



23 December 2010

Mr John Pierce  
Chairman  
Australian Energy Market Commission  
PO Box A2449  
Sydney South NSW 1235

By email: [submissions@aemc.gov.au](mailto:submissions@aemc.gov.au)

Dear Mr Pierce

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

ActewAGL Retail welcomed the Australian Energy Market Commission's (AEMC's) review of the effectiveness of competition in the ACT retail electricity market and notes the release of the *Stage 1 Final Report* and *Stage 2 Draft Report* on 24 November 2010. ActewAGL Retail fully supports the key recommendation that price regulation in the ACT electricity market be removed from 1 July 2012.

The release of the reports marks the end of stage 1 of the review (assessment of competition) and the start of stage 2 (development of policy advice). The AEMC has therefore asked for comments on the *Stage 2 Draft Report*. However, given the dependency of Stage 2 recommendations on the conclusions in Stage 1, ActewAGL Retail has taken this opportunity to comment on both reports.

ActewAGL Retail's previous submissions<sup>1</sup> to the review show that it disagrees with the AEMC's final conclusion that competition in the ACT is not effective.<sup>2</sup> ActewAGL Retail believes that competition in the ACT is effective, as evidenced by constant threat of competitor entry, the resultant ongoing product innovation and the continually high service standards and customer satisfaction achieved by ActewAGL Retail. The AEMC has acknowledged the reality of the presence and consequences of these competitive pressures in the *Stage 2 Draft Report*.<sup>3</sup>

ActewAGL Retail is also disappointed with the significant shift in the AEMC's underlying reasons for its finding that competition in the ACT is not effective. In its *Stage 1 Draft Report* the AEMC concluded, supported by market based evidence and economic analysis, that the low regulated retail price was the main barrier to entry and expansion in the ACT retail electricity market and other barriers were "comparatively minor".<sup>4</sup> This finding received considerable support in ActewAGL Retail's and other submissions on the *Stage 1 Draft Report*. However, in the *Stage 1 Final Report* the AEMC ignore this evidence and instead identify a set of what it now regards as unique and inter-linking factors that limit competition, of which the level of the regulated tariff (or transitional franchise tariff) is given seemingly low weighting.<sup>5</sup> In the summary document

<sup>1</sup> For example, ActewAGL Retail, *ActewAGL Retail Response to AEMC First Draft Report*, September 2010, (*ActewAGL Retail Response*), p. 11 – 12

<sup>2</sup> AEMC, *Stage 1 Final Report – Review of the effectiveness of competition in the electricity retail market in the ACT*, November 2010, (*Stage 1 Final Report*), p. i

<sup>3</sup> AEMC, *Stage 2 Draft Report – Review of the effectiveness of competition in the electricity retail market in the ACT*, November 2010, (*Stage 2 Draft Report*), p. 6

<sup>4</sup> AEMC, *Stage 1 Draft Report – Review of the effectiveness of competition in the electricity retail market in the ACT*, July 2010, (*Stage 1 Draft Report*), p. 5

<sup>5</sup> AEMC, *Stage 1 Final Report*, p. i - ii

released with the reports, the level of the regulated electricity price is not even mentioned as a factor limiting competition, despite being the primary factor in the draft report. Several factors not previously mentioned, or considered of only comparatively minor importance in the draft report, are now found to be significant by the AEMC in the *Stage 1 Final Report*.

The AEMC's conclusions have changed substantially without relevant supporting evidence and analysis being presented. This is of particular concern when the AEMC's findings in the *Stage 1 Final Report* are the basis for the policy options presented in the *Stage 2 Draft Report*.

For example, in the *Stage 1 Final Report* the AEMC identifies ActewAGL Retail's economies of scale and scope as a reason for the absence of effective competition in the ACT market.<sup>6</sup> Economies of scale were correctly not identified as a key factor in the *Stage 1 Draft Report*, and no new analysis has been presented in the *Stage 1 Final Report* to warrant this revised conclusion. ActewAGL Retail considers that if the AEMC had analysed the matter of economies of scale and scope in the same way that it did in its earlier reviews of competition in the South Australian and Victorian markets, then it could not conclude that these are factors limiting effective competition in the ACT market.

It also remains beyond our reasoning how ActewAGL's corporate structure or behaviour in respect of cost allocation and internal transactions can be raised in the reports as factors impacting competition<sup>7</sup> when this line of argument is completely unwarranted and without foundation. The AEMC then proceeds to propose policy options regarding cost allocation and ring fencing<sup>8</sup>, when there is no evidence of problems that need to be addressed. This commentary must be withdrawn in the *Stage 2 Final Report*.

Despite these failings, ActewAGL Retail does fully support the AEMC's recommendation for the removal of retail price regulation in the ACT<sup>9</sup>, having long argued for the removal of regulation in a competitive market. ActewAGL Retail considers that the costs and risks associated with ongoing price regulation are the key problems to be addressed in the ACT retail electricity market. Any policy recommendations by the AEMC must not unfairly constrain or burden ActewAGL Retail in the new competitive environment emerging as a result of retail ownership changes in New South Wales.

Further comments from ActewAGL Retail are contained in the attachment to this letter. We will be pleased to discuss this submission further at our next meeting, our contact is Leanne Holmes, Manager Economic Regulation, phone 0412 850 715.

Yours sincerely



Ayesha Razzaq  
General Manager Retail

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<sup>6</sup> AEMC, *Stage 1 Final Report*, p. 3

<sup>7</sup> AEMC, *Stage 2 Draft Report*, p. 22

<sup>8</sup> AEMC, *Stage 2 Draft Report*, p. 75

<sup>9</sup> AEMC, *Stage 2 Draft Report*, p. ii



## Attachment 1: Further Comments

### *Removal of price regulation*

ActewAGL Retail fully supports the AEMC draft recommendation to remove retail price regulation in the ACT from 1 July 2012.<sup>10</sup> Contrary to the AEMC's conclusion that a series of unique inter-linked factors are negatively impacting competition in the ACT retail electricity market, ActewAGL Retail considers that the costs and risks associated with ongoing price regulation are the key problems to be addressed in the ACT retail electricity market.

ActewAGL Retail considers removal of retail price regulation from 1 July 2012 is appropriate as it would coincide with the expiry of the Independent Competition and Regulatory Commission's current 2010–12 retail electricity price direction. Removing price regulation on this basis would result in minimal administrative and compliance burdens on retailers, as prices have historically been adjusted on a financial year basis. Setting a clear date for the removal of price regulation will provide consumers, retailers and the ACT Government with certainty, allowing for a smooth transition to a fully deregulated retail electricity market.

As noted in ActewAGL Retail's September 2010 response to the AEMC's *Stage 1 Draft Report*, removing retail price regulation in the ACT would directly address the problems in the ACT market, and would be consistent with the ACT Government's commitments under the Australian Energy Market Agreement.<sup>11</sup> Further, ActewAGL Retail notes that there is industry consensus that removing price regulation would be positive outcome for ACT consumers.<sup>12</sup> ActewAGL Retail considers the removal of price regulation in the ACT retail gas market (noted by the AEMC<sup>13</sup>), provides a good precedent for the full deregulation of ACT retail electricity prices.

### *Price monitoring*

As part of the AEMC's price policy recommendations for the ACT, it is proposed that the ACT should introduce a price monitoring program for three years, with a review at the end of the initial period to assess whether the program should continue.<sup>14</sup> As previously noted, ActewAGL Retail considers price monitoring is a second-best alternative when compared with full price deregulation, and is not required in the ACT.<sup>15</sup>

If a price monitoring scheme is introduced it must be designed in a way that does not hinder the efficient operation of the competitive market. The monitoring program must provide certainty and transparency to retailers, particularly in relation to the nature and extent of regulator involvement, and the triggers that may prompt the ACT Government to re-introduce price regulation. ActewAGL Retail also suggests that the potential benefits and costs of a one or two year price monitoring program, rather than the proposed three year program, should be considered by the AEMC, before a final policy recommendation is made.

Finally, from an implementation perspective, ActewAGL Retail believes it is critical that the AEMC's proposed non-price policy responses do not hinder or prevent the timely removal of price regulation. As noted above, ActewAGL Retail considers removal of price regulation is the policy response capable of delivering the greatest benefits to consumers, and delaying its removal would be to the detriment of consumers and the competitive market, particularly given recent changes to the energy market reforms in New South Wales.

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<sup>10</sup> AEMC, *Stage 2 Draft Report*, p. ii

<sup>11</sup> ActewAGL Retail, *ActewAGL Retail Response*, pp. 5 - 6

<sup>12</sup> See submissions on the AEMC's *Stage 1 Draft Report* from TRUenergy, the Energy Retailers Association of Australian and the Energy Supply Association of Australian.

<sup>13</sup> AEMC, *Stage 2 Draft Report*, p. 37

<sup>14</sup> AEMC, *Stage 2 Draft Report*, p. ii

<sup>15</sup> ActewAGL Retail, *ActewAGL Retail Response*, pp. 7 - 8

### *Economies of scale and scope*

While economies of scale and scope were not identified as factors limiting competition in the *Stage 1 Draft Report*, in the *Stage 1 Final Report* and the *Stage 2 Draft Report* the AEMC concludes that ActewAGL Retail's economies of scale and scope are a reason for the absence of effective competition in the ACT market.<sup>16</sup> The AEMC provides no evidence or analysis to support this conclusion.

ActewAGL Retail considers that a simple analysis leads to the clear conclusion that ActewAGL Retail's economies of scale and scope are not factors limiting competition in the ACT. With a customer base of around 130,000 electricity customers in the ACT, ActewAGL Retail operates on a much smaller scale than most of its competitors and potential competitors in the ACT market. There is therefore no basis on which to argue that ActewAGL Retail enjoys economies of scale relative to these larger competitors.

ActewAGL Retail also notes that in the reviews of competition in South Australia and Victoria, the AEMC did undertake a detailed analysis of the impact of economies of scale and scope. In both cases, the AEMC concluded that economies of scale and scope do not deter entry or restrict competition.<sup>17,18</sup> The analysis in these reviews is relevant to the ACT review, and further supports ActewAGL Retail's view that economies of scale are not a factor limiting competition in the ACT. The analysis in the previous reviews also highlights the inconsistencies in the AEMC's approach in the ACT review.

The AEMC explains in the Victorian and South Australian reviews that for small retailers, the potential disadvantage of size can be overcome. The AEMC observes that a number of new retailers are adopting business models that render fixed costs, such as costs associated with in-house billing and call centres, "scalable" by outsourcing the functions to third parties, and that "this enables the retailer to benefit from the scale of the contracted service provider without the need for a large customer base."<sup>19</sup> In the ACT review, the AEMC disregards this analysis and actually concludes that ActewAGL Retail has cost advantages over its competitors, despite ActewAGL Retail having a much smaller customer base than the major competitors.

The AEMC's conclusions from the South Australian and Victorian reviews on economies of scale and other potential competitive advantages of the incumbent are also relevant to the ACT review, and support ActewAGL Retail's view that the conclusions in the *Stage 1 Final Report* and *Stage 2 Draft Report* are not defensible. For example, in relation to potential economies of scale, the AEMC concluded in the Victorian review that "electricity-only retailers are unlikely to experience any material disadvantage relative to their dual fuel competitors"<sup>20</sup> The AEMC further noted that the "competitive advantage afforded by dual fuel is reduced by the scalable nature of many of the retail operating costs."<sup>21</sup>

### *Customer awareness*

In the *Stage 2 Draft Report*, the AEMC state that a two phase process involving first increasing customer awareness, and then removal of price regulation, is needed because:

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<sup>16</sup> AEMC, *Stage 1 Final Report*, p3

<sup>17</sup> AEMC, *First Final Report – Review of the effectiveness of competition in the electricity and gas retail markets – Victoria*, December 2007, (*Victorian First Final Report*), p. 123

<sup>18</sup> AEMC, *First Final Report – review of the effectiveness of competition in the electricity and gas retail markets – South Australia*, September 2008, p. 158

<sup>19</sup> AEMC, *Victorian First Final Report*, p. 121

<sup>20</sup> AEMC, *Victorian First Final Report*, p. 123

<sup>21</sup> AEMC, *Victorian First Final Report*, p. 123

“The AEMC considers the lack of customer awareness to be a significant factor influencing competition in the ACT. Therefore, phase one consists of measures to foster customer awareness and reduce the ‘stickiness’ of customers...”<sup>22</sup>

Underpinning this conclusion is evidence from qualitative and quantitative research. Based on interviews with retailers and consumers, the AEMC find that customer awareness levels of full retail contestability in the ACT are only 60 per cent, whilst in Victoria and South Australia (jurisdictions deemed by the AEMC to be competitive) awareness levels are above 80 per cent.<sup>23</sup> However, ActewAGL Retail is concerned that the AEMC has presented no evidence or analysis which explains why and how customer awareness levels of only 60 per cent are significantly detrimental to competition, or the costs and benefits of moving from 60 to 80 per cent awareness levels.

ActewAGL Retail notes that the AEMC has recommended the removal of retail price regulation in the ACT only after the ACT Government has implemented and carried out policies designed to improve customer awareness and education about full retail contestability and competition. While ActewAGL Retail believes additional measures, such as consumer awareness programs and price monitoring can be relevant in fostering competitive market outcomes, these must be applied in a manner consistent with the COAG principles of best practice regulation, which the AEMC refers to in the *Stage 2 Draft Report*.<sup>24</sup> Application of these guidelines requires the AEMC to clearly establish the costs and benefits of increasing customer awareness levels, and demonstrate that the benefits outweigh the costs.<sup>25</sup>

It is also important that any customer education programs focus on making customers aware of their rights, while being neutral among competing retailers. Any education programs should not favour retail new entrants into the market at the expense of ActewAGL Retail.

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<sup>22</sup> AEMC, *Stage 2 Draft Report*, p. ii

<sup>23</sup> AEMC, *Stage 2 Draft Report*, p. 12

<sup>24</sup> AEMC, *Stage 2 Draft Report*, p. 9

<sup>25</sup> Council of Australian Governments, *Best practice regulation – A guide for ministerial councils and national standard setting bodies*, October 2007, p. 4