Energy Retailers Association of Australia
Suite 3, Level 5, 189 Kent Street, SYDNEY NSW 2000
T (02) 8241 1800 **W** www.eraa.com.au

12 July 2013

Victoria Mollard
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

By email: aemc@aemc.gov.au

Dear Ms Mollard,

RE: Advice on best practice retail price regulation methodology Issues Paper

The Energy Retailers Association of Australia (ERAA) welcomes the opportunity to provide a submission to the *Best practice retail price regulation methodology Issues Paper* (the Issues Paper).

The ERAA represents the organisations providing electricity and gas to almost 10 million Australian households and businesses. Our member organisations are mostly privately owned, vary in size and operate in all areas within the National Electricity Market (NEM) and are the first point of contact for end use customers of both electricity and gas. Of particular relevance to this review is the ERAA's unique insight into what drives a new entrant (sometimes referred to as a 'second tier') retailer to enter a market and compete for customers.

Under the Competition and Consumer Act 2010 (Cth), the ERAA is not permitted to share or discuss information within the Association in relation to prices and the mechanisms for setting prices. As such, we refer to the individual submissions of our members for more detailed comments on retail pricing methodology.

The ERAA has consistently advocated for price deregulation where competition is effective. Open, competitive energy markets free from distortions such as retail price regulation naturally encourage prices to be efficient through the development of market offers. Competition in retail energy markets, as in other sectors of the Australian economy, incentivises businesses to improve service, develop products that meet consumer needs and find ways to lower their costs and to pass these savings onto consumers. Price regulation is an oddity in the Australian economy as it does not apply to almost any other contestable good or service such as food, fuel, telecommunications, insurance and housing.

Advice – approach and implementation
The ERAA notes that there have been significant developments in the retail energy market since this advice was commissioned in 2012. On 1 February 2013 South Australia deregulated retail energy prices. On 23 May 2013 the AEMC released their *Review of Competition in the Retail Electricity and Natural Gas Markets in New South Wales Draft Report*, finding competition to be effective in the NSW retail energy markets and recommending the removal of retail price caps. In June 2013 the Queensland Government announced their plan to remove retail energy price caps in South East Queensland on 1 July 2015. The final methodology should reflect these developments to ensure it is suitable for regulated markets including those that are already strongly competitive.

The ERAA considers that the AEMC's advice should focus on principles, rather than prescriptive methodology. A high-level approach is needed to provide the flexibility required by Australia's diverse retail energy markets. If advice is too specific, it may lead to unsuitable or inflexible retail price regulation across a number of jurisdictions. To ensure the advice remains relevant it must be reviewable to allow relevant stakeholders including energy retailers to provide feedback on its ongoing suitability.

Methodology
If retail prices are to be regulated, they should be cost-reflective and derived from a consistent and predictable price setting methodology. The different elements that contribute to the regulated retail price should be calculated in a transparent manner.

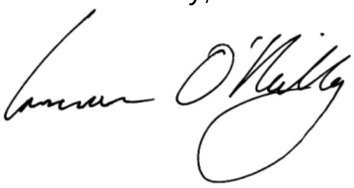
Wholesale energy costs
The ERAA supports the use of a Long Run Marginal Cost (LRMC) floor for calculating wholesale energy costs. Any approach which seeks to set regulated prices close to or at current market costs creates an investment risk for retailers, leading to adverse outcomes for customers as the competitiveness of the market decreases.

A market based approach will result in greater price volatility flowing from spot and contract markets and ultimately, non-cost reflective prices. Estimating future wholesale costs is inherently uncertain. Retailers face this uncertainty on a day-to-day basis and use a wide range of options to manage these risks, including purchasing different types of hedging products, long-term Power Purchase Agreements and investing directly in generation themselves. Reliance on a single point estimate is also more likely to result in a wholesale cost allowance that turns out to be inadequate for retailers to cover the costs.

The ERAA has consistently advocated this position in jurisdictional pricing reviews. As part of the Queensland Competition Authority's (QCA) Regulated Retail Electricity Prices 2013-14 determination process, the QCA based their wholesale methodology on from ACIL Tasman. In response, the ERAA and the Energy Supply Association of Australia (esaa) commissioned Frontier Economics to prepare a paper outlining our views on the approach taken by ACIL Tasman. This report, *Commentary on ACIL Tasman's approach for measuring energy costs*, is provided as **Attachment A** to this submission.

Should you wish to discuss the details of this submission, please contact me on (02) 8241 1800 and I will be happy to facilitate such discussions with my member companies.

Yours sincerely,



Cameron O'Reilly
CEO
Energy Retailers Association of Australia