have small customers, only two are taking new customers and just one is actively marketing'.[55]

The ICRC commented that 'there is little doubt that the market volatility that occurred in 2007 caused a rethink by some retailers of their marketing and target market strategy'.[56] It questioned what could drive this change in the large customer segment of the market that is not subject to ICRC price determinations and whether this was reflected in their decisions about the small customer segment.

6.2.3 Further analysis and conclusion

The AEMC agrees with the ESAA that of the 19 retailers licensed in the ACT, the small number actively marketing is not consistent with what would be expected in a competitive market. However, ActewAGL Retail's 'win-back' campaign in response to the increased level of retailer rivalry in 2006-07 suggests that it responds well to competitive pressures.

Additionally, the AEMC agrees with the ICRC that the conduct exhibited by retailers since 2007 may suggest factors other than the level of the regulated price are influencing behaviour. For example, increased price levels or volatility in the wholesale electricity market could cut into the already slim retail margins and so cause retailers to reassess their market operating strategies. This could have been the case in 2007 when prices increased by substantial (and unprecedented) amounts – more than double in some cases – in a relatively short time. At the time, retailers reported that hedging contracts were not sufficient to cover the most extreme peaks experienced although coverage for the average peak could be achieved. In this environment, retailers may be reluctant to seek out new customers if this requires obtaining additional hedging contracts.[57]

Overall, the AEMC has not found rivalrous conduct in the ACT electricity market exhibits the characteristics of a competitive market. However, ActewAGL Retail's 'win-back' campaign does suggest that it responds well to competitive pressures.

Nevertheless, as in the Stage 1 Draft Report, the AEMC has concluded that retailer rivalry and marketing has decreased significantly since the middle of 2007 and remains low today. This conduct is not consistent with a market where there is effective competition.

---

55 ESAA submission, 27 August 2010, p. 3.

56 ICRC submission, 31 August 2010, p. 5.

57 Frontier Economics, *Analysis of recent changes in NEM wholesale electricity prices*, May 2007, pp. 3 & 6-7.

6.3 The exercise of market choice by consumers

The Stage 1 Draft Report evaluated consumer awareness of competition and choice in the ACT electricity retail market. The analysis relied heavily on the qualitative and quantitative surveys undertaken by Roy Morgan Research to assess the behaviour and attitudes of residential and small business consumers of electricity in the ACT. A summary of the AEMC's draft findings are provided below.

6.3.1 Draft findings

Although retailers can differentiate electricity services on the basis of price, quality and other non-price terms and conditions, consumers generally regard energy as a homogenous and low involvement commodity. Therefore, consumers tend to have a low degree of interest in exercising choice between energy retailers and products. In addition, consumers tend to perceive that the costs associated with switching may outweigh the benefits. That is, the time taken to search for alternative supply arrangements outweighs the potential savings gained through switching retailers.

There are two key aspects related to the exercise of market choice by consumers, namely:

- consumer awareness of competition and choice; and
- the ability of consumers to obtain, understand and compare information.

In terms of the first, Roy Morgan Research found that 58 per cent of small businesses and 60 per cent of residential consumers were aware that they had a choice of electricity supplier in the ACT.[58] This suggests that there is some awareness among consumers in the ACT of the ability to choose their electricity supplier. However, 40 per cent of consumers remain unaware more than seven years after FRC was introduced, which is a concern. By comparison, at the time of the AEMC Retail Reviews for Victoria and South Australia, 94 per cent of residential customers in Victoria and 82 per cent of residential customers in South Australia were aware of FRC.[59]

Additionally, while the majority of consumers are aware that they can choose their electricity supplier, when asked to name an alternative to their current provider, one in two people were not able to do so.[60]

When focus group participants were queried about how they obtain information on electricity supply options, Choice Magazine was frequently mentioned, in addition to

58 Roy Morgan Research Small Business Report, p. 1; Roy Morgan Research Residential Report, p. 1.

59 AEMC, *Review of the effectiveness of competition in electricity and gas retail markets in Victoria, First Final Report*, 19 December 2007, p. 38; AEMC, *Review of the effectiveness of competition in electricity and gas retail markets in South Australia, First Final Report*, 19 September 2008, p. 22.

60 Roy Morgan Research Small Business Report, pp. 1-2; Roy Morgan Research Residential Report, p. 1.

the internet, the Ombudsman, word of mouth, friends, and family. The participants concluded that they wanted information that allowed them to make informed decisions and comparisons. For example, clearer cost comparisons, better disaggregation of cost components and information about the discounts available.[61]

The results from the quantitative surveys conducted by Roy Morgan Research are consistent with the findings of the focus group studies. Ninety per cent of residential consumers and 94 per cent of businesses said that they had not looked for information in the past 12 months to assist in making a decision to switch electricity suppliers.[62]

However, of the residential participants that had looked for information on switching retailers (approximately ten per cent), the main source of information used to search for alternative suppliers was the internet (56 per cent), followed by the electricity company (20 per cent) and newspaper advertisements (11 per cent). In addition, approximately 70 per cent of these participants stated that the information was easy to obtain and/or easy to understand.[63] The small business survey yielded similar results.

In summary, about 60 per cent of electricity consumers are aware of FRC in the ACT, however half of those consumers are unable to name an alternative supplier. This compares to 94 per cent and 82 per cent of the residential consumers in Victoria and South Australia, respectively, being aware of FRC at the time of the AEMC Retail Reviews.

Additionally, the studies carried out by Roy Morgan Research indicate that most consumers have not looked for information on switching retailers in the past 12 months. However, of the small proportion of consumers that have been more actively engaged, the information relevant to making a choice about switching electricity retailers has generally been accessible and understandable.

6.3.2 Responses to draft findings

None of the submissions to the Stage 1 Draft Report raised any concerns regarding the AEMC's analysis of market choice by consumers.

6.3.3 Further analysis and conclusions

The AEMC has not undertaken any further analysis in relation to market choice by consumers. It notes that the surveys conducted by Roy Morgan Research found a relatively low level of awareness of FRC in the ACT (as compared to Victoria and South Australia). Therefore, the AEMC concludes that consumers are likely to be 'sticky' due to the limited level of awareness of FRC in the ACT, and because only a small portion of customers are able to name an alternative retailer. Additionally, customers have not been actively looking for information on switching retailers

61 ibid., p. 18.

62 Roy Morgan Research Residential Report, p. 1; Roy Morgan Research Small Business Report, p. 1.

63 ibid., p. 33.

recently. This customer conduct is not consistent with the conduct that would be expected of consumers in a market that has an effective level of competition.

6.4 Consumer switching behaviour

The purpose of this segment of the Stage 1 Draft Report was to analyse consumer switching behaviour in the ACT electricity retail market to determine whether it exhibits the characteristics that would be expected to prevail in a competitive market. This analysis is summarised below.

6.4.1 Draft findings

When assessing whether competition is effective, it can be informative to consider the rate at which consumers are actively switching to, and between, market contracts. Where a sufficient number of customers are willing to switch to contracts with more attractive price or non-price terms, retailers are likely to be constrained in terms of the extent to which they can obtain and/or exercise market power in respect to any particular customer group.

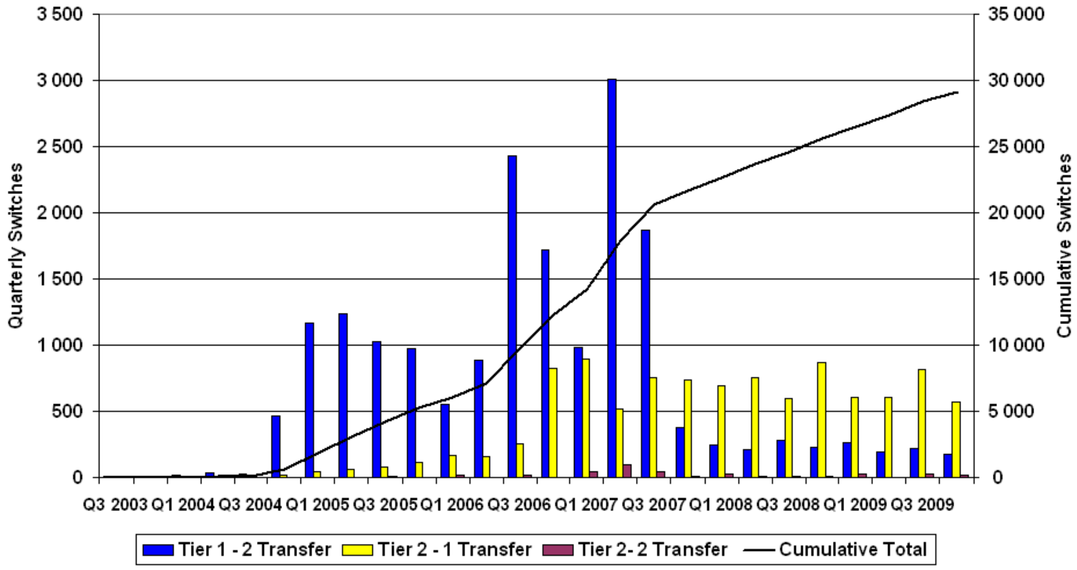
When switching to, or between, market contracts, consumers may switch to a new retailer (gross switching) or from the standing offer to a market contract with their host retailer (internal switching). Importantly, in an effectively competitive market, consumer switching patterns should reflect both the acquisition strategies of new retailers, as well as the retention strategies of the host (incumbent) retailers.

There are three main areas of focus in this analysis, namely:

- switching trends between retailers;
- gross switching trends; and
- consumer switching trends to market contracts.

Customer churn refers to the proportion of customers who change, or switch, their electricity supplier over a certain period of time. Customer churn in the ACT has been relatively low compared to other jurisdictions. In Victoria and NSW, both of which opened their retail markets to FRC in January 2002, cumulative monthly switching as a proportion of total customers reached more than 130 and 57 per cent, respectively, by January 2009. In comparison, cumulative switching in the ACT was just over 20 per cent (or approximately 29 000 switches) as at December 2009. The figure below illustrates the switching trends observed in the ACT since FRC was introduced in July 2003.

Figure 6.1 Cumulative switching trends in the ACT, 2003-2009



Source: AEMC calculations from AEMO MSATS data.

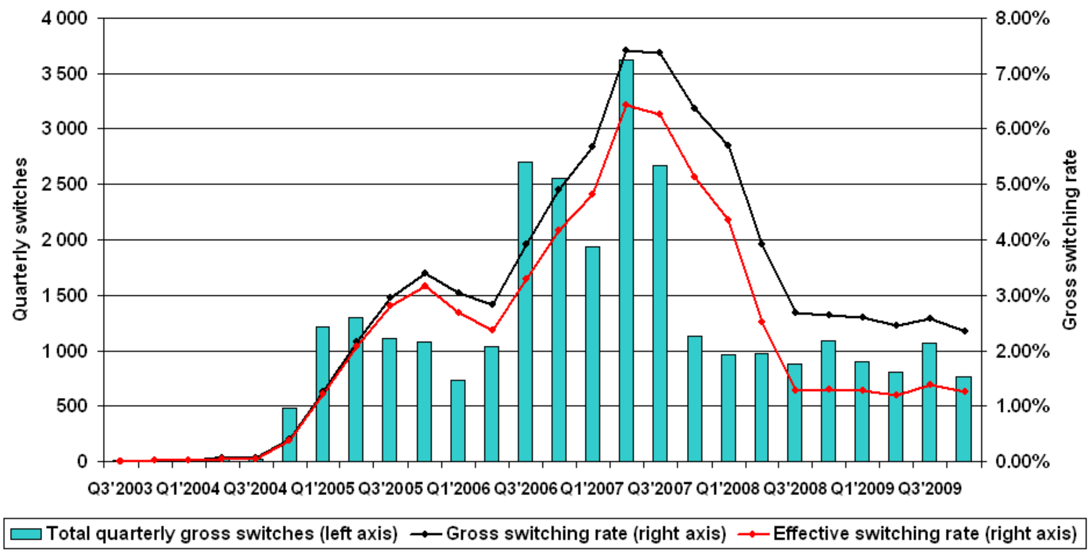
Figure 6.1 above highlights the three main types of switching patterns in the ACT: quarterly switches away from ActewAGL Retail (Tier 1 - 2 Transfer); switches between tier two retailers (Tier 2 - 2 Transfer); and switches back to ActewAGL Retail (Tier 2 - 1 Transfer). For those switches away from ActewAGL Retail (that is, Tier 1 - 2 Transfers), the increase during 2005 corresponds to EnergyAustralia's entry into the ACT market. Similarly, the peaks observed during the third quarter of 2006 (Q3'2006) and the Q2'2007 correspond with the entry of TRUenergy and active marketing campaigns by both new entrants to solicit customers. Since Q2'2007, there has been little movement of customers away from ActewAGL Retail to tier two retailers.

Customer switching between tier two retailers is also illustrated in the figure above. Transfers between tier two retailers are relatively low for the ACT, peaking at approximately 100 transfers in Q2'2007. This low rate may reflect the limited number of tier two retailers operating in the ACT.

The figure also shows that from the middle of 2007 onwards, the proportion of switches away from ActewAGL Retail decreased markedly, as tier two retailers reduced marketing activities. In recent years, most switches have been back to ActewAGL Retail (Tier 2 - 1 Transfer). However, these results should be read with an element of caution, as the majority of switches during this period have been as a result of 'move-ins'.[64] Move-ins contributed between 45 and 55 per cent of all switches during this period.[65]

Figure 6.2 below shows both total quarterly gross switches and the annual gross switching rate (the number of gross switches in a 12 month period divided by the total number of connection points in the same period) since the commencement of FRC in the ACT. The effective annual gross switching rate is also plotted in Figure 6.2.[66]

Figure 6.2 Total quarterly switches and annual gross switching rates, 2003-2009



Source: AEMC calculations from AEMO MSATS data.

Figure 6.2 shows that during the two periods that EnergyAustralia and TRUenergy were actively marketing, that is, 2005 to early 2007, there was a corresponding increase in the gross switching rate. The gross switching rate peaked at just over seven per cent in the Q2'2007. However, from late 2007 to the present, the gross switching rate has declined significantly.

Figure 6.3 sets out the total number of small customers (residential and non-residential) that were on a negotiated market contract between 2004-05 and 2008-09. As

---

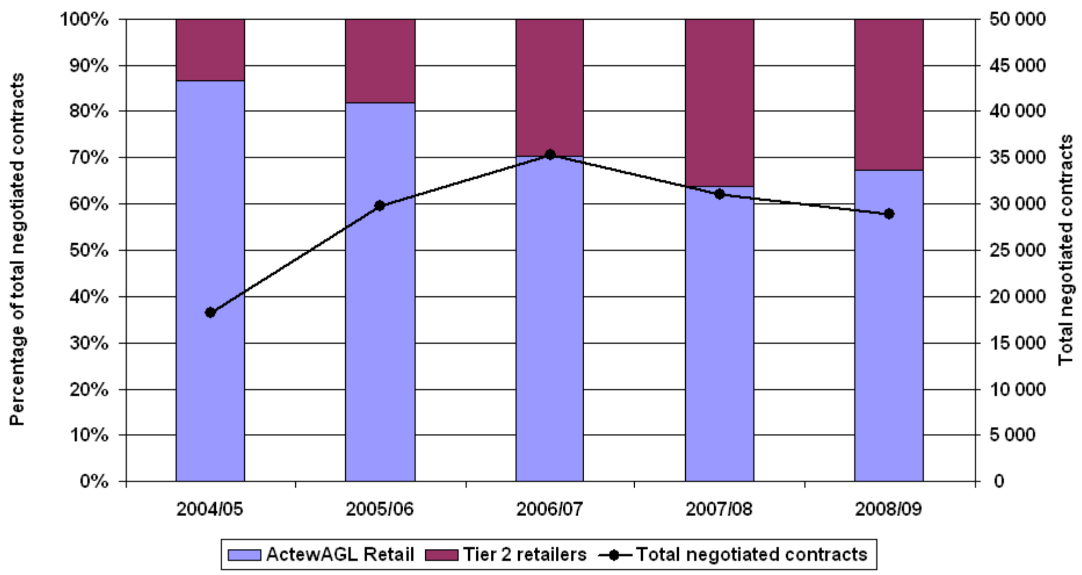
64 A 'move-in' occurs when a customer, who has a contract with retailer A, moves into a new residence where the former tenant or owner had a contract with (and the National Metering Identifier (NMI) is allocated to) retailer B. When the customer carries their old contract with retailer A to their new residence, the NMI at the new residence is then transferred to retailer A. For the purpose of switching data, this transfer will show up as a 'switch' from retailer B to retailer A, even though there has been no actual active switch between retailers by the customer.

65 When a customer moves residence this may act as a trigger for the customer to actively switch retailers. As a result, a percentage of 'move-ins' will reflect an active choice by a customer to switch to the retailer currently allocated to the NMI in the new residence. However, analysis undertaken by Roy Morgan Research indicates that moving home does not appear to motivate ACT consumers to switch (Roy Morgan Research Residential Report, p. 21; Roy Morgan Research Small Business Report, p. 23).

66 This is the annual gross switching rate net of 'move ins'.

shown, the number of customers on negotiated contracts increased initially and peaked in the middle of 2007 with approximately 35 000 (24 per cent) of consumers on market contracts. However, since that time, EnergyAustralia and TRUenergy have ceased marketing activities in the ACT and generally stopped seeking out additional customers. This coincides with the number of consumers on market contracts steadily falling and standing at approximately 29 000 (19 per cent) at 30 June 2009.[67]

Figure 6.3 Number of market contracts and relative share among retailers, 2004-05 to 2008-09



Source: AEMC calculations from AEMO MSATS and ICRC data.

The main reason cited by retailers for customers returning to the standing offer is that second tier retailers are not able to offer customers a market contract as attractive as the standing offer. That is, those customers that signed market contracts with tier two retailers have subsequently returned to the incumbent's standing offer at the maturation of their market contract term because their retailer is unable to provide a more competitive offer.

In summary, the switching behaviour of electricity consumers in the ACT indicate that:

- the proportion of small customers that have switched retailers in the ACT is relatively low compared to other jurisdictions; and
- although there was some switching to market contracts, more recent switching shows consumers moving back to ActewAGL Retail and the standing offer at the conclusion of their market contract.

The Stage 1 Draft Report concluded that these observations are not consistent with what would be expected in a market that has an effective level of competition.

67 ICRC, *Draft Decision: Retail prices for non-contestable electricity customers 2010-12*, April 2010, p. 47.

6.4.2 Responses to draft findings

The Consumer Agencies noted that they did not support the 'use of "switching data" as a primary indicator for the effectiveness of competition'.[68] The Consumer Agencies stated that the arguments against using switching as a primary indicator were well documented in the AEMC's Victorian Retail Review. The AEMC was unable to find any discussion on this topic in any of the submissions to the Victorian Retail Review. Notwithstanding, this argument was made by UnitingCare Wesley in its submission to the South Australian Retail Review.[69] The key points of that submission were:

- the extent of switching is probably not a good indicator of informed decision making, and that a significant proportion of the switching that has occurred is not an indicator of consumers making use of apparent retail competition, but more that retailers have been pushing for consumers to change; and
- despite consumers regarding themselves as well informed about the market, in fact their decisions clearly indicate that this is not the case.

Additionally, the Consumer Agencies acknowledged that while some ACT customers have elected to switch, the market exhibits capacity for additional switching. Furthermore, while the market can be described as 'slow', there is capacity for new retailers to move into the market and some customers are prepared to switch, which suggests 'effective competition'.[70]

6.4.3 Further analysis and conclusions

The AEMC is not convinced that switching data should not be used as an indicator for the effectiveness of competition. In assessing the effectiveness of competition in retail energy markets, there are a number of criteria analysed, with consumer switching behaviour being one.[71] The analysis of any one criterion on its own is insufficient to conclude the effectiveness of competition. The AEMC's analysis necessitates looking at criteria reflecting both the supply-side (retailers) and the demand-side (consumers) of the market and basing its conclusions on a combination of all available evidence. This approach provides a much fuller picture of the market.

What can be ascertained from the switching data for the ACT is consistent with information from the consumer surveys: ACT electricity consumers are sticky; they exhibit little understanding of the market; and some are reluctant to switch away from the regulated standard offer. That is, on the whole, the behaviour exhibited by consumers in the ACT market is not consistent with that of a competitive market. In a more competitive market, more switching overall would be expected and less switching back to the incumbent.

---

68 Consumer Agencies' submission, 27 September 2010, pp. 8-9.

69 UnitingCare Wesley, submission for the South Australian Retail Review, August 2008, pp. 21-26.

70 Consumer Agencies' submission, 27 September 2010, p. 9.

71 See AEMC, *Revised statement of approach*, 21 December 2009, pp. 14-15.

Nevertheless, as noted by the Consumer Agencies, the ACT market does have the potential for greater active participation by consumers. If this were achieved, it would be reasonable to see an increase in switching and the use of second tier retailers. A greater level of retailer rivalry should also be observed, both as a result of, and to encourage, more engaged consumers.

7 Market performance

7.1 Introduction

The performance of a market is a reflection of both its structure (chapter 5) as well as the collective conduct of the participants acting in the market (chapter 6). The RSoA requires an assessment of the following key elements related to market performance:

- price and profit margins (including changes in the retail price over time and evidence of prices converging to an efficient long-term cost of supply);
- product and service offerings (including an analysis of whether customer preferences and needs are being met); and
- consumer satisfaction (including an analysis of customer complaints and regulatory enforcement investigations).

The purpose of this chapter is to summarise the AEMC's assessment of these elements set out in the Stage 1 Draft Report. Additionally, where relevant, the submissions to the Stage 1 Draft Report are discussed, and then the AEMC sets out its final findings on market performance.

7.2 Price and profit margins

This portion of the Stage 1 Draft Report focussed on the current prices offered and possible profit margins earned by retailers operating in the ACT electricity market. This discussion is summarised below.

7.2.1 Draft findings

An important indication of market performance, and therefore the effectiveness of competition in a market, is a comparison between the prices being charged for the provision of goods or services relative to the cost of supply. This provides an indication of the profit margins being earned.

ACG was engaged to undertake an analysis of electricity retail price and profit margins in the ACT. This section draws on ACG's analysis.[72]

Economic costs and regulated prices

The cost categories used by the ICRC (and other regulators) relevant to the supply of electricity to small customers include:

---

72 The Allen Consulting Group, *Review of the effectiveness of competition in the electricity retail market in the ACT: price and profit margin analysis*, July 2010. (ACG Price and Profit Margin Analysis)

- wholesale electricity costs, which include the costs of purchasing wholesale electricity through either the spot or contract market (including the risks faced in purchasing electricity and mitigating those risks), as well as various ancillary costs, network losses and 'green' energy requirements;

- the costs associated with using the transmission and distribution networks, as reflected by network use of system charges (determined by the AER);

- retail operating costs, including, among other things, issuing bills, managing customer enquiries, financing costs, IT systems, overheads and indirect costs, and regulatory compliance obligations; and

- a retail margin to capture the appropriate return to the business taking into account the risks associated with retailing of electricity in the ACT.

Table 7.1 below sets out the ICRC's regulated electricity retail prices (that is, Transitional Franchise Tariffs - TFTs), based on its assessment of ActewAGL Retail's efficient economic costs, for the period 2007-08 to 2010-11.[73]

Table 7.1 TFTs determined by the ICRC, 2007-08 to 2010-11

Cost component	2007-08	2008-09	2009-10	2010-11
WEC ($/MWh)	70.70	78.86	71.24	69.15
ROC ($/MWh)	9.70	9.94	10.37	10.56
Network costs ($/MWh)	53.22	56.06	66.52	71.44
Total retail costs ($/MWh)	133.62	144.86	148.13	151.01
Retail margin (% of total retail costs)	4.00%	5.00%	5.00%	5.40%
TFT ($/MWh)	**138.96**[a]	**152.10**	**155.54**	**159.16**

Notes: According to ACG, the figure published by the ICRC for 2007-08 is $137.63 which erroneously used a retail margin of 3%. This figure has been adjusted in the table above to be consistent with a 4% retail margin, as stated in the ICRC determination.

All figures are in dollars of the day.

Source: ACG Price and Profit Margin Analysis, Appendix A.

It is important to note that the ICRC determines the TFT in accordance with the specific terms of reference provided by the ACT Attorney-General and the requirements set out in s. 20 of the ICRC Act. The ICRC's terms of reference require it to set prices to allow for the recovery of the efficient costs incurred by the incumbent retailer, ActewAGL Retail. Regulators in other jurisdictions have different objectives and frameworks to set regulated retail prices. For example, the terms of reference for IPART allows for the recovery of the costs a 'hypothetical retailer' would incur if it were a mass market new

73 A breakdown of costs is not available prior to the 2007-08 decision.

entrant.[74] In contrast, the QCA is required to determine the costs a stand-alone retailer would face assuming it has an established customer base of a mix of customers.[75]

ACG compared the ICRC's method for calculating ActewAGL Retail's efficient economic costs against the approaches used by regulators in other jurisdictions and concluded that, with the exception of the CAC/CARC component, the ICRC's approach is generally consistent with that applied in other jurisdictions.[76]

However, retailers have indicated that volatility in the wholesale electricity market has increased substantially since 2007 and, as a result, the WEC allowance calculated by the ICRC has not accurately reflected the electricity costs that retailers incur to participate in this market. Importantly, the AEMC has not found wholesale prices in NSW (and so the ACT) to be any more volatile than in other jurisdictions. As a result, it would not only be ACT retailers that may have faced difficulties in managing wholesale price volatility against regulated retail prices. Any retailer will face this if there is a regulated price around which they compete and the regulated price is unable to fully account for changes in wholesale price movements.

Notwithstanding the above, the ICRC's approach to estimating the WEC is slightly different to that used by other regulators. Since 2007 the ICRC has used independent and verifiable market information on the price of forward contracts.[77] This approach takes into account the spot price for the NSW-ACT region of the NEM, load profile and hedging costs. "Energy contracting costs" are also included in the WEC allowance as well as relevant greenhouse scheme costs.

Other jurisdictions have used long-run marginal costs estimates of generating electricity as an input into their calculations of a WEC allowance. More recently, they have also included specific allowances for market risk such as IPART's ‘volatility allowance’.[78] The ICRC has not included such a specific allowance. However, its market-based approach to the WEC estimate combined with the frequency of pricing decisions would appear to accommodate wholesale price volatility without the need for an additional term in the calculation.[79]

---

74 In its 2010 determination, IPART actually set prices based on a standalone incumbent retailer that is not vertically integrated into electricity distribution and has economies of scale with an existing customer base to defend. See: IPART, *Review of regulated retail tariffs and charges for electricity, 2010-13 - Final Report*, March 2010, p. 112.

75 Additionally, in its 2010 determination, QCA set prices based on the costs of a representative retailer, rather than an actual retailer, which has a significant share of the market, is efficient and has a customer base that is representative of all customers in Queensland connected to the NEM. See: QCA, *Benchmark Retail Cost Index for Electricity: 2010-11 - Final Decision*, May 2010, p. 33.

76 It is important to note that since the Stage 1 Draft Report was published, the AEMC has conducted a review of the methodologies used in setting the retail cost allowances across jurisdictions. In doing so, the AEMC has found that there is a fair amount of disparity between jurisdictions. See Table 5.4 for more information.

77 Prior to this, the ICRC used information from ActewAGL Retail.

78 ACG Price and Profit Analysis, pp. 9-10.

79 ICRC, *Final decision: retail prices for non-contestable electricity customers 2010-12*, June 2010, pp. 31-33.

While there is a correlation between the level of retailer activity in the ACT market and wholesale price movements since 2007, the lack of clear information makes it difficult to be sure whether this was the driving factor.[80] Nevertheless, it can be argued that the ICRC's approach to determining the wholesale cost component of the TFT has not provided any undue difficulties for ACT retailers in comparison to other jurisdictions with a regulated retail price. Additionally, the frequency of determinations in the ACT is relatively high compared to other jurisdictions, which is likely to be beneficial to retailers.

In summary, ACG reviewed the ICRC's approach for calculating the TFT and found that, with the exception of the CAC/CARC component, the ICRC's methodology is generally consistent with that applied in other jurisdictions. Nevertheless, several retailers have indicated that the WEC allowance is not sufficient to account for the risks and uncertainties associated with purchasing wholesale electricity.

Actual retail margins

In order to investigate the implications of excluding a CAC/CARC element from the ROC, ACG calculated ActewAGL Retail's 'effective' margins, which are the margins ActewAGL Retail is able to achieve assuming these costs directly reduce its regulated margins. ACG determined a low, intermediate and high value for CAC/CARC to use in its analysis based on a benchmarking exercise of other jurisdictions. These values (in June 2009 dollars) were:

- $26 per customer per year (that is, $2.75/MWh);
- $36 per customer per year ($3.80/MWh); and
- $42 per customer per year ($4.44/MWh).

ActewAGL Retail's effective margins for the period 2007-08 to 2010-11 are set out below in Table 7.2.

80 Section 5.3.3 of this report explored this relationship further.

Table 7.2 ActewAGL Retail's effective margins

		2007-08	2008-09	2009-10	2010-11
Regulated TFT ($/MWh)		138.96	152.10	155.54	159.16
Calculated CAC/CARC allowance ($/MWh)					
	Low CAC/CARC	2.57	2.63	2.75	2.80
	Intermediate CAC/CARC	3.55	3.64	3.80	3.87
	High CAC/CARC	4.14	4.24	4.44	4.52
Retail margins (%)					
Regulated retail margins (excl. CAC/ CARC)		4.00	5.00	5.00	5.40
Effective retail margins (incl. CAC/ CARC)					
	Low CAC/CARC	2.04	3.13	3.09	3.48
	Intermediate CAC/CARC	1.30	2.43	2.37	2.76
	High CAC/CARC	0.87	2.01	1.95	2.33

Notes: According to ACG, the figure published by the ICRC for 2007-08 is $137.63 which erroneously implies a retail margin of 3%. This figure has been adjusted in the table above to be consistent with a 4% retail margin, as stated in the ICRC determination.

All figures are in dollars of the day.

Source: ACG Price and Profit Margin Analysis, p. 18.

Importantly, the potential competitor to ActewAGL Retail is likely to earn less than these effective margins. For example, the calculation of the TFT is based on ActewAGL Retail's efficient costs. As a result, the costs are likely to incorporate an element of economies of scale and scope that a new entrant or stand-alone retailer may not be able to achieve. If this is the case, the effective margins set out in Table 7.2 are likely to be at the high-end of the possible margins that a new entrant or stand-alone retailer would be able to achieve.[81]

Additionally, it is understood that to attract customers away from ActewAGL Retail, tier two retailers would most likely need to offer retail supply at prices less than those for the regulated services. This would also reduce the actual margins that tier two retailers in this market would be able to achieve to less than the effective margins set

81 Additionally, as discussed above, the lack of customer awareness surrounding FRC and the ACT's feed-in tariff scheme would further reduce the margins achievable by second tier retailers.

out in the table above. Finally, increased prices in the wholesale electricity market could further squeeze these margins.

Benchmark retail margins

One way of ascertaining whether retailers' revenues are consistent with the economic cost of delivery is to compare the effective margins (that is, margins based on ActewAGL Retail's costs plus a CAC/CARC allowance) with an estimate of the 'benchmark' margins that would be expected to prevail in a market where there is effective competition. In circumstances where actual margins fall below the level where firms are able to recover their efficient economic costs, some may be forced to exit the market while potential entrants may be discouraged from entering the market. That is, low actual margins may result in a low level of competition (that is, few retailers actively participating in the market).

An analysis of margins set by regulators in other jurisdictions over time suggests that, on average, regulators have historically determined an appropriate return for the provision of electricity retail services to be approximately four to five per cent. As the ACT is part of the NSW wholesale market, retailers in the ACT and NSW will face similar wholesale risks and uncertainties. Accordingly, the most appropriate comparison is with NSW.

IPART's terms of reference for retail price setting refer to the recovery of costs that a 'hypothetical retailer' would incur if it were a mass market new entrant.[82] This is likely to be more consistent with the actual costs that a retailer would incur in a market where there is an effectively competitive environment compared to a calculation based on ActewAGL Retail's efficient costs.

In its most recent retail pricing decision, IPART developed what it considered a reasonable range of retail margins for electricity retailers in NSW of 4.8 to 6.5 per cent. This range may also be appropriate for electricity retailers in the ACT. However, the effective margins (which, for the reasons stated above, are likely to be at the high-end of the margins that a new entrant or standalone retailer would be able to achieve) estimated by ACG do not fall within this range. In some years (notably 2007-08), the ACT effective margins are significantly below the IPART range.

Consequently, during the retailer interviews, and in their submissions to the Issues Paper and the Stage 1 Draft Report, several stakeholders commented on the need for an increase in the regulated price.

82 As noted above, in its 2010 determination, IPART set prices based on a standalone incumbent retailer that is not vertically integrated into electricity distribution and has economies of scale with an existing customer base to defend.

7.2.2 Responses to draft findings

This section provides a summary of the submissions to the Stage 1 Draft Report in relation to price and profit margins. The relevant comments focussed on two areas of the Report, namely:

- economic costs and regulated prices (including the WEC allowance); and
- actual retail margins.

These responses are summarised below.

Economic costs and regulated prices

ActewAGL Retail did not agree with the AEMC that the ICRC's terms of reference require it to calculate the regulated retail tariff on the basis of the efficient costs incurred by ActewAGL Retail. It claimed that the requirement for the ICRC to consider ActewAGL Retail's costs is only in relation to the recovery of additional and specific costs arising from Australian Government and Territory policy obligations (for example, the feed-in tariff scheme). ActewAGL Retail stated that this 'does not relate to, the need to reflect the commercial costs of a retailer in a competitive market environment under the terms of reference per section 20 of the ICRC Act 1997, which explicitly refers to the need to provide an appropriate return on investment and also to the costs of providing the regulated service'.[83]

TRUenergy noted that it did not 'believe that the TFT will ever be effective in encouraging new entrant retailers into the ACT if it continues to be based on ActewAGL's Retail costs'. This is due to ActewAGL Retail's economies of scale, that ActewAGL Retail is well established, and that there is a low level of customer churn in the market. Therefore, TRUenergy considered that 'a methodology based on the costs incurred by a "theoretical" new entrant retailer is likely to be more realistic'.[84]

Additionally, Origin Energy commented that the 'competing interests of the current regulatory policy in the ACT between offering an efficient price and taking account of consumer impacts of price increases has distorted the regulated price'. In its view, 'effective competition in the ACT may prove difficult while price regulation exists'. Specifically, s.20(2)(g) of the ICRC Act 'allows social objectives to obscure the cost build-up process and consequently have the effect of holding the price level below competitive levels. Accordingly, social objectives strictly applied in a price setting scenario appear to be at the detriment of new entrants and impede the development of competition'.[85]

Origin Energy also stated that 'regardless of future price levels a policy to continue with price regulation will not alleviate the regulatory uncertainty associated with price

83 ActewAGL Retail submission, 6 September 2010, p. 9.

84 TRUenergy submission, 3 September 2010, p. 1.

85 Origin Energy submission, 27 August 2010, p. 2.

setting and may remain a sufficient deterrent for new entrants in the absence of more prevalent market activity'.[86]

There were several other submissions that specifically referred to the ICRC's calculation of the WEC allowance and volatility in the wholesale electricity market. For example, the ESAA commented that the 'combination of regulated retail prices, inherently volatile wholesale energy costs, and notoriously thin margins means that retailers contemplating operating in a market under the shadow of price regulation expose themselves to the risk of error by jurisdictional regulators.'[87]

Additionally, the ICRC noted that wholesale electricity price volatility has 'been a significant issue for regulators of retail electricity prices in other jurisdictions'. To the extent that 'fundamental differences in regulatory price setting methodologies exist between the ACT and other east coast electricity regulated markets, which can result in WEC prices significantly above the observed market price'.[88]

Despite 'significant' increases in the TFT in recent pricing determinations, TRUenergy 'remains of the view that the ICRC's calculation of the WEC for the TFT has nevertheless been insufficient to encourage new entrant retailers into the ACT market'. TRUenergy stated that IPART's 'calculation of the energy purchase cost allowance better reflects the actual wholesale costs incurred by retailers'.[89]

Actual retail margins

The ICRC stated that the AEMC's analysis of effective margins was not a complete picture, insofar as 'ACG has relied upon its own calculation of effective margins using CAC/CARC costs taken from NSW and Queensland pricing determinations and applying these to the ACT'. However, the ICRC noted that the ROC allowance in the ACT already 'includes some element of a CAC/CARC' through the sales and marketing cost element (adjusted annually for inflation).[90]

ActewAGL Retail referred to the ICRC submission, noting that the ICRC's statement that ROC includes 'some element' of a CAC/CARC confirms that the current ROC allowance does not fully reflect a commercial CAC/CARC.

Additionally, ActewAGL Retail stated that in 2003, when the marketing and sales component was included in the ROC, the retail market was very different to the present and therefore considers 'the subsequent CPI-only adjustments have not kept with the costs of responding to actual and potential competition in the ACT.'[91]

86 ibid.

87 ESAA submission, 27 August 2010, p. 3.

88 ICRC submission, 31 August 2010, p. 4.

89 TRUenergy submission, 3 September 2010, p. 1.

90 ICRC submission, 31 August 2010, p. 5.

91 ActewAGL Retail submission, 6 September 2010, p. 10.

Notwithstanding the above, the ICRC noted that the TFT with the inclusion of ACG's estimated CAC/CARC component would have increased prices by 4.2 to 5.4 per cent in 2010-11 (an additional 1.8 to 3.0 percentage points above the actual 2.4 per cent increase). In its view, this would 'only meet the lower end of the range of price increases that retailers have identified as being required before they will re-enter the ACT market.'[92]

7.2.3 Further analysis and conclusion

The AEMC has considered the issues raised by stakeholders regarding price and profit margins. As set out in section 5.4.3, the AEMC has found the situation to be much more complicated than set out in the Stage 1 Draft Report. Notably, the AEMC has found that the actual margins available to second tier retailers may not be the same as those earned by ActewAGL Retail because of the unique characteristics of the ACT market (for example, customer stickiness). The additional analysis undertaken by the AEMC and its relevant conclusions are summarised below.

Economic costs and regulated prices

The AEMC notes ActewAGL Retail's comment that the ICRC's terms of reference do not legally require it to determine the regulated retail tariff on the basis of ActewAGL Retail's costs. Notably, it is true that s. 20 of the ICRC Act does not specifically reference ActewAGL Retail. Instead, s. 20(2)(e) states that the ICRC must have regard to the cost of providing the regulated retail services, which the ICRC interprets to be ActewAGL Retail's costs: 'the costs it considers for ActewAGL Retail (s. 20(2)(e))'.[93] Subsequent discussions with the ICRC have confirmed that it interprets this to be ActewAGL Retail's costs. As a result, ActewAGL Retail's costs are the basis for the ICRC's determination of the TFT. However, the ICRC does balance the information it receives from ActewAGL Retail by looking at benchmark data derived from public sources or from market data.

Accordingly, in practice and consistent with the requirements of the ICRC's terms of reference and the relevant sections of the ICRC Act, the basis of the cost build up for the TFT are, in the view of the ICRC, the efficient costs that ActewAGL Retail incurs to provide the regulated service (that is, the supply of electricity to franchise customers). As highlighted in section 5.4.3, setting regulated prices based on the efficient costs of ActewAGL Retail would reduce the margins available to second tier retailers if they have higher costs. This could be addressed by changing the ICRC's terms of reference so that it instead sets prices based on a second tier retailer (for example, based on the costs incurred by a single fuel supply efficient new entrant). The Stage 2 Draft Report discusses this matter further.

The AEMC agrees with the ESAA and the ICRC that accounting for changes in wholesale electricity prices is a difficult task for regulators when setting a regulated

92 ICRC submission, 31 August 2010, p. 7.

93 ICRC, *Final Decision: Retail prices for non-contestable electricity customers 2010-2012*, June 2010, p. 26.

retail price. IPART and the QCA both determine the WEC based on long run marginal costs (LRMC).[94] However, the ICRC is of the view that 'there is no economic justification for using the LRMC as a floor when determining the wholesale energy cost in the build-up of the efficient costs.'[95]

As discussed in the Stage 1 Draft Report, the AEMC considers that the ICRC's market-based approach to calculating the WEC appears to be an appropriate and valid method. Having said that, pricing uncertainty and the regulatory risk that prices do not accurately reflect efficient costs is common to all second tier retailers active in the NEM. Notably, this could reduce retailer rivalry if retailers are not hedged properly with generation units. Additionally, it is possible that retailers with limited generation resources would shift into other markets where they believed higher returns were achievable. This may warrant further consideration to be given to specific allowances to account for wholesale market risk, such as IPART's volatility allowance. However, the ICRC's relatively high frequency of pricing determinations partially offsets this need.

In conclusion, basing the TFT on the ActewAGL Retail's efficient costs could reduce the margins available to second tier retailers if their costs are higher. This would discourage second tier retailers from entering into and expanding within the ACT market. In addition, the ICRC's methodology for determining the WEC appears to be appropriate.

Actual retail margin

The AEMC's analysis in section 5.4.3 is also relevant in addressing the submissions pertaining to the exclusion of an allowance for CAC/CARC and the ICRC's comment that the TFT already includes a sales and marketing component in the ROC. To address the ICRC's comment, the AEMC compared the retail cost allowance in the ACT (which includes CAC/CARC elements) to those in other jurisdictions (also including CAC/CARC allowances). Notably, this analysis showed that the ACT's regulated retail cost allowance is relatively low compared to other jurisdictions.

Importantly, given that retailers are not entering into or expanding within the ACT retail electricity market, it appears that second tier retailers do not perceive the allowance to be sufficient to recover their costs and earn a rate of return that is commensurate with the risks and uncertainties of operating in the market over the long-term.

However, if the unique characteristics of the market are addressed to make it easier for second tier retailers to enter into and expand within the market then the current tariff levels could be adequate for retailers to earn sufficient profit. That is, prices do not need to increase to promote competition in the ACT electricity market. This is discussed further in the Stage 2 Draft Report.

---

94 However, in its 2010 pricing determination the QCA moved to a 50/50 weighting of LRMC and market-based costs.

95 ICRC, *Final Decision: Retail prices for non-contestable electricity customers 2010-2012*, June 2010, p. 31.

Notwithstanding, as pointed out by the ICRC, ACG's calculation of ActewAGL Retail's effective margins relied on CARC allowances taken from the NSW and QLD pricing determinations. These allowances are based on the costs efficient retailers incur to acquire new customers, retain existing customers and encourage existing customers on standing offer contracts to transfer to market contracts. Given that the switching and transfer rates differ across jurisdictions, it may not have been appropriate to apply the CARC allowances from other jurisdictions to the ACT.

In conclusion, regardless of whether or not certain elements of CAC/CARC are included in the retail allowance in the ACT, the margins available to second tier retailers based on the relatively low allowance, are not perceived to be sufficient to encourage entry and expansion, given the risks associated with the provision of retail services and the unique characteristics of the market.

7.3 Retail products and services

This segment of the Stage 1 Draft Report described the retail products and services available to consumers in the ACT electricity market. The key components are set out below.

7.3.1 Draft findings

Another important indicator of market performance is product differentiation and innovation. This section sets out the types of market offers and discounts currently available to small electricity customers in the ACT.

ActewAGL Retail and TRUenergy are currently the only two retailers that are active (in the sense of accepting new customers) in the ACT electricity retail market. While ActewAGL Retail continues to market, TRUenergy has indicated that it has discontinued all proactive marketing activities to attract new customers in the ACT. Country Energy and EnergyAustralia continue to provide retail services to existing customers but are no longer accepting new customers.

ACG reviewed the websites of these four retailers to determine what products and prices they offer to small electricity customers. It found the prices offered by EnergyAustralia in the ACT are identical to those offered by ActewAGL Retail, while Country Energy's ACT prices are not publicly available. Importantly, the differences between the prices offered by ActewAGL Retail (and so, EnergyAustralia) and TRUenergy are fairly minor, and the optimal plan would depend on a household's electricity usage patterns.

Additionally, it is useful to compare the level of innovation and product differentiation in the ACT electricity market to that of other jurisdictions. A review of offers available via website brokers to NSW and Victorian small electricity customers indicates that there are numerous offers available from several retailers. Not only do these offers include discounts for prompt payments, loyalty discounts, choices in exit fees and contract length, some retailers also offer other benefits, such as complimentary magazine subscriptions.

In terms of the discounts available to small customers, both TRUenergy and ActewAGL Retail offer reductions off their market offer prices. For example, ActewAGL Retail offers a 5.5 cent per day discount for those customers who sign a direct debit agreement, while TRUenergy offers a three per cent discount to customers who pay their bill on time.[96]

Additionally, ActewAGL Retail offers a discount for customers who bundle three or more ActewAGL or TransACT services. Electricity, natural gas and landline telephone are compulsory services to receive a discount from ActewAGL Retail.[97] Additional optional services include mobile telephone, broadband, internet, subscription TV, and green energy. The bundling discounts range from three per cent for three bundled services to 25 per cent for seven services (to a limit of $500 per year). Customers who bundle at least five services also receive a privilege card that provides discounts throughout Canberra.[98]

The bundling discounts offered by ActewAGL Retail and its affiliate TransACT do not currently appear to be offered by any of the other retailers. In contrast, the ICRC stated in its most recent determination that in 2006 there were at least two other retailers offering bundled services:[99]

> “only ActewAGL Retail appears to be offering discounts from the TFT price, and these discounts are only being offered in conjunction with the provision of bundled services....This situation is in contrast to market conditions in 2006, when the Commission found at least two retailers other than ActewAGL Retail willing to offer discounts from the TFT in conjunction with the provision of bundled services.”

Additionally, it is acknowledged that in general, retailers do not view ActewAGL Retail's bundling discounts as a primary barrier to entry to the market.[100]

In summary, ActewAGL Retail is currently the only retailer offering bundling discounts, as compared to 2006 when at least two other retailers were willing to offer discounts in conjunction with the provision of bundled services. Therefore, the level of product innovation and differentiation in the ACT electricity retail market appears to be weak at present. However, the extent of discounts currently being offered by ActewAGL Retail has never been offered by another retailer. This suggests that ActewAGL Retail may have cost advantages over second tier retailers.

---

96 ACG Price and Profit Margin Analysis, p. 21.

97 TransACT is a telecommunications service provider that has been managed by ActewAGL since 2004 and is 18 per cent owned by Actew Corporation. Gas is only compulsory in the bundle for customers who already have a natural gas connection.

98 ACG Price and Profit Margin Analysis, p. 22.

99 ICRC, *Draft Decision: Retail prices for non-contestable electricity customers, 2010-12*, April 2010, p. 48

100 GA Research Retailer Interviews, p. 17.

7.3.2 Responses to draft findings

ActewAGL Retail did not agree with the AEMC's draft finding that the level of innovation and product differentiation currently appears to be weak compared to that of other jurisdictions. Importantly, it noted that 'a simple survey approach of the number of products currently on offer by electricity retailers across jurisdictions does not provide an appropriate comparison'. It elaborated by stating that it 'offers a variety of products, which have evolved over the past decade with changing market conditions, including bundled service offers, discounts, the One Call Connects All (OCCA) contact centre and Green Energy combinations'.[101]

Further, ActewAGL Retail refers to the AER's *2009 State of the Energy Market*, which lists ActewAGL Retail as offering 20 different products, more than 'retailers in Victoria, South Australia, NSW and Queensland'.[102]

The ESAA commented that the advantage of competitive markets is that they are much more capable of dealing with complex issues such as an ETS and result in greater product innovation, stating that 'competitive markets are far more capable of processing the complex impacts of climate change policies on supply and demand than a regulator and are more likely to find the most appropriate pricing structures and encourage competition in the development of alternative products and levels of service'.[103]

Finally, TRUenergy considered that ActewAGL Retail's ability to bundle water with electricity and gas was a concern. Specifically, 'the issue in the ACT is that the discounts ActewAGL offer are substantially more than those of its competitors, and the fact that water is not contestable'.[104]

7.3.3 Further analysis and conclusion

ActewAGL Retail has argued that it is not appropriate for the AEMC to look only at a 'snapshot' of the number of products being offered by retailers across jurisdictions. It referred to the AER's *2009 State of the Energy Market* and noted that ActewAGL Retail offers more products than retailers in Victoria, South Australia, NSW, and Queensland. However, it should be noted that ActewAGL Retail is the only retailer listed by the AER for the ACT, whereas all of the other jurisdictions have several retailers offering different combinations of products.[105] The AEMC views a more appropriate comparison to be the total number of product offerings by retailers in each jurisdiction (that is, by capital city). This analysis does not support ActewAGL Retail's argument as it results in 79 product offerings in Victoria, 41 in South Australia, 49 in NSW, 48 in Queensland, and only 20 in the ACT.

---

101 ActewAGL Retail submission, 31 August 2010, p. 13.

102 ibid, p. 13.

103 ESAA submission, 27 August 2010, p. 4.

104 TRUenergy submission, 3 September 2010, p. 2.

105 AER, *State of the energy market 2009*, 8 December 2009, p. 203.

Notwithstanding the above, ActewAGL Retail is currently the only retailer offering bundling discounts, where it remains the case that in 2006 there were at least two other retailers offering bundling discounts. This suggests that the level of innovation and product offerings for the ACT electricity retail market has declined, and in any event, less than in other jurisdictions. However, it also highlights that ActewAGL Retail has differentiated itself from its competition.

The AEMC agrees with the ESAA's comment that competitive markets are typically more capable at dealing with complex issues such as climate change and are more likely to result in an efficient level of services and quality. However, this only holds true if the incumbent is constrained by competitive pressure, which is currently being diminished by the risks and costs second tier retailers incur to enter into or expand within the market (as set out in section 5.4.3). As a result, the Stage 2 Draft Report assesses the various options to improve the level of competitive pressure by reducing these risks and costs.

In regard to TRUenergy's comment, while Actew Corporation outsourced the billing and customer service aspects of its water and wastewater operations to ActewAGL Retail, water is not included in any of the bundled service options available from ActewAGL Retail. Additionally, the AEMC understands that water bills are provided separately to energy and telecommunication invoices to consumers. Importantly, as discussed in Section 6.4, the majority of customers do not bundle their services.

In summary:

- the differences between the services and prices currently being offered by active electricity retailers in the ACT are quite minor;
- ActewAGL Retail is currently the only company offering products that are significantly different than the TFT (in the form of bundling discounts);
- the level of innovation and product offerings appears to be weak compared to that of other jurisdictions; and
- the number of retailers willing to offer discounts in conjunction with the provision of bundled services has declined since 2006.

Therefore, the AEMC maintains its draft finding that the retail products and services being offered in the ACT electricity retail market are not consistent with a well functioning competitive market.

7.4 Customer satisfaction

This section of the Stage 1 Draft Report discussed customer satisfaction in the ACT electricity retail market. A summary of this discussion is provided below.

7.4.1 Draft findings

Customer satisfaction is an important indicator of market performance. This section discusses:

- customer satisfaction feedback captured by the consumer surveys undertaken for the AEMC; and
- historical customer complaints in the ACT (including a comparison with other jurisdictions).

Customer satisfaction was assessed during the Roy Morgan Research quantitative surveys of residential and small business consumers. Roy Morgan Research found that there was an overall feeling of satisfaction by participants with their current retailer and that experiencing a problem was a rare occurrence. In total, 78 per cent of residential consumers and 80 per cent of small business consumers had not contacted their electricity supplier in regard to service problems in the past 12 months. Most participants that had contacted their electricity supplier were satisfied with the timeliness of the response and the assistance provided.

The survey also asked those participants that had not experienced any problems who they would turn to in the event that they did have issues with their electricity supply. Most participants (75 per cent of residential and 65 per cent of small business consumers) indicated that they would complain directly to their electricity retailer.

The surveys also found that consumer awareness of independent sources of assistance was low - approximately ten per cent for both groups. For example, consumer awareness of ACAT, who performs functions carried out by an industry Ombudsman in other jurisdictions, was extremely low. Combined with the generic answer 'energy ombudsman', only five per cent of small businesses and 11 per cent of residential consumers were aware of ACAT as a provider of independent assistance in matters relating to the supply of electricity to their premises.

The Stage 1 Draft Report also reported on the number of complaints made to the related energy Ombudsman in Victoria, South Australia and the ACT.[106] As expected, the overall number of complaints in Victoria and South Australia are higher than the ACT, in part as a result of the greater size and population of these jurisdictions. However, the number of electricity related complaints per 1 000 customers is also lower in the ACT.

In 2008-09, the number of electricity related complaints per 1 000 customers in the ACT stood at 8.5 compared to 10.7 and 17.7 in South Australia and Victoria, respectively. Additionally, where the number of complaints in both Victoria and South Australia have increased over the past two years, complaints in the ACT have remained relatively constant.

106 Note that the ACT does not have an energy ombudsman and ACAT is the relevant body to deal with customer complaints that are escalated beyond the retailer.

7.4.2 Responses to draft findings

There was little response to the Stage 1 Draft Report discussion on customer satisfaction. Origin Energy noted that 'given retail price levels are below that expected in a competitive market, ... there appears little cause for customers to be disgruntled. However, this is evidence that short-term social objectives have been given too much weight in the price setting process to the detriment of long-term market outcomes'.[107]

The Consumer Agencies suggested that the data 'indicates that ACT consumers are satisfied with the service they are receiving'.[108]

7.4.3 Further analysis and conclusion

The Consumer Agencies generally supported the AEMC's analysis of consumer satisfaction. In addition, Origin Energy noted that consumers appear to have little to complain about. This appears a reasonable conclusion given the relatively low regulated price in the ACT that many small consumers use. Having said that, it is worth noting that a high level of customer satisfaction means that second tier retailers will have a more difficult time attracting customers away from the incumbent. This is likely to require both discounts off the standing offer tariff (or some other form of incentive such as a complimentary magazine subscription) and increased marketing activities. Both will cut into the already limited margins available to second tier retailers operating in the ACT electricity market.

Importantly, a high level of customer satisfaction suggests that despite ActewAGL Retail's dominance, competitive pressure (that is, the threat of entry or expansion) has encouraged it to maintain a high quality of service. This is one positive indicator of market performance. Therefore the evidence is that limited competition pressure exists, but increasing the level of competition will lead to benefits for consumers.

The suggestion from Origin Energy that social objectives have impacted regulated prices to the long term detriment of the market is important. However, the ICRC must have regard to certain social and environmental objectives as determined by the ACT Government. These objectives are discussed further in sections 8.2 and 8.3.

Overall, the AEMC concludes that customers in the ACT are generally satisfied with their current retailer and fewer problems are experienced in comparison to other jurisdictions. However, this high level of satisfaction means that second tier retailers will have a more difficult time attracting customers away from the incumbent, and as a result, the margins available to them will be squeezed.

107 Origin Energy submission, August 2010, p. 2.

108 Consumer Agencies' submission, 27 September 2010, p. 10.

8 Compliance with social welfare and equity objectives

8.1 Introduction

A review into the effectiveness of competition in a retail energy market requires the AEMC to assess and report on whether a jurisdiction's social welfare and equity objectives are met through 'clearly specified and transparently funded State or Territory community service obligations that do not materially impede competition'.[109]

This chapter firstly sets out the AEMC’s assessment of the ACT social welfare and equity objectives relevant to the provision of electricity supply to small customers. In addition, and although not directly related to social welfare and equity objectives, the chapter then discusses environmental policies relevant to the market.

8.2 ACT social welfare and equity objectives

The following sections refer to the important legislative instruments relevant to addressing social welfare and equity objectives in the energy sector. Each section will include a brief description of the legislative instrument, how it is implemented to address social welfare and equity objectives, and any impact on retail competition. Where relevant, matters raised by stakeholders are discussed.

8.2.1 ACT Government energy policy

The First Draft Report noted that the draft sustainable energy policy of the ACT Government seeks to achieve certain outcomes.[110] There are a number of facets to the sustainable energy policy such as encouraging: an increase in the use of renewable energy sources; a reduction in transport emissions; and achieving carbon neutrality for the ACT Government. The policy goals most relevant to the ACT Retail Review are:

- increased customer information and choice; and
- to maintain equity.

Increased customer information and choice

There are a number of existing requirements and targeted programs for improving customer information. One example is that electricity bills include information comparing consumption and resultant emissions with previous bills. In addition, current targeted programs include:[111]

109 AEMA, clauses 14.11(b) and (c).

110 ACT Government, *Draft sustainable energy policy 2010-2020*, December 2009.

111 ibid., p. 16.

- ACTSmart Rebates and Assistance – a one-stop-shop and website for consumers (households, businesses, schools and community groups) to access ACT Government rebates and assistance in saving energy and water usage;
- Home Energy Advice Team (HEAT) – a service that provides free advice on reducing energy use;
- ACT Energy Wise – a program that undertakes home energy audits;
- Home Energy Action Kits – home use kits for monitoring domestic energy consumption, which are available for loan from ACT public libraries; and
- City Switch, Business Smart, Office Smart and the Energy Efficiency Fund – programs which work to improve energy efficiency and reduce waste in buildings.

These programs should, where they are well promoted, provide households with additional information on making energy use decisions. Assistance in improving energy efficiency provides benefits to the immediate household, in terms of lower bills, but also to the wider community. In terms of developing these policies in the future, the ACT Government draft energy policy plans to:[112]

1. consider fast-tracking the installation of smart meters into ACT households where it is demonstrated to be cost-effective to better assist residents in managing their energy loads and allow them to make more informed decisions about their energy consumption; and
2. consider the removal of the regulated electricity tariff with the aim of encouraging new and innovative pricing and service arrangements that will result in greater choice for customers.

In terms of the ACT Government's objectives to 2020, it is reasonable to expect that with relevant support over a period, households will be able to make use of smart meters to make better energy use decisions. Similarly, if households express an interest in different energy products (either by different service levels, use of green energy, or by different payment plans) a market that displays effective competition would be a market where retailers are motivated and able to address the needs of consumers.

Maintain equity

For the purpose of the sustainable energy policy, the ACT Government defines 'equity' to be the 'fairness and ability of all ACT residents to be able to meet their energy requirements without undue financial stress'.[113] Currently, the ACT Government maintains an internet based one-stop-shop for concessions offered in the ACT. Specifically for energy requirements, the ACT Government provides an Energy

112 ibid., p. 17.

113 ibid., p. 19.

Concession, equal to $214.87 per annum, to consumers who hold a Centrelink health care card, Centrelink or Department of Veterans Affairs pension card.[114] The purpose is to improve the affordability of essential energy services for low income residents of the ACT. The Government has noted that at any one time, there are over 22 000 households in the ACT receiving the Energy Concession.[115]

Going forward, the ACT Government's overarching policy objectives to assist low-income and vulnerable energy customers include:[116]

1. considering increasing the Energy Concession to a level commensurate with expected energy price increases. Such an increase would immediately assist the households that receive this benefit each year;

2. considering the establishment of a mechanism by which percentage increases in energy prices are automatically applied to the Energy Concession each year;

3. identifying and considering implementing in each residential based program within ACTSmart a specific benefit payable to low-income households in addition to the benefit already available. This requirement would potentially flow through to any subsequent delivery of programs under industry agreements; and

4. ensuring that considerations regarding the Energy Efficiency Improvement scheme include a focus on low-income and vulnerable customers.

Of these, it is understood that the recent increase in the Energy Concession from $194 to $214 was welcomed by a number of interested parties and the ICRC. It was also announced that the amount of the concession would increase periodically in line with changes to the consumer price index (CPI).[117]

Responses to the maintaining equity discussion

Although, as noted in the Stage 1 Draft Report and above, a number of parties welcomed the June 2010 changes to the Energy Concession, ACT Council of Social Service (ACTCOSS) stated that the 'rate of the concessions is insufficient'. In its 2010-11 budget, the ACT Government announced that Energy Concessions for hardship consumers would increase by $20 per year. This equates to a '14 per cent increase since 2004-05, [however] electricity prices have grown on average by 23 per cent over the same period'.[118] The Consumer Agencies also commented that 'the concession is a step

---

114 The Energy Concession is administered by the ACT Department of Disability, Housing, and Community Services. There are currently five energy providers registered. Retailers are recompensed by the ACT Government. See www.dhcs.act.gov.au/wac/concessions/energy_concession.

115 DECCEW, *Draft sustainable energy policy 2010-2020*, December 2009, p. 19.

116 ACT Government, *Draft sustainable energy policy 2010-2020*, December 2009, p. 19.

117 ICRC, *Final decision: retail prices for non-contestable electricity customers 2010–12*, June 2010, p. 6.

118 ACTCOSS submission, 3 September 2010, pp. 3-4.

in the right direction, however, it does not make up for the costs low-income consumers will need to carry'.[119]

Further analysis and conclusions

In general, the AEMC considers that increasing the Energy Concession in line with CPI will assist in (although not guarantee) maintaining the real value of the assistance over time. It notes that the comments by ACTCOSS that there are instances when energy price inflation is higher than CPI are quite valid. There have been, and may be in the future, instances where energy prices increase at a rate greater than CPI. In particular, the introduction of any carbon tax or other related emissions trading scheme that is passed directly through to end users may result in significant retail price increases. However, until the details of these schemes are developed, the extent to which these matters impact on consumers and how this can be managed can not be finalised. This is particularly relevant to the ACT given the relatively high household energy consumption (driven by the climatic conditions) that has been observed as discussed in section 5.2 of this report.

As shown in Table 8.1, the level of the Energy Concession in the ACT is comparable with that of other jurisdictions in Australia. With the exception of the Northern Territory and Tasmania, which both have comparatively generous concessions, the energy concession at the state average consumption in the ACT is broadly similar, in dollar terms, with that of Queensland and South Australia at 2.6 c/kWh. However, at approximately 16 per cent of the total bill (based on the regulated tariff or standing offer contract and the average consumption for that jurisdiction), the ACT Energy Concession is more generous than a number of other jurisdictions.

119 Consumer Agencies' submission, 27 September 2010, p. 2.

Table 8.1 Cross jurisdictional comparison of energy concessions

	c/kWh at state average consumption		concession as a
	price	concession	% of price
NT	21.0	9.7	46.2
Tasmania	20.9	4.6	22.0
ACT	16.3	2.6	16.0
Victoria	22.7	3.0	13.2
Queensland	20.6	2.6	12.6
South Australia	25.4	2.5	9.8
Western Australia	23.0	2.2	9.6
NSW	26.2	1.5	5.7

Source: Office of the Tasmanian Economic Regulator, *Comparison of 2010 Australian standing offer energy prices: fact sheet*, 9 September 2010.

8.2.2 Utilities Act

The *Utilities Act 2000* (ACT) (Utilities Act) regulates the provision of services by entities supplying regulated utility services (this includes electricity, natural gas and water) in the ACT and to protect the interests of the ACT community as consumers of these services. The Utilities Act consists of 16 parts, with Part 12 (complaints to ACAT about utilities, primarily in relation to customer hardship applications) and Part 13 (community service obligations) being those provisions most relevant to the social welfare and equity obligations in the ACT and this Review.

Part 12 of the Utilities Act outlines the consumer complaint process with ACAT including the requirements for complaint lodgement and ACAT's processes and powers to make decisions. Of particular importance to customer hardship applications are ss. 179 and 180. Section 179 sets out the powers available to ACAT with respect to the actual or potential withdrawal of a utility service because of a failure to pay a customer debt. Section 180 allows ACAT to discharge a customer debt where it is satisfied that the payment of the debt would cause substantial hardship for the customer.

The establishment of ACAT as an independent body to hear civil disputes on certain matters, including those related to the supply of energy to households, is an important aspect of the Utilities Act and the overall social assistance framework of the ACT Government. The societal benefit of such an organisation is significant to the community. More specifically, and relevant to this Review, the inclusion of energy related matters in ACAT’s jurisdiction is an important aspect of the ACT electricity market.

The purpose of Part 13 of the Utilities Act is to set out the obligations on utilities to supply services in accordance with relevant Government programs relating to, for example, community services, the environment or other social issues.[120]

With respect to these obligations, the AEMC notes that ActewAGL Retail provides information relating to each community service obligation and rebate on its website.[121] The following concessions are available from ActewAGL Retail for energy users:

- ACT pensioner and veteran rebates;
- ACT health care card rebate; and
- ACT life support rebate.

These types of rebates are also available to NSW energy users. As with the ACT Energy Concession, the NSW Energy Rebate requires the recipient to hold a pensioner concession card from Centrelink or the Department of Veterans' Affairs or a health care card from Centrelink. The current (from 1 July 2010) NSW Energy Rebate is $145 per year.[122]

Further analysis and conclusions

A well functioning market should provide avenues for consumers to seek assistance in the paying of their bills as well as understanding their rights and obligations relating to the supply of energy. For the first of these, consumers who require assistance with their household bills are able to seek assistance from ACAT after raising the matter with the relevant utility. If participation in the utility's hardship program or use of a payment plan cannot be agreed upon or does not provide the desired benefit, then the consumer is able to apply to ACAT for hardship assistance.

In 2009-10 ACAT received 1 389 new hardship water and energy complaints, a significant increase on the previous year.[123]In addition, requests for reconnection (of water or energy supply) increased to 286 in the year. As hardship matters require on-going management by ACAT, this increase will impact on the operations of ACAT for some time. Nevertheless, ACAT anticipates that the recent hardship program improvements by ActewAGL will reverse the trend.[124]

ACAT also manages non-hardship complaints from consumers. These matters include failure by a utility to comply with its billing obligations, failure by a utility to make

120 See section B.13 of the Second Draft Report. ACT specific environmental matters are outlined in section 8.3 of this report.

121 www.actewagl.com.au/rebates/ACTenergy.aspx

122 See http://www.myenergyoffers.nsw.gov.au/useful-information/pensioner-and-low-income-rebates-and-assistance.aspx.

123 The AEMC understands that the majority of these matters relate to the supply of electricity. These figures do not include matters that did not progress (as it was resolved or was not continued) beyond the utility.

124 ACT Department of Justice and Community Safety, Annual Report 2009-10, p. 202.

good damaged property, misleading marketing, failure to protect personal information, and (from 1 July 2009) complaints about the feed-in tariff. As with hardship complaints, consumers must first raise the matter with their utility. If a satisfactory outcome is not found, a consumer can lodge a complaint with ACAT who will seek to resolve it with the utility concerned. The number of non-hardship complaints increased between 2008-09 and 2009-10 from 71 to 109.[125]This increase has been attributed to problems arising from the ActewAGL Gas national billing system. One of the problems particularly noted by ACAT was that some customers under ACAT's hardship protection were disconnected as a result of the errors in the ActewAGL Gas billing system. Nevertheless, the majority of non-hardship complaints were resolved by ACAT facilitating communication between the concerned parties.[126]

The above is consistent with other information before the AEMC that there has been an increase in the number of matters relating to energy before ACAT in recent years. The number of hardship matters is particularly noted. The resulting workload is understood to impact on ACAT's ability to manage non-hardship water and energy matters even though this is within ACAT's jurisdiction. This situation raises the question of whether consumers are sufficiently aware of their rights and obligations in relation to the supply of energy services to enable them to resolve disputes with their retailer directly. This is despite the Consumer Protection Code requirements for utilities to inform customers of their complaints handling systems and of ACAT's hardship jurisdiction. Consequently, there may be scope for reconsideration of the appropriate level of consumer awareness and education in the ACT.

8.2.3 ICRC Act

The *Independent Competition and Regulatory Act 1997* (ACT) (ICRC Act) establishes an independent commission - the ICRC - to regulate pricing, access and other matters in relation to industries involved in the provision of electricity, gas, water and sewerage services, and other industries. It also investigates competitive neutrality complaints and government regulated activities. Part 4 of the ICRC Act addresses pricing directions. In making a decision on the level of prices for services, the ICRC must have regard to the 'social impacts of the decision' under s. 20(2)(g) of the ICRC Act.

ICRC's pricing decisions always discuss the important aspects of balancing its multiple objectives of setting efficient cost reflective prices and adhering to the social impacts of its decisions. For example, chapter 6 of its draft pricing decision for 2010-2012, included a discussion on the impact of a higher TFT in relation to s. 20 of the ICRC Act. The ICRC concluded that it 'does not consider that the potential benefits to consumers from artificially increasing the TFT (on the basis that it may result in vigorous competition)

---

125 Note that this does not include matters that did not progress (as it was resolved or was not continued) beyond the utility.

126 ACT Department of Justice and Community Safety, Annual Report 2009-10, p. 202.

outweigh the potential negative impacts, which will include higher prices in the short-term, and possibly in the long-term as well'.[127]

Furthermore, in chapter 10 of its final decision, the ICRC discussed the social implications of its pricing decision, although it noted that addressing broader social equity problems was beyond the scope of its terms of reference. That is, the focus of ICRC's pricing determinations should be 'on how best to link pricing outcomes with the wider range of policy objectives'.[128] Notwithstanding, while acknowledging its obligations under s. 20(2)(g), the ICRC has noted that 'the TFT is not intended to be a "safety net" to be used for social or targeted support to smaller customers and targeted Energy Concessions are a much better vehicle for delivering that support'.[129] The ICRC considers that directly funded programs that take into account the prices of the essential services involved are the most appropriate mechanisms to target households and individuals in need.

The AEMC has noted that the Energy Concession and community service obligations (CSOs) are in place to ameliorate customer hardship with respect to the cost of energy supply to households. These rebates are independent of the ICRC and its role. Nevertheless, it is clear that the ICRC does have regard to the social implications of its decisions pursuant to s. 20 of the ICRC Act. Together, the various rebates and the ICRC’s obligations have the effect of ensuring that matters relevant to low income households in particular are taken into account in the supply of energy to the ACT community.

Responses to the ICRC Act discussion

Origin Energy stated that while it accepts the inclusion of considerations under s. 20 by the ICRC, it suggested that these social objectives may actually obscure the cost build-up process, be at the detriment of new entrants and impede the development of competition. Therefore, Origin Energy concluded that 'short-term social objectives have been given too much weight in the price setting process to the detriment of long-term market outcomes'.[130]

8.2.4 Further analysis and conclusions

The AEMC acknowledges that consideration of matters such as those listed in s. 20 of the ICRC Act will impact on the final regulated retail price that is determined by the ICRC. There is no evidence to suggest that consideration of social objectives is not appropriate. The key is that the regulator must undertake an analysis that balances between pricing and social objectives. It is important, as noted above, that such analysis be clearly identified and acknowledged.

127 ICRC, *Draft Decision: Retail prices for non-contestable electricity customers 2010-2012*, April 2010, pp. 56-57.

128 ICRC, *Final Decision: Retail prices for non-contestable electricity customers 2010-2012*, June 2010, p. 64.

129 ibid., p. 63.

130 Origin Energy submission, 27 August 2010, p. 2.

8.2.5 Consumer Protection Code

The Consumer Protection Code (Code) is an industry code under Part 4 of the Utilities Act. The Code outlines the basic rights of customers and utilities with respect to access to, and provision of, utility services. It supports other consumer protection requirements such as those relating to door to door sales and general provisions under the *Fair Trading Act 1992* (ACT). Utilities are obliged to give effect to the rights in the Code primarily through customer contracts.[131]

The Code applies to all utilities that are licensed under the Utilities Act to provide services such as, water, electricity and natural gas. It is divided into a number of parts. The most relevant of these are:

- Part 2 contains generic provisions that apply to all utilities and deals with the protection of customers and consumers;
- Part 3 applies only to utilities in the provision of utility services to franchise customers, that is, network services and gas and electricity supply to customers on market contracts;
- Part 4 applies to suppliers of electricity and gas supply services to small non-franchise customers, that is, network services and gas and electricity supply to customers on the TFT; and
- Part 5 deals with marketing of electricity and gas to franchise customers and small non-franchise customers.

The Code is enforceable under the Utilities Act, which states that a utility licence is subject to the condition that the utility comply with each industry code that applies to the utility.[132] The ICRC is responsible for monitoring utilities' compliance with this Code.

Provisions relating to the protection of customers are outlined under Part 2 of the Code. The key provisions of the Code relating to social welfare and equity objectives are:

- the obligations of utilities and customers and the processes that must be followed in relation to customer disconnection; and
- the obligations of utilities and customers and the processes that must be followed in relation to bill payment difficulties and customer hardship complaints to ACAT.

The Code provides transparent processes to protect consumers from disconnection. It sets out obligations and responsibilities for utilities and customers as well as

131 ICRC, *Consumer Protection Code*, July 2010, p. I.

132 Utilities Act , s. 25(2)(iii).

acknowledging the role of ACAT, an independent tribunal for those consumers experiencing problems in the supply of utility services.

Responses to Consumer Protection Code discussion

While no submissions were received on the content of the Code specifically, some stakeholders did raise issues relating to matters covered by the code. For example, the ESAA acknowledged that 'governments can have an important role to play in supporting a deregulated market by monitoring the state of competition and importantly, supporting those consumers that find electricity prices unmanageable'.[133]

In relation to disadvantaged customers, ACTCOSS expressed concern that these customers may be unable to participate effectively in the competitive market, for example, in purchasing bundled products. ACTCOSS noted that a '2008 report by the ACT Chief Minister's Department (CMD) Social Impacts of Climate Change in the ACT also examined the number of low income households in the ACT. According to this study, there were approximately 20 000 low income households in the ACT earning less than $650 a week. In 2008, this equated to 17 per cent of all households'.[134] ACTCOSS also stated that 'the extra costs of electricity correlate with the extremes of the Canberra weather', especially the extra cost burden to disadvantaged customers during the winter months.[135]

ActewAGL Retail stated that it had 'recently relaunched an improved and comprehensive Staying Connected program for customers experiencing ongoing financial hardship'.[136] The program provides low income and vulnerable customers with information on flexible payment plan options and incentive schemes for customers who make regular payments on their accounts. As part of the program, ActewAGL Retail also 'offers a referral service to other agencies that provide assistance and support for those customers experiencing financial hardship'.[137] In terms of the protection of low income and/or vulnerable customers, ActewAGL Retail 'firmly believes that initiatives such as the Staying Connected Hardship Program are a much more effective and appropriate mechanism for assisting [these customers] ... when compared with relying on a regulated retail tariff'.[138]

Further analysis and conclusions

The AEMC acknowledges the comments by ACTCOSS regarding the importance of providing assistance to low income households. The AEMC also agrees that the climatic conditions in the ACT as noted in Chapter 5 of this report are likely to result in higher average demand, which may be a financial burden for low income households

133 ESAA submission, 27 August 2010, p. 2.

134 ACTCOSS submission, 3 September 2010, pp. 3-4.

135 ibid.

136 ActewAGL Retail submission, 31 August 2010, p. 7.

137 ibid.

138 ibid.

in the ACT. However, assistance is not limited to only financial elements (such as the Energy Concession), as noted in the ACT Government's draft sustainable energy policy non-financial assistance such as energy audits and energy efficiency programs are also available to consumers in the ACT. As previously discussed in the Stage 1 Draft Report, the AEMC considers that direct funding through financial and non-financial assistance programs is the most appropriate mechanism to target households and individuals in need. That is, as noted by the ESAA, it is the role of governments to support those consumers that find prices unmanageable, not the role of the regulated retail tariff. The ICRC have in its pricing determinations also noted that 'the regulated retail tariff is not intended to be a safety net to be used for social or targeted support for smaller customers'.[139]

Consistent with this approach, the AEMC notes that the improvements that ActewAGL Retail has added to its Staying Connected program will also assist customers. Importantly, the AEMC considers that the enactment of government initiated CSOs directly by retailers (such as this) is the most efficient way of reaching those customers in greatest need. In addition, the referral service that ActewAGL Retail has with ACAT should assist in ensuring that support will be provided where it is needed.

In conclusion, a multi-faceted approach, consisting of both financial and non-financial elements supported by government, is an approach that should have more success in allocating the appropriate assistance to the relevant members of society in a timely manner. The ACT's application of this approach appears to be consistent with the AEMA objective of social welfare and equity objectives being met in a manner that does not impede competition.

8.2.6 Human Rights Act

The Public Interest Advocacy Centre (PIAC), in its response to the Issues Paper, made submissions relating to the relevance of the *Human Rights Act 2004* (ACT) (HRA). The HRA provides that it is unlawful for a public authority to act in a way that is incompatible with a human right, or, in making a decision, to fail to give proper consideration to a relevant human right.[140] A public authority is defined to include those entities whose functions are, or include functions of a public nature, for the ACT.[141] Matters relevant in deciding whether a function of an entity is a function of a public nature includes whether the function is conferred under a territory law, whether the function is connected with functions of government, and whether the function is of a regulatory nature.[142]

PIAC has submitted that the human rights relevant to this review are rights relating to the right to life, and the right to protection of family life.[143] The AEMC notes that the

---

139 ICRC, *Final Decision - Retail prices for non-contestable electricity customers*, June 2010, p. 56.

140 HRA, s. 40.

141 ibid., s. 40A(1)(g).

142 ibid., s. 40A(1)(a)-©).

143 ibid., ss. 9 & 11.

HRA provides that 'every child has the right to the protection needed by the child because of being a child, without distinction or discrimination of any kind'.[144]

The AEMC, in making recommendations for this Review, has had regard to the HRA, and considers that it has not acted in a way that is incompatible with a human right under the HRA.

8.2.7 Conclusions on social welfare and equity objectives

As required by the AEMA, the AEMC has reviewed the social welfare programs in the ACT relevant to the electricity market.

The ACT Government has initiated a number of financial and non-financial programs to assist small electricity consumers. Most significantly, the Energy Concession and the operation of ACAT. The Energy Concession represents 16 per cent of an average annual household bill. Given the proportion of low income households and the climate of the ACT, it is important that other assistance, such as improving the energy efficiency of homes, is also available. The AEMC considers that the ACT Government's approach to providing a framework to address social welfare and equity matters through financial and non-financial means is a sound approach. The clear funding arrangements in place and the ability of all retailers to participate in the programs are positive features.

The AEMC notes the recent improvements in ActewAGL Retail's Stay Connected program are consistent with the Government's approach. Nevertheless, the current programs should be reviewed, and where necessary amended, as changes to the electricity (and gas) markets occur. Periodic reviews and amendments will provide the opportunity to ensure that the benefit of these programs does not diminish over time. That is, as noted by stakeholders, it is a government responsibility to assist consumers over time.

On the whole, the AEMC considers that the ACT Government approach to social welfare and equity matters relating to the supply of electricity to small consumers to be consistent with good policy practice. There is no indication that these programs operate in a manner that would materially distort or influence competition in the market.

The provision of assistance and information to the general population on the ability to choose an electricity retailer, the available services from retailers, as well as rights and obligations relating to the supply of electricity should go some way to assisting all households to actively participate in the electricity market. Consequently, it is important that such information be made available over time.

---

144 ibid., s. 11(2)(protection of the family and children).

8.3 Environmental obligations

The following refers to the ACT Government's policy objectives relating to the environment. The ACT's environmental policies and obligations are an important aspect of the electricity market. That is, the implementation of these policies may impact on the operation of the electricity retail market and the welfare of electricity users. For these reasons, the AEMC has included a discussion on environmental policy objectives in this report, although it is not required to do so under the AEMA.

8.3.1 Energy efficiency

In respect of energy efficiency, the ACT Government has been promoting a number of programs. For example, all new homes constructed in the ACT are now required to conform to a five star energy efficiency rating. In addition, the ACT Government has been increasing the minimum energy performance requirements of appliances, such as air conditioners, incrementally.[145] Other programs currently administered by the ACT Government aimed at improving energy efficiency are the same as those mentioned in section 8.2.1 above. For example, HEAT, which is directly funded by the ACT Government and provides free, independent, expert advice on how to improve the energy efficiency of homes.[146]

In addition, the ACT Government aims to reduce ACT greenhouse gas emissions by at least ten per cent relative to 2020 business-as-usual emissions. It plans to:[147]

1. introduce legislation (in 2010) that will require energy businesses to identify and provide energy efficiency products and services to ACT customers, with priority given to low-income and other disadvantaged households; and

2. adopt an active policy of implementing energy efficiency reforms arising from the National Partnership Agreement on Energy Efficiency.

The first of these most clearly provides benefits to disadvantaged households as well as an overall benefit to the community. The implementation of this policy should see the clear identification of energy efficient products and service aimed at improving energy efficiency within households. As a consequence, these households should be able to make more informed choices that will have the long-term benefit of meeting their energy needs, as well as, taking into account their household budget.

In terms of the second, the ACT Government recently announced an expansion of its feed-in tariff scheme. The Government proposes to expand the existing scheme to include medium and large scale renewable energy generation.[148]This will assist the

---

145 ACT Government, *Draft sustainable energy policy 2010-2020*, December 2009, p. 7.

146 For further information see: www.heat.net.au

147 ACT Government, *Draft sustainable energy policy 2010-2020*, December 2009, p. 7.

148 Simon Corbell, Minister for Energy media release, *Labour delivers on making Canberra Australia's solar capital*, 13 September 2010.

ACT in meeting the Government's goal of reducing greenhouse gas emissions and promoting the generation of electricity from renewable sources.

8.3.2 Sustainability principles

Section 20 of the ICRC Act relating to price directions also contains reference to environmental obligations. In particular, s. 20(2)(f) states that the ICRC must have regard to the 'principles of ecologically sustainable development mentioned in subsection (5)' in any pricing direction. Section 20(5) states the following:

(5) ecologically sustainable development requires the effective integration of economic and environmental considerations in decision-making processes through the implementation of the following principles:

(a) the precautionary principle - that if there is a threat of serious or irreversible environmental damage, a lack of full scientific certainly should not be used as a reason for postponing measures to prevent environmental degradation;

(b) the inter-generational equity principle - that the present generation should ensure that the health, diversity and productivity of the environment is maintained or enhanced for the benefit of future generations;

(c) conservation of biological diversity and ecological integrity; and

(d) improved valuation and pricing of environmental resources.

In terms of making decisions on the TFT, the ICRC has had regard to s. 20(5). It has noted that the cost of government initiated environment related programs would expect to be managed in the TFT as pass-through events.[149] For example, changes in green energy scheme obligations, including the Australian Government's Mandatory Renewable Energy Target, would be subject to pass-through arrangements. However, to address uncertainty for customers through frequent tariff changes, the ICRC limits pass-through applications to one per year.[150]

The ICRC has also had regard to the implications that setting the TFT too low would encourage excessive use of electricity, which has negative environmental consequences in the short and long term.

8.3.3 Conclusions on environmental obligations

In reviewing the environmental obligations and policies relating to the supply of electricity in the ACT, it is apparent that the ACT Government places some weight on

149 Note that pass-through of the Australian Government's carbon pollution reduction scheme is not included in the ICRC's current pricing determination.

150 ICRC, *Final Decision: Retail prices for non-contestable electricity customers 2010-2012*, June 2010, pp. 59-61.

environmental improvements over the long term. The aim is clearly to reduce the environmental impact of the ACT through a multi-faceted approach covering various segments of the economy. That the various programs and initiatives are available to the whole population is a positive feature of the ACT Government's approach.

In addition to these policies, the ICRC does have regard to environment-related obligations when determining the TFT.

Abbreviations

ABS	Australian Bureau of Statistics
ACAT	ACT Civil and Administrative Tribunal
ACCC	Australian Competition and Consumer Commission
ACG	Allen Consulting Group
ACT Retail Review	Review into the effectiveness of competition in electricity retail market in the Australian Capital Territory
ACTCOSS	ACT Council of Social Service
AEMA	Australian Energy Market Agreement
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
CAC	Customer Acquisition Cost
CARC	Customer Acquisition and Retention cost
Consumer Agencies	Care Inc, ACTCOSS and Uniting Care Australia
CPI	Consumer Price Index
CSOs	Community Service Obligations
DECCEW	Department of the Environment, Climate Change, Energy, and Water
ERAA	Energy Retailers Association of Australia
ESAA	Energy Supply Association of Australia
ESCOSA	Essential Service Commission of South Australia
ETEF	Electricity Tariff Equalisation Fund
FRC	Full Retail Contestability
GGAS	Greenhouse Gas Abatement Scheme

ICRC	Independent Competition and Regulatory Commission
IPART	Independent Pricing and Regulatory Tribunal of NSW
LRMC	Long Run Marginal Costs
MCE	Ministerial Council on Energy
NEM	National Electricity Market
NMI	National Metering Identifier
NUOS	Network Use of System
OTTER	Office of the Tasmanian Economic Regulator
PIAC	Public Interest Advocacy Centre
QCA	Queensland Competition Authority
ROC	Retail Operating Costs
RSoA	Revised Statement of Approach
Stage 1 Draft Report	AEMC, Stage 1 Draft Report: Review of the effectiveness of competition in the electricity retail market in the ACT
TFT	Transitional Franchise Tariff
WEC	Wholesale Electricity Costs

A Consultation process

A.1 Outline of process

The MCE Request for Advice requires the AEMC to follow a two stage reporting and advice process for the ACT Retail Review. This is as follows:

- Stage one addresses the question of whether competition in the ACT electricity retail market is effective. Following consideration of submissions in response to an Issues Paper, the AEMC will publish a Stage 1 Draft Report setting out its draft findings on this matter. Submissions will be invited. A Stage 1 Final Report will then be released.
- Stage two of the review process addresses one of two matters (depending on the outcome of stage one). These are:
  - where the AEMC has found in stage one that competition is effective, stage two will focus on ways to phase out retail price regulation in the relevant market, including a draft timeline within which the phase out should occur; or
  - where stage one of the review has concluded that competition is not effective, stage two will provide draft advice on ways to promote competition in the relevant market.
- In both cases, a Stage 2 Draft Report will be published for consultation. This will set out draft advice to the relevant jurisdictional Minister and the MCE. Following the consideration of submissions, the AEMC will publish a Stage 2 Final Report containing its final advice.

A.2 Issues Paper

On 4 March 2010, the AEMC published an Issues Paper seeking comments from stakeholders and other interested parties on their experiences of electricity retailing in the ACT. In particular, the AEMC sought information that would further its understanding of:

- changes in the nature and extent of competition that have occurred since the introduction of FRC, particularly the experiences of residential and small business customers of FRC to date;
- the extent of the current competitive environment for electricity; and
- the likely effectiveness of competition in the electricity retail market in the ACT in the future.

Submissions closed on 9 April 2010 and seven submissions were received from:

- ACT Civil and Administrative Tribunal (ACAT);
- ACT Minister for Energy;
- ActewAGL Retail;
- TRUenergy;
- Public Interest Advocacy Centre (PIAC);
- Origin Energy; and
- Energy Retailers Association of Australia (ERAA).

A summary of the submissions, outlining the main issues raised by stakeholders, is provided at Appendix D of the Stage 1 Draft Report. All submissions are available from the AEMC's website.

A.3 Public forum on the Stage 1 Draft Report

A public forum was held in Canberra, on 13 August 2010, to discuss the draft findings presented in the Stage 1 Draft Report. The purpose of the public forum was to:

- allow the AEMC to present its draft findings; and
- give stakeholders and interested parties the opportunity to ask questions and discuss issues prior to finalising their written submissions on the Stage 1 Draft Report.

A summary of this forum was published on the AEMC's website.

A.4 Stage 1 Draft Report

On 30 July 2010, the AEMC published its Stage 1 Draft Report for the ACT Retail Review. The AEMC’s draft finding was that competition in the ACT electricity retail market is not effective. Stakeholders were invited to provide submissions in response to the draft finding. Submissions closed on 27 August 2010 and eight submissions were received from the following organisations:

- ACT Council of Social Services (ACTCOSS);
- ActewAGL Retail;
- Care Inc., ACT Council of Social Service (ACTCOSS) and Uniting Care Australia (together referred to as the Consumer Agencies);
- Energy Retailers Association of Australia (ERAA);
- Energy Supply Association of Australia (ESAA);

- Independent Competition and Regulatory Commission (ICRC);
- Origin Energy; and
- TRUenergy.

A summary of the submissions, outlining the main issues raised by stakeholders, is provided at Appendix B of this Stage 1 Final Report. All submissions are available from the AEMC's website.

A.5 Way forward

The purpose of the first stage of the ACT Retail Review is to address the question of whether competition in the ACT electricity retail market is effective. After considering submissions to the Stage 1 Draft Report, the AEMC maintains the view that competition in the electricity retail market of the ACT is not effective. This Stage 1 Final Report aims to provide stakeholders and other interested parties with the AEMC's reasons for its decision.

With the publication of this Report, the ACT Retail Review now moves on to stage two. This second stage provides advice on ways to promote competition in the ACT electricity retail market. The key dates for stage two of the Review are set out below.

Date	Milestone
Publication of the Stage 1 Final Report and Stage 2 Draft Report	24 November 2010
Submissions on the Stage 2 Draft Report due	24 December 2010
Publication of the Stage 2 Final Report	28 February 2010

B Summary of submissions to the First Draft Report

B.1 Submissions received

ACT Council of Social Services (ACTCOSS), 3 September 2010

ActewAGL Retail, 27 August 2010 (amended 6 September 2010)

Care Inc., ACT Council of Social Service (ACTCOSS) and Uniting Care Australia (Consumer Agencies), 27 September 2010

Energy Retailers Association of Australia (ERAA), 1 September 2010

Energy Supply Association of Australia (ESAA), 27 August 2010

Independent Competition and Regulatory Commission (ICRC), 18 August 2010 (amended 31 August 2010)

Origin Energy, 27 August 2010

TRUenergy, 3 September 2010

B.2 Summary of stakeholder responses

The table below provides a summary of the submissions to the Stage 1 Draft Report and an outline of the AEMC's response to the matters raised. Further discussion is contained in Chapters 4-8 as relevant.

Chapter heading	Sub topic level 1	Sub topic level 2	Issue raised in submission
Market definition			No submissions commented on this point.
Market structure	Market demand		Some of the submissions to the First Draft Report questioned the AEMC's conclusion that the ACT is an attractive electricity market for retailers. However, these concerns seem to be centred around the AEMC's analysis of the barriers to entry and expansion rather than its evaluation of the demand characteristics.
	Market supply and independent rivalry		The ICRC suggested (pp. 4-5) that the behaviour of ActewAGL Retail and tier two retailers in the unregulated large customer segment of the market should be further analysed by the AEMC. Primarily the ICRC considered that as no regulated prices are set, the 'apparent withdrawal of some of these larger retailers from the ACT market post 2007' should be addressed. In particular, the ICRC queried (p. 5) 'what has caused this major change in approach, and to what extent were the factors that influenced these decisions by major retailers also reflected in their decisions in terms of the household market in the ACT?'.
	Ability of suppliers to enter the market	Regulated prices	Origin Energy agreed (p. 1) with the AEMC's conclusions that the 'ACT retail electricity market is subject to barriers to entry and that, primarily, the regulated tariff is set at a low level that has the effect of eliminating sufficient margins for a new entrant to recover its entry costs over a reasonable period of time'. Similarly, the ERAA considered (p. 1) that the 'ACT's low regulated retail tariff is the single most significant barrier to developing effective competition'. Notably, the 'absence of customer acquisition and retention costs in the determination of the TFT does not allow sufficient head-room for competitors to enter the market and compete for customers in the ACT'. In addition, the ESAA stated (p. 3) that 'if retailers cannot be confident of recovering costs incurred in acquiring customers ... and making a commercial return, the incentive to enter markets and compete for customers is diminished'.

Chapter heading	Sub topic level 1	Sub topic level 2	Issue raised in submission
			Origin Energy also observed (p. 1) that 'if the regulated retail price in the ACT does not reflect the marginal cost of customer acquisition, it will likely have a detrimental effect on competitiveness and consumer choice'. However, the ICRC stated (p. 3) that the AEMC 'does not appear to have critically analysed other possible factors influencing the decisions of retailers to enter or actively compete in the ACT market'. Specifically, it commented (p. 3) that while a number of factors have been identified, these have been 'put aside as secondary to the CAC/CARC issue [and] in support of this view, the AEMC has relied heavily upon comments received in its retailer interviews undertaken by Roy Morgan [sic]'.
		Secondary barriers	The ICRC noted (pp. 4&8) that retailers have offered alternative views on the reasons for the apparent reduction in direct competition observed in the ACT. For example, its physical location and lack of close geographical links with other major metropolitan areas within Australia, potentially make it a market that is not as easy to service from a retailers perspective'. Other possible influences could include, structural market changes occurring in NSW, the 2007 change in wholesale prices and the prospect of some form of carbon pricing. TRUenergy stated (p. 2) that in relation to ActewAGL Retail, '[its] historical role, and continuing community support has resulted in a strong level of brand loyalty, which while not anti-competitive in itself, does provide incumbent advantage'. In addition, Origin Energy noted (p. 3) that the 'structure of the ACT retail electricity market, with a single vertically integrated incumbent holding a dominant market share, is unique in Australia'. Therefore, Origin Energy have highlighted that the 'current ring-fencing arrangements in the ACT may require additional consideration in the context of facilitating effective competition'. However, the ERAA considered (p. 1) that the 'risk that the incumbent will see deregulated prices as an opportunity to exercise price control by setting non-competitive prices is alleviated by the strong threat of entry [by licensed second tier retailers] in the ACT'. Similarly, ActewAGL Retail noted (p. 12) that as there are 19 licensed retailers, it is under competitive pressure to continuously improve services and provide attractive products and prices. The ERAA agreed (pp. 1-2) and stated

Chapter heading	Sub topic level 1	Sub topic level 2	Issue raised in submission
			that 'given the ACT is an attractive market for retailers, the threat of entry will force the incumbent to set competitive price levels'. While the removal of price regulation would be constructive in promoting a national electricity market, the ESAA considered (p. 4) that 'even without price regulation, a number of ACT specific factors will remain that retailers will have to accommodate, such as the feed-in tariff regime'. Furthermore, the ESAA was concerned (p. 5) that the ACT may end up in a 'circular policy trap where insufficient competition is used to justify price regulation, which further entrenches [the] lack of competition through being a barrier to entry'. With respect to the feed-in tariff, TRUenergy considered (p. 2) it to be 'another disincentive for retailers to enter the ACT market'. Noting that the ACT scheme is more complex, which adds cost to retailers for any system changes and information to customers.
Market conduct	Behaviour of suppliers		The ESAA noted (p. 3) that 'a particular telling indictment of the deleterious effects of price regulation on the market is the fact that while there are 19 licensed retailers, only four have small customers, only two are taking new customers and just one is actively marketing'. The ICRC considered (p. 5) that the market volatility that occurred in 2007, may have resulted in a change in the 'risk appetite' of retailers and 'caused a rethink ... of their marketing and target market strategy'.
	Exercise of market choice by consumers		No submissions commented on this point.
	Consumer switching behaviour		The Consumer Agencies noted (pp. 8-9) that the 'use of "switching data" as a primary indicator for effectiveness of competition' was not supported. It was noted that the arguments against using switching as a primary indicator were well documented in the Victorian Retail Review.

Chapter heading	Sub topic level 1	Sub topic level 2	Issue raised in submission
			The AEMC notes this argument was made by UnitingCare Wesley in its submission to the South Australian Retail Review. The conclusions from that submission were: • the extent of switching is probably not a good indicator of informed decision making, and that a significant proportion of the switching that has occurred is not an indicator of consumers using apparent retail competition, but more retailers pushing for changes; and • despite consumers considering that they are well informed about the market, in fact their decisions clearly indicate that this is not the case. Additionally, the Consumer Agencies suggested (p. 9) that although some customers in the ACT have chosen to switch, the market exhibits capacity for additional switching. Furthermore, while the market can be described as 'slow', there is capacity for new retailers to move into the market and some customers are prepared to switch, which suggests 'effective competition'.
Market performance	Prices and profit margins	Economic costs and regulated prices	ActewAGL Retail (p .9) did not agree with the AEMC that the ICRC's terms of reference require it to calculate the regulated retail tariff on the basis of the efficient costs incurred by ActewAGL Retail. It claimed that the requirement for the ICRC to consider ActewAGL's costs is only in relation to the recovery of additional and specific costs arising from Australian Government and Territory policy obligations (for example, the feed-in tariff). TRUenergy noted (p. 1) that it did not 'believe that the TFT will ever be effective in encouraging new entrant retailers into the ACT if it continues to be based on ActewAGL's retail costs'. Therefore, it considered that 'a methodology based on the costs incurred by a "theoretical" new entrant retailers is likely to be more realistic'. Additionally, Origin Energy commented (p .9) that the 'competing interests of the current regulatory policy in the ACT between offering an efficient price and taking account of consumer impacts of price increases has distorted the regulated price'. In its view, 'effective competition in the ACT may prove difficult while price regulation

Chapter heading	Sub topic level 1	Sub topic level 2	Issue raised in submission
			exists'. In addition, the social objectives strictly applied in a price setting scenario appear to be at the detriment of new entrants and impede the development of competition'. Origin Energy also stated (p. 2) that 'regardless of future price levels a policy to continue with price regulation will not alleviate the regulatory uncertainty associated with price setting and may remain a sufficient deterrent for new entrants in the absence of more prevalent market activity' There were several other submissions that specifically referred to the ICRC's calculation of the WEC allowance. For example, the ESAA commented (p. 3) that the 'combination of regulated retail prices, inherently volatile wholesale energy costs, and notoriously thin margins means that retailers contemplating operating in a market under the shadow of price regulation expose themselves to the risk of error by jurisdictional regulators.' The ICRC noted (p. 4) that wholesale electricity price volatility has 'been a significant issue for regulators of retail electricity prices in other jurisdictions'. It observed that other east coast electricity regulated markets, have had WEC prices significantly above the observed market price'. Despite recent increases in the TFT, TRUenergy (p. 1) 'remains of the view that the ICRC's calculation of the WEC of the TFT has nevertheless been insufficient to encourage new entrant retailers into the ACT market'. TRUenergy stated that IPART's calculation better reflects the actual wholesale costs incurred by retailers'.
		Actual retail margins	The ICRC stated (p. 5) that the AEMC's analysis of effective margins is not a complete picture, insofar as 'ACT has relied upon its own calculation of effective margins using CAC/CARC costs taken from NSW and Queensland pricing determinations and applying these to the ACT'. However, the ICRC declared that the ROC allowance in the ACT already 'includes some element of a CAC/CARC' through the sales and marketing cost element (adjusted annually for inflation). ActewAGL Retail acknowledged (p. 10) that the ICRC has stated that ROC includes

Chapter heading	Sub topic level 1	Sub topic level 2	Issue raised in submission
			'some element' of a CAC/CARC but this confirms that the current ROC allowance does not *fully* reflect a commercial CAC/CARC. Additionally, in 2003, when the marketing and sales component was included in the ROC, the retail market was very different to the present. ActewAGL Retail considers 'the subsequent CPI-only adjustments have not kept with the costs of responding to actual and potential competition in the ACT.' Notwithstanding the above, the ICRC noted (p. 7) that the TFT with the inclusion of ACT's estimated CAC/CARC component would have increased prices 4.2 to 5.4 per cent in 2010-11 (an additional 1.8 to 3.0 per cent above the actual 2.4 per cent increase). This would 'only meet the lower end of the range of price increases that retailers have identified as being required before they will re-enter the ACT market.'
	Retail products and services		ActewAGL Retail (p. 13) did not agree with the AEMC's draft conclusion that the level of innovation and product differentiation currently appears to be weak compared to jurisdictions. It notes that 'a simple survey approach of the number of products currently on offer by electricity retailers across jurisdictions does not provide an appropriate comparison.' It elaborates by stating that it 'offers a variety of products, which have evolved over the past decade with changing market conditions. Further, ActewAGL refers (p. 13) to the AER's 2009 State of the Energy Market, which lists ActewAGL Retail as offering 20 different products, more than 'retailers in Victoria, South Australia, NSW and Queensland'. The ESAA commented (p. 4) that the advantage of competitive markets is that they are much more capable of dealing with complex issues such as climate change and result in greater product innovation, stating that 'competitive markets more likely to find the most appropriate pricing structures and encourage competition in the development of alternative products and levels of service'. Finally, TRUenergy considered (p. 2) that ActewAGL Retail's ability to bundle water with electricity and gas was a concern. Specifically, 'the issue in the ACT is that the discounts ActewAGL offer are substantially more than those of its competitors, and

Chapter heading	Sub topic level 1	Sub topic level 2	Issue raised in submission
			the fact that water is not contestable'.
	Customer satisfaction		Origin Energy noted (p. 2) that 'given retail price levels are below that expected in a competitive market, ... there appears little cause for customers to be disgruntled. However, this is evidence that short-term social objectives have been given too much weight in the price setting process to the detriment of long-term market outcomes'. The Consumer Agencies commented (p. 10) that the data 'indicates that ACT consumers are satisfied with the service they are receiving'.
Compliance with social welfare and equity objectives	ACT social welfare and equity objectives	Maintaining equity	ACTCOSS stated (pp. 3-4) that the 'rate of the concessions is insufficient'. While the 2010-2011 ACT budget increased the energy concession $20 per year, this only equates to a '14 per cent increase since 2004-05, [however] electricity prices have grown on average by 23 per cent over the same period'. The Consumer Agencies commented (p. 2) that 'the concession is a step in the right direction, however, it does not make up for the costs low-income consumers will need to carry'.
		Consumer protection code	The ESAA noted (p. 2) that 'governments can have an important role to play in supporting a deregulated market by monitoring the state of competition and importantly, supporting those consumers that find electricity prices unmanageable'. ACTCOSS expressed concern (pp. 3-4) that some customers may be unable to participate effectively in the competitive market, for example, in purchasing bundled products. It noted that a '2008 report by the ACT Chief Minister's Department (CMD) Social Impacts of Climate Change in the ACT there were approximately 20 000 low income households in the ACT earning less than $650 a week. In 2008, this equated to 17 per cent of all households'. ACTCOSS also stated (pp. 3-4) that 'the extra costs of electricity correlate with the extremes of the Canberra weather', especially the extra cost burden to disadvantaged customers during the Winter months. ActewAGL Retail stated (p. 7) that is has 'recently relaunched an improved and

Chapter heading	Sub topic level 1	Sub topic level 2	Issue raised in submission
			comprehensive Staying Connected program for customers experiencing ongoing financial hardship'. The program provides information on flexible payment plan options and incentive schemes for customers who make regular payments on their accounts. It also 'offers a referral service to other agencies that provide assistance and support for those customers experiencing financial hardship'. ActewAGL Retail (p. 7) 'firmly believes that initiatives such as the Staying Connected Hardship Program are a much more effective and appropriate mechanism for assisting [these customers] ... when compared with relying on a regulated retail tariff'.