

# REVIEW

**Australian Energy Market Commission**

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## **FIRST DRAFT REPORT**

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

**Commissioners**

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30 July 2010

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Reference: EPR0017

## **Citation**

AEMC, Review of the effectiveness of competition in the electricity retail market in the ACT, First Draft Report, 30 July 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 an AEMC initiative.

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## Summary

The AEMC's draft finding is that competition in the ACT retail electricity market for small electricity customers is not effective. The primary reason for this conclusion is that there are barriers to entry in the market. In particular, that the terms of reference to the Independent Competition and Regulatory Commission require the regulated retail price to be calculated on the basis 'of the efficient costs incurred by ActewAGL Retail', the incumbent retailer. The resulting low regulated retail price has had the effect of deterring potential entrants from entering into, or expanding within, the ACT retail electricity market.

In reaching this conclusion, the AEMC has analysed electricity retail supply in the ACT as the relevant market with reference to the MCE 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 certain characteristics of the ACT market appear to be attractive.

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. Furthermore, the rate of consumer switching in the ACT has been considerably less than what has been observed in other jurisdictions.

An assessment of the performance of the ACT electricity market indicates that it is not exhibiting the characteristics that would be expected to exist in a competitive market. Overall, however, customers appear to be satisfied with the retail services provided to them.

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 has been carried out. The AEMC's draft 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.

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# 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 First Draft 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. This First Draft Report aims to provide stakeholders and other interested parties with the AEMC's draft findings on this question. Stakeholders are invited to provide the AEMC with their views and comments on the draft findings or any other matter they consider relevant, in particular highlighting any additional evidence supporting their view.

After considering submissions responding to this First Draft Report, the AEMC will prepare a First Final Report on the effectiveness of competition in the electricity retail market of the ACT.

The ACT Retail Review will then move to stage two. This stage will either: address options to phase out retail price regulation (where the First Final Report has concluded that competition is effective); or provide advice on ways to promote competition (if the First Final Report has concluded that competition in the ACT electricity retail market is not effective).

## 1.2 Lodging submissions on the First Draft Report

Written submissions from interested parties in response to this First Draft Report are requested by **5pm, Friday 27 August 2010**.

Submissions should refer to project number 'EPR0017' and be uploaded electronically through the AEMC's online lodgement facility at [www.aemc.gov.au](http://www.aemc.gov.au).

All submissions received during the course of the ACT Retail Review will be published on the AEMC website, subject to any claims for confidentiality. The AEMC's approach to confidentiality is set out below.

In order for the ACT Retail Review to be completed by 31 December 2010 (as required by the MCE), strict deadlines for the various milestones in the review process will be followed. Accordingly, full regard will be had to all submissions lodged within the specified time period; however, late submissions may not be afforded the same level of consideration. To ensure that submissions in response to the First Draft Report are fully considered, submissions must be lodged by 27 August 2010.

### 1.2.1 Confidentiality

The AEMC's approach to confidentiality is set out in full at section 4.4 of the Revised Statement of Approach (RSOA). In general, information that is relied upon by the AEMC in its reports should be published to allow it to be commented upon and tested in open debate.

The AEMC considers that its established practice of omitting confidential or commercially sensitive information contained in a submission prior to publishing the submission on its website offers adequate protection to stakeholders. Where certain information is considered to be (in all or in part) confidential or commercially sensitive, the party may request that the information be kept confidential. A request to maintain confidentiality should:

- be made in writing;
- clearly identify the information which is confidential and, where possible, separate that information from the other non-confidential information in the submission; and
- set out the basis upon which the information is confidential and/or commercially sensitive, including, for example, a statement as to any detriment that is likely to result to the person or any third party from the disclosure of that information.

Each request for confidentiality will be considered in the context of the ACT Retail Review and in accordance with the relevant procedures.

### 1.3 Structure of the First Draft Report

The remainder of the First Draft Report is structured as follows:

- **Chapter 2** summarises the AEMC's draft findings on the effectiveness of competition in the electricity retail market in the ACT;
- **Chapter 3** summarises the analytical framework that has been utilised in this 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;

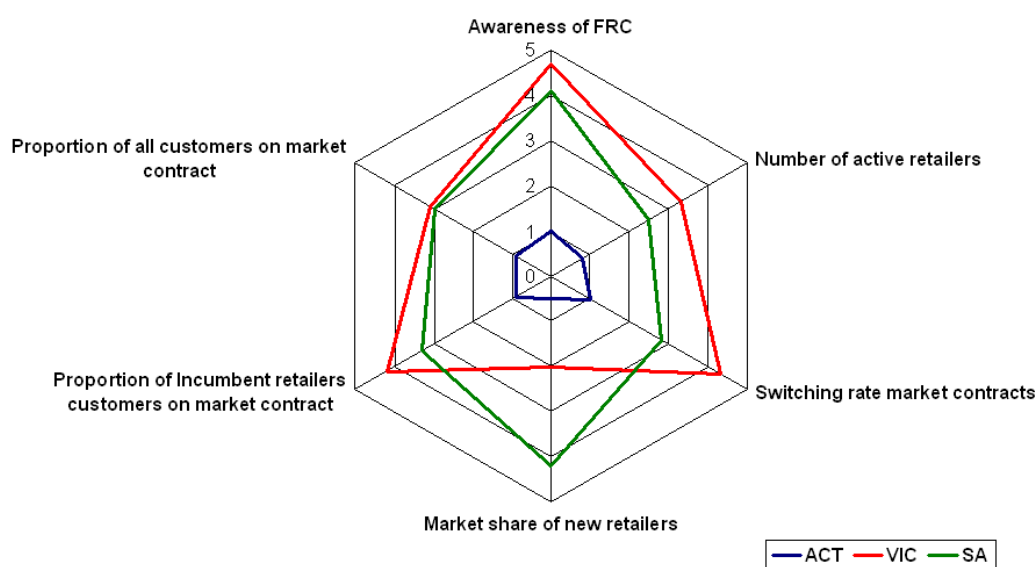
- **Chapter 8** provides an assessment of the available social welfare and equity instruments in the ACT;
- **Appendix A** summarises the consultation process for the ACT Retail Review;
- **Appendix B** provides an overview of electricity regulation in the ACT;
- **Appendix C** identifies the retailers operating in, or licensed to operate in, the ACT;
- **Appendix D** provides a summary of stakeholder issues in relation to the Issues Paper; and
- **Appendix E** contains a brief synopsis of the consultancy reports commissioned by the AEMC for this Review.

## 2 Draft findings

The AEMC's draft finding is that competition in the ACT retail electricity market for small customers is not effective.<sup>1</sup>

The primary reason for this conclusion is that there are barriers to entry in the market. In particular, that the terms of reference to the Independent Competition and Regulatory Commission (ICRC) require the regulated retail price to be calculated on the basis 'of the efficient costs incurred by ActewAGL Retail', the incumbent retailer. As a result, margins available to new entrants that wish to compete against the regulated retail price appear very low. This has had the effect of deterring potential entrants from entering into, or expanding within, the ACT retail electricity market. Accordingly, very little retailer rivalry has been observed and there are limited product choices available to small electricity customers.

**Figure 2.1 Cross jurisdictional comparison of competition indicators**



Indicator	0	5	ACT	VIC	SA
Awareness of full retail contestability (FRC)	50%	100%	60%	92%	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.

<sup>1</sup> The analysis in this First Draft Report has used a definition of small customers as those who consume less than 160 MWh of electricity per year. See section 5.2.

In reaching this conclusion, 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 MCE criteria is set out in Figure 2.1.<sup>2</sup>

A summary of the AEMC's draft findings, covering each of the MCE criteria, is set out below. Stakeholder submissions in response to these draft findings will be considered in the preparation of the First Final Report of this Review.

## **2.1 Market structure**

The market structure is not consistent with what would be expected in a market with effective competition, although certain characteristics of the ACT market appear to be attractive.

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

- Although the ACT market is small (approximately 350 000 residents, 131 000 households), other 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, appear to make the market attractive to retailers. However:
  - While there are 19 retailers licensed in the ACT, only four licensees have small customers, of which only two retailers are accepting new customers. The ACT market is dominated by the incumbent retailer, which has maintained a total share of the market greater than 90 per cent;
  - The main barrier to entry identified by retailers and supported by further analysis is that the level of the transitional franchise tariff (TFT) is too low to promote market entry and expansion. Other barriers to entry and expansion were comparatively minor and were not expected to significantly limit retailer activity in the ACT market; and
  - Retailer rivalry has been limited since full retail contestability (FRC) commenced, and has weakened more recently.

## **2.2 Market conduct**

The conduct of market participants 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:

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

- There is little retailer rivalry as evidenced by limited marketing, product differentiation and price rivalry. The incumbent retailer is the only retailer marketing in traditional media, in addition to undertaking significant community involvement;
- 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); and
- Customer switching away from the incumbent to second tier retailers has decreased markedly since 2007. Customer switching is now low, consistent with a dormant market.

### **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.

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

- Analysis supports the views of retailers that the effective margin under the TFT is not attractive to encourage entry, nor is it what they would expect from a competitive market. This appears to be the main factor deterring entry into the market;
- Given the low level of retail activity, there has been limited product innovation and differentiation in the ACT retail electricity market; and
- The overwhelming majority of consumers surveyed in the ACT did not express dissatisfaction with their current supplier of electricity. 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 they 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.

### **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 assessing 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.<sup>3</sup> Where competition is found to be effective, the AEMC is to provide advice on ways to phase out retail price regulation. Where competition is found not to be effective, 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).<sup>4</sup>

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 by the MCE (MCE criteria).<sup>5</sup> The MCE criteria are:

- 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

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<sup>3</sup> AEMA, clause 14.11(a). Western Australia will be assessed by the Economic Regulation Authority and not the AEMC.

<sup>4</sup> MCE Communique, 10 July 2009.

<sup>5</sup> 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.

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)<sup>6</sup> in conducting the retail competition reviews. This is outlined below.

### **3.2 Assessment framework in the Revised Statement of Approach**

In order to assess the effectiveness of competition, the AEMC must 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 (or peaceful co-existence) 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 assessing the effectiveness of competition.

While economic theory suggests that market type can be a good indicator of the effectiveness of competition in a market, the AEMC recognises that 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 in 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 AEMC will assess the degree to which the electricity retail market of the ACT is competitive.

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<sup>6</sup> The AEMC prepared and published a Statement of Approach (April 2007), which was adopted for the reviews undertaken in Victoria and South Australia 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.



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 plans to define the ACT market having regard to the following four dimensions, product, geographic, functional and temporal. It is appropriate to approach the question of market definition afresh at the commencement of the review for each jurisdiction.

#### **3.3.2 Market structure**

The market structure component of this review will cover both demand and supply aspects of the ACT market.

##### **Consumer component of the market**

This component of the structure of the market focuses on the demand for electricity in the ACT. In particular, the demographics of small electricity consumers in the ACT market, such as the numbers of households, temperature profiles in the ACT and seasonal aggregate demand. 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 in the market**

Independent rivalry in the market will focus on 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.

## **Ability of suppliers to enter the market**

In analysing market structure in relation to the ability of electricity suppliers to enter 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 is essentially the behaviour of those participating in the market. As with market structure, this can be viewed from both demand and supply-side aspects. The relevant MCE criteria are:

#### **Behaviour of electricity suppliers**

The behaviour of electricity suppliers is an important indicator of the actual degree of rivalrous conduct, that is, what may colloquially be referred to as competition between electricity suppliers in the ACT market. The behaviour of electricity suppliers has been assessed with regard to the following indicators:

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

#### **The exercise of market choice by consumers**

The demand-side aspect of market conduct will reflect how well customers 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 had regard to the following indicators:

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

## **Consumer switching behaviour**

In addition to how well consumers are able to make choices, there is also 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 or second tier customers.

### **3.3.4 Market performance**

Market performance will be assessed through the following MCE criteria.

#### **Differentiated products and services**

In evaluating the performance of the ACT market, the AEMC has had regard to:

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

#### **Prices and profit margins**

In evaluating the performance of the ACT market in relation to price and profit margins, the following indicators have been considered:

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

#### **Consumer satisfaction**

In analysing the satisfaction of consumers in the ACT electricity 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

This chapter provides an assessment on the definition of the market relevant to the ACT Retail Review. Defining the relevant market will establish the products over which competition occurs. As set out in the RSoA, the assessment draws on the framework used by the Australian Competition and Consumer Commission (ACCC). The key to market definition is product or service substitution; that is, the extent to which 'goods or services that are substitutable for, or otherwise competitive with, the goods or services under analysis'.<sup>7</sup>

There are four aspects or dimensions to the determination of product (a good or service) substitutability. These are: product, functional, geographic and temporal, and are considered below.

### 4.1 Product and function

Defining the relevant market for the ACT Retail Review requires consideration of the product or products that should be considered as being 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 will be in the same market if sellers and buyers readily substitute between one and another. In some cases, products will be close substitutes where, for example, in response to a price increase of one product, consumers increase their demand of another product readily.

It is understood that there may be some switching by consumers from electricity to another energy source (such as gas) in response to price increases in the supply of electricity. This suggests that some energy sources in addition to electricity could be included within the relevant market definition.

However, in terms of the functions and use of electricity for small end-users, there is no alternative that is able to be a complete substitute for electricity supply. For some functions such as space heating and cooking, gas and other energy sources can provide the same or similar service. While these energy sources could be regarded as weak or partial substitutes for electricity, the question is whether the substitutability is sufficient to broaden the market from the supply of electricity.

The functional aspect of market definition also has regard to the stages of production. A market typically involves multiple stages of production. For example, production, wholesale and retail. These are referred to as functional levels.

In this instance, the different stages of production leading to the supply of electricity to end-users are able to be separated. An observation of the businesses involved in, and

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<sup>7</sup> ACCC, *Merger guidelines*, November 2008, p. 15.

the operation of, the National Electricity Market (NEM) indicates that the generation of electricity, its transmission and distribution and the retail interface can be, and have been in some jurisdictions, separated to varying degrees. This separation is recognised and reflected in the national and ACT legislative frameworks for energy.

For end-users located in the ACT, there is a clear separation of generation and transmission as the businesses carrying out these functions are separate entities. However, it appears that it is unclear to some end-users that there are different businesses providing the distribution and incumbent retail functions of electricity supply.<sup>8</sup> Nevertheless, while both of these functions are carried out by ActewAGL businesses, separation, cost allocation and ring fencing arrangements are in place.

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

## 4.2 Geographic

The geographic dimension of market definition is the physical area or areas over which the relevant product or products are supplied and over which consumers can practically access.

The widest geographic area to consider is the area covered by the NEM. For retailers of electricity, the registration as a market participant in the NEM does not require a retailer to offer products to supply electricity across the entire NEM area. If this was the relevant geographic area for end-users, then all product offers made by all retailers would be available and substitutable. This is not the case in practice. A review of various retailer offers indicates 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. As a result of requiring retailers to be licensed to operate within a jurisdiction, a consumer located within one jurisdiction cannot obtain the services of a retailer that is not licensed in that jurisdiction. That is, a consumer located within the ACT cannot obtain their electricity supply from a retailer that is not licensed in the ACT.

In addition, discussions with retailers indicate that offers do not vary according to the geographic location of the end-user within the ACT (although this may occur within other jurisdictions).<sup>9</sup> Nor does there appear to be any other differentiation of offers according to the demographic characteristics of small energy end-users. Although it is acknowledged that certain retailers may focus on particular niches of the market (that is, a certain type of end-user such as those interested in 'green energy' products).

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<sup>8</sup> Roy Morgan Research Focus Group Report, p. 17.

Accordingly, for the ACT Retail Review, it appears most relevant to focus 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.

### **4.3 Temporal**

The temporal dimension of market definition refers to the time over which suppliers and consumers of the relevant product 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 energy users is influenced by the need to replace relevant equipment such as hot water services, cooking facilities and space heaters. As a consequence, in the short term consumers may have a limited ability 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. Nevertheless, the long run substitutability of energy sources such as gas for electricity supply is still weak as there are functions, such as lighting, that require the use of electricity. As a result, 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.

The ability of consumers to change supplier of electricity may be less restrictive (assuming that there are a number of retailers in the market that are seeking to acquire customers). Small energy users that are supplied in accordance to the regulated price, terms and conditions 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 timeframe over which supplier substitution decisions can be made by small end-users.

### **4.4 Conclusion**

In brief, the relevant market for the ACT Retail Review is the retail supply of electricity to small energy end-users within the ACT geographic area. This is relevant for the short and long term.

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<sup>9</sup> TRUenergy submission, 9 April 2010, p. 5.

## 5 Market structure

### 5.1 Introduction

This chapter sets out the structure of the electricity retail market in the ACT. In doing so, it compares electricity demand in the ACT to that of other jurisdictions and describes how electricity demand in the ACT has changed since FRC was introduced in July 2003. It also looks at the historical supplier rivalry in the market by analysing the number of retailers operating in the ACT over time. In addition, historical market shares and market concentration indices are explored as a tool for assessing the level of competition. Finally, the ability of retailers to enter and expand within the market is examined.

### 5.2 Market demand

The starting point for this analysis is to examine 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, it is important to consider 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).

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.<sup>10</sup> 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. However, the ACT has experienced the third highest population growth since July 2003 (Table 5.1).

**Table 5.1 Population growth for selected jurisdictions**

	NSW	VIC	QLD	SA	TAS	ACT
Population, as at Sept 2009	7.2m	5.5m	4.5m	1.6m	0.5m	0.4m
Growth, since July 2003	7.3%	10.8%	16.1%	6.3%	5.3%	8.6%

Source: ABS, *Population by age and sex, Australian states and territories*, cat. no. 3201.0, March 2010, Table 8.

<sup>10</sup> Australian Bureau of Statistics (ABS), *Population by age and sex, Australian states and territories*, cat. no. 3201.0. There were just over 131 000 households in the ACT as at 2006 census. ABS, *Census QuickStats: Australian Capital Territory, 2006*. This had grown to approximately 133 500 households by 2009. ABS, *Household and family projections, Australia, 2006 to 2031*, cat. no. 3236.0, June 2010, Table 1.23.

Unlike other jurisdictions, the ACT is comprised almost entirely of urban customers. The ACT's 350 000 residents equate to more than 150 000 small customers (comprising of households and small businesses) and approximately 1 500 large customers.<sup>11</sup>

These customer number estimates are based on the total number of National Metering Identifier (NMI) connections recorded by AEMO. It should be noted that for the ACT, AEMO defines a small customer as an end-user that consumes less than 160 MWh of electricity per year.<sup>12</sup> However, the TFT applies to customers using less than 100 MWh per year.<sup>13</sup> Nevertheless, the AEMC has used the available data on NMI connections as a proxy for customer numbers in the ACT throughout this report. The practical difference to the analysis is minimal: the NMI data suggests that 99 per cent of total customers are small customers (consuming less than 160 MWh of electricity per year); while ActewAGL Retail has stated that customers using less than 100 MWh per year represent approximately 98 per cent of the total customer base in the ACT.<sup>14</sup>

Figure 5.1 illustrates the growth in the number of small and large customers in the ACT compared to increases in the population since the introduction of FRC. Between 2003 and the end of 2005 the total number of customers in the ACT was steady while the population continued to grow. During that period the total number of small customers remained the same while the number of large customers declined about three per cent. In contrast, the population of the ACT steadily increased 1.6 per cent during that same period. By the end of 2005 the trend shifted and the total number of small and large customers started to grow. Between the fourth quarter of 2005 (Q4'2005) and Q3'2009, the number of small customers increased 8.1 per cent while the number of large customers grew 23 per cent. During that period the ACT population grew by 6.4 per cent. Overall, since July 2003, the number of small and large customers has increased by 8.2 per cent and 19.1 per cent, respectively, while the number of people living in the ACT has increased approximately 8.6 per cent.

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11 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. AER, *State of the energy market*, 8 December 2009, p. 194.

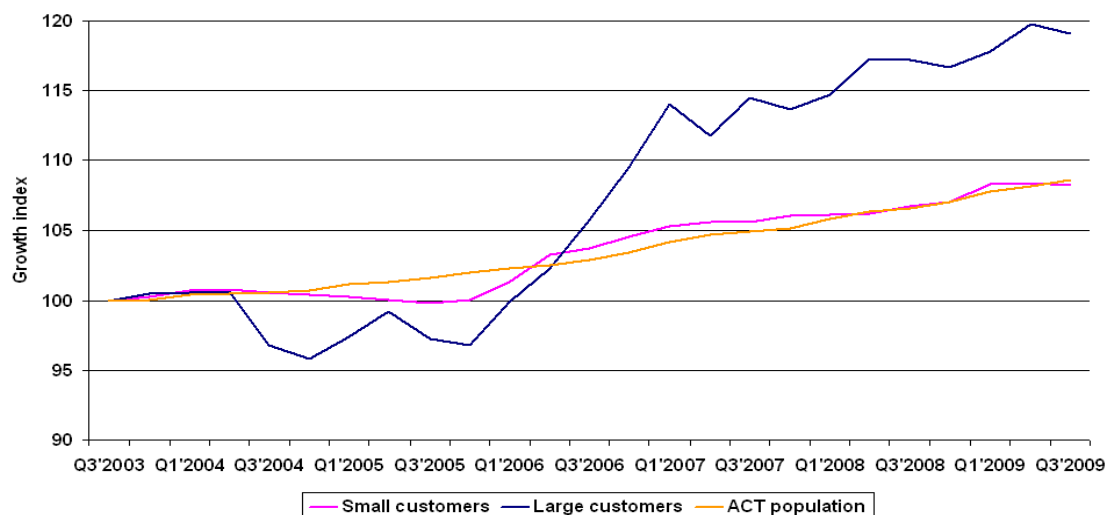
12 AEMO, *MSATS procedures: CATS procedure principles and obligations*, 25 November 2009, p. 41.

13 See section B.2 of this report.

14 ActewAGL Retail submission, 9 April 2010, p. 4.



**Figure 5.1 Customer and population growth for the ACT, 2003 to 2008**

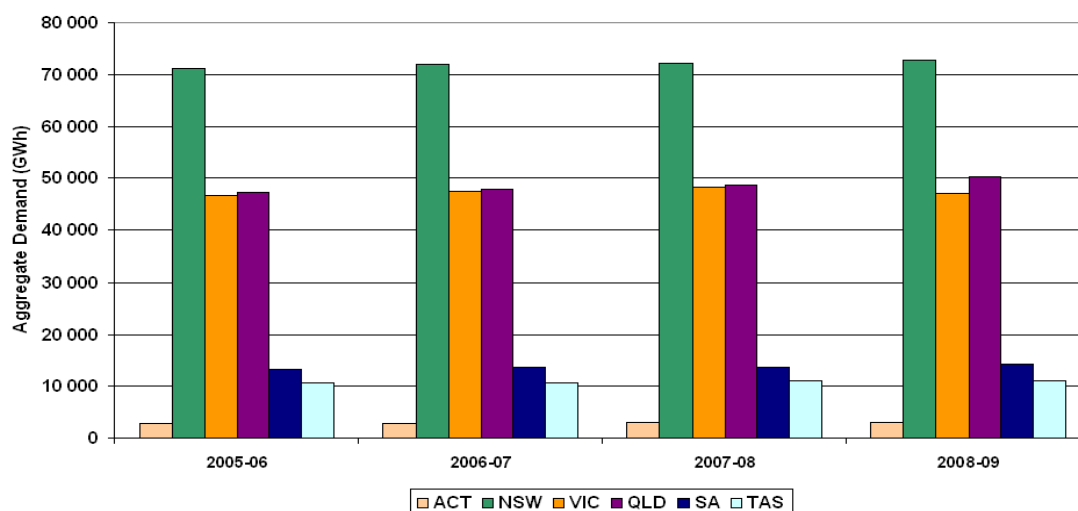


Source: ABS, *Population by age and sex, Australian states and territories*, cat. no. 3201.0, March 2010, Table 8; AEMO NMI connection data.

This information suggests that the ACT population has grown moderately fast compared to the other jurisdictions and recently at a higher rate than during the first two years after FRC was introduced.

Despite this growth, the ACT remains a small market, particularly in terms of total electricity consumed, when compared to other jurisdictions. During the period 2005-06 to 2008-09, aggregate demand in the ACT increased 3.6 per cent compared to 2.2 per cent in NSW, 0.9 per cent in Victoria, 6.3 per cent in Queensland, 7.5 per cent in South Australia, and 3.5 per cent in Tasmania.

**Figure 5.2 Aggregate annual demand by jurisdiction, 2005-06 to 2008-09**



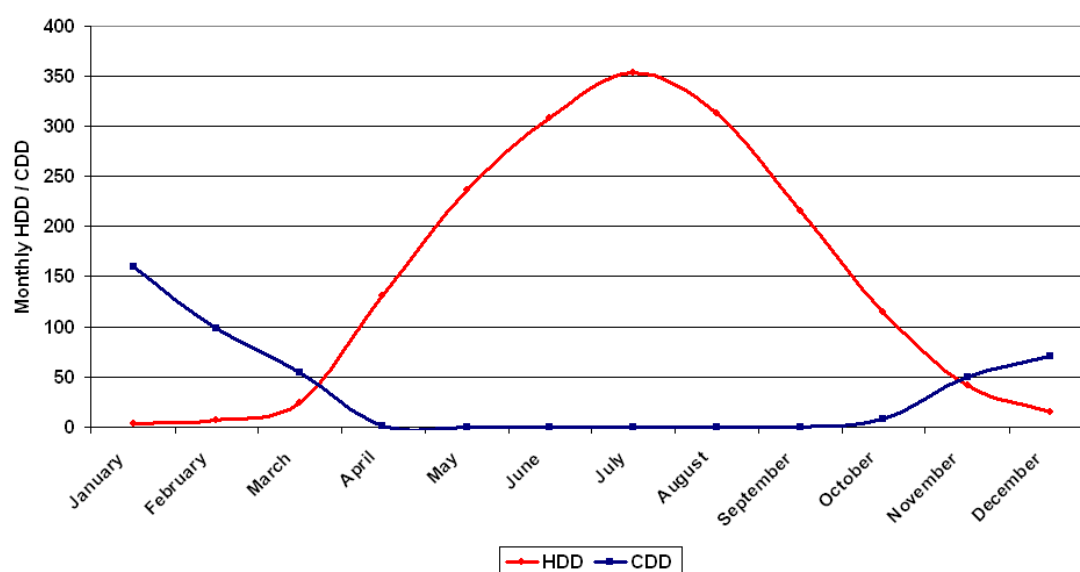
Source: AEMO, *Electricity statement of opportunities*, August 2009, Appendix B.

Note: Data for small electricity consumers only is not publicly available. Therefore, this figure shows total annual aggregate demand for both large and small consumers by jurisdiction.

While the ACT market is relatively small, it is a geographically concentrated pool of customers. In addition, there is a comparably high per customer electricity demand as a result of the relatively cold winters and warm summers. 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 5 600 kWh annually<sup>15</sup> and the typical household in Victoria uses about 6 500 kWh per year.<sup>16</sup>

To provide background information on the ACT climate, the following figure sets out the average monthly aggregate heating degree day and cooling degree day over the past five years in the ACT.

**Figure 5.3 Heating and cooling degree days for the ACT**



Source: BoM, Daily minimum and maximum temperature data at the Canberra Airport, station number 70014, 1 May 2005 - 30 April 2010.

Note: The heating (HDD) and cooling (CDD) degree days have been calculated using an 18°C temperature base. Each monthly sum has been averaged over five years.

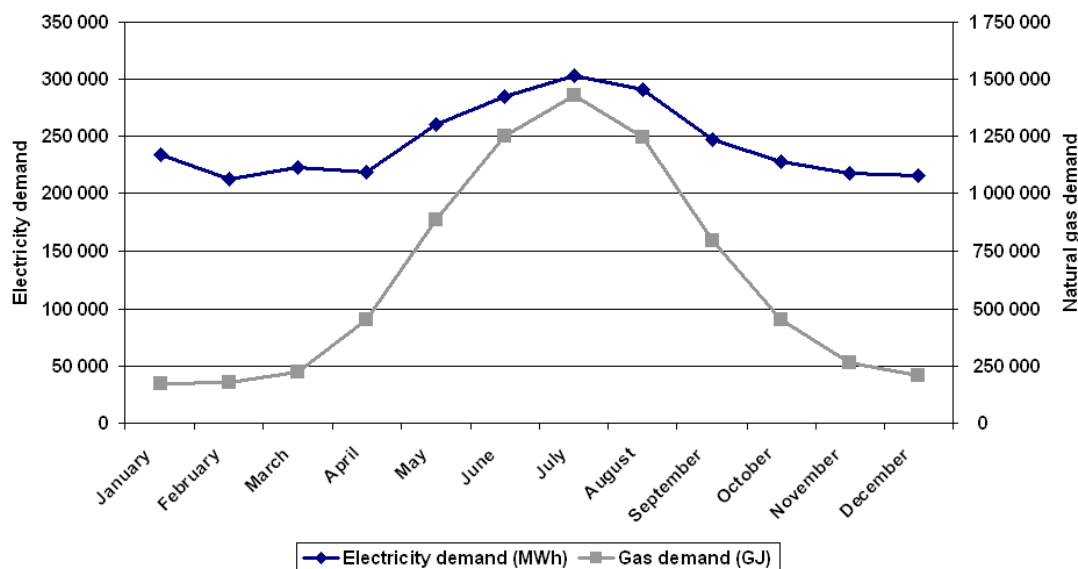
Based on this analysis, one might expect electricity consumption to be significantly greater during the winter months than in the summer. However, as shown below, the average monthly electricity demand over the past five years has been fairly stable between months. In fact, the maximum average electricity demand in the ACT, which occurs in July, is only about 1.4 times greater than the minimum average demand in February. This relatively low peak, as the figure below indicates, reflects the use of gas in winter (particularly for residential space heating). In effect, the significant winter peak in energy demand is largely taken up by gas rather than electricity.

<sup>15</sup> ICRC, *Draft Decision: Retail prices for non-contestable electricity customers, 2010-2012*, April 2010, p. 72.

<sup>16</sup> Essential Services Commission of Victoria, *Energy retailers: Comparative performance report - pricing and competitive market 2008-09*, December 2009, pp. 8-9.

For comparison, NSW and Tasmania are the only other jurisdictions that have had electricity demand peak during a winter month for the past five years.<sup>17</sup>

**Figure 5.4 Average monthly electricity and gas demand for the ACT**



Source: AEMC calculations from AEMO data.

Another 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.<sup>18</sup> 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.<sup>19</sup>

Several retailers have indicated that the ACT is an attractive market because they consider that:<sup>20</sup>

- despite its relatively small size, there are enough customers to make entry viable and warrant competitive pursuit;<sup>21</sup>
- there is particularly large energy demand during the winter;<sup>22</sup>

<sup>17</sup> AEMO, *Electricity statement of opportunities*, August 2009, Appendix B.

<sup>18</sup> ABS, *Average weekly earnings*, cat. no. 6302.0, 20 May 2010, table 12.

<sup>19</sup> Importantly, the ACT also has over 22 000 households receiving the Energy Concession. This represents approximately 17% of all ACT households. DECCEW, *Draft sustainable energy policy 2010-2020*, December 2009, p. 19.

<sup>20</sup> GA Research Retailer Interviews, pp. 34-35

<sup>21</sup> For example, a retailer has stated, 'But specifically about the ACT I would say that it'd be, from our point of view a critical mass would be a very small number of customers...A few hundred, 500 say'.

<sup>22</sup> One retailer stated, 'I think an initial catalyst would be the higher on average consumption, just having the cold and hot climate; very cold in winter and very warm in summer, so you get more through-put in average'.

- the geographic concentration of customers presents logistical benefits in terms of mobilising sales teams;<sup>23</sup>
- the ability to provide electricity and possibly other services to politicians and government decision makers has the potential to increase their corporate profile;<sup>24</sup>and
- 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.<sup>25</sup>

Finally, the RSoA requires that it be determined 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 to date. Notably, there do not appear to be any differences in tariffs available to small customers. TRUenergy highlights this point, '[t]he market is characterised by generic offers available to all consumers, based on tariff-type, not any social or consumption-level dimension'.<sup>26</sup>

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

### 5.3 Market supply and independent rivalry

This section explores 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 are examined to assist in the evaluation of the effectiveness of retail competition.

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23 Another retailer stated, '...there's no such rural areas; you can drive from one end of Canberra to the other end of Canberra in half an hour, so...geographically, there's no restrictions...Very easy to door-knock'.

24 For example, one retailer stated, '[i]n terms of political visibility I guess the market is attractive. Political awareness and you get reasonable interaction with government. It is always good to be operating in [the] backyard of people you are doing business with. That is one attractive feature of the ACT'.

25 One retailer noted, '...I think the demographics are strong in the ACT in that the average household income is probably higher than average, and so it's got some socio-economic demographics that make it a stronger market, so credit is less likely to be an issue in the ACT.' In contrast, another retailer pointed out that there is also a significant level of low income individuals stating, '[t]here's probably a greater polarisation in the ACT, I think a lot of people don't realise that it's not a particularly high income area, despite of the prevalence of the public service there, there's a substantial welfare population in the ACT, and they are customers who can make significant drains on the resources of companies such as our in terms of credit risk...'

26 TRUenergy submission, 9 April 2010, p. 5.

### 5.3.1 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 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.<sup>27</sup> Since that time, the number of firms holding retail licences has increased to 19 (see Appendix C for more information on these retailers).

The number of licence holders has been fairly constant over the past few years, with some new entrants joining the market, such as Sanctuary Energy and Momentum Energy, while others have exited (for example, Energy One). 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.

Despite the number of licence holders remaining fairly constant over the past few years, and increasing overall since FRC commenced, the number of active retailers has actually fallen. In April 2006, ActewAGL Retail, Country Energy and EnergyAustralia were active in the residential market,<sup>28</sup> and by June 2008, TRUenergy had also started actively competing for customers.<sup>29</sup> 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.<sup>30</sup> 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.<sup>31</sup>

Importantly, it appears that several inactive retailers have licences in the ACT simply as a defensive strategy because maintaining an ACT retail licence would allow them to enter into the market quickly in the event that there is a significant change in the market environment. Despite the apparent attractiveness of the market (as noted earlier, retailers have acknowledged that the ACT offers relatively high per customer demand with a winter peak in a small area with a relatively high average income), many of these licensed retailers have no real intention of entering the market in the near future. It appears that retailers are taking into account other aspects of the ACT's operating environment. The following comment from an inactive retailer highlights this fact, '[w]e're all competing against each other aggressively in Victoria, but other states; some of them are in other states but they're just keeping their position warm, hoping for when price deregulation comes in'.<sup>32</sup> Another inactive retailer pointed out

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

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

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

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

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

32 GA Research Retailer Interviews, p. 25.

that maintaining licences in each jurisdiction is important for national exposure, '[s]o because customers like to know and feel that you are a big national company, big retailer, before they want to do business with you, because you're always being compared to an Origin or an AGL or a TRU, because they have the national presence. So therefore it's important to have retail licences in other states so that you can actually make that claim that you're national. And the others do the same'.<sup>33</sup> Additionally, several of these retailers provide retail services to large customers in the ACT which necessitates a licence.

In conclusion, despite the number of licencees in the ACT, there have been (and are currently) limited supplier alternatives for small electricity customers. The next section sets out the historical customer shares of retailers that have entered into the market.

### 5.3.2 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.<sup>34</sup>

Data provided by the Australian Energy Market Operator (AEMO) on customer numbers for each retailer are confidential. However, the interviews held with various retailers, have indicated that there is a general sense that ActewAGL Retail has approximately 70-80 per cent of the total customers by number.<sup>35</sup>

The figure below sets out the quarterly shares of the small customer segment of the ACT's electricity retail market since the introduction of FRC in 2003.

Figure 5.5 shows that 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. During that quarter, EnergyAustralia had 6.1 per cent of the market, TRUenergy supplied 1.8 per cent of the customers, and the remaining retailers together held less than one per cent of the total.

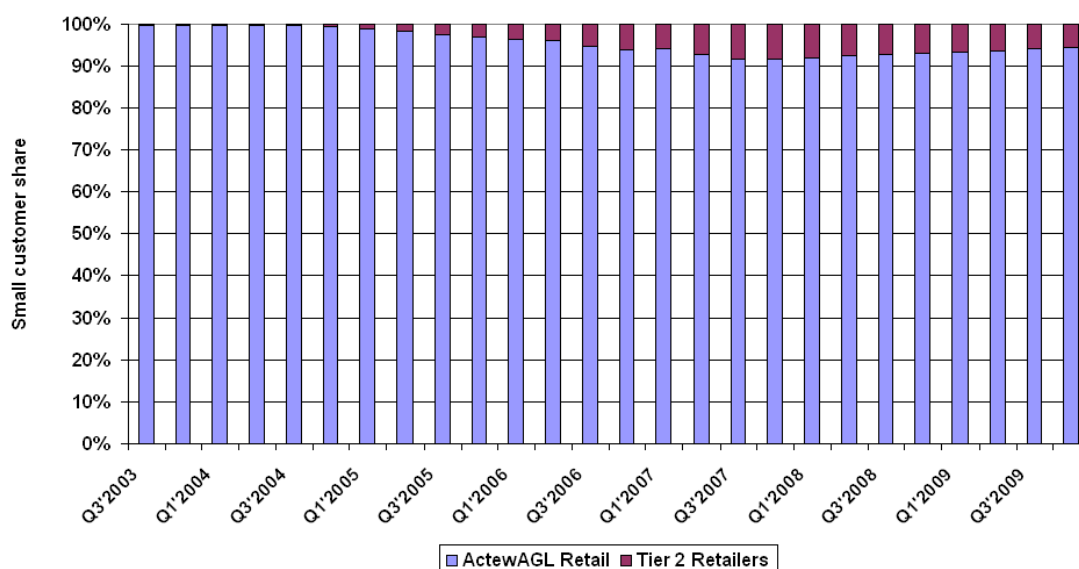
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<sup>33</sup> *ibid.*, p. 34.

<sup>34</sup> For further discussion see sections 6.2.2 (marketing by retailers), 6.3.1 (consumer awareness of competition and choice), and 7.2 (price and profit margins).

<sup>35</sup> GA Research Retailer Interviews, p. 15.

**Figure 5.5 Share of small customer market, 2003-2009**



Source: AEMC calculations from AEMO MSATS data.

These changes in the relative market shares of retailers were noted by the ICRC. In its 2006 retail price determination, the ICRC concluded that the ACT electricity retail market was sufficiently competitive to allow for the removal of the regulated tariff. The ICRC believed this change would lead to further opportunities for competition to evolve. This conclusion was, among other things, based on: the potential and actual competition in the market; the number of retailers; the discounts being offered through market tariffs; the steadily falling customer share of the incumbent retailer; the level of customer awareness; the widespread advertising taking place; and the range of service options available to small customers.<sup>36</sup>

Despite the changes in the market that were observed by the ICRC, the competitiveness in the small customer market did not continue to develop. From late 2007 until the present, customer switching between retailers has been limited (see also section 6.4). 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. 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 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

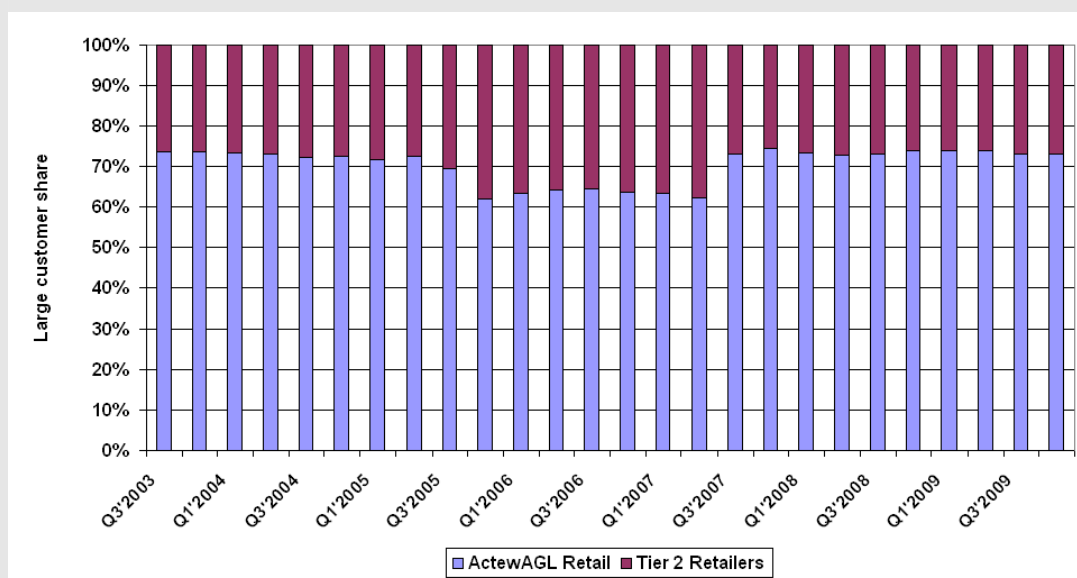
<sup>36</sup> ICRC, *Final Report - Retail prices for non-contestable electricity customers*, April 2006, pp. 15-23.

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. This result is not consistent with what would be expected in a market where competition is effective.

**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 the figure below, ActewAGL Retail's share by number of the large customer segment is substantially below the level it maintains in the small customer segment. Additionally, there are more active retailers in this market who have been successful in attracting reasonable customer shares.

**Figure 5.6 Share of large customer market, 2003-2009**



Source: AEMC calculations from AEMO MSATS data.

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. 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 brief, 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. Additionally, large customers use significantly more electricity than small customers. Where electricity is a greater proportion of total expenses, large customers may have more incentive to find the best market offer to obtain substantial cost savings.

### 5.3.3 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 (CR<sub>x</sub>) 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 (CR<sub>3</sub>) and four-firm concentration ratio (CR<sub>4</sub>) 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.<sup>37</sup> These extremely high ratios are the result of ActewAGL Retail's significant customer share, which has never fallen below 91.6 per cent, and, as discussed above, 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.

The HHI measurement of market concentration is also widely used. The ACCC uses the HHI as an initial screening tool when assessing the potential impact a merger may have on a market. It will generally be less likely to identify competition concerns when the HHI is less than 2 000.<sup>38</sup> Like the CR<sub>x</sub> measures, the HHI 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.

While these measurements imply that the ACT retail market is highly concentrated, it is important to note that these only provide an indication of the competitive nature of the market. As outlined in the RSoA, the CR<sub>x</sub> ratios and the HHI can be useful tools in competition assessments but these metrics alone are not conclusive indicators of the

<sup>37</sup> The CR<sub>3</sub> includes ActewAGL Retail, EnergyAustralia and TRUenergy. The CR<sub>4</sub> also includes either Country Energy or the AGL businesses (depending on the quarter).

<sup>38</sup> ACCC, *Merger guidelines*, November 2008, p. 37.

presence or absence of effective competition.<sup>39</sup> These tools must be considered in combination with other relevant information including evidence of the scope for retailers to enter the market and the extent of retailer rivalry. If sufficient rivalry exists between firms and there is sufficient threat of new entry, a market with a small number of firms may be effectively competitive.

#### **5.4 Ability of suppliers to enter and expand in the market**

A new entrant who can establish itself within a market or a retailer that can expand its existing business, within a reasonable period of time and on a sufficient scale can impose a competitive discipline on its competitors. This discipline constrains the pricing and output decisions of other retailers, encouraging them to supply customers with a better price-product-service package than their rivals and potential rivals. It also encourages businesses to facilitate the flow of information about their products to consumers, who exercise choice on the basis of this information. Conditions that enable a retailer to establish or expand its energy retailing business and impose constraints of this nature on its rivals can encourage competition in a market.

Conversely, where the conditions for new entry or expansion are unfavourable, all things being equal, the behaviour of existing retailers is less constrained. This can lead to one or more retailers accumulating market power, resulting in prices being maintained above competitive levels, and/or output and service delivery being below levels expected in a more competitive environment. The absence of competitive discipline (arising from the threat of entry or expansion) may also lead to a failure by retailers to distribute to customers the information that is necessary to enable them to make informed decisions about their energy supply. Market conditions that protect retailers from the threat of new entry and expansion can stifle the development of effective competition.

A barrier to entry refers to any market characteristic or condition that places an efficient potential new entrant at a disadvantage relative to a business already established in the relevant market. Barriers to entry are an important element of an assessment of the effectiveness of competition because, where they are high, new entrants will not be encouraged to enter the market and erode any excess profits that are being earned by the incumbents. As a result, the behaviour of the businesses already in the market will be less effectively constrained by the threat or actual entry of new participants.

Once a business has started trading, it may also face costs or impediments that prevent, or limit, its ability to expand, within the industry relative to its established competitors. These restrictions are known as barriers to expansion. Barriers to expansion exist where fringe or niche entry may be possible but there are obstacles to expanding to a size that would allow a new entrant to compete effectively against larger, more established businesses. In such circumstances, established large retailers may still not be effectively constrained by the threat of entry. In addition, the ability to exit the

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<sup>39</sup> AEMC, *Review of the effectiveness of competition in the ACT electricity retail market: Revised statement of approach*, December 2009, p. 12.

market may act as a barrier to entry if the costs of exiting are so prohibitive that the incentive to enter is reduced or destroyed altogether. For example, where entry requires substantial capital investment that cannot be recovered upon exit (that is, there are significant sunk costs) entry may be discouraged.

As shown above, to date, entry into and expansion within the ACT electricity retail market has 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 remainder of this chapter explores these potential barriers.

#### **5.4.1 Barriers to entry and expansion**

Barriers to entry and expansion in retailing electricity in the ACT can take a variety of forms. They can be structural, strategic or related to the legal and regulatory framework. There appear to be several possible barriers preventing firms from entering into and expanding within this market.

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 have 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 why retailers believe the current regulated tariff is too low, namely:

- the TFT is based on a cost build up that 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 increasing volatility and uncertainty in 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. However, there is broad agreement that the key elements that make up these costs include (see section 7.2.1 for further information):

- wholesale electricity costs (WEC), which include the costs of purchasing wholesale electricity through either the spot or contract market, as well as various ancillary costs and 'green' energy requirements;
- the costs associated with using the transmission and distribution networks, as reflected by network use of system charges;

- retail operating costs (ROC), including, among other things, issuing bills, managing customer enquiries and regulatory compliance obligations; and
- a retail margin to capture the appropriate return to the business taking into account the risks and uncertainties associated with the retailing of electricity (see section 7.2.2 for further information).

The major difference between the cost build-up approach taken by the ICRC and that applied by most other regulators in jurisdictions where retail prices are regulated is that a customer acquisition cost (CAC) or a customer acquisition and retention cost (CARC) allowance is not included in the ROC. 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 but also assumes that existing customers will only need to be retained, and therefore, 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,<sup>40</sup> which includes (among other things) the social impacts of the decision (s. 20(g)).

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 'minimum' price based on ActewAGL Retail's costs (excluding CAC/CARC) rather than a more 'competitive' price, based on the costs that a new entrant and/or stand-alone retailer would be likely to incur.

In its most recent retail price decision process, the ICRC was informed by two retailers that the TFT would need to increase by between five and ten per cent in order for them to consider entering into the market again. However, the ICRC stated that it did not believe that including a CAC/CARC allowance would equate to an increase that would attract vigorous competition back into the ACT electricity retail market.<sup>41</sup> As a result, the ICRC concluded, '[i]n balancing the objectives of the Act and having regard to its terms of reference, the Commission does not consider that the potential benefits to consumers from artificially increasing the TFT (on the basis that it may result in vigorous competition) outweigh the potential negative impacts, which include higher prices in the short-term, and possibly in the long-term as well'.<sup>42</sup>

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<sup>40</sup> *Independent Competition and Regulatory Commission Act 1997 (ACT)*. See Chapter 8 for further discussion.

<sup>41</sup> ICRC, *Draft Decision: Retail prices for non-contestable electricity customers*, 2010-12, April 2010, p. 53.

<sup>42</sup> *ibid.*, pp. 56-57.

Nevertheless, despite the ICRC's comprehensive discussions on its approach and the framework to calculating the TFT, the exclusion of an allowance for CAC/CARC from the TFT calculation remains an issue for retailers.

In its submission to the Issues Paper, Origin Energy stated that the exclusion of a CAC/CARC allowance has historically been a barrier to entry in this market, 'some of the barriers deterring entry include marketing to establish brand identity given the strength of the incumbent's business model and the cost imposed on retailers of building systems and processes to cater for different regulatory regimes. Price regulation has not historically recognised these costs'.<sup>43</sup>

The Energy Retailers Association of Australia (ERAA) raised similar concerns noting, '...the regulatory burden and cost of acquiring customers in the ACT must be spread over a smaller customer base. The regulated retail price set by the ICRC has been criticised by a number of retailers in recent years for not taking this into account; this may be acting as a barrier to entry for retailers looking to enter the ACT and therefore holding back competition'.<sup>44</sup>

In addition, an inactive retailer also highlighted concerns about the ACT regulated tariff during its interview,<sup>45</sup>

“...potentially an indication that the price setting is not reflective of the true cost to serve. One of the aspects of the price setting in the ACT is they don't include costs that are included in other jurisdictions. For example my understanding is the current regime doesn't include customer acquisition costs in the costs for determining the regulated price, which is a cost that is included in other jurisdictions. So that goes potentially to squeeze the margin for the retailer on the electricity side of the business.”

This information indicates that 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. As discussed further in Chapter 7, analysis undertaken by the Allen Consulting Group (ACG) indicates 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.

### **Wholesale electricity cost allowance**

The other major criticism of the TFT from retailers is that the WEC allowance in the TFT cost base is not sufficient to account for the risks and uncertainties associated with purchasing wholesale electricity. Several retailers have indicated that volatility in the wholesale electricity market has increased substantially since 2007 and, as a result, the

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<sup>43</sup> Origin Energy submission, 12 April 2010, p. 5.

<sup>44</sup> ERAA submission, 19 April 2010, p. 2.

<sup>45</sup> GA Research Retailer Interviews, p. 21.

WEC allowance has not accurately reflected the electricity costs that retailers incur to participate in this market.

TRUenergy highlighted this point in its submission, stating that,<sup>46</sup>

“[i]t is the role of retailers in the competitive market to manage wholesale risk, and retailers compete on this basis. However, the ability of regulators to accurately forecast, in some cases years in advance, movements in wholesale markets when setting retail prices is problematic in the extreme. The regulatory risk this imposes on retailers diminishes the benefits of competition that would otherwise flow to consumers.”

The ERAA also discussed this issue, suggesting that part of the problem has to do with the uncertainties surrounding government policies:<sup>47</sup>

“[i]n coming years, the electricity market will become more complex and volatile. This is due to the introduction and amendment of Government policies (e.g. enhanced Renewable Energy Target, Carbon Pollution Reduction Scheme (CPRS) and state-based feed-in-tariffs). The ability of the ICRC to set accurate electricity prices into the future will therefore be diminished.”

Two retailers also raised concerns about regulated retail price setting and the implications for competition during their interviews. The first retailer, which currently provides electricity retail services in the ACT, revealed that it has been unable to offer discounts from the regulated standing offer since the wholesale price spiked in 2007.<sup>48</sup>

“[a]nd in recent times customers that are coming off contract we're advising them to go back to the standing tariff, back to ActewAGL. We are one of the retailers that said to the ICRC that we are now advising customers that come off contract that we can't make an offer that is better than the standing offer that they'd had....So I think generally things changed in the market sort of mid, early to mid 2007 when the wholesale price went ballistic. At that stage we largely pulled back from our proactive acquisition activities and then progressively through 2007, 2008 we've reached this position that you can't actually secure a wholesale position that allows you to have a reasonable margin below the regulated rate.”

The second, an inactive retailer, stated:<sup>49</sup>

“[w]hy people would switch back to a regulated rate is because obviously the market rates were higher. Why are the market rates higher? The market rates are higher because they'd be reflecting higher wholesale curved prices,

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46 TRUenergy submission, 9 April 2010, p. 4.

47 ERAA submission, 19 April 2010, p. 2.

48 GA Research Retailer Interviews, p. 22.

49 GA Research Retailer Interviews, p. 23.

which by deduction means that where the regulated rates are being set are either not reflecting where the wholesale market has moved or not reflecting a realistic margin... their process doesn't deal with a wholesale market that's moving around. For them to try and set a four year view or something it's just totally unrealistic because the wholesale market's not like that, and secondly, they don't set realistic margins."

Further analysis on the WEC, how it is determined for the purpose of setting the TFT, and its potential impact on competition in the ACT retail market is included in Chapter 7 of this report. However, as the above comments indicate, retailers are concerned about their ability to manage wholesale electricity costs. This concern appears to result in the retailers regarding the WEC allowance as a barrier to entry into the ACT market. However, it should be noted that in an environment where there is volatility in the wholesale electricity market and retail prices are regulated, there is the potential for profit margins to be squeezed due to unexpected changes in wholesale electricity prices. This is not necessarily an ACT specific issue: it could occur in any market where there is a regulated price around which retailers compete.

### **Other potential barriers**

There are several other potential barriers to entry and expansion within the ACT electricity retail market that have been identified by stakeholders. 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.

The remainder of this chapter briefly discusses each of these secondary issues.

One potential barrier to entry and expansion that has been identified by stakeholders is the relatively small size of the ACT electricity retail market compared to other jurisdictions. However, as discussed earlier in this chapter, although there are a small number of customers, per customer demand is relatively high due to the climate. While there may be a small number of customers, there is a geographic concentration rather than a geographic spread. This is a benefit in terms of customer management in that it is easy to visit many customers within a set timeframe. In addition, ACT residential customers have a relatively high average income. These features of the small customer

segment of the ACT electricity market appear to counter the suggestion that the size of the market is a barrier to entry and expansion.

Another potential barrier that has been identified by retailers is the dominance of ActewAGL Retail and its bundling capabilities through its related companies in providing other utility services.<sup>50</sup> Retailers have previously informed the ICRC that ActewAGL Retail's historically strong presence in the electricity retail market has led to significant brand loyalty which has created a major barrier to entry and expansion in the market.<sup>51</sup> The qualitative and quantitative studies carried out by Roy Morgan Research support this view. For example, focus group participants displayed little knowledge about retailers other than ActewAGL Retail but were very aware of ActewAGL Retail's significant community involvement. The participants were also aware of the potential to bundle various services with ActewAGL Retail and that in doing so, significant savings could be obtained.<sup>52</sup> Retailers have identified the degree of bundling and consequent customers' savings as something that it is difficult to compete against.<sup>53</sup>

“I think one of the things that is unique about the ACT market is the TransACT component, with the telephones and the water that's linked in, so it's much more of a bundled service, which certainly makes those customers potentially harder to move because ActewAGL bundle a lot more than any other retailer. ... So it's a bit of a competitive advantage for the incumbent around that.”

Nevertheless, they do not appear to see this as an insurmountable barrier:<sup>54</sup>

“... it wasn't as though we're after 50% market share. We just wanted customers who wanted to be with us and ... if you're only talking about a few hundred as being sort of a viable base, I don't see the incumbency's ... necessarily an issue ...”

Therefore, while some retailers have identified the dominant presence of ActewAGL Retail and its significant bundling capabilities as potential barriers to entry and expansion within the ACT electricity retail market, these features of the market do not appear to be insurmountable for second tier retailers.

It has also been suggested that the inflexible way in which ActewAGL negotiates network user system agreements may create a barrier to second tier retailers. One inactive retailer stated, '[w]ell, the issues around them for us would be really the prudential requirements that [ActewAGL Retail] want, which are sort of pretty onerous. And the inflexibility in how they negotiate the network user system

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50 ActewAGL Retail, through its partnership with TransACT, offers bundling discounts of up to 25 per cent off customers' electricity bills, up to a \$500 cap.

51 ICRC, *Draft Decision: Retail prices for non-contestable electricity customers, 2010-12*, April 2010, p. 49.

52 Roy Morgan Research Focus Group Report, pp. 10-16.

53 GA Research Retailer Interviews, p. 18.

54 *ibid.*, p. 17.



agreements, which are pretty much 'sign here'. They're non-negotiable. That's an issue in all states, not just in the ACT'.<sup>55</sup>

During its interview, one small retailer stated that the bank guarantee is more than ten times the amount of the next most costly jurisdiction. The retailer commented that, '[i]t is basically saying if you are not from a government owned company, don't come to the ACT. A majority of them are government owned companies so they by default have the credit rating required. There's not very much competition I think really happening from a sense I get from the other retailers who just get into the ACT because of the completeness as opposed to it being a large interest within their companies'.<sup>56</sup>

These comments suggest that dealing with ActewAGL Distribution (as all ACT retailers are required to do) may, in itself, create a barrier to entry and expansion for some tier two retailers, particularly the smaller ones. However, the AEMC understands that the requirements specified in the ACT and by ActewAGL Distribution are not significantly different to those in NSW.<sup>57</sup>

More generally, a number of retailers have stated that the fact that the ACT electricity retail market has its own regulations that are different from any other jurisdiction creates additional compliance and administrative costs which form a barrier to entry. For example, one retailer commented:<sup>58</sup>

"I guess as another barrier I would say, and it is in no way unique to the ACT market. Is like every state they've got their own sets of criteria for everything. Reporting requirements, licensing and contract requirements. And obviously quite a large overhead for a retailer who has to maintain differences in every state. Processes to deal with them."

As indicated by Origin Energy, one ACT specific requirement is the feed in tariff scheme. Origin Energy has commented that '[b]arriers to expansion may be imposed by the imposition of new regulation (or complex changes to existing regulation, for example, the feed-in tariff scheme) ...'<sup>59</sup> TRUenergy also indicated that the ACT's feed in tariff scheme is an additional barrier to entry and expansion within this market stating,<sup>60</sup>

"[i]n addition, the ACT feed in tariff scheme imposes additional jurisdictional-specific costs on retailers, and is a further disincentive for second tier retailers to enter and expand in that market. The scheme guarantees eligible customers a set feed-in rate (based on year of installation) for 20 years, with the potential for the rate to change annually

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55 *ibid.*, p. 40.

56 *ibid.*

57 ICRC, *Electricity network use of system code*, October 2007, pp. 24-26, and NSW Government Industry and Investment, *Network use of system agreements*, January 2002, pp. 4-6.

58 GA Research Retailer Interviews, p. 40.

59 Origin Energy submission, 12 April 2010, p. 5.

60 TRUenergy submission, 9 April 2010, pp. 1-2.

(although the Government has set the 2010 rate for a period of two years). Such an approach requires retailers to, in effect, establish a new retail product in their billing and customer management systems on each occasion the feed-in tariff rate changes, and retain that product for 20 years. Substantial system and operating costs are incurred for new product builds, and the retention of legacy products which are not available to new customers imposes additional administrative costs.”

Similarly, while not specific to the ACT market, a number of retailers viewed contractual agreements and the obligation to supply customers to be a potential barrier to entry and expansion. For example, one retailer commented,<sup>61</sup>

“[s]o electricity’s a little bit unique in that if you can’t sell or assign your customers, you can’t just get rid of your customers. We’re unlike other industries where you come to the end of a contract and you say, 'Well, that’s it. That’s all done.'...That person is still with you, so even if... I don't want you with me, you might still stay with me. So depending on the legal question, there could be a barrier to exit ... if you just can’t sell your base.”

Another retailer stated,<sup>62</sup>

“[t]here’s only some costs, which is the fact that we’ve invested in compliance. In terms of break costs, no, from our point of view. There’s a difficulty around just walking away and leaving your customers, it’s not something you do as a sensible brand exercise, so you don’t just write to people and say ‘we’re not longer going to supply you unless you have absolutely no other option’ ”

Given the size of the ACT electricity retail market, additional or ACT specific regulatory and operating requirements have the potential to be a barrier to entry in this market in that there are fewer customers over which to spread those fixed costs. However, the fact that there are jurisdictional specific requirements is not an issue limited to the ACT. Retailers are required to manage specific requirements in each jurisdiction in which they operate. This is the current environment in which retailers operate across the NEM. Over time, differences across jurisdictions are expected to diminish (with, for example, the introduction of national approaches such as the National Energy Customer Framework). It is acknowledged that under current arrangements, the cost of managing specific requirements may be heightened in the ACT where customer numbers are relatively small compared to large states such as NSW and Victoria. Nevertheless, while this requires some management on the part of the retailers, this does not appear to raise an insurmountable barrier to entry or expansion for second tier retailers.

On balance, of the various potential barriers to entry and expansion identified by stakeholders, the issues surrounding the level of the TFT (that is, the exclusion of an

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61 GA Research Retailer Interviews, p. 42.

62 *ibid.*

allowance for CAC/CARC and whether the WEC is calculated and structured to accommodate price volatility in the wholesale market) appear to be the most significant for tier two retailers. The concerns surrounding these two issues appear to be influencing the behaviour of retailers to the extent that there are limited constraining factors on the behaviour of the incumbent retailer, ActewAGL Retail. That is, retailer concerns about the level of the TFT are ultimately stifling the development of effective competition. This in turn has resulted in limited product options being available to small electricity customers in the ACT.

## **5.5 Conclusions**

This chapter began with a description of the nature of small customer demand in the ACT electricity retail market and concluded that, based on these demand characteristics alone, the ACT appears to be an attractive market even though there are a relatively small number of customers. This conclusion is supported by comments made during retailer interviews. Supplier rivalry in the market was then assessed. It was found that rivalry had been limited in the past and could now be described as weak. As a result, an analysis of historical market shares and concentration indices suggested that the ACT does not exhibit the characteristics of an effectively competitive market.

Finally, barriers to entry into, and expansion within, the market were evaluated. This analysis revealed several potential barriers to entry and expansion that may limit effective competition. Of these, the TFT is the most significant. Specifically, the exclusion of customer acquisition costs from the cost index and that the WEC allowance is not believed to be sufficient to account for the risks and uncertainties associated with volatility in the wholesale electricity market. The views held by second tier retailers on the TFT appear to have influenced their behaviour and has led to the result that there is limited competition in the small customer segment of the ACT electricity retail market.

In conclusion, the market structure of the ACT electricity retail market is not consistent with what would be expected in a market in which there is effective competition.

## **6 Market conduct**

### **6.1 Introduction**

This chapter sets out the conduct of electricity suppliers and consumers of the electricity retail market in the ACT. In doing so, it assesses the degree of rivalrous conduct between electricity retailers and the extent to which retailers are marketing to solicit new customers. The chapter also looks at the exercise of market choice by consumers, their awareness of competition, the ability to choose their electricity supplier and the extent of information available to inform their decisions. Finally, customer switching trends since the introduction of FRC are investigated to assess consumer behaviour in the market.

### **6.2 Behaviour of electricity suppliers**

Independent rivalry between existing retailers 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 meet the requirements of customers. Retailers achieve this by engaging in price and non-price rivalry with other retailers. Viewed in this way, retailer rivalry can facilitate the delivery of those products most sought after by customers and at prices that reflect the long-run efficient cost of supply.

To assist the AEMC in ascertaining the nature and extent of retailer rivalry that has emerged since the commencement of FRC, and is likely to exist in the future, the AEMC engaged GA Research to undertake interviews with retailers licensed to operate in the ACT. The relevant aspects of the interviews that provide some insights into the behaviour of electricity suppliers in the ACT are:

- knowledge and perceptions of the ACT electricity market;
- competitiveness, retailer rivalry and customer switching; and
- retailer offers and marketing activities.

The above points will inform the discussion that follows.

#### **6.2.1 Retailer rivalry**

Following the introduction of FRC in the ACT, two retailers - EnergyAustralia and TRUenergy - entered the market in competition with ActewAGL Retail. EnergyAustralia undertook a door-knocking campaign from 2005 and was the first new entrant in the ACT market. EnergyAustralia offered a dual fuel product comprising of electricity and natural gas. The price for electricity was generally offered at a discount to the published TFT. From mid-2006 TRUenergy also entered the ACT market 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.<sup>63</sup> Over this period, several other second tier retailers also acquired a small number of customers, but in each case their market 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).<sup>64</sup> 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):<sup>65</sup>

“Actew came back with a ... win back campaign where they basically put ads in papers and things like that saying to customers, ‘Look’, you know, relying on the parochialism ... of the area, and saying to customers, ‘Look stick with us, you know, we’re Canberra based, we’re here for you’...”

From mid-2007, following increased volatility in the wholesale market, an inability by some retailers to obtain adequate forward contracts coinciding with retailers' perception that the margins achievable under the TFT were too low, rivalrous conduct between retailers has declined.<sup>66</sup>

A number of stakeholders have noted that 'there is no current significant competition in the ACT electricity retail market' and this appears to remain the current situation.<sup>67</sup> Similarly, the ICRC stated the following during its most recent retail pricing decision process:<sup>68</sup>

“Although the ACT electricity market is clearly open to competition, it appears that at this time vigorous competition does not exist in the small customer segment of the market.”

### 6.2.2 Marketing by retailers

As noted above, following the introduction of FRC, a number of second tier retailers began actively marketing in the ACT. Both EnergyAustralia and TRUenergy marketed products that offered a discount to the published TFT. At this time, ActewAGL Retail was not offering many differentiated products and services. A retailer made the following observations about its initial marketing activity in the ACT market.<sup>69</sup>

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<sup>63</sup> ACAT submission, 9 April 2010, p. 3; TRUenergy submission, 9 April 2010, p. 2.

<sup>64</sup> Internal switching is where a customer moves from the standing offer to a market contract with their current electricity supplier.

<sup>65</sup> GA Research Retailer Interviews, p. 29.

<sup>66</sup> A discussion on the impacts of the wholesale market is outlined in sections 6.4.1 and 7.2.

<sup>67</sup> ACAT submission, 9 April 2010, p. 3; TRUenergy submission, 9 April 2010, p. 1.

<sup>68</sup> ICRC, *Draft decision: Retail prices for non-contestable electricity customers 2010-12*, April 2010, p. 49.

<sup>69</sup> GA Research Retailer Interviews, p. 27.

“I don’t think it was until 2004 that we actually took the step in. When we did, because it’s such a small place and there’s an ActewAGL person that lives in every street in Canberra, they knew we were there within about 30 minutes. And we made reasonably good headway with customers down there, we had an offer. It was something that Actew hadn’t come to them with. There was an alternative, there was an offering we had and at that time Actew wasn’t making any offers at all, so they were relying on the base that they had all these customers and it was a closed shop. So we came in with a [product] that effectively offered a discount off the standing rates...”

ActewAGL Retail is regarded by other retailers as having a very active marketing approach to customer retention, suggesting that it may genuinely feel the threat of the other licensed retailers in the market. During the retailer interviews, most participants noted that currently the most prominent electricity marketing activities in the ACT are 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.<sup>70</sup> A number of consumers participating in the focus groups conducted by Roy Morgan Research also noted the special role of ActewAGL Retail in the ACT community as follows:<sup>71</sup>

“ActewAGL is very skilful at promoting its image in the community. By sponsoring sport ... [t]heir logo is plastered over community events, so they are thought to be a local company. [They do this so] that we will like them. It is a feeling of familiarity isn't it? That they're part of our community.”

Two active retailers also provided the following observations about ActewAGL Retail's marketing in the ACT:<sup>72</sup>

“ActewAGL do a lot of things with the community down there and I think that gets them a lot of favours against the football teams or the different events that are around the city. They’ve got a lot more presence.”

“ I mean the ACT’s had a great allegiance ... to ActewAGL, it’s ... like a family relationship ... So they are very, very strong in terms of getting this brand allegiance. So to make a compelling offer was challenging ...”

Currently there is very little active marketing being undertaken in the ACT aside from the bundling offer marketed by ActewAGL Retail (an outline of the offers currently being marketed in the ACT can be found in section 7.3).<sup>73</sup>

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70 ActewAGL homepage at [www.actewagl.com.au](http://www.actewagl.com.au); ActewAGL, *Annual and sustainability report 2008-09*, p. 45 (which provides information on community sponsorship undertaken by the ActewAGL group of companies).

71 Roy Morgan Research Focus Group Report, p. 13.

72 GA Research Retailer Interviews, p. 20.

Marketing by other retailers is passive, relying on the consumer to find offers. In relation to current marketing practices, active retailers in the ACT made the following observations:<sup>74</sup>

“In the early days ... we went hard. At the moment we don’t have a definitive marketing strategy because we think the degree of difficulty in being successful there is probably the most challenging in terms of the markets we operate in ...”

“You can click on our website and find the price for the ACT, which is entirely passive. And you could arrange a connection through a real estate agent using someone like Connect Now, or you could go direct to [their] website yourself, and you will find [retailer] promoted there, but that’s it.”

Overall, this information indicates that while there has been some marketing by second tier retailers in the past, there is essentially no active marketing (such as advertising in the media or door knocking) undertaken by any retailer except ActewAGL Retail at present.

### **6.3 The exercise of market choice by consumers**

Although retailers can differentiate energy services on the basis of price, service and other non-price terms and conditions, consumers generally regard energy as a homogenous and low involvement commodity. These characteristics of energy demand mean that consumers tend to have a low degree of interest in exercising choice between energy retailers and products. These characteristics can also contribute to a perception on the part of the consumer 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.

To assess the behaviour and attitudes of small-scale residential and business consumers of electricity in the ACT, the AEMC commissioned Roy Morgan Research to undertake both qualitative and quantitative surveys. In relation to the exercise of market choice by consumers, the surveys assessed consumer engagement in their choice and their ability to act as agents to drive the competitive market.

#### **6.3.1 Consumer awareness of competition and choice**

In the quantitative surveys, 58 per cent of small businesses and 60 per cent of residential consumers indicated they were aware they had a choice of electricity suppliers.<sup>75</sup> These results indicate that there is a general awareness among consumers in the ACT of the ability to choose their supplier. However, the finding that

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<sup>73</sup> The ActewAGL group of companies actively advertises its products and services through television commercials and two commercial radio stations in Canberra. In addition, it advertises in traditional print media, including *The Canberra Times* and its own *essentials* magazine.

<sup>74</sup> GA Research Retailer Interviews, pp. 19-20.

<sup>75</sup> Roy Morgan Research Small Business Report, p. 1; Roy Morgan Research Residential Report, p. 1.

approximately 40 per cent of consumers are still unaware some seven years after FRC was introduced means there is room for improvement. By comparison, residential customer awareness of FRC in Victoria is 94 per cent and in South Australia is 82 per cent.<sup>76</sup>

However, while some consumers are aware of the ability to choose their supplier, when queried as to what alternative electricity suppliers were available in the ACT one in two people were not able to name an alternative.<sup>77</sup> The survey results suggest that this response is a result of approximately 50 per cent of ActewAGL Retail customers not being able to identify another supplier.

### **6.3.2 Ease of obtaining, understanding and comparing information**

The ACT Minister noted in its submission to the Issues Paper that the level of participation in the competitive market seems to be affected by the 'amount and availability of information about the market itself and the products and prices being offered'.<sup>78</sup> It also stated that 'the lack of customer information about, and knowledge of, competition', may be affecting the development of competition.<sup>79</sup> Similarly, ACAT noted 'it has observed little action by retailers to assist customers experiencing difficulties in participating in the contestable retail electricity market in the ACT. Because the ACT market is relatively small, it may not be cost effective for inter-state retailers to adapt existing web-based or print media to the ACT market'.<sup>80</sup> In contrast, ActewAGL Retail considered that 'there is appropriate publicly available information for customers to make informed choices about their electricity retailer. Information is freely available on [its] award-winning website, as well as, the websites of other retailers and web-based brokers. The web-based brokers provide comparisons of products and offers across suppliers'.<sup>81</sup>

The qualitative study conducted by Roy Morgan Research noted the 'importance of making an informed choice with accurate information'.<sup>82</sup> When focus group participants were queried about obtaining information, Choice Magazine was frequently mentioned, in addition to 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 - such as clearer cost

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<sup>76</sup> 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.

<sup>77</sup> Roy Morgan Research Small Business Report, pp. 1-2; Roy Morgan Research Residential Report, p. 1.

<sup>78</sup> ACT Minister for Energy submission, 17 May 2010, p. 4.

<sup>79</sup> *ibid.*, p. 2.

<sup>80</sup> ACAT submission, 9 April 2010, p. 3.

<sup>81</sup> ActewAGL Retail submission, 9 April 2010, p. 16.

<sup>82</sup> Roy Morgan Research Focus Group Report, June 2010, p. 17.



comparisons, better disaggregation of cost components, and information about the discounts available.<sup>83</sup>

The results from the quantitative surveys conducted by Roy Morgan support the findings of the focus groups. When asked the question as to whether a participant had looked for any information in the past 12 months to assist in making a decision to switch electricity supply arrangements, 90 per cent of residents and 94 per cent of small businesses surveyed responded 'no'.<sup>84</sup> However, of the approximately ten per cent of the residential participants who had looked for information on switching retailers, 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, when asked whether the information was easy to obtain and/or easy to understand, approximately 70 per cent of participants agreed that this was the case.<sup>85</sup> The small business survey yielded similar results to the residential survey.

In summary, the studies carried out by Roy Morgan Research indicate two key aspects about consumer awareness in the ACT. First, that the level of awareness of competition and the availability of choice in the electricity retail market is still relatively low. Second, of the small proportion of consumers that have been more actively engaged, the information relevant to making a choice about switching electricity retailers has been accessible and understandable.

## 6.4 Consumer switching behaviour

An important assessment of customer behaviour in a competitive market is the rate at which customers 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 or exercise market power in respect of any particular customer group.

When switching to, or between, market contracts, customers may switch to a new retailer (this is referred to as gross switching) or from the standing offer to a market contract with their host retailer (internal switching).<sup>86</sup> That is, in an effectively competitive market, customer switching patterns should reflect both the acquisition strategies of new retailers, as well as the retention strategies of host (incumbent) retailers. Moderate to high rates of internal switching suggests that host retailers are constrained by the conduct of new entrants. That is, in order to maintain market share,

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<sup>83</sup> *ibid.*, p. 18.

<sup>84</sup> Roy Morgan Research Residential Report, p. 1; Roy Morgan Research Small Business Report, p. 1.

<sup>85</sup> *ibid.*, p. 33.

<sup>86</sup> The standing offer is where a customer is supplied electricity at the regulated retail price and in accordance with associated terms and conditions in a standard contract. A market contract is where a customer specifically enters into a contractual agreement with a retailer that contains price and non-price terms and conditions that differ from the standing offer.

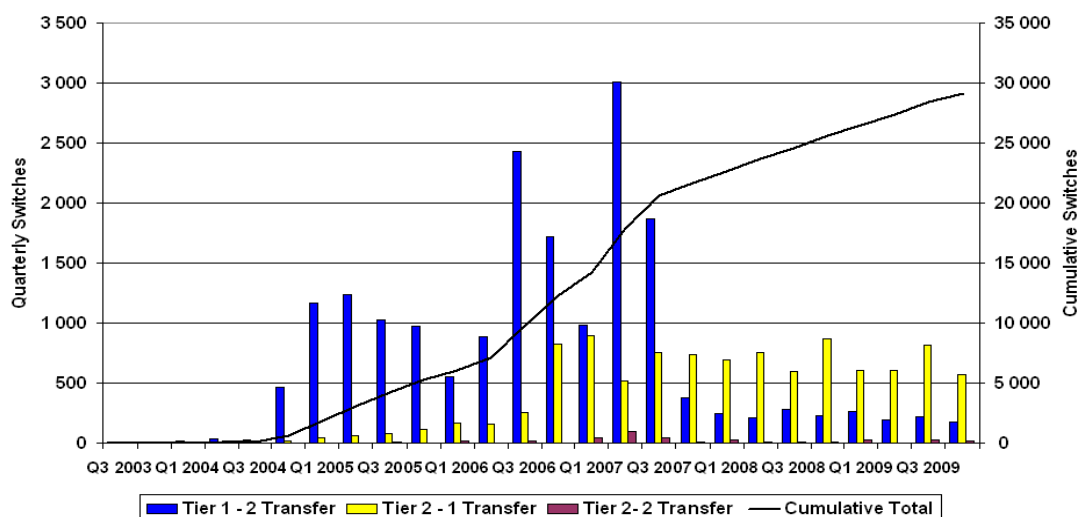
the host retailer increases the proportion of its customer base on market contracts, therefore decreasing the number of customers able to switch.

The remainder of this section examines the level of switching to, and between market contracts and switching to, and between retailers that has occurred to date in the ACT. First, an analysis into customer transfers between the host retailer and tier two retailers, transfers between tier two retailers and transfers back to the host retailer will be undertaken. This will be followed by an investigation of gross switching trends in the ACT. Finally, the number of customers that have switched to a market contract will be analysed.<sup>87</sup>

### 6.4.1 Switching trends between retailers

Customer churn refers to the proportion of customers who change, or switch, their electricity supplier during a given time period. Customer churn in the ACT has been lower than that in other jurisdictions. In Victoria and NSW, both of which opened their 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.<sup>88</sup> In comparison, cumulative switching in the ACT was just over 29 000 (or approximately 20 per cent) as at December 2009. This illustrates that since the introduction of FRC in the ACT, one in five customers have taken advantage of the competitive market to switch their electricity retailer. The figure below illustrates the switching trends observed in the ACT since FRC was introduced.

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



Source: AEMC calculations from AEMO MSATS data.

<sup>87</sup> For the ACT, data on internal switching (customers moving from the standing offer to a market contract with ActewAGL Retail) is not available.

<sup>88</sup> Victoria is considered a 'hot' (extremely active) market and NSW is considered active. P Grey, 'The world's hottest retail energy markets', <http://issuu.com/vaasaett/docs/worlds-hottest-energy-markets>; ERAA media release 'Victoria sets global benchmark for customer switching', 10 May 2010.

Figure 6.1 above illustrates the three main types of switching patterns in the ACT: switches away from ActewAGL Retail; switches between tier two retailers; and switches back to ActewAGL Retail. For those switches away from ActewAGL Retail (that is, tier one to tier two 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. Switches of this kind peaked at approximately 1 000 per month in Q2'2007. Since then, there has been little movement of customers away from ActewAGL Retail to tier two retailers.

Customer switching from one tier two retailer to another tier two retailer is also set out in the figure above. By comparison with switches to and from ActewAGL Retail, transfers between tier two retailers are low for the ACT peaking at approximately 100 in Q2'2007. This low rate may reflect the limited number of tier two retailers operating in the ACT.

In addition, from the middle of 2007 onwards the proportion of switches away from ActewAGL Retail decreased markedly as retailers reduced marketing activities. In recent years, most switches have been back to ActewAGL Retail (identified in Figure 6.1 as tier two to tier one transfers). 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'.<sup>89</sup> Move-ins contributed between 45 and 55 per cent of all switches during this period.<sup>90</sup>

The ICRC's decision in setting a TFT for the period 1 July 2006 to 30 June 2007 concluded that it considered the ACT market was competitive and that the removal of the regulated price would assist further in providing opportunities to evolve and deliver a wider range of benefits to consumers. For this period, the ICRC decided to only adjust the regulated price for inflation and not recalculate the individual cost components of it.<sup>91</sup> The lack of real increase in the regulated price coupled with an increase in the volatility of wholesale electricity prices during this period may have impacted on retailer activity in the ACT which diminished considerably at this time. This is discussed in section 7.2.1 of this report.

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<sup>89</sup> 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 (and the 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.

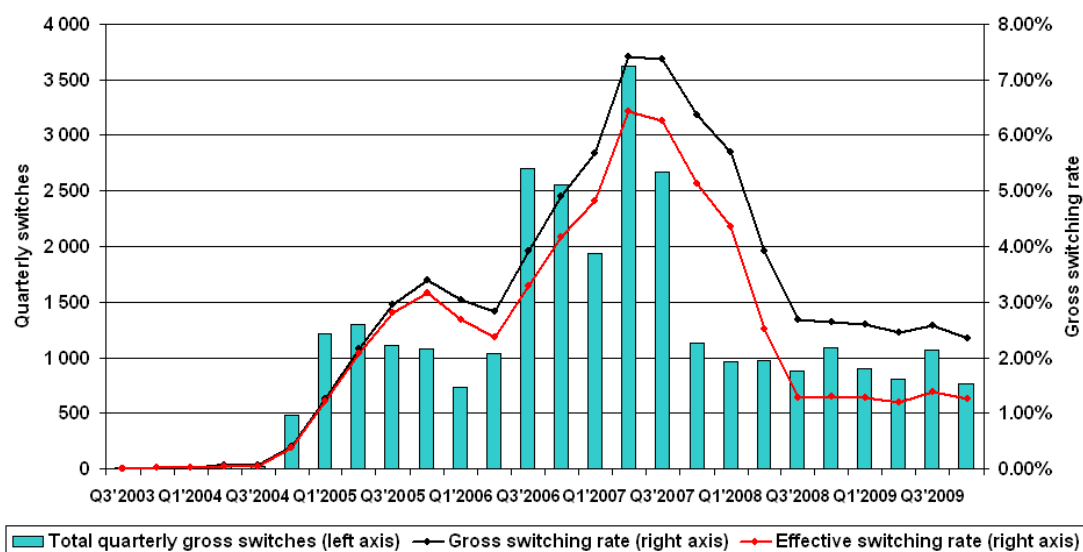
<sup>90</sup> When a customer moves residence this may act as a trigger for the customer to actively switch retailers. As a result, a percentage of 'move-ins' will reflect an active choice by a customer to switch to the retailer currently allocated to the NMI in the new residence. Analysis undertaken 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).

<sup>91</sup> ICRC, *Final report: Retail prices for non-contestable electricity customers*, April 2006, pp. 33-35.

## 6.4.2 Gross switching trends

The figure below shows both the 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 has also been plotted. This is the degree of switching that has occurred net of 'move-ins'.

**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 and late 2006 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, there has been a marked decrease in the gross switching rate. The rate for the past six quarters has typically been around 2.5 per cent. As noted above, during this period 'move-ins' comprised a significant proportion of total switches and with their removal from the data, the effective gross switching rate is closer to one per cent.

International research comparing customer switching across competitive retail energy markets uses an equivalent measure to the annual gross switching rate shown in the figure above. The researchers also classify a market into one of four possible categories based on its annual gross switching rate: namely, hot, active, slow and dormant. Hot markets demonstrate annualised switch rates of 15 per cent or higher; active markets have a rate of at least five per cent; slow is below five per cent; and dormant markets exhibit a switching rate of less than one per cent per year.<sup>92</sup> With reference to this metric, the ACT market would have been classified as an active market during 2007.

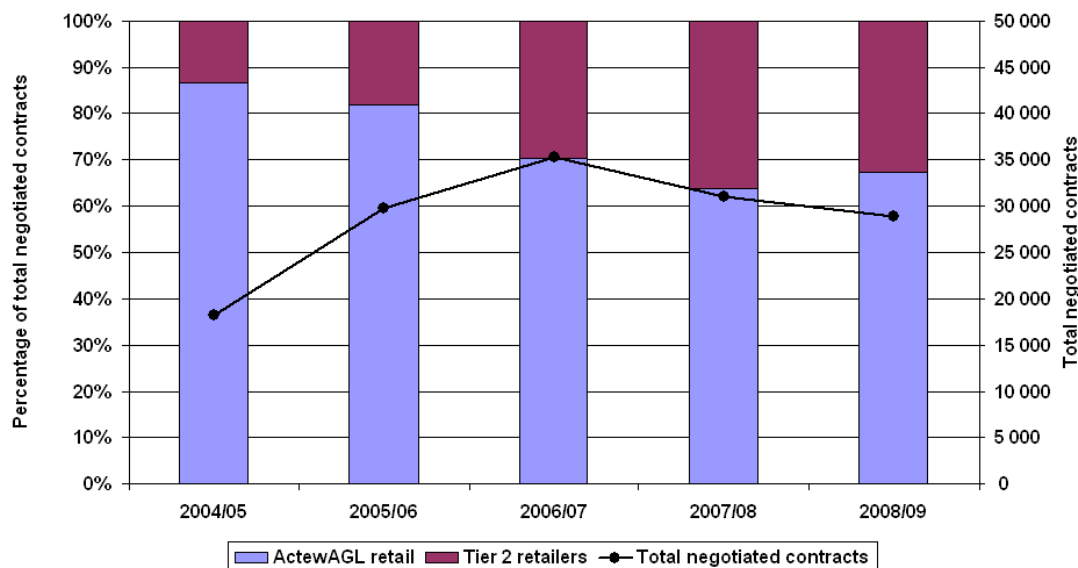
<sup>92</sup> P Grey, 'The world's hottest retail energy markets', <http://issuu.com/vaasaett/docs/worlds-hottest-energy-markets>.

However, in more recent years the market would be classified as a slow market. With the removal of 'move-ins', the ACT market can be described as a dormant market. By comparison, Victoria is considered a hot market under this metric with annualised switching rates exceeding 20 per cent. South Australia and NSW are considered active markets as both have annualised switching rates in excess of five per cent.

### 6.4.3 Customers switching to market contracts

The following Figure 6.3 illustrates the proportion of small customers (residential and non-residential) that were being supplied with electricity under a market contract between 2004 and 2009. This figure demonstrates that since 2003 and other retailers entered the market, the proportion of customers switching away from the standing offer (and the TFT) to market contracts initially increased. The total number of consumers on market contracts peaked at approximately 35 000 (24 per cent of all consumers) by 30 June 2007. However, from mid-2007, after some retailers (EnergyAustralia and TRUenergy) ceased marketing activities in the ACT and generally stopped seeking out additional customers, the number of consumers on market contracts has steadily fallen and stood at approximately 29 000 (19 per cent of all consumers) at 30 June 2009.<sup>93</sup>

**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 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 standing offer at the maturation of their market contract

<sup>93</sup> ICRC, *Draft Decision: Retail prices for non-contestable electricity customers 2010-12*, April 2010, p. 47.

term because their retailer is unable to provide a more competitive offer. This behaviour has been noted by retailers.<sup>94</sup>

“And in recent times customers that are coming off contract we're advising them to go back to the standing tariff, back to ActewAGL. We are one of the retailers that said to the ICRC that we are now advising customers that come off contract that we can't make an offer that is better than the standing offer that they'd had.”

“Why people would switch back to a regulated rate is because obviously the market rates were higher ... The margins they set, no right business person in their mind would be able to make a business case ... So, if a whole lot of people have jumped back on the regulated tariffs that tells you the very issue for the market, why the market's a flawed market. Because those retailers have had them on market contracts have spent money and time signing up the customer to come across, to then lose them. So yeah, poor business.”

To ascertain an approximation for the proportion of contracted consumers with ActewAGL Retail and second tier retailers, those connection points allocated to a second tier retailer were deemed, by definition, to be market contracts.<sup>95</sup> This total was subsequently removed from the total number market contracts quoted by the ICRC in its latest pricing decision, providing approximate proportions of consumers on market contracts with ActewAGL Retail and those with other retailers. These calculations indicate that the approximate share of small consumers on market contracts with ActewAGL Retail fell from around 85 per cent (at 30 June 2004) to around 65 per cent (at 30 June 2008). However, the proportion of market contracts with ActewAGL Retail slightly increased again in 2008-09 to approximately 70 per cent. The reasons for this increase may include ActewAGL Retail directly soliciting customers that are about to end their contractual obligations with a tier two retailer (as noted in the following quote from the retailer interviews). Alternatively, ActewAGL Retail may have a larger share as a result of customers switching from tier two retailers to the standing offer, as noted above.<sup>96</sup>

“We were also aware in terms of our competitor monitoring that [about two years ago] ActewAGL were phoning customers that were on contract looking to secure, looking to make them an offer to move back. So they were actually deliberately marketing to customers that we'd acquired. Now, again I didn't think it was necessarily inappropriate, but it sort of shows again their efforts to preserve their market share and to really sort of resist losses as we've done.”

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94 GA Research Retailer Interviews, pp. 20 & 23.

95 This is due to the fact that only ActewAGL Retail is able to have customers on the standing offer. Customers with second tier must be on a market contract.

96 GA Research Retailer Interviews, p. 17.

In summary, the switching data indicates that:

- the number of small customers that have switched retailers in the ACT has been much lower than what has been observed in Victoria, South Australia and NSW to the extent that the ACT market could be described as 'dormant'; and
- although there has been some switching to market contracts, more recent switching indicates customer movement back to ActewAGL Retail and the standing offer.

## 6.5 Conclusions

This chapter has focused on the conduct of both retailers and customers in the ACT electricity market. Since the commencement of FRC in the ACT, retailer rivalry has, at best, been fairly limited. Despite the number of licensees, there are now only four retailers with any reasonable small customer numbers. Of these, only two are presently accepting new customers and only one (ActewAGL Retail) could be accurately described as actively marketing. This outcome is not what would be expected in a market that displays an effective level of competition.

To gain an insight into consumer behaviour, Roy Morgan Research conducted both qualitative (that is, focus groups) and quantitative (telephone surveys) studies. The research showed that small customers in the ACT are not as aware of competition and the availability of choice in the electricity retail market as in other jurisdictions. Nevertheless, of the small proportion of consumers that have been more actively engaged in the market, the information relevant to making a choice about switching electricity retailers has apparently been accessible and understandable.

In addition, to consider whether consumers were able to exercise choice in the selection of an electricity retailer, data from AEMO has been analysed to determine the switching patterns of small customers in the ACT. The data indicates that the number of small customers that have switched retailers in the ACT has been much lower than has been observed in Victoria, South Australia and NSW. In fact, on some measures, the ACT small customer electricity retail market could be described as 'dormant'. The data has also shown that while there was some switching to market contracts in the past, more recently, switching to ActewAGL Retail and the standing offer have increased. Again, these observations indicate that customer behaviour in the ACT has not been consistent with what would be expected to occur in a market that has an effective level of competition.

## 7 Market performance

### 7.1 Introduction

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. One of the key indicators 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.

In markets characterised by effective competition, rivalry between firms and the threat of new entry will provide firms with an incentive to match and improve upon the price and non-price offers of their rivals. Over time these competitive pressures will cause prices to converge toward the efficient economic cost of delivery. The term 'economic cost' in this context includes all costs incurred in supplying a good or service, including a return that is commensurate with the prevailing financial conditions of the market and the risks involved in delivering that good or service.

As long as prices generate 'above normal' profits, the market will appear attractive and firms will (subject to any barriers to entry) have an incentive to enter the market. In circumstances where prices fall below the level where efficient firms are able to recover their economic costs, some firms may be forced to exit the market while potential entrants may be discouraged from entering the market. Existing market participants may also be discouraged from expanding their operations.

The purpose of this chapter is to examine:

- the prices and profit margins of retailers operating in the ACT electricity market over time;
- the products available to small customers in this market; and
- customer satisfaction with the products available as well as with the retailers operating in this market.

First, historical regulated prices and profit margins set by the ICRC are examined. Second, the margins of retailers competing in the ACT electricity retail market are estimated and consideration is given as to whether the margins are reflective of outcomes that would be expected in a competitive environment. Third, market offers available to small customers are described and product innovation and differentiation is considered as an important indicator of effective competition. Finally, consumer satisfaction is explored based on an analysis of customer complaints over time and feedback from the consumer survey.



## 7.2 Price and profit margins

This section begins with a description of the economic costs electricity retailers incur to operate in the ACT as determined by the ICRC. The historical regulated retail tariffs, which are based on these costs, are then set out. Finally, this section considers the profit margins available under the TFT over time.

The Allen Consulting Group (ACG) was engaged to undertake an analysis of electricity retail price and profit margins in the ACT. This section draws extensively on ACG's analysis.<sup>97</sup>

### 7.2.1 Economic costs and regulated prices

As briefly set out in Chapter 5, the cost categories used by the ICRC (and other regulators) relevant to the supply electricity to small customers include:

- Wholesale electricity costs (WEC) - These are the costs associated with purchasing wholesale electricity for small customers through either the spot or contract market. Additionally, other factors are considered such as the risks faced in purchasing electricity, the costs of mitigating risks, ancillary service costs, and network losses. The costs of participating in the NEM also fall into this category as well as the cost of meeting legislative obligations with respect to energy purchases (such as purchasing the required amount of renewable energy under the mandatory renewable energy target scheme).
- Transmission and distribution charges - These costs are incurred by retailers for the transmission and distribution services used to deliver electricity from the point of production to the site of the small customer. The distribution and transmission prices are regulated by the AER. Accordingly, these costs are passed through to retail customers.
- Retail operating costs (ROC) - These are the costs associated with providing the services of electricity retailing. These typically include billing and revenue collection, call centres, financing costs, IT systems, fulfilling regulatory obligations, and overheads and indirect costs. Retailers either provide these services internally or outsource them to third parties.
- Retail margin - This is the additional revenue that retailers earn above their recovery of the ROC. The role of the retail margin is to compensate retailers for: the cost of financing the stock of capital required to provide retail services (such as IT costs); the working capital required; and the risk incurred in retailing. Retailers require compensation for these financing costs (investments) and risks in order to remain commercially viable (and hence to remain in operation) over the long-term.

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<sup>97</sup> 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)

Table 7.1 below sets out the ICRC's regulated electricity retail prices (transitional franchise tariffs, TFTs), based on its assessment of ActewAGL's efficient economic costs, for the period 2007-08 to 2010-11.<sup>98</sup>

**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)	<b>138.96<sup>a</sup></b>	<b>152.10</b>	<b>155.54</b>	<b>159.16</b>

Note: <sup>a</sup> 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 should be noted 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.

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. As noted by ACG, other regulators have different objectives and frameworks to set regulated retail prices. For example, the terms of reference for the Independent Pricing and Regulatory Tribunal of NSW (IPART), allows for the recovery of the costs a 'hypothetical retailer' would incur if it were a mass market new entrant. In contrast, the Queensland Competition Authority is required to determine the costs a stand-alone retailer would face assuming it has an established customer base of a mix of customers.<sup>99</sup>

The ICRC's terms of reference were updated for the 2010 pricing process. Under these terms of reference, the ICRC is required to consider:<sup>100</sup>

- the modelling of electricity costs;

<sup>98</sup> A breakdown of costs is not available prior to the 2007-08 decision.

<sup>99</sup> ACG Price and Profit Margin Analysis, p. 7.

<sup>100</sup> ICRC, *Final Decision: Retail prices for non-contestable electricity customers, 2010 - 2012*, June 2010, pp. 71-72.

- the full costs of hedging and other risk management strategies in purchasing energy;
- the implications of the AEMC Review in Light of Climate Change Policies;
- the price level that would facilitate vigorous competition in the market and the short and long run costs and benefits of such a price level and ensuring appropriate consumer protection;
- the recovery of ActewAGL Retail's efficient costs incurred in complying with relevant Australian Government and Territory policies; and
- the requirements of s. 20 of the ICRC Act.

Section 20 of the ICRC Act requires ICRC decisions to address, among other things:

- protecting consumers from abuses of monopoly power in terms of prices, pricing policies and standard regulated services (s. 20(2)(a));
- the need for greater efficiency in the provision of regulated services to reduce costs to consumers and taxpayers (s. 20(2)(c));
- an appropriate rate of return on any investment in the regulated industry (s. 20(2)(d)); and
- the social impacts of the decision (s. 20(2)(g)).

As a result of the various requirements noted above, the ICRC must attempt to balance efficiency and equity objectives, which often conflict, when setting the TFT. This is particularly relevant for ICRC's consideration of whether to include a CAC/CARC allowance in the calculation of the TFT. In each decision made to date, the ICRC has concluded not to include a CAC/CARC allowance. This has the effect of the TFT being a 'minimum' price based on ActewAGL Retail's costs, excluding CAC/CARC, rather than a more 'competitive' price, based on the costs that a new entrant or stand-alone retailer would be likely to incur to compete in this market.

As noted by two retailers:<sup>101</sup>

“... potentially an indication that the price setting is not reflective of the true cost to serve. One of the aspects of the price setting in the ACT is they don't include costs that are included in other jurisdictions. For example my understanding is the current regime doesn't include customer acquisition costs in the costs for determining the regulated price, which is a cost that is included in other jurisdictions. So that goes potentially to squeeze the margin for the retailer on the electricity side of the business.”

“... we do have costs of going and acquiring new customers, and that's not currently recognised the way the regulator puts the pricing together. So if

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<sup>101</sup> GA Research Retailer Interviews, pp. 21 & 39.

you want to encourage new entrants you have to recognise that there is - I guess the incumbent has an advantage if you're not recognising that cost of acquisition of new customers. ”

As a result, a number of retailers have indicated that they tend to focus on markets where they can earn higher margins that are likely to be more in line with expected returns (given the prevailing financial conditions of the market and the risks involved in delivering retail services). For example, one retailer has stated, 'we're not wedded to any one market as being a preference. We look at where we can get a good supply site, and where the return's great'.<sup>102</sup>

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.<sup>103</sup> The implications of this difference in approach are discussed in the remainder of this chapter.

### **Wholesale electricity cost allowance**

The other major criticism of the TFT from retailers is that the WEC allowance in the cost base is not sufficient to account for the risks and uncertainties associated with purchasing wholesale electricity. Several retailers have indicated that volatility in the wholesale electricity market has increased substantially since 2007 and, as a result, the WEC allowance has not accurately reflected the electricity costs that retailers incur to participate in this market. For example, active retailers have stated:<sup>104</sup>

“... I think generally things changed in the market sort of mid, early to mid 2007 when the wholesale price went ballistic. At that stage we largely pulled back from our proactive acquisition activities and then progressively through 2007, 2008 we've reached this position that you can't actually secure a wholesale position that allows you to have a reasonable margin below the regulated rate.”

“I think that the whole market generally changed profoundly in 2007 with the wholesale prices, the drought and ... the effects of that. I suspect that that changed a lot of retailers' strategies quite profoundly ... with the huge price excursions that occurred in the wholesale market. So people that had positions that weren't well covered would have seen or taken a whole new view of the risk that was involved in being in these markets, and that meant then probably there needed to be more risk premium built into ... the margins that you were offering ... ”

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102 *ibid.*, p. 19.

103 ACG Price and Profit Margin Analysis, p. 14.

104 GA Research Retailer Interviews, pp. 22 & 26-27.

While retailers have expressed concern about the impact that actual wholesale costs can have on their ability to compete against the TFT, it is apparent that they also appreciate the difficulty a regulator has in setting retail prices as the following comments indicate:<sup>105</sup>

“[i]t is the role of retailers in the competitive market to manage wholesale risk, and retailers compete on this basis. However, the ability of regulators to accurately forecast, in some cases years in advance, movements in wholesale markets when setting retail prices is problematic in the extreme. The regulatory risk this imposes on retailers diminishes the benefits of competition that would otherwise flow to consumers.”

“[w]hy are the market rates higher? The market rates are higher because they'd be reflecting higher wholesale curved prices, which by deduction means that where the regulated rates are being set are either not reflecting where the wholesale market has moved or not reflecting a realistic margin... their process doesn't deal with a wholesale market that's moving around. For them to try and set a four year view or something it's just totally unrealistic because the wholesale market's not like that ...”

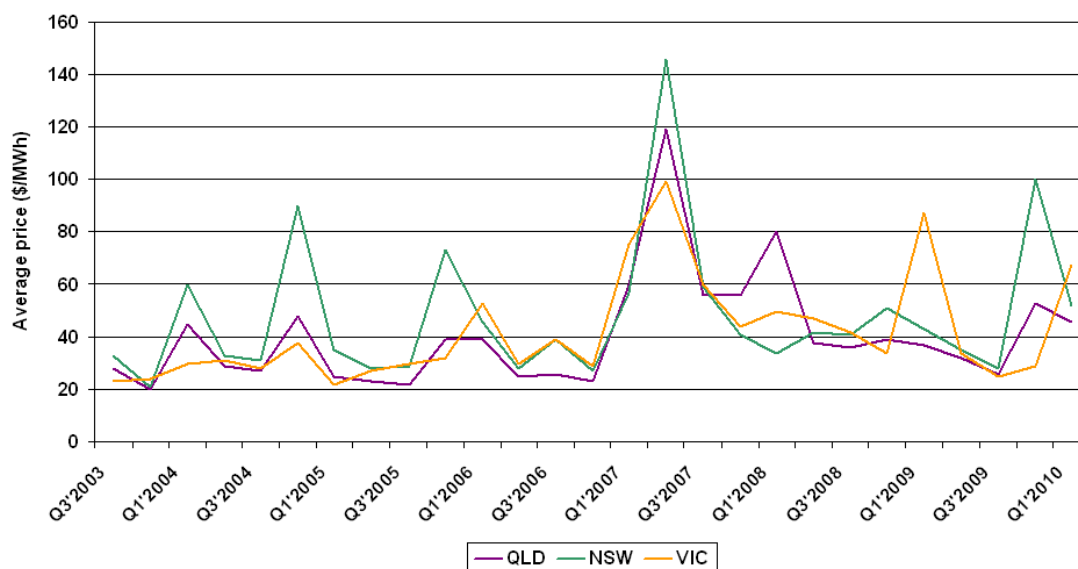
“[i]n coming years, the electricity market will become more complex and volatile. This is due to the introduction and amendment of Government policies (e.g. enhanced Renewable Energy Target, Carbon Pollution Reduction Scheme (CPRS) and state-based feed-in-tariffs). The ability of the ICRC to set accurate electricity prices into the future will therefore be diminished.”

The following figure shows the volume weighted average spot prices in the NSW region (which includes the ACT), Victoria and Queensland since July 2003. Figure 7.1 illustrates that wholesale electricity prices in each jurisdiction were extremely volatile in 2007. However, wholesale prices in NSW (and so the ACT) do not appear to be any more volatile than prices 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.

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<sup>105</sup> TRUenergy submission, 9 April 2010, p. 4; GA Research Retailer Interviews, p. 23; ERAA submission, 19 April 2010, p. 2.

**Figure 7.1 Quarterly volume weighted average spot prices, 2003 - 2010**



Source: AER, Market snapshot: long-term analysis, viewed 1 June 2010, <[http://www.aer.gov.au/content/index.phtml/tag/MarketSnapshotLongTermAnalysis/fromItemId/722740#h2\\_1601](http://www.aer.gov.au/content/index.phtml/tag/MarketSnapshotLongTermAnalysis/fromItemId/722740#h2_1601)>.

In light of the fact that tier two retailers were gaining market share in the ACT until 2007 when volatility in the wholesale electricity market increased and profit margins were squeezed, the WEC allowance in the TFT could be a barrier to entry and expansion. However, this issue may not be limited to the ACT. 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.

In assessing this issue two factors should be considered. The first is the ICRC's approach to setting the WEC component of the TFT and, the second is the ability of retailers to hedge against wholesale price volatility.

The ICRC's approach to estimating the WEC is a little different to that used by other regulators. Since 2007 the ICRC has used independent and verifiable market information on the price of forward contracts.<sup>106</sup> 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'.<sup>107</sup> The ICRC has not included such a specific allowance. However, its market-based approach to the WEC estimate combined with

<sup>106</sup> Prior to this, the ICRC used information from ActewAGL Retail.

<sup>107</sup> ACG Price and Profit Analysis, pp. 9-10.

the frequency of pricing decisions would appear to accommodate wholesale price volatility without the need for an additional term in the calculation.<sup>108</sup>

The second issue is whether retailers are able to successfully hedge their businesses to provide some protection against wholesale price volatility. This is needed as the actual wholesale price has the potential to vary significantly over time. To achieve this, retailers enter into forward contracts with generators to effectively lock in the future price of electricity that the retailer will purchase from the generator. These contracts may be in the form of derivative instruments such as: swaps, options, caps and futures to hedge their exposure. The extent to which these contracts are used will be dependent on the risk appetite of each retailer.

The effectiveness of this course of action is dependent upon retailers being able to purchase a financial contract for a future period. This, in turn, is contingent on whether the contract market is liquid. A lack of liquidity, or depth, in the futures contract market will result in the prices of contracts being vulnerable to the effects of large purchases and may actually increase the risks faced by retailers.

Retailers have not specifically commented on the depth of the forward contract market in interviews or in submissions. However, retailers have noted the general uncertainty in the market that has occurred from such potential government-led changes as the introduction of carbon pricing and trading and the role that renewable energy sources. Such uncertainties have, to some degree, dampened the availability of hedging contracts over the longer term. This has, in turn, increased the uncertainty and risk that retailers must manage within their businesses. While the extent and impact that the uncertain operating environment has created for retailers is not clear, retailers are concerned that they may not be able to manage significant wholesale price volatility while the TFT exists. As a result, retailers consider that the TFT is a barrier to entry and expansion in the ACT market. While there is a correlation between the level of retailer activity in the ACT market and wholesale price movements during 2007, the lack of clear information makes it impossible to be sure whether there is a causal link.<sup>109</sup>

Overall, 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. In fact, the methodology and the frequency of determining the TFT are likely to be relatively beneficial to retailers.

### **7.2.2 Actual retail margins**

In order to investigate the implications of excluding a CAC/CARC element from the ROC, ACG recalculated the regulated electricity tariffs to include a range of reasonable CAC/CARC allowances. The CAC/CARC allowances from other jurisdictions were used to determine an appropriate range. The table below sets out the CAC/CARC

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<sup>108</sup> ICRC, *Final decision: retail prices for non-contestable electricity customers 2010-12*, June 2010, pp. 31-33.

<sup>109</sup> ACG Price and Profit Margin Analysis, pp. 24-25.

allowances for NSW and Queensland that were available to ACG. These are the only jurisdictions that have clearly specified an allowance.

**Table 7.2 CAC/CARC estimates in NSW and Queensland, 2006-07 to 2012-13**

Jurisdiction	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
NSW (\$/customer)	0.00	37.20	37.20	37.20	36.30	36.30	36.30
Queensland (\$/customer)	2.10	29.20	27.10	26.10	41.80	N/A	N/A

Note: All figures are in June 2009 dollars.

Source: ACG Price and Profit Margin Analysis, p. 17.

Based on this information, ACG determined a low, intermediate and high value for CAC/CARC to include in the recalculation of ActewAGL Retail's regulated tariffs. These values 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).

The recalculated ActewAGL Retail costs and margins for the period 2007-08 to 2010-11 are set out below in Table 7.3.

**Table 7.3 Restatement of ActewAGL Retail's costs and margins**

		2007-08	2008-09	2009-10	2010-11
<b>Regulated TFT (\$/MWh)</b>		138.96 <sup>a</sup>	152.10	155.54	158.82
<b>Calculated CAC/CARC allowance (\$/MWh)</b>					
	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
<b>Adjusted TFT retail price, incl. CAC/CARC allowance (\$/MWh)</b>					
	Low CAC/CARC	141.53	154.73	158.28	161.61
	Intermediate	142.52	155.74	159.34	162.69



		2007-08	2008-09	2009-10	2010-11
	CAC/CARC				
	High CAC/CARC	143.11	156.35	159.97	163.33
<b>Retail margins (%)</b>					
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

Note: <sup>a</sup> 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.

To recalculate the retail margin after including an allowance for CAC/CARC (the effective retail margin), ACG set the adjusted TFT equal to the original TFT determined by the ICRC. The result of this calculation is that the inclusion of a CAC/CARC component has a significant impact on margins. For example, in 2007-08, when the high CAC/CARC allowance is included in the ROC, the margin drops from the regulated margin of 4.00 per cent (as used by the ICRC) to an effective margin of 0.87 per cent. That is, if a retailer:

- faced the same costs as ActewAGL Retail;
- offered retail services priced at levels equal to ActewAGL Retail's regulated services; and
- incurred CAC/CARC of \$42 per customer;

then it would face earning a margin of 0.87 per cent.

However, if any of these assumptions do not hold, the potential competitor to ActewAGL Retail may earn less. 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 7.3 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.

Additionally, it is understood that to attract customers away from ActewAGL Retail, tier two retailers would offer retail supply at prices less than those for the regulated services. This would reduce the actual margins that tier two retailers in this market would be able to achieve to less than the effective margins set out in the table above. Also, volatility in the wholesale electricity market could further squeeze these margins.

### **7.2.3 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 doing so, it is important to consider whether the effective margins are at a level that reflects the conditions in the financial markets and the risks involved in delivering electricity retail services in the ACT. 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 limited effective competition.

An analysis of benchmark margins in the ACT electricity retail market involves:

- an analysis of margins set by regulators in other jurisdictions over time; and
- qualitative information from the retailer interviews.

The table below compares the retail margins applied by the regulators in each jurisdiction for the period 2007-08 to 2010-11.<sup>110</sup>

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<sup>110</sup> Information for Victorian regulated tariffs is not available in the public domain.

**Table 7.4 Retail margins in each jurisdiction, 2007-08 to 2010-11**

	2007-08	2008-09	2009-10	2010-11
<b>Jurisdiction</b>	<b>(%)</b>			
ACT	4.0	5.0	5.0	5.4
NSW	5.0	5.0	5.0	5.4
QLD	5.0	5.0	5.0	5.0
TAS	3.0	3.0	3.0	3.0
SA <sup>a</sup>	5.0	5.0	5.0	5.0
WA	N/A	N/A	3.0	3.0
Avg.	4.4	4.6	4.3	4.5

Note: <sup>a</sup> The South Australian retail margin is adjusted from 10% of controllable costs (WEC+ROC). ESCOSA states in its most recent determination that a 1:2 conversion rate from a margin on total costs as opposed to a margin on controllable costs is appropriate (ESCOSA 2007 determination).

Western Australia does not currently have FRC.

Source: ACG Price and Profit Margin Analysis, p. 15.

Table 7.4 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, the most appropriate comparison is with NSW. Retailers in the ACT and NSW will face the same wholesale risks and uncertainties.

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.<sup>111</sup> 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 recent retail pricing decisions, IPART has developed ranges for the retail margin using three alternative approaches:<sup>112</sup>

- the expected returns that a retailer would earn from small customers and the systematic risk associated with those returns;
- a benchmark approach that examines the reported margins of comparable listed firms to establish a range of the retail margin; and

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111 ACG Price and Profit Margin Analysis, p. 7.

112 *ibid.*, p. 13.

- a bottom-up approach that begins with an assessment of an assumed investment base and cost estimate, and then determines the earnings and revenue which would allow the retailer to earn an expected return equal to its estimate cost of capital.

Using these approaches, IPART specified that a reasonable range of margins for electricity retailers in NSW was 4.8 to 6.5 per cent. This range may also be reasonable 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 stand alone retailer would be able to achieve) estimated by ACG do not fall within this range. In some years (notably 2007-08), the ACG effective margins are significantly below the IPART range.

The ACT's relatively low retail margins, and the consequent need to increase regulated prices, were addressed several times throughout the retailer interviews. For example, one inactive retailer said,<sup>113</sup>

“So it basically needs to be in the margin that you make after wholesale and retail. So if you don't increase it enough, I know I would be as a manager of a retail business, I'd be really cautious about going in that market. Whereas if it was to increase by 20% or 30%, I might say, “I think they're serious about this, so I might go in there.” But my prices wouldn't need to increase. Sorry, I wouldn't need to pitch my prices at 20% or 30% higher than what I would today; I'd only need to probably go in at about 10%. And then it would depend what Actew does because they're the real competitor, right? So what do they do? Do they go, do they take advantage of the new price cap and price it at 30% more? Or do they, because if they did that then I could come in 20% under them. What would they do? They would bring, they would trim their prices. So there you go. You've got the beginning of competition starting to happen. And then it'd be on for young and old and you'd drive prices back down again, 'cause then that will have a knock-on effect on the wholesale market and you've got true competition happening. And that's what's happening in Victoria. And you know, you just need, I guess whoever, because I'm not sure who it is that actually pulls the trigger on this at the end of the day, on price deregulation. That body should make the first move, make this step happen. And I, you know, I think it'd be good for all consumers in the ACT... It might be short-term pain for long-term gain, I think.”

Another added,<sup>114</sup>

“The fact you have got a non-competitive market and a flawed market should be telling them to say, ‘You have to change things to make it a competitive market’. Don't look for the sign of a competitive market to then say, ‘Right, now we can move to price removal’, because you're never

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113 GA Research Retailer Interviews, p. 48.

114 *ibid.*, p. 44.

going to get past base one of a competitive market unless they either remove price controls or go and crank up the margins by, you know, prices by about 30% or 40%. So ... we're now two years more down the track from probably the last time we had a discussion like this [about South Australia] with someone and I think they've now got some evidence to suggest that their thinking needs to be looked at as a process because waiting to prove a market's competitive, ... as I said to you today, South Australia's not competitive. We aren't active there. We're two years on from when we had that discussion so if nothing changes, we'll be sitting here in another five years and SA still won't be competitive if it's a price controlled regime. What they need to be looking at is more, 'What are the things we need to change in the market to make it competitive?'"

Additionally, in its submission to the Issues Paper, ActewAGL Retail noted, '[a]s part of the regulated ACT TFT determined by the ICRC, the TFT 'cost build-up' makes an allowance for the retail margin. ActewAGL Retail believes this margin is set too low relative to other jurisdictions, and hinders competitive outcomes in the ACT market.'<sup>115</sup> Finally, during its interview another inactive retailer commented, '[s]o some states have moved to a more cost reflective cap mechanism, so that would always be our fall back position, that if you can't get the competence to let the market manage itself, set the prices to a level that allows people to make a return or achieve at least some competition there.'<sup>116</sup>

In conclusion, this analysis suggests that the effective margin (the regulated margin less an allowance for CAC/CARC) available under the TFT in the ACT is below the level that has been set by the ICRC. More importantly, it is also less than what retailers expect to prevail in a market that has effective competition. It also appears to be less than that available in other jurisdictions. As a result, the retailers' views on the effective margin available in the ACT are likely to influence their decision on whether to participate in the market. This is one factor that may be hindering effective competition in the ACT electricity retail market.

### **7.3 Retail products and services**

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

#### **Market offers**

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.

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<sup>115</sup> ActewAGL submission, 9 April 2010, p. 10.

<sup>116</sup> GA Research Retailer Interviews, p. 45.

Additionally, Country Energy and EnergyAustralia continue to provide retail services to existing customers but are no longer accepting new customers.

ACG reviewed the websites for these four retailers to determine what products and prices they offer to small electricity customers. ACG's findings are summarised in the table below.

**Table 7.5 Selected current market offers**

<b>Retailer</b>	<b>Supply charge (¢/day)</b>	<b>Base rate (¢/kWh)</b>	<b>Other rate (¢/kWh)</b>
<b>ActewAGL Retail<sup>a</sup></b>			
Always Home @ ActewAGL	53.90	15.598	N/A
Always Home @ ActewAGL Saver	77.55	13.860 (first 60 kWh per day)	15.598 (thereafter)
Always Home @ ActewAGL Saver plus	124.85	12.210 (first 165 kWh per day)	15.598 (thereafter)
Always Home @ ActewAGL SmartSaver	53.90	19.690 (peak)	14.465 (shoulder) 10.736 (off-peak)
<b>TRUenergy<sup>b</sup></b>			
Go Easy	58.55	15.400 peak	10.07 (off peak)
Go for More	58.55	15.400 peak	8.393 (off peak)
<b>EnergyAustralia</b> - Identical to ActewAGL Retail. Not currently taking new customers.			
<b>Country Energy</b> - Prices unknown. Not currently taking new customers.			

Note: <sup>a</sup> ActewAGL Retail offers a 5.5 cent/day discount on the supply charge for customers in a direct debit arrangement (discount not valid in combination with other offers).

<sup>b</sup> TRUenergy Go Easy has no exit fee and offers a 3% discount if their bill is paid by the due date. The TRUenergy Go for More offer has an exit fee and a 3% discount against usage and supply charges as well as a 3% discount for prompt payment.

Source: ACG Price and Profit Margin Analysis, p. 21.

EnergyAustralia's ACT prices are identical to those offered by ActewAGL Retail and Country Energy's ACT prices are not publicly available.<sup>117</sup> 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. For example, TRUenergy offers a market contract (GoEasy)

<sup>117</sup> However, it is estimated that for a typical household (with an annual consumption of 8 000 kWh and on the relevant standing contract) an ACT household would incur an annual cost of \$1 450 while a Queanbeyan household would pay \$2 200 per year.

that has no early termination fees (most likely to match ActewAGL Retail's standing offer 'Always Home').

ActewAGL Retail and TRUenergy both offer green energy services to small customers which are not presented above. ActewAGL offers green energy both on fixed usage plans (a certain amount of green energy per day) and on a percentage usage basis. This allows customers to buy more than their actual usage in green energy to offset emissions (for example, they can choose to offset 200 per cent of their emissions). TRUenergy offers ten per cent green energy for free with one of its packages. It is also possible to have up to 100 per cent green energy for an additional annual fee.<sup>118</sup>

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 magazine subscriptions. A variety of green products are also offered. In summary, there are significantly more, and a greater variety of, offers available to customers in NSW and Victoria compared to what is currently available in the ACT.

Several retailers have stated that the lack of product differentiation and innovation in the ACT is the result of regulated prices being set too low to encourage price competition and innovative product offerings. For example, in its submission to the Issues Paper, TRUenergy noted, '[p]rice regulation and the restrictions upon varying the minimum terms and conditions of energy contracts impede innovation, differentiation and service competition. This is demonstrated by the dominance among second tier retailers of price discounted products, and restricted service level differentiation'.<sup>119</sup> Additionally, in its interview, one retailer stated, '...I really don't see any aggressive price competition in the ACT at all'.<sup>120</sup>

Another important consideration, especially given the similarities between market offers, is the level of discounts offered by each of these retailers.

## Discounts

Both active retailers offer some form of discounts off the prices stated in Table 7.5 above. ActewAGL Retail offers a 5.5 cent per day discount for those customers who sign a direct debit agreement. TRUenergy offers a three per cent discount to customers who pay their bill on time.<sup>121</sup>

Notably, ActewAGL Retail offers a discount for customers who bundle three or more ActewAGL or TransACT services. Electricity, natural gas and landline telephone are

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

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

120 GA Research Retailer Interviews, p. 30.

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

compulsory services to receive a discount from ActewAGL.<sup>122</sup> 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 can choose to take the discount off their total electricity bill or from one of their TransACT services. Customers who bundle at least five services also receive a privilege card that provides discounts throughout Canberra.<sup>123</sup>

The bundling discounts offered by ActewAGL Retail and its affiliate TransACT do not 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 retailers (other than ActewAGL Retail) offering bundled services,<sup>124</sup>

“[o]nly 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.”

Importantly, stand-alone retailers looking to enter or expand within the ACT electricity retail market are unlikely to be able to match the extent of ActewAGL Retail's discounts. This is particularly evident in light of the effective margins that are available to second tier retailers. ACG estimated that in allowing for a low CAC/CARC allowance within the TFT, a second tier retailer would face an effective margin of approximately 3.5 per cent for 2010-11. A high CAC/CARC allowance would result in an approximate effective margin of 2.3 per cent.<sup>125</sup> Clearly, these margins provide very little opportunity for second tier retailers to offer products at prices sufficiently discounted to attract customers.

However, the margin included in the TFT calculation is not unusually high compared to what is provided by other regulators.<sup>126</sup> There is no information to suggest that ICRC's calculation of 5.4 per cent is not a reasonable estimate of an appropriate retail margin for ActewAGL Retail. This raises the question of how ActewAGL Retail is able to offer such significant bundling discounts to small electricity customers. That is, what is the source of ActewAGL Retail's competitive advantage that allows it to bundle and discount so extensively?

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122 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.

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

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

125 See Table 7.3 above.

126 Table 7.4 above provides a cross-jurisdictional comparison of margins under various regulated retail prices.



In considering this question, the AEMC notes the following comment from Origin Energy:<sup>127</sup>

“The multi-utility offerings of the incumbent retailer present a challenge to new entrants in the ACT electricity market. What is critical however is the strength of ring-fencing that applies to the incumbent's retail and monopoly business units.”

It is acknowledged that in general, retailers do not view ActewAGL Retail's bundling discounts as a primary barrier to entry to the market.<sup>128</sup> Nevertheless, the source of ActewAGL Retail's competitive advantage that allows such behaviour is not yet evident to the AEMC.

In conclusion, the level of product innovation and differentiation in the ACT electricity retail market appears to be weak at present.

## **7.4 Customer satisfaction**

The level of customer satisfaction with both their retailer and the product offers available is also an indicator of market performance. This section discusses:

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

### **7.4.1 Customer feedback**

In the Roy Morgan Research quantitative surveys of residential and small business consumers, customer satisfaction was assessed. It was noted in the reports that there was an overall feeling of satisfaction by participants with their current supplier and problems had been rarely experienced. 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. Those participants that had contacted their electricity supplier were satisfied with the timeliness of the response and the assistance provided (81 per cent and 79 per cent of residential consumers and 67 per cent and 75 per cent of small business consumers were respectively 'very' or 'somewhat' satisfied).<sup>129</sup>

Survey participants were also asked whether they had encountered any of seven identified problems, such as prices not matching what was charged, or being pressured to sign a contract. Most survey participants in the ACT, 93 per cent of residential consumers and 92 per cent of small business consumers, had never encountered any of

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<sup>127</sup> Origin Energy submission, 14 April 2010, p. 5.

<sup>128</sup> GA Research Retailer Interviews, p. 17.

<sup>129</sup> Roy Morgan Research Residential Report, p. 35; Roy Morgan Research Small Business Report, p. 36.

these problems. Of those participants who had experienced problems with their retailer, the main problems identified were:<sup>130</sup>

- told things about the terms and conditions of the contract which were not true;
- felt pressured into signing a contract with the electricity supplier;
- the actual price charged did not match the price quoted by the electricity supplier; and
- being transferred to another electricity supplier without explicit informed consent.

Of those participants who had encountered these problems, approximately 95 per cent indicated they complained directly to their electricity supplier.

The survey also asked participants who had not experienced any problems themselves 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 to their electricity retailer directly. Consumer awareness of independent sources of assistance was low - approximately ten per cent in both surveys. ACAT performs functions that in other jurisdictions would be carried out by an industry ombudsman. However, consumer awareness of ACAT was extremely low. Combined with the generic answer 'energy ombudsman', only five per cent of small business 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.

#### **7.4.2 Customer complaints**

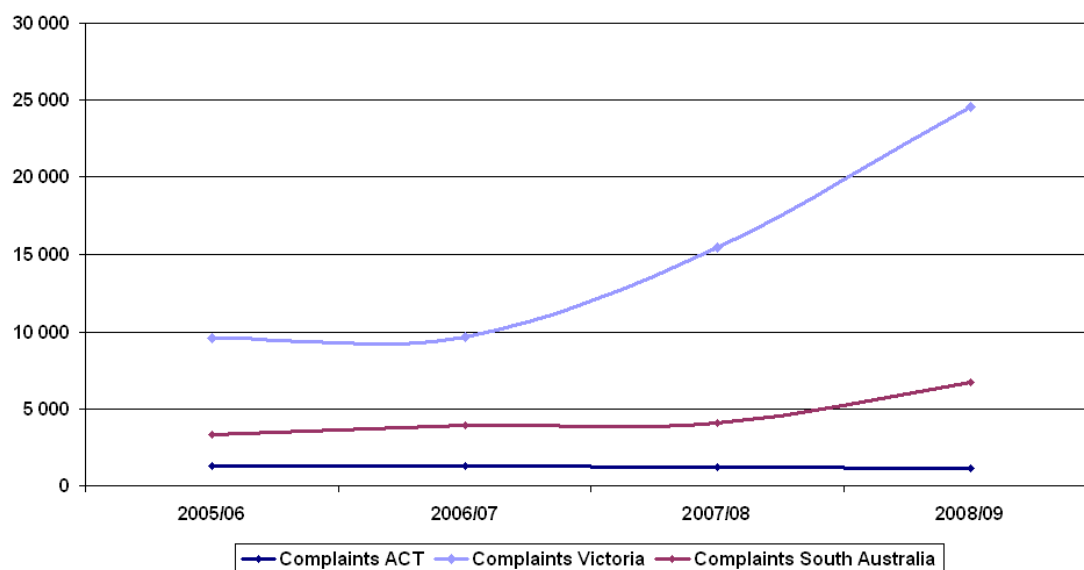
Figure 7.2 below shows a cross-jurisdictional comparison of the number of complaints made to the related energy ombudsman in Victoria, South Australia and the ACT.<sup>131</sup> As expected, the overall number of complaints in Victoria and South Australia are higher than the ACT, in part as a result of the greater size and population of these jurisdictions. However, where the numbers of complaints in both Victoria and South Australia have increased over the past two years, complaints in the ACT have remained relatively constant.

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<sup>130</sup> Roy Morgan Research Residential Report, p. 36; Roy Morgan Research Small Business Report, p. 37.

<sup>131</sup> 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.

**Figure 7.2 Cross-jurisdictional comparison of customer complaints, 2005-06 to 2008-09**



Source: Data for the ACT sourced from ACAT for tribunal cases relating to electricity (retail and distribution). Data for Victoria sourced from the Energy and Water Ombudsman Victoria (EWOV) for complaints relating to electricity (retail and distribution). Data for South Australia sourced from Energy and Industry Ombudsman of South Australia (EIOSA) for complaints relating to electricity (retail and distribution).

A key aspect of ACAT's work is assisting residents that have difficulties in meeting household bills (that is, assessing hardship matters). As noted above, with respect to electricity, the number of matters before ACAT has remained fairly constant over the last few years. However, by comparison with the Victorian and South Australian ombudsmen, the total share of hardship matters investigated by ACAT is high. For example, the most recent ACAT report shows that approximately 95 per cent of the electricity related matters before it are associated with customer hardship.<sup>132</sup> By contrast, while EIOSA reported an 83 per cent increase in the number of electricity related hardship matters (in the sense of disconnection, difficulty in payment, or liability for charges) between 2007-08 and 2008-09, hardship matters only accounted for approximately 14 per cent of total investigations in 2008-09.<sup>133</sup> Similarly in Victoria, EWOV reported an increase in electricity related hardship matters (that is, payment difficulties, disconnection/restriction, or collection) of 75 per cent between 2007-08 and 2008-09, which equates to approximately 12 per cent of total investigations in 2008-09.<sup>134</sup>

In addition to credit related hardship matters, these organisations also receive queries and complaints about other aspects of the supply of electricity. The number of matters in each of the three jurisdictions is set out in the table below. The ICRC reports these complaints by 'per 1 000 customers'. To aid in a cross-jurisdictional comparison (which

<sup>132</sup> Calculated from data supplied by ACAT.

<sup>133</sup> EIOSA 2009 Annual Report, p. 25.

<sup>134</sup> EWOV 2009 Annual Report, p.18.

does not appear to be carried out by the various jurisdictional organisations), the AEMC has converted the number of complaints lodged with EIOSA and EWOV to 'per 1 000 customers' with the use of NMI data from AEMO.

Table 7.6 indicates that for all three jurisdictions, the total number of electricity related complaints per 1 000 customers has increased between 2005-06 and 2008-09. For the 2008-09 financial year, electricity supply related complaints in the ACT stood at 8.5 per 1 000 customers, which is lower than both South Australia and Victoria at 10.7 and 17.7 per 1 000 customers respectively.

Another comparison between jurisdictions is the overall share of billing complaints. For both South Australia and Victoria, billing was the single largest issue, accounting for 48 and 45 per cent of total complaints respectively. For electricity customers, the aspects of high bills, billing delays and billing errors are cited as their major concern. By contrast, billing disputes in the ACT are relatively low at around 23 per cent or 1.9 complaints per 1 000 customers.

**Table 7.6 Cross-jurisdictional comparison of complaints before energy related ombudsmen, 2005-06 to 2008-09**

Jurisdiction	2008-09		2007-08		2006-07		2005-06	
	Complaints per 1 000 customers	Percentage	Complaints per 1 000 customers	Percentage	Complaints per 1 000 customers	Percentage	Complaints per 1 000 customers	Percentage
<b>ACT - Electricity</b>								
Total	8.51	100.0	9.39	100.0	4.65	100.0	3.47	100.0
Billing	1.93	22.7	1.57	16.7	0.98	21.0	0.57	16.0
Marketing	0.75	8.9	1.05	11.2	1.24	26.8	1.78	51.0
Other <sup>a</sup>	5.83	68.4	6.77	72.1	2.43	52.2	1.12	33.0
<b>South Australia - Energy <sup>b</sup></b>								
Total	10.66	100.0	6.65	100.0	6.14	100.0	4.92	100.0
Billing	5.13	48.1	2.67	40.1	2.44	39.7	2.11	42.9
Competition <sup>c</sup>	1.49	14.0	1.38	20.7	1.72	28.0	1.19	24.1
Other	4.04	37.9	2.61	39.2	1.98	32.3	1.62	33.0
<b>Victoria - Electricity <sup>d</sup></b>								
Total	17.71	100.0	8.96	100.0	5.4		6.03	
Billing	6.06	45.5	4.36	48.6	N/A		N/A	

Jurisdiction	2008-09		2007-08		2006-07		2005-06	
Transfer	2.39	13.5	1.18	13.1	N/A		N/A	
Marketing	0.85	4.8	0.56	6.2	N/A		N/A	
Other	6.41	36.2	2.87	32.1	N/A		N/A	

Source: ACT data from ICRC, *Licensed electricity, gas and water and sewerage utilities, compliance and performance report for 2008-09*. South Australian data from the EIOSA annual report (various years) and Victorian data from EWOV annual report (various years).

Notes:

<sup>a</sup> 'Other' issues in relation to electricity include for example, service request not being met, customer service, credit management and supply quality.

<sup>b</sup> 'Energy' includes complaints for electricity, natural gas and dual fuel.

<sup>c</sup> Competition comprises contractual issues, conduct of sales people, delays in transfer and consent not given for transfer.

<sup>d</sup> Historical data for Victoria was not in a form that would allow easy comparison with later years.

In conclusion, the quantitative analysis undertaken by Roy Morgan Research indicated that customers in the ACT are generally satisfied with their current retailer and problems are rarely encountered. Further analysis and cross-jurisdictional comparison of customer complaints per 1 000 customers also showed that the level of customer satisfaction in the ACT was generally higher than Victoria and South Australia.

## **7.5 Conclusions**

In summary, this chapter has explored the economic costs of providing retail services in the ACT electricity market. The analysis has found that the exclusion of a CAC/CARC allowance in the cost index that determines regulated prices has resulted in margins that do not appear to be commensurate with the prevailing financial conditions of the market and the risks involved in providing retail services as reported by retailers. It is therefore possible that these margins have hindered supplier rivalry and, consequently, the development of effective competition. As a result, it appears that retailers have not had an incentive to match and improve upon the price and non-price offers of their rivals and so product differentiation and innovation has been limited to date. Having said that, electricity customers in the ACT appear to be generally satisfied with their retail service providers, as well as the products and services available to them.

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

## **8 Compliance with social welfare and equity objectives**

### **8.1 Introduction**

Clause 14.11(c) of the AEMA requires the AEMC to report on compliance with, among other things, clause 14.11(b). That is, 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'.

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. It then discusses environmental requirements relevant to the market.

### **8.2 ACT social welfare and equity objectives**

The following sections refer to the important legislative instruments available in the ACT to address social welfare and equity objectives. Each section will include a brief description of the legislative instrument, how it is implemented to address social welfare and equity objectives, and where relevant, its impact on retail competition.

#### **8.2.1 ACT Government energy policy**

The draft sustainable energy policy of the ACT Government seeks to achieve certain outcomes.<sup>135</sup> 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**

The ACT Government's draft sustainable energy policy states its current requirements and targeted programs for improving customer information. An example of a mandatory requirement used by the ACT Government to improve customer information is that electricity bills include information comparing consumption and resultant emissions with previous bills. In addition, the targeted programs include:<sup>136</sup>

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<sup>135</sup> ACT Government, *Draft sustainable energy policy 2010-2020*, December 2009.

<sup>136</sup> *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.

The overarching policy objectives that the ACT Government plans to implement to enhance customer information and choice further by 2020 are to:<sup>137</sup>

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.

The policies already implemented by the ACT Government 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 the ACT Government's objectives for the medium term, 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, a market that displays effective competition would be expected to address these needs.

### **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'.<sup>138</sup> 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

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<sup>137</sup> *ibid.*, p. 17.

<sup>138</sup> *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.<sup>139</sup> 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.

Going forward, the ACT Government's overarching policy objectives to assist low-income and vulnerable energy customers include:<sup>140</sup>

1. considering increasing the Energy Concession to a level commensurate with expected energy price increases. Such an increase would immediately assist the more than 22 000 ACT 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 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).<sup>141</sup>

The AEMC notes the diverse government programs operating in, or planned to operate in, the ACT. The AEMC considers that these programs will further directly assist those customers experiencing financial hardship and aid in promoting social equity. In particular, the indexation of the Energy Concession will assist in maintaining the real value of the assistance over time to those households that are most vulnerable to general and energy price inflation. This is particularly relevant to the ACT given the relatively high household energy consumption (driven by the climatic conditions) that has been observed.

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139 The concession is administered by the ACT Department of Disability, Housing, and Community Services. Five energy providers are currently registered. See [www.dhcs.act.gov.au/wac/concessions/energy\\_concession](http://www.dhcs.act.gov.au/wac/concessions/energy_concession)

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

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

## 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 utility services. The Utilities Act consists of 16 parts, with Part 12 (complaints to ACAT about utilities) 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 relevantly to this Review, the inclusion of energy related matters in ACAT's jurisdiction is one necessary aspect of the ACT electricity market. A well functioning market should provide avenues for consumers to seek assistance in understanding their rights and obligations relating to the supply of energy and the paying of their bills. ACAT clearly fills this role.

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.<sup>142</sup>

With respect to these obligations, the AEMC notes that ActewAGL Retail provides information relating to each community service obligation and rebate on its website.<sup>143</sup> 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.

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<sup>142</sup> See section B.13 of this report.

<sup>143</sup> [www.actewagl.com.au/rebates/ACTenergy.aspx](http://www.actewagl.com.au/rebates/ACTenergy.aspx)

### 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. With respect to the regulation of pricing, 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, includes 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) outweigh the potential negative impacts, which will include higher prices in the short-term, and possibly in the long-term as well'.<sup>144</sup> Furthermore, in chapter 10 of its final decision, the ICRC discusses the social implications of its pricing decision, although it does note that addressing broader social equity problems is 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'.<sup>145</sup> Notwithstanding, while acknowledging its obligations under s. 20(2)(g), the ICRC notes 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'.<sup>146</sup> The ICRC considers that direct funding 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 Energy Concessions 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.

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<sup>144</sup> ICRC, *Draft Decision: Retail prices for non-contestable electricity customers 2010-2012*, April 2010, pp. 56-57.

<sup>145</sup> ICRC, *Final Decision: Retail prices for non-contestable electricity customers 2010-2012*, June 2010, p. 64.

<sup>146</sup> *ibid.*, p. 63.

#### 8.2.4 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.<sup>147</sup>

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

- Part 1 addresses formal matters of the Code;
- Part 2 contains generic provisions that apply to all utilities, including utilities that provide services to large non-franchise customers. However, these utilities may agree with customer terms and conditions other than those specified in the Code;
- 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;
- Part 5 deals with marketing of electricity and gas to franchise customers and small non-franchise customers; and
- Part 6 deals with customer transfers and new supply arrangements.

The Code is enforceable under the Utilities Act. The Utilities Act provides, in s. 25(2)(iii), that a utility licence is subject to the condition that the utility comply with each industry code that applies to the utility. The ICRC is responsible for monitoring utilities' compliance with this Code and other industry codes.

Provisions relating to the protection of customers and consumers are outlined under Part 2 of the Code. The key provisions of the Code relating to social welfare and equity objectives are:<sup>148</sup>

- the obligations of utilities and customers and the processes that must be followed in relation to customer disconnection; and

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<sup>147</sup> ICRC, *Consumer Protection Code*, July 2010, p. i.

<sup>148</sup> See section B.7 of this report.

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

### **8.2.5 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.<sup>149</sup> A public authority is defined to include those entities whose functions are, or include functions of a public nature, for the ACT.<sup>150</sup> 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.<sup>151</sup>

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.<sup>152</sup> The AEMC notes that the 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'.<sup>153</sup>

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.

## **8.3 Environmental obligations**

The following refers to the ACT Government's policy objectives relating to the environment. The implementation of these policies may impact on the operation of the electricity retail market and the welfare of electricity users.

### **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

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<sup>149</sup> HRA, s. 40.

<sup>150</sup> *ibid.*, s. 40A(1)(g).

<sup>151</sup> *ibid.*, s. 40A(1)(a)-(c).

<sup>152</sup> *ibid.*, ss. 9 & 11.

<sup>153</sup> *ibid.*, s. 11(2)(protection of the family and children).

conform to a five star energy efficiency rating.<sup>154</sup> In addition, the ACT Government has been increasing the minimum energy performance requirements of appliances, such as air conditioners, incrementally.<sup>155</sup> 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, the Home Energy Advice Team (HEAT), which is directly funded by the ACT Government and provides free, independent, expert advice on how to improve the energy efficiency of homes.<sup>156</sup>

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:<sup>157</sup>

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.

### **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 certainty should not be used as a reason for postponing measures to prevent environmental degradation;

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<sup>154</sup> See section B.13 of this report.

<sup>155</sup> ACT Government, *Draft sustainable energy policy 2010-2020*, December 2009, p. 7.

<sup>156</sup> For further information see: [www.heat.net.au](http://www.heat.net.au)

<sup>157</sup> ACT Government, *Draft sustainable energy policy 2010-2020*, December 2009, p. 7.

- (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.<sup>158</sup> 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.<sup>159</sup>

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.

## 8.4 Conclusion

As noted above, the AEMC is required 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'. It is apparent that there are a number of programs already underway in the ACT that aim to address certain community needs. The most prominent of these is the Energy Concession.

In addition to the immediate need to ensure that energy supply is affordable to all households, the ACT Government has implemented policies (which it expects to enhance over the medium term) that go to addressing the environmental issues that arise with the use of energy. While these policies have benefits for the whole community, they should also provide assistance in terms of energy affordability for long-term disadvantaged households.

The evidence considered and outlined in this chapter, indicates that the social welfare objectives set out by the ACT Government are clearly aimed to achieve certain desirable outcomes. In addition, the relevant programs that implement these policies have been clearly specified and are transparently funded as required under the AEMA. In ensuring that these AEMA objectives are met, the ACT Government has established a framework that is available to all interested licensed energy suppliers. As a result, the

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<sup>158</sup> Note that pass-through of the Australian Government's carbon pollution reduction scheme is not included in the ICRC's current pricing determination.

<sup>159</sup> ICRC, *Final Decision: Retail prices for non-contestable electricity customers 2010-2012*, June 2010, pp. 59-61.



programs should not impact on the level of retail competition that may exist in the ACT small customer electricity market.

## **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 First Draft Report setting out its draft findings on this matter. Submissions will be invited. A First 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 Second Draft Report will be published for consultation. This will set out draft findings and recommendations. Following the consideration of submissions, the AEMC will publish a Second Final Report on its recommendations.

### **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 the 9 April 2010 and seven submissions were received from the following organisations:

- 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 this First Draft Report.

### **A.3 Public forum on the First Draft Report**

The AEMC intends to hold a public forum in Canberra, on Friday 13 August 2010, to discuss the draft findings presented in the First Draft Report. The purpose of the public forum is 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 First Draft Report.

Further details of the public forum will be published by the AEMC on its website. Stakeholders will also be advised by an AEMC stakeholder email.

### **A.4 Way forward**

The focus of this First Draft Report is to inform stakeholders of the AEMC's draft findings and obtain from stakeholders any additional information that supports or refutes its position. This will provide invaluable input into the development of the First Final Report and the Second Draft Report.

In addition to submissions and comments received on the First Draft Report, the following will be taken into account in developing the First Final Report:

- submissions made by stakeholders throughout the review process;
- reports from consultants commissioned by the AEMC; and
- other information on competition regulation and the removal of price regulation.

The remainder of the ACT Retail Review will follow the timetable set out below.

<b>Date</b>	<b>Milestone</b>
Public forum on the First Draft Report	13 August 2010
Submissions on the First Draft Report due	27 August 2010
Publication of the First Final Report and the Second Draft Report	September 2010
Publication of the Second Final Report	December 2010

## **B Overview of the regulatory framework for electricity retailing in the ACT**

This Appendix sets out the regulatory framework that electricity retailers in the ACT are required to comply with. The ACT regulatory framework includes the specific requirements prescribed by legislation and a range of subordinate instruments including regulations, licences, codes and guidelines. These requirements affect many aspects of energy retailing, including prohibiting the retailing of energy without a licence. In addition, the energy products and services offered by retailers must comply with specific requirements, including the terms and conditions on which they are offered (including for some products the price), and the way in which information about products and services are communicated to prospective customers.

This Appendix does not cover wider obligations that retailers are required to comply with, including:

- obligations contained in the National Electricity Rules and the National Electricity Law for retailers operating in the NEM. These obligations include, for example, the requirement for retailers to provide financial security in the form of prudential guarantees, and other wholesale market obligations; and
- obligations contained in ACT and Commonwealth legislation that are not part of the regulatory framework for electricity retailing, but are required to be complied with by electricity retailers. Examples include obligations under the *Trade Practices Act 1974 (Cth)*, *Corporations Act 2001 (Cth)*, and *Fair Trading Act 1992 (ACT)* among others.

### **B.1 Principal legislation**

The principal legislation regulating the supply of electricity from an electricity network to premises for consumption (electricity retailing) in the ACT is the *Utilities Act 2000 (ACT)* (Utilities Act). In relation to electricity retailers in the ACT the Utilities Act gives effect to (among other things), the following obligations:

- the licensing framework;
- the energy industry levy;
- industry codes submitted by third parties or determined by the ICRC;
- a customer contracts framework; and
- an avenue for consumer complaints to ACAT.

Under the Utilities Act and the *Independent Competition and Regulatory Commission Act 1997 (ACT)*, the ICRC is responsible for administering the licensing system that applies to electricity retailers and enforcing compliance with those licenses. The ICRC is also

responsible for approving standard customer contracts and the approval or determination of industry codes.

## **B.2 Transitional franchise tariff**

Another important regulatory instrument is the ICRC's TFT. The TFT sets the price for the supply of electricity to non-contestable franchise customers. It applies to customers who have not elected to enter into a negotiated contract with either the incumbent retailer, ActewAGL Retail, or an alternative licensed electricity retailer.

The TFT was issued as part of transitional arrangements to the introduction of full retail contestability in the ACT on 1 July 2003. It was intended to ensure that customers consuming less than 100 MWh/year were able to remain on non-negotiated contracts. A price direction relating to the TFT is made by the ICRC in response to terms of reference issued by the ACT Attorney-General.<sup>160</sup> The first TFT was issued by the ICRC for a period from 1 July 2003 to 30 June 2006. Four further TFTs have been issued, each applicable for a one year period up to 30 June 2010. The most recent TFT is to apply for a two year period from 1 July 2010 to 30 June 2012.

## **B.3 Licensing**

Unless exempted, a person must not retail electricity in the ACT without a licence.<sup>161</sup> The ICRC is responsible for administering the licensing framework outlined in the Utilities Act including granting, varying, transferring and revoking electricity retail licences. A licence to retail electricity to franchise customers however, may only be granted by the ICRC with the written approval of the Minister.<sup>162</sup> The ICRC is also responsible for determining and monitoring compliance with licence conditions, granting exemptions from compliance with licence conditions, determination of licence fees, and approval or determination of industry codes.

The ICRC must grant a licence if satisfied that:<sup>163</sup>

- the applicant has the capacity, as determined in accordance with the relevant technical and prudential criteria adopted by the ICRC, to comply with the licence conditions and to operate a viable business as licensee. The ICRC will take into account matters such as: the previous good character of the applicant; the applicants risk management strategy; the financial resources available to the applicant; advice from external ratings agencies; whether the applicant has met the prudential requirements to be a market participant in the NEM; the ability of the applicant to meet licence conditions; statutory code requirements and

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<sup>160</sup> ICRC, (*Price Direction for the Supply of Electricity to Franchise Customers*) *Terms of Reference Determination 2009 (Disallowable Instrument DI2009-196)*. The price direction is also made in accordance with the ICRC Act.

<sup>161</sup> Utilities Act, ss. 6(c) & 21

<sup>162</sup> *ibid.*, s. 37(3).

<sup>163</sup> *ibid.*, s. 37(2)

guidelines; the experience of the applicant; human resources available to the applicant; and external resources (among other things);<sup>164</sup> and

- the applicant satisfies any other requirement that is relevant to the ICRC's objects under the Utilities Act, (the ICRC's objects are provided in s. 3 of the Utilities Act).

The Utilities Act provides for a licence to be subject to a number of general conditions specified in the Utilities Act.<sup>165</sup> Licences to supply electricity are also subject to special conditions specified in the Utilities Act.<sup>166</sup> The ICRC is able to determine other conditions to be included in the licence (including the term of the licence) as long as those conditions are not inconsistent with a requirement of the Utilities Act or any other law of the ACT.<sup>167</sup>

By virtue of the Utilities Act and its retail licence, a retail licensee is required to comply with industry codes and technical codes that apply to the licensee. These codes include the Electricity Metering Code, Electricity Customer Transfer Code, Prepayment Meter System Code, Electricity Network Use of System Code, Electricity Feed-In Code, and the Utilities (Consumer Protection Code) Determination 2010 (Utilities Consumer Protection Code).

These codes impose a range of (generally consumer protection related) obligations on energy retailers (including electricity retailers). The ICRC is responsible for considering draft industry codes submitted by third parties for approval, and determining industry codes in accordance with s. 59 of the Utilities Act. Before approving or determining an industry code the ICRC must undertake a process of public consultation.<sup>168</sup>

Retail licences also require the licensees to comply with environmental requirements provided in the licence, as well as the ACT Greenhouse Gas Abatement scheme, the *Electricity Feed-in (Renewable Energy Premium) Act 2008 (ACT)*, and the GreenPower offer scheme. These obligations are discussed in further detail in section B.9 of this appendix below.

Furthermore, the retail licences require licensees to comply with any direction by the ICRC, or the Chief Executive responsible for administering Part 5 of the Utilities Act.<sup>169</sup>

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<sup>164</sup> ICRC, *Guidelines on technical and prudential criteria for licence applications under the Utilities Act 2000 (ACT)*, March 2009, pp. 8-19.

<sup>165</sup> Utilities Act, s. 25.

<sup>166</sup> *ibid.*, ss. 27 & 28.

<sup>167</sup> *ibid.*, s. 25(1).

<sup>168</sup> *ibid.*, s. 60.

<sup>169</sup> Part 5 of the Utilities Act deals with the technical regulation of utilities. The Chief Executive has the following functions under the Utilities Act: to monitor and enforce compliance with technical codes; to provide advice to the Minister and ICRC about technical codes, including advice about compliance by utilities with the codes; and to report to ICRC the operation of Part 5 of the Utilities Act and the costs incurred by the ACT in relation to the operation of Part 5 of the Utilities Act.

Licencees are also required to comply with any applicable ring fencing requirements.<sup>170</sup>

#### **B.4 Energy industry levy**

Under the Utilities Act electricity retailers are required to pay the energy industry levy.<sup>171</sup> The levy is imposed on energy utilities to recover the amount of the ACT's national regulatory costs, and local regulatory costs in relation to the energy industry sectors.<sup>172</sup>

In 2008-09 and 2009-10 the energy industry levy replaced the licence fees for energy utilities (including electricity retailers). The amount of the levy is set by the Chief Executive Officer of the ICRC.<sup>173</sup>

#### **B.5 Framework underpinning customer contracts**

The Utilities Act provides a contractual framework for the supply of electricity. In addition the Utilities Consumer Protection Code regulates the terms and conditions upon which a retailer may supply electricity to small customers under a standard or negotiated customer contract.

##### **B.5.1 Standard customer contract**

The standard customer contract is a contract for the supply of electricity offered to customers by the incumbent retailer in the ACT, ActewAGL Retail. The standard customer contract is required to be approved (where terms are submitted by third parties) or determined by the ICRC.<sup>174</sup> It applies to customers who consume less than 100 MWh per year of electricity, and who have not elected to enter into a negotiated contract with either ActewAGL Retail or with an alternative electricity retailer.

The price charged to customers under the standard contract is set by the ICRC through the TFT in response to terms of reference issued by the ACT Attorney-General. Some of the terms of the standard customer contract are specified in the Utilities Consumer Protection Code which applies to electricity retailers by virtue of their retail licence and the Utilities Act.<sup>175</sup>

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170 The current ring fencing requirements are set out in the ICRC, *Ring fencing guidelines for gas and electricity network service operators in the ACT*, November 2002.

171 Utilities Act, s. 54C.

172 *ibid.*, s. 54B.

173 For the actual amounts levied to each energy utility sector (these being electricity distribution, electricity supply, gas distribution and gas supply) see *Utilities (energy industry levy - other) Determination 2009 Notifiable instrument NI 2009-476*, [www.act.gov.au](http://www.act.gov.au).

174 Utilities Act, ss. 89 & 90.

175 *ibid.*, s. 56.



The terms specified in the Utilities Consumer Protection Code include matters relating to:<sup>176</sup>

- the obligation of the retailer to supply electricity to franchise customers;
- circumstances where the retailer is not required to supply electricity;
- circumstances when the retailer can and cannot disconnect customers including the disconnection of service for failure to pay accounts and during emergency situations;
- when the retailer can interrupt the supply of electricity; and
- when security deposits may be required by the retailer and other particulars relating to security deposits.

### **B.5.2 Negotiated customer contract**

A negotiated customer contract is a contract between an electricity retailer and a customer for the supply of electricity on terms other than those of the standard customer contract.<sup>177</sup>

Unlike for the standard customer contract, the ICRC does not determine the electricity price for negotiated contracts. The Utilities Consumer Protection Code does, however, specify some terms that are to be given effect as part of a negotiated contract. These terms apply to customers that are on a negotiated contract and consume less than 100 MWh annually. The terms specified include matters relating to:<sup>178</sup>

- disconnecting the supply of electricity by the retailer when the customer fails to pay their account;
- the cooling off period under a negotiated customer contract. The cooling off period must not be less than ten business days from when the contract is made and when the customer is provided with the full terms, conditions and applicable costs of the contract. During the cooling-off period the customer may terminate the contract with no liability for payment or compensation to the retailer;
- the ability of a customer to rescind the contract if a marketer is in serious breach of the Utilities Consumer Protection Code;
- notice by an electricity retailer to a customer of the end of the negotiated contract period; and
- repayment of security deposits by retailers to customers, and the purposes for which security deposits are not to be used.

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<sup>176</sup> ICRC, *Consumer Protection Code*, July 2010, clauses 15–20.

<sup>177</sup> Utilities Act, s. 95.

<sup>178</sup> ICRC, *Consumer Production Code*, July 2010, clauses 22–27.

## **B.6 Minimum service standards for retailers**

The Utilities Consumer Protection Code sets out minimum service standards that utilities in the ACT (including electricity retailers) are required to comply with. These standards apply unless alternative arrangements have been agreed to by the utility and the customer, or events are outside of the utility's control.<sup>179</sup>

Rebates are to be paid by electricity utilities for failure to meet the minimum service standards upon application by entitled customers. The minimum service standards include:<sup>180</sup>

- that utilities must acknowledge complaints from customers immediately and respond to the complaint within 20 business days. If the utility fails to meet this standard, then it must pay \$20 (upon application by the customer) to the entitled customer; and
- if a customer's installation is physically connected to the electricity network, and the customer is entitled to the supply of electricity, then the customer must be provided with that service:
  - on the same day as the request is made if the request is made before 2:00pm; or
  - by the end of the next business day if a request is made after 2:00pm; or
  - on a day agreed between the customer and the utility.

If this standard is not met, the customer may apply for a rebate of \$60 to a maximum of \$300 for each day after the date the service should have been provided.

Utilities must make customers aware of the minimum service standards and inform them of entitlements available if the utilities do not meet the standards.<sup>181</sup>

## **B.7 Protection of customers and financial hardship provisions**

The Utilities Consumer Protection Code contains further provisions apart from those that deal with standard and negotiated electricity customer contracts (described above) relating to the protection of customers and consumers. Some key provisions of the Code are summarised in the table below.

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179 *ibid.*, clause 11.1.

180 *ibid.*, Schedule 1.

181 *ibid.*, clause 11.5.

**Table B.1 Key provisions of the Consumer Protection Code**

Clause	Provision
Conduct of utilities (clause 5)	<ul style="list-style-type: none"> <li>• A utility must act ethically, fairly and honestly in all its dealings with a customer or consumer.</li> <li>• A utility must not call or contact a customer or consumer:               <ul style="list-style-type: none"> <li>— during a public holiday in the ACT;</li> <li>— on a Saturday or Sunday, between midnight and 9:00am or between 5:00pm and midnight; or</li> <li>— on any other day, between midnight and 8:00am or between 8:00am and midnight;</li> </ul> <p>unless it is during an emergency or the customer or consumer has given express approval.</p> </li> </ul>
Complaints procedures (clause 6.1)	<p>A retailer must develop, maintain and implement procedures to deal with:</p> <ul style="list-style-type: none"> <li>• a complaint of a customer or consumer; and</li> <li>• the resolution of a dispute between the retailer and a customer or consumer.</li> </ul> <p>A utility that receives a complaint from a customer or consumer must advise the customer or consumer of the utility's complaint handling practices and procedures in its initial response.</p>
Utility to provide information (clause 7.1)	<ul style="list-style-type: none"> <li>• A utility on request must provide a customer or consumer with information about the services provided by the utility to the customer or consumer's premises.</li> <li>• A utility must, on request, provide a customer or consumer with information about:               <ul style="list-style-type: none"> <li>— load profiles and power factors, if applicable;</li> <li>— meter readings for utility services provided to the customer's premises by the utility;</li> <li>— the account of a customer with the utility; and</li> </ul> </li> </ul>

Clause	Provision
	<ul style="list-style-type: none"> <li>— efficient energy consumption;</li> <li>to the extent that the information is reasonably available to the utility.</li> </ul>
Utility to prepare summary (clause 9.1)	<ul style="list-style-type: none"> <li>• A utility must prepare a statement summarising the rights of customers, consumers and the utility under the Utilities Act, the Consumer Protection Code and the relevant customer contract with respect to the utility service provided by the utility under the customer contract.</li> <li>• A utility is not required to prepare the statement for a customer who has agreed with the utility to alternative arrangements or standards.</li> </ul>
Special needs - disconnection or interruption to services (clause 10.1)	<ul style="list-style-type: none"> <li>• If a customer or consumer provides evidence from a registered medical practitioner or a hospital that a person residing at the customer or consumer's premises requires a life support machine, the operation of which requires a utility service, the relevant utility must record those premises as a life support machine supply address.</li> <li>• Where the operation of a life support machine requires electricity supply services, the electricity supplier must immediately notify the electricity distributor that a premises has been registered as a supply address. The electricity distributor must update its special needs records not later than two business days after notification.</li> <li>• The utility must not disconnect the utility service to the supply address while any life support equipment is in use at the supply address unless: <ul style="list-style-type: none"> <li>— it has been notified by the customer or consumer, in the case of electricity supply services, by the electricity supplier, that the person no longer resides at that address or no longer requires the life support machine; or</li> <li>— the customer or consumer fails to provide evidence to a utility, at the utility's request, that the person still resides at that address and still requires the life support machine.</li> </ul> </li> <li>• The utility must give the customer or consumer not less than four business</li> </ul>

Clause	Provision
	<p>days written notice of a planned interruption to the supply of utility services at the supply address.</p> <ul style="list-style-type: none"> <li>• A period of notice longer than four business days may be given provided it is: <ul style="list-style-type: none"> <li>— requested by the customer or consumer;</li> <li>— reasonably necessary; and</li> <li>— able to be provided by the utility.</li> </ul> </li> <li>• The utility must: <ul style="list-style-type: none"> <li>— to the extent that it is able, assist the customer or consumer, upon request, to prepare a contingency plan in case of an unplanned interruption in the supply of the utility service to the customer or consumer; and</li> <li>— provide an emergency telephone contact number.</li> </ul> </li> </ul>
Maximum intervals between sending customer accounts (clause 13.3)	A utility must send a customer account to each customer at least every 120 days from the issue of the last customer account unless the customer and the utility have agreed to an alternative arrangement.
Content of customer accounts (clause 13.5)	<p>A customer account must contain (amongst other things) the following information:</p> <ul style="list-style-type: none"> <li>• the charges payable (fixed and variable), specifying the particular utility service they are for, and whether they are utility service related charges or charges for other goods and services;</li> <li>• any amount deducted, credited or received under: <ul style="list-style-type: none"> <li>— an ACT Government sponsored rebate or concession scheme; or</li> <li>— an instalment plan which applies to the customer;</li> </ul> </li> <li>• the amount of any payments received from the customer during the account period;</li> <li>• the amount of any arrears or credit standing to the customer's name;</li> <li>• the total amount due;</li> </ul>

Clause	Provision
	<ul style="list-style-type: none"> <li>• the due date for payment; and</li> <li>• a telephone number for the customer to call for any queries relating to: <ul style="list-style-type: none"> <li>— the customer account;</li> <li>— the complaints handling procedures of the utility;</li> <li>— how to claim a rebate from the utility if the minimum service standards are not met;</li> <li>— how to make a hardship complaint to the ACT; and</li> <li>— how to apply for an ACT Government sponsored rebate or concession that the utility provides.</li> </ul> </li> </ul>
Payment of customer accounts (clause 13.7)	<ul style="list-style-type: none"> <li>• A utility must give a customer not less than 12 business days to pay the customer account from the date on which the customer account is sent to the customer, unless an alternative period has been agreed between the utility and the customer.</li> </ul>
Difficulties in paying customer account (clause 13.14)	<ul style="list-style-type: none"> <li>• If a customer informs a utility that the customer is experiencing difficulty in paying the customer account or requires payment assistance, the utility must offer the customer: <ul style="list-style-type: none"> <li>— an advance payment plan or instalment payment plan option;</li> <li>— information about and referral to, any hardship program offered by the utility;</li> <li>— information about, and referral to, any ACT Government assistance program; and</li> <li>— information about independent financial counselling services,</li> </ul> <p style="margin-left: 40px;">at no cost to the customer.</p> </li> <li>• A utility is not required to offer an advance payment plan or an instalment plan to a customer who has, in the previous 12 months, had two or more advance payment or instalment plans cancelled due to non-payment.</li> </ul>
Instalment plan options (clause 13.15)	<ul style="list-style-type: none"> <li>• A utility is not required to offer an advance</li> </ul>

Clause	Provision
	payment plan or an instalment plan to a customer who has, in the previous 12 months, had two or more advance payment or instalment plans cancelled due to non-payment.
Interest charges (clause 14.1)	<ul style="list-style-type: none"> <li>• A utility may charge interest on the account of a customer if at least 14 days have passed after the due date for payment of the account.</li> <li>• A utility may charge interest on the account of a customer from the due date of payment of the account.</li> <li>• If the customer is a franchise customer, the utility must not charge a rate of interest which: <ul style="list-style-type: none"> <li>— is not specified in the standard customer contract; and</li> <li>— exceeds the default rate.</li> </ul> </li> </ul>

## B.8 Retailer of last resort arrangements

All jurisdictions in the NEM, including the ACT, have schemes in place to ensure that the customers of a second tier electricity retailer who exits the market in an unplanned fashion are guaranteed to continue receiving a supply of electricity. These Retailer of Last Resort (RoLR) arrangements reflect the essential nature of electricity supply.

In the ACT the ICRC is responsible for coordinating the RoLR process and to transfer customers to the RoLR. The process is set out in the ICRC's Retailer of Last Resort Guidelines. The trigger for a RoLR in the ACT is if a retailer ceases either permanently or temporarily to be able to lawfully supply electricity.<sup>182</sup> Examples of a RoLR trigger include where a retailer is issued a suspension notice by AEMO, or the retailer's licence is suspended or cancelled by the ICRC.

A retailer supplying RoLR services must have a standard RoLR contract. The standard RoLR contract must contain (among other things) provisions to the effect that:<sup>183</sup>

- the RoLR must supply electricity to the customers of a failed retailer;
- the RoLR must supply RoLR services until the termination of the RoLR contract by the customer, or three months from the relevant trigger time;

<sup>182</sup> ICRC, *Retailer of Last Resort Guidelines*, December 2002, p. 4.

<sup>183</sup> *ibid.*, pp. 2-3.

- information must be provided to the customer including an explanation of what has happened to the customer’s former electricity supplier and of the RoLR process; and
- the charges payable by the customer are the greater of the RoLR default tariff (as defined by reference to tariffs regulated by the ICRC) or the AEMO pool price plus a margin of ten per cent (margin capped at \$20 per MWh with adjustment for change in the CPI relative to the December quarter of 1998).

Currently, the RoLR for the ACT is ActewAGL Retail.<sup>184</sup>

## **B.9 Environmental requirements**

The ACT electricity retail licences require retailers to comply with a number of environmental measures.

First, retailers are required to develop and comply with strategies for promoting energy efficiency, demand management and sustainable energy sourcing. Retailers are also required to report annually to the ICRC on their implementation of, and compliance with, these strategies.

Second, retailers are required to offer GreenPower products to potential new or reconnecting customers and make GreenPower products available to existing customers. GreenPower is a joint initiative of the ACT, NSW, SA, Queensland, Victoria and WA government agencies to provide accreditation for renewable energy products. A GreenPower product is a product accredited under the rules and guidelines of the National GreenPower Accreditation Program as having ten per cent or more accredited GreenPower.<sup>185</sup>

Electricity retailers are also required to comply with the ACT greenhouse gas abatement scheme set out in the *Electricity (Greenhouse Gas Emissions) Act 2004* (ACT). This scheme:<sup>186</sup>

- establishes ACT, and individual greenhouse gas benchmarks to be met by electricity retail suppliers, market customers and certain other people who supply and consume electricity annually;
- provides for greenhouse gas benchmarks to be complied with by acquiring certificates relating to the carrying out of activities that promote the reduction of greenhouse gas emissions; and

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<sup>184</sup> ICRC, *Licence to Supply Electricity under the Utilities Act 2000 (ACT) granted to ACTEW Retail Ltd and AGL ACT Retail Investments trading as “ActewAGL Retail”*, Schedule 1, clause 2.

<sup>185</sup> ICRC, *Licences to supply electricity under the Utilities Act 2000 (ACT)*.

<sup>186</sup> *Electricity (Greenhouse Gas Emissions) Act 2004* (ACT), s. 3(2).



- provides an economic incentive to undertake activities resulting in the reduction of greenhouse gas emissions by imposing a penalty on greenhouse gas emissions above the benchmark.

A benchmark participant's<sup>187</sup> compliance with its greenhouse gas benchmark for a year is calculated by subtracting the participant's greenhouse gas benchmark from the number of tonnes of carbon dioxide equivalent of greenhouse gas emissions in the year for which the participant is responsible. Where this calculation is greater than zero a greenhouse shortfall exists, and the benchmark participant has failed to comply with its greenhouse gas benchmark.<sup>188</sup>

An amount of a greenhouse shortfall can be carried forward to the following compliance year but must be abated in that year or a penalty is required to be paid by the electricity supplier for the greenhouse shortfall.<sup>189</sup> The amount of greenhouse shortfall carried forward in relation to a year may not exceed ten per cent of the benchmark participant's greenhouse gas benchmark for the year.<sup>190</sup> Retailers may abate greenhouse shortfalls through surrendering abatement certificates and counting any renewable energy certificates.<sup>191</sup>

Scheme participants are required to demonstrate compliance with the scheme by lodging an annual greenhouse gas benchmark statement with the ICRC by no later than 1 March of the year following a compliance year, or at a later date permitted by the ICRC. The statement must contain:<sup>192</sup>

- an assessment of the benchmark participant's greenhouse gas benchmark for the previous year;
- an assessment of the participant's liability (if any) for the greenhouse penalty for the previous year;
- an assessment of the participant's liability (if any) for a greenhouse penalty payable in relation to a greenhouse shortfall carried forward from the year before the previous year; and
- anything else required by the regulator.

The ACT scheme is distinct from the Australian Government's mandatory renewable energy target scheme.<sup>193</sup> Renewable energy certificates surrendered by retailers under

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<sup>187</sup> A retail supplier is a benchmark participant under s. 9(a) of the *Electricity (Greenhouse Gas Emissions) Act 2004* (ACT).

<sup>188</sup> *Electricity (Greenhouse Gas Emissions) Act 2004* (ACT), s. 11.

<sup>189</sup> *ibid.*, ss. 12 & 16.

<sup>190</sup> *ibid.*, s. 12(6).

<sup>191</sup> *ibid.*, ss. 11 & 12(4). Renewable Energy Certificates are created under the *Renewable Energy (Electricity) Act 2000* (Cth).

<sup>192</sup> *ibid.*, s. 17.

<sup>193</sup> The Australian Government scheme is created under the *Renewable Energy (Electricity) Act 2000* (Cth).

the Commonwealth scheme may however, be counted towards a retailer's greenhouse gas benchmark, or to abate a greenhouse shortfall under the ACT scheme.

## B.10 Electricity feed-in scheme

The ACT electricity feed-in scheme is established under the *Electricity Feed-in (Renewable Energy Premium) Act 2008* (ACT) (Feed-in Tariff Act). It seeks to compensate premises (other than premises exempt under the Feed-in Tariff Act) with renewable energy generators that have a total capacity of less than 30kW that feed electricity from the premises to the distribution network.<sup>194</sup>

Electricity retailers are obliged under the scheme and by virtue of their retail licence to pay occupiers of premises for the total amount of electricity generated at the premises in accordance with the payment methodology outlined in the Feed-in Tariff Act.<sup>195</sup> Electricity distributors are required to reimburse electricity retailers the difference between the amount payable under the scheme and the normal cost of electricity.<sup>196</sup>

## B.11 Regulation of marketing conduct

Part 5 of the Consumer Protection Code relates to the marketing conduct of utilities (including electricity retailers). Both retailers and their marketers are required to comply with the relevant clauses of Part 5. Selected marketing conduct requirements are summarised in the table below.

**Table B.2 Consumer Protection Code marketing provisions**

Clause	Provision
Marketing obligations – obligations of marketer (clause 29.1)	<p>For the purposes of marketing, a marketer must:</p> <ul style="list-style-type: none"> <li>• understand and comply with the obligations of Part 5 of the Consumer Protection Code and all applicable Laws;</li> <li>• have product knowledge, including knowledge about tariffs, billing procedures, payment options, and redress available to all customers and consumers experiencing financial hardship;</li> <li>• understand and be able to explain all offers made to customers and consumers; and</li> <li>• understand what is misleading, deceptive</li> </ul>

<sup>194</sup> Feed-in Tariff Act, s. 5B.

<sup>195</sup> *ibid.*, ss. 6(3) & 8.

<sup>196</sup> *ibid.*, s. 6(2). The normal cost of electricity is outlined in s. 6A.

Clause	Provision
	or unconscionable conduct.
Marketing obligations – obligations of utility (clause 29.2)	<p>Where a marketer is not a retailer, the retailer on whose behalf the marketer is contracted, must:</p> <ul style="list-style-type: none"> <li>• take steps to ensure that the marketer meets the conduct requirements set out in clause 30.1 of the Consumer Protection Code (see below); and</li> <li>• obtain a written statement of compliance with Part 5 of the Consumer Protection Code and all applicable Laws from the marketer where the marketer introduces a customer or consumer to the utility or where the marketer arranges or facilitates a supply arrangement on behalf of that utility.</li> </ul>
Contact with customers – conduct (clause 30.1)	<p>A marketer shall:</p> <ul style="list-style-type: none"> <li>• not harass or coerce a customer or consumer;</li> <li>• not engage in misleading, deceptive or unconscionable conduct, whether by act or omission;</li> <li>• not make false or misleading representations; and</li> <li>• provide all relevant facts in an accurate and truthful way.</li> </ul> <p>A marketer must not call or contact a customer or consumer:</p> <ul style="list-style-type: none"> <li>• during a public holiday in the ACT;</li> <li>• on a Saturday or Sunday, between midnight and 9:00am or between 5:00pm and midnight; or</li> <li>• on any other day, between midnight and 9:00am or between 8:00pm and midnight,</li> </ul> <p>unless the customer or consumer has given express approval.</p>
Contact with customers – duties of marketers (clause 30.2)	<p>To the extent not otherwise required by the <i>Door to Door Trading Act 1991</i> (ACT), a marketer that contacts a customer or consumer for the purposes of marketing must, as soon as practicable, clearly:</p> <ul style="list-style-type: none"> <li>• identify his or her name and the name of the company that the marketer works for;</li> </ul>

Clause	Provision
	<ul style="list-style-type: none"> <li>• where the marketer is not a utility, the name of the utility on whose behalf the marketer is acting;</li> <li>• identify, if requested, the marketer's contact number and address, and the contact number and address of the utility on whose behalf the marketer is acting;</li> <li>• explain the purpose for contacting the customer; and</li> <li>• ask the customer if the customer or consumer wishes to proceed further in the marketing process.</li> </ul> <p>If a customer or consumer indicates, at any time during a conversation with a marketer that the customer or consumer does not wish to proceed, the marketer must cease marketing promptly and must not contact that customer or consumer for the purposes of marketing for not less than 28 days, unless requested by the customer or consumer.</p> <p>Where a marketer makes personal contact with a customer or consumer either at the customer or consumers premises or outside the premises, the marketer must display an identity card.</p>
Contact with customers and consumers – contract information (clause 30.3)	<p>A marketer must provide the following information to the consumer at or immediately before the consumer enters into a contract with the utility:</p> <ul style="list-style-type: none"> <li>• the type and frequency of accounts the consumer will receive, and the payment methods available to the consumer;</li> <li>• details of applicable charges and service levels that will apply to the consumer including, if applicable, any fees or commissions that a marketer is entitled to receive as a result of introducing the consumer to a utility or facilitating a supply arrangement between the consumer and utility;</li> <li>• the full name, address and telephone number of the utility;</li> <li>• the consumer's entitlement to a cooling-off period;</li> <li>• the length of the cooling-off period;</li> <li>• any rights the consumer has to cancel or</li> </ul>

Clause	Provision
	<p>rescind the contract and any charges that would apply on cancellation, together with a notice explaining the right of the consumer to rescind the contract, and a notice that may be used by the consumer to rescind the contract;</p> <ul style="list-style-type: none"> <li>• the full terms of the contract including the period of the contract, unless the contract is formed electronically;</li> <li>• the name and contact number of the utility responsible for providing the relevant connection services, if this differs to the utility providing the supply service;</li> <li>• the consumers right to make a complaint and to whom it should be made;</li> <li>• any other information reasonably necessary for the consumer to make an informed decision about entering into a contract.</li> </ul>

## B.12 Role of ACAT

ACAT's functions relating to licensed utilities are established in the Utilities Act. It has the power to consider applications relating to complaints about the supply of electricity to customers by retailers. It has jurisdiction in regards to (among other things):<sup>197</sup>

- complaints about hardship caused, or likely to be caused, by the disconnection of the electricity supply;
- contravention of a customer contract; and
- contravention of the protection of personal information provisions (s. 51 of the Utilities Act 2000).

ACAT may make orders and determinations that are binding on retailers in relation to matters within its jurisdiction. The directions and declarations it may make include:<sup>198</sup>

- a direction for a retailer not to withdraw an electricity service where it would cause hardship;
- where a service has been withdrawn and causes hardship, a direction for the retailer to restore the service as soon as practicable within 24 hours;

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<sup>197</sup> Utilities Act, s. 172.

<sup>198</sup> *ibid.*, Part 12, Division 12.5.

- in relation to a customer debt for a residential premises that would cause substantial hardship for a customer, ACAT may, in writing, declare that the debt is discharged in whole or to a stated extent. The amount of the debt so discharged may not be more than \$10 000. The amount discharged through the ACAT declaration is a debt due to the utility by the ACT Government; and
- a written direction for a retailer to pay a complainant a stated amount for loss or damage. This amount may not be more than \$10 000.

### **B.13 Community service obligations**

Apart from the role of ACAT described above, the Utilities Act also provides for CSOs the purposes of which are:<sup>199</sup>

- to oblige utilities to provide utility services in accordance with relevant ACT Government programs, for example, for community services, the environment or other social issues; and
- to achieve that result by agreement with particular utilities or, where agreement is not reached, by directions of the Minister; and
- to provide utilities with a reasonable recompense for the provision of services in accordance with such directions.

Under the CSO provisions the Minister for a Government program may give a written direction to a utility (including an electricity retailer) to take a stated action that the Minister considers appropriate to ensure that the utility's services are provided in accordance with the program. Such a direction may, for example, require the utility to provide particular services to particular classes of people free of charge, at stated charges, or subject to stated discounts or rebates.<sup>200</sup>

Directions under the CSO provisions can only be given if the responsible Minister is satisfied that despite all reasonable efforts having been made, no agreement has been reached with the utility about achieving the intended result or about the liability for the associated costs.<sup>201</sup> Furthermore, for a community service direction to have effect, the ACT Treasurer must certify in writing that proper arrangements exist for the ACT to pay the utility the amount of costs stated in the direction or determined by arbitration in accordance with the Utilities Act.<sup>202</sup>

CSO provisions have been used to provide concessions for electricity supply to consumers who hold a Centrelink health care card, Centrelink or Department of

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199 *ibid.*, s. 219.

200 *ibid.*, s. 221.

201 *ibid.*, s. 220.

202 *ibid.*, s.223. The arbitration provisions are provided in s. 225.

Veterans' Affairs pension card.<sup>203</sup> The Government has noted that at any one time, there are over 22 000 households in the ACT receiving the Energy Concession.<sup>204</sup>

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203 The concession is administered by the ACT Department of Disability, Housing and Community Services. Five energy providers are currently registered.  
[http://www.dhcs.act.gov.au/wac/concessions/energy\\_concession](http://www.dhcs.act.gov.au/wac/concessions/energy_concession)

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

## C Retailers licensed to operate in the ACT

Retailer	Ownership (at April 2009)	ACT electricity retail licence commencement date	NEM jurisdictions where active in electricity retailing (at April 2009)	NEM jurisdictions where licensed as an electricity retailer	NEM jurisdictions where active in gas retailing (at April 2009)
Australian Power and Gas Pty Ltd	Australian Power and Gas Pty Ltd	July 2008	VIC	QLD, NSW, VIC, SA & ACT	VIC
ActewAGL Retail	ACT Gov't & AGL Energy	July 2001	NSW & ACT*	NSW, VIC & ACT*	NSW & ACT*
AGL Sales Pty Ltd	AGL Energy	July 2001	QLD, NSW, VIC* & SA <sup>a</sup>	QLD, NSW, VIC*, SA* & ACT <sup>a</sup>	QLD*, NSW*, VIC* & SA <sup>a</sup>
AGL Sales (Queensland Electricity) Pty Ltd	AGL Energy	July 2001	QLD, NSW, VIC* & SA <sup>a</sup>	QLD, NSW, VIC*, SA* & ACT <sup>a</sup>	QLD*, NSW*, VIC* & SA <sup>a</sup>
Aurora Energy	Tasmanian Gov't	July 2005	SA & TAS*	QLD, NSW, VIC, SA, TAS* & ACT	TAS
Country Energy	NSW Gov't	July 2001	QLD, NSW*, VIC & SA	QLD, NSW*, VIC, SA, TAS & ACT	NSW*
Dodo Power and Gas Pty Ltd <sup>b</sup>	Dodo Power and Gas Pty Ltd	September 2007		QLD, NSW, VIC, SA & ACT	
EnergyAustralia	NSW Gov't	July 2001	QLD, NSW* & VIC	QLD, NSW*, VIC, SA & ACT	NSW
ERM Power Retail Pty Ltd	ERM Power Retail Pty Ltd	December 2007	QLD	QLD, NSW, VIC, SA & ACT	



<b>Retailer</b>	<b>Ownership (at April 2009)</b>	<b>ACT electricity retail licence commencement date</b>	<b>NEM jurisdictions where active in electricity retailing (at April 2009)</b>	<b>NEM jurisdictions where licensed as an electricity retailer</b>	<b>NEM jurisdictions where active in gas retailing (at April 2009)</b>
Integral Energy Australia	NSW Gov't	July 2001	QLD & NSW*	QLD, NSW*, VIC, TAS & ACT	
Jackgreen (International) Pty Ltd <sup>c</sup>	Jackgreen (International) Pty Ltd	May 2007		QLD, NSW, VIC, SA & ACT	
Momentum Energy Pty Ltd	Hydro Tasmania (Tasmanian Gov't) <sup>d</sup>	August 2009	VIC & SA	QLD, NSW, VIC, SA, TAS & ACT	
Origin Energy Electricity Ltd	Origin Energy Electricity Ltd	July 2001	QLD*, NSW, VIC* & SA	QLD*, NSW, VIC*, SA & ACT	QLD*, NSW*, VIC* & SA*
Powerdirect	AGL Energy	July 2004	QLD*, NSW, VIC & SA	QLD*, NSW, VIC, SA & ACT	
Red Energy	Snowy Hydro (58% NSW Gov't, 29% Victorian Gov't & 13% Australian Gov't)	January 2006	VIC & SA	QLD, NSW, VIC, SA & ACT	VIC
Sanctuary Energy Pty Ltd	Sanctuary Energy Pty Ltd (50% Living Choice Australia Ltd & 50% Sanctuary Life Pty Ltd)	July 2009	QLD	QLD, SA & ACT	
Sun Retail	Origin Energy Electricity Ltd	July 2001	QLD*, NSW, VIC* & SA <sup>e</sup>	QLD*, NSW, VIC*, SA & ACT <sup>e</sup>	QLD*, NSW*, VIC* & SA <sup>e</sup>
TRUenergy Pty Ltd	CLP Group	July 2001	QLD, NSW, VIC*, SA & ACT <sup>f</sup>	QLD, NSW, VIC*, SA, TAS & ACT <sup>f</sup>	NSW, VIC*, SA & ACT <sup>f</sup>

<b>Retailer</b>	<b>Ownership (at April 2009)</b>	<b>ACT electricity retail licence commencement date</b>	<b>NEM jurisdictions where active in electricity retailing (at April 2009)</b>	<b>NEM jurisdictions where licensed as an electricity retailer</b>	<b>NEM jurisdictions where active in gas retailing (at April 2009)</b>
TRUenergy Yallourn Pty Ltd	CLP Group	July 2001	QLD, NSW, VIC*, SA & ACT <sup>f</sup>	QLD, NSW, VIC*, SA, TAS & ACT <sup>f</sup>	NSW, VIC*, SA & ACT <sup>f</sup>

Source: Various regulator and retailer websites.

Notes:

\* Incumbent retailer in this jurisdiction.

a. Includes all AGL Energy subsidiaries.

b. Dodo does not currently provide electricity or gas services.

c. Jackgreen has been suspended from trading in the NEM.

d. Hydro Tasmania (which is owned by the Tasmanian Government) purchased a controlling share (51 per cent) in Momentum Energy in August 2008 and the remaining share in September 2009.

e. Includes all Origin Energy subsidiaries.

f. Includes all TRUenergy subsidiaries.

## D Summary of submissions to the Issues Paper

### D.1 Submissions received

ACT Civil and Administrative Tribunal (ACAT), 9 April 2010

ACT Minister for Energy, 17 May 2010

ActewAGL Retail, 9 April 2010

Energy Retailers Association of Australia (ERAA), 19 April 2010

Origin Energy, 14 April 2010

Public Interest Advocacy Centre (PIAC), 13 April 2010

TRUenergy, 9 April 2010

### D.2 Summary of stakeholder comments

Framework elements	MCE criteria	Sub-topic	Issue raised in submission	AEMC response
Market definition			<p>A number of features of the ACT market have been identified in submissions. ActewAGL Retail (p. 4) noted that:</p> <ul style="list-style-type: none"><li>'residential and small business customers consuming less than 100 MWh/y represent around 98 per cent of the customer base';</li></ul>	<p>These features of the ACT market have been noted. See Chapter 4 and Chapter 5.</p>

Framework elements	MCE criteria	Sub-topic	Issue raised in submission	AEMC response
			<ul style="list-style-type: none"> <li>• 'average consumption per residential customer is relatively high, largely reflecting the climate in the ACT';</li> <li>• 'the ACT customer base is relatively transient, with around 9 per cent of the ACT population moving in or out of their premises annually'; and</li> <li>• 'the ACT has the highest average disposable income in Australia. Where electricity costs represent a relatively [small] proportion of the household budget, customers may not have as strong an incentive to seek out and respond to alternative market offers'.</li> </ul> <p>Furthermore, ACAT (p. 2) noted the following:</p> <ul style="list-style-type: none"> <li>• 'energy is an essential service in the ACT as a consequence of the winter climate'; and</li> <li>• 'the ACT's load profile is markedly different from metropolitan New South Wales, as the main peak load is a winter heating peak rather than a summer air conditioner peak'.</li> </ul> <p>However, Origin Energy (p. 4) noted that it 'does not believe the characteristics of the ACT market differ greatly from any other electricity market within the NEM'. Given that small electricity customers in the ACT are indistinguishable from those in other jurisdictions, 'the AEMC should focus on retail market competition'.</p>	
Market structure	Ability of suppliers to enter the market	Barriers to entry (cost)	ERAA (p. 2) stated that the regulated price set by the ICRC has been criticised by a number of retailers in recent years for not taking into account the regulatory burden and cost of acquiring customers in the ACT. ERAA considers that this 'may be acting as a barrier to entry for retailers looking to enter the ACT and therefore holding back	The ACG's analysis is consistent with the views of retailers that the level of the regulated price may be a key barrier to entry. See section 5.4.

Framework elements	MCE criteria	Sub-topic	Issue raised in submission	AEMC response
			<p>competition'. TRUenergy (p. 3) also considered that 'not recognising customer acquisition costs and setting the retail margin too low' are significant barriers to entry.</p> <p>More generally, retailers have stated that the regulated TFT remains a significant potential barrier to retailer entry and the development of effective competition. Most retailers indicate that 'continuing to regulate prices in a competitive market threatens to deny consumers the benefits from a fully competitive market' (ActewAGL Retail, pp. 13-14; TRUenergy p. 3).</p> <p>On the contrary, ACAT (p. 3) stated 'there is no competition in the ACT domestic retail gas market. Given the strong links, and possibility of substitution, between gas and electricity ... the lack of competition in the ACT gas market suggests that the [regulated] electricity [price] may have little or no relevance to the current absence of competition in the ACT electricity market'.</p>	<p>Analysis indicates that the TFT is impacting on retailer behaviour and ultimately, the level of competition.</p>
		<p>Barriers to entry (dominance of the incumbent)</p>	<p>Origin Energy (p. 5) noted that 'some of the barriers deterring entry include marketing to establish brand identity given the strength of the incumbent's business model'. Similarly, the ACT Minister (p. 2) notes the 'dominance of ActewAGL Retail and its related companies in the retail electricity and related markets and the relatively small size of the ACT electricity market compared to Victoria, NSW and Queensland' may form barriers to entry and affect the development of competition. However, ActewAGL Retail (pp. 12-13) considers that '[its] size does not provide a cost advantage relative to its major competitors, which are also large retailers in other markets ... and while the market is small, the costs of entry are low. In addition, the ACT's proximity to other large markets allow retailers to operate over more than one jurisdiction and spread the costs across a larger customer base'.</p> <p>Furthermore, Origin Energy (p. 13) noted that 'the multi-utility offerings</p>	<p>ActewAGL Retail has a large share of the market and uses extensive marketing to maintain high brand awareness.</p> <p>ActewAGL Retail, with TransACT, also provides a number of other services (telecommunications, pay television), which may be bundled with energy services. However, from the evidence available this is not considered to be a significant barrier to entry. See section 5.4.</p>

Framework elements	MCE criteria	Sub-topic	Issue raised in submission	AEMC response
			<p>of the incumbent retailer present a challenge to new entrants in the ACT market'. Similarly, PIAC (p. 3) notes that a 'dominant retailer that offers dual fuel and multi-utility services provides that retailer with a significant market advantage over any new or potential entrants into the market'. By contrast, ActewAGL Retail (p. 13) states that 'several of the competing retailers are also licensed to supply gas in the ACT, and are therefore not disadvantaged by ActewAGL Retail's ability to provide dual fuel offers'.</p>	
		Barriers to entry (regulation)	<p>The ACT Minister (p. 1) stated that there are low regulatory barriers to entry for new retail market participants. 'The barriers focus on technical and financial capacity to operate in the market and to meet the requirements for customer protection as well as the prudential requirements of the NEM'. Furthermore, the ACT Minister considered that 'the NECF will reduce these barriers, making it easier for new retailers to enter the market and to operate across the NEM'. Similarly, ActewAGL Retail (p. 13) noted that 'structural or strategic barriers have not impacted on the development of effective competition in the ACT electricity market, and there has been a high degree of entry since the market was opened to full retail contestability in 2003'.</p> <p>However, specifically in the context of the ACT market, the ACT Minister (p. 2), TRUenergy (p. 1) and Origin Energy (p. 5) noted that 'the ACT feed-in tariff imposes additional jurisdictional specific costs on retailers and is a further disincentive for second tier retailers to enter and expand in that market'. Origin Energy (p. 5) also notes that historically price regulation has not recognised the 'cost imposed on retailers of building systems and processes to cater for different regulatory regimes'.</p>	<p>The introduction of the NECF may over time align jurisdictional requirements (except retail price regulation).</p> <p>The feed-in tariff has been raised by a number of stakeholders as a potential barrier to entry; however, the AEMC considers it to be relatively manageable. See section 5.4.</p>
		Barriers to expansion	<p>Most retailers noted that the major impediment to expansion in the market was the regulated retail price, especially in relation to 'significant changes to the regulated price from year to year (where the</p>	<p>No major barriers to expansion (in addition to the TFT) have been identified. See section 5.4.</p>

Framework elements	MCE criteria	Sub-topic	Issue raised in submission	AEMC response
			<p>change fails to account for costs, including wholesale market costs) faced by new entrants' (Origin Energy, p. 5).</p> <p>Origin Energy (p. 5) does not 'believe there are significant barriers to exit for new entrant retailers'.</p>	
		Other	<p>Origin Energy (p. 5) notes that 'what is critical however is the strength of ring-fencing that applies to the incumbent's retail and monopoly business units. If ring-fencing is perceived to be weak, it diminishes confidence in the market and will deter entrants on the basis that the market may not be competitively neutral'.</p> <p>Origin Energy (p. 2) notes that ActewAGL Distribution has 'installed manually read interval meters ('type 5') on a new and replacement basis since 2007. Advanced metering infrastructure will amplify the risk of error in setting regulated prices, since interval measurement of small customer consumption unwinds cross subsidies that exist among small customers, with differential impacts on customers and more complex retail and network price offerings'.</p>	<p>It is noted that the ring-fencing obligations do not prohibit common distribution and retail marketing, nor include an obligation to have separate brand identification for the distribution and retail businesses.</p> <p>It is uncertain if the functionality of 'type 5' meters are being utilised in the ACT market.</p>
Market conduct	Behaviour of suppliers	Retailer rivalry	<p>The ACT Minister (p. 3) agrees with the ICRC that there is no vigorous rivalry in the ACT. However, the ACT Minister notes the divergent views of stakeholders regarding competition, a number of retailers consider that competition is occurring, but that price is the greatest constraint on competition.</p> <p>In particular, retailers operating in the ACT consider the regulated retail price is the biggest impediment to rivalrous conduct. For example, TRUenergy (pp. 3-5) stated that in 'other jurisdictions price is the dominant source of competitive tension for second-tier retailers. This has been restricted in the ACT by the failure to transition regulated</p>	<p>Currently, the ACT market is exhibiting a low level of retailer rivalry.</p> <p>Analysis by ACG indicates that the TFT is a factor. See section 7.2 for</p>

Framework elements	MCE criteria	Sub-topic	Issue raised in submission	AEMC response
			<p>tariffs to cost-reflective levels'. Similarly, Origin Energy (p. 5) noted the 'easing of competitive outcomes ... was in our view largely a reflection of uncertainty of the price regulation framework in the ACT and the difficulties of optimising regulatory decision making in an environment of input cost volatility for retailers (especially wholesale costs)'.  On the contrary, ActewAGL Retail (pp. 13-14) stated that 'retailers compete strongly to acquire new customers and retain existing customers. In addition to offering significant discounts (up to 25 per cent) relative to the regulated tariff, retailers compete by offering other inducements such as superior service and accessibility (for example through local shopfronts)'. Furthermore, ActewAGL Retail (p. 14) considered that 'price and customer service will continue to be crucial areas in which retailers will actively compete with one another in the future'.  In respect of future rivalry, TRUenergy (pp. 3 &amp; 4) considered that 'the low level of rivalry reflects a failure to set regulated tariffs at cost-reflective levels, and the adoption of unique jurisdictional regulations, such as the ACT feed-in tariff scheme'.</p>	<p>further information.</p> <p>It is observed that ActewAGL Retail is the only ACT retailer that offers a 25 per cent discount and the only retailer with local shopfronts.</p>
		Marketing by retailers	<p>TRUenergy (p. 4) noted that 'marketing strategies are developed in accordance with each respective retailer's business model, with the market determining the success of each approach. As a low-involvement commodity, energy sales are overwhelmingly retailer-driven, with low transfer rates reflecting little marketing activity'. Similarly, ACAT (p. 3) noted 'there is no current significant competition in the ACT market and no marketing activities other than promotion of bundling by ActewAGL Retail'. However, TRUenergy (p. 3) considered that 'while [it] has products available for ACT consumers, we are not currently actively marketing these products'.  ActewAGL Retail (pp. 14 &amp; 16) stated that 'the move to FRC has</p>	<p>Based on the evidence there appears to be very little marketing activity on the part of second tier retailers. However, there is evidence of significant marketing by ActewAGL Retail.</p> <p>The ACT market does not appear to be attractive to enter and, as a result, marketing by tier two</p>



Framework elements	MCE criteria	Sub-topic	Issue raised in submission	AEMC response
			delivered many benefits to consumers including significant discounts relative to the regulated tariff, as well as innovative bundled products and services which are responsive to the changing needs and preferences of customers'.	retailers is very limited. See section 6.2.2.
	The exercise of market choice by customers	Offers and switching	TRUenergy (p. 5) stated that 'the market is characterised by generic offers available to all consumers, based on tariff-type, not any social or consumption-level dimension'. Furthermore, TRUenergy (p. 4) considered that 'it is primarily in response to a marketing contact that a customer will switch retailer'. Similarly, in respect of customer switching, ActewAGL Retail (p. 16) noted that 'price is often the most important factor for customers ... customers will come firstly for price, and will then stay for service'.	Switching (since 2007) has been limited with the majority of switches going back to ActewAGL Retail and, more recently to the regulated tariff. See section 6.3.
			PIAC (p. 3) disagreed that simple switching measures are a reliable indicator of competition between retailers. It has observed that 'there has been a noticeable reduction in customer switching in the ACT'.	Customer switching behaviour is only one of the criteria that the AEMC has used to inform its draft findings.
		Availability of information	<p>The ACT Minister (p. 4) noted that one of the issues relating to the level of participation in the competitive market seems to be the 'amount and availability of information about the market itself and the products and prices being offered'. The Minister also raised two potential issues, 'firstly that more information may be available about some providers than others and secondly there is information available about how the market operates in general, which should support the competitive market'.</p> <p>The ACT Minister (p. 2) considered that the 'lack of customer information about, and knowledge of, competition' may be affecting the development of competition. ACAT (p. 3) also noted that it 'has observed little action by retailers to assist customers experiencing difficulties in participating in the contestable retail electricity market in</p>	<p>Historically, any new entrant marketing appears to rely on door-to-door sales.</p> <p>The quantitative and qualitative surveys undertaken by Roy Morgan Research indicate that consumers consider that there is some information available; however, it is difficult to compare</p>

Framework elements	MCE criteria	Sub-topic	Issue raised in submission	AEMC response
			<p>the ACT. Because the ACT market is relatively small it may not be cost effective for interstate retailers to adapt existing web-based or print media to the ACT market'.</p> <p>By contrast, ActewAGL Retail (p. 16) considered 'there is appropriate publicly available information for customers to make informed choices about their electricity retailer. Information is freely available on ActewAGL's award-winning website, as well as the websites of other retailers and web-based brokers. The web-based brokers provide comparisons of products and offers across suppliers'.</p>	<p>the available offers effectively. See Roy Morgan Research reports and section 6.2.</p>
Market performance	Differentiated products and services		<p>Origin Energy (p. 5) considered it 'difficult to see how price regulation has encouraged innovative tariff structures, differentiation and competition on the basis of greater service'. Similarly, TRUenergy (p. 3) noted that 'price regulation and the restrictions upon varying the minimum terms and conditions of energy contracts impede innovation, differentiation and service competition. This is demonstrated by the dominance among second tier retailers of price discounted products, and restricted service level differentiation'.</p> <p>However, ActewAGL Retail (p. 13) stated that 'evidence of retailers offering multi-utility and dual fuel products is an indication of healthy competition, not an impediment to competition'. TRUenergy (p. 5) also notes that 'the growth in green energy products is evidence that developments in consumer preferences are reflected in product offerings, to the extent the regulatory framework allows'.</p>	<p>The offers available are limited and appear to focus on discounts from the regulated retail price. See section 7.3.</p> <p>The Roy Morgan Research Residential Report indicates that green energy and bundling are of limited interest to consumers when deciding whether to switch.</p>
	Prices and profit margins	Regulated retail price	<p>ERAA (p. 2) considered that the 'single most limiting factor and the greatest risk for competition in the ACT is the regulated retail price'. This view was also supported by Origin Energy (p. 6) and TRUenergy (p. 4). Similarly, ActewAGL Retail (p. 10) also considered that the allowance for the retail margin in the cost build-up determined by the ICRC is 'set too low relative to other jurisdictions, and hinders</p>	<p>ACG's analysis supports retailer views that the regulated retail price is not attractive for a new entrant. See sections 5.4 and 7.2.</p>

Framework elements	MCE criteria	Sub-topic	Issue raised in submission	AEMC response
			<p>competitive outcomes in the ACT market'.</p> <p>However, the ACT Minister (p. 4) stated that 'ACT electricity prices are efficient and cost-reflective, consistent with the expected outcomes from a competitive market. This has occurred in the context of a regulated market tariff'. The ACT Minister also noted that 'pricing has never precluded market entry and there has been no retailer failures, except for JackGreen...'. In setting regulated prices in the future, ActewAGL Retail (p. 16) considered that the 'extent to which profit margins allow retailers to recover efficient costs, and thereby encourage entry, depends on the level at which the regulated tariff is set. If the TFT is retained in the future, there will be ongoing uncertainty about whether expected profit margins will be sufficient'. Similarly, ERAA (p. 2) stated that 'due to the introduction and amendment of Government policies (for example, enhanced Renewable Energy Target, Carbon Pollution Reduction Scheme (CPRS) and state-based feed-in tariffs), future market conditions will become more complex and volatile. ERAA therefore considered that the ability of the ICRC to set accurate electricity prices into the future will be diminished'.</p>	<p>The AEMC agrees that changes in the market will make it difficult for any regulator to set a price based on forecasts.</p>
			<p>ACAT (p. 3) stated that it 'sees potential customer disadvantage in setting an artificially high electricity TFT so that 'competition' can provide discounts from that price for the small segment of the ACT population who are likely to enter into non-franchise contracts'. ACAT agreed with the ICRC's view that 'the regulated price would need to be raised well above the current level to encourage vigorous competition in the ACT and that this would conflict with the requirements of section 20 of the ICRC Act'.</p>	<p>The AEMC agrees with ACAT and the ICRC that there is a conflict within the framework that the ICRC must have regard to when setting the TFT.</p>
		Wholesale electricity prices	<p>In relation to wholesale electricity prices, Origin Energy (p. 6) stated that 'wholesale market fluctuations are difficult to manage where price regulation remains in place'. Furthermore, while 'a new entrant may decide to enter the market based on an acceptable regulated price</p>	<p>ACG's analysis has found that the ICRC's approach is reasonable. However, the AEMC does agree that regulated retail prices in an</p>

Framework elements	MCE criteria	Sub-topic	Issue raised in submission	AEMC response
			<p>level, their continued presence or growth in the market may be significantly affected if regulated prices fail to reflect wholesale market volatility'.</p> <p>TRUenergy (p. 4) stated that 'it is the role of retailers in the competitive market to manage wholesale risk, and retailers compete on this basis. However, the ability of regulators to accurately forecast, in some cases years in advance, movements in wholesale markets when setting retail prices is problematic in the extreme. The regulatory risk this imposes on retailers diminishes the benefits of competition that would otherwise flow to consumers'.</p>	<p>environment of volatile wholesale prices can be problematic for retailers.</p>
	Consumer satisfaction	Nature and frequency of consumer complaints	<p>ACAT (p. 3) noted that 'during the period of active marketing in the ACT, a large proportion of ACAT's non-hardship complaints by customers related to marketing activities and the operation of the contestable market. The complaints varied widely, but the majority fell into the following categories, marketing conduct, contractual problems, supply transfer related issues and poor customer service'.</p> <p>However, in relation to evidence that retailers are engaging in mis-selling and other anti-competitive marketing practises, TRUenergy (p. 4) stated 'this is a compliance issue not related to the retention of price regulation'.</p>	<p>The AEMC has analysed data on customer satisfaction and compared this with other jurisdictions. See section 7.4.</p>
		Disadvantaged customers	<p>The ACT Minister (p. 5) considered the question about 'whether regulated tariffs deter competition or whether they are a safety net for the development of competition ... consumers in the ACT appear relatively indifferent to the benefits that might arise from competition'. The ACT Minister asked 'is the market exhibiting some 'failure', such as scale economics deterring entry, or is the customer base disinterested?'</p> <p>TRUenergy (p. 5) noted that 'customer "difficulties" generally relate to</p>	<p>This is a matter for social policy to address. As noted by ICRC, it is not the function of retail price regulation to protect disadvantaged consumers. Other mechanisms, which the ACT Government does have in place, can be used. See Chapter 8.</p>

Framework elements	MCE criteria	Sub-topic	Issue raised in submission	AEMC response
			<p>bill payment rather than participation in the competitive market. While payment difficulties generally reflect broader financial issues, given that energy is only a small proportion of total household expenditure, retailers provide multi-layered assistance including through customer hardship programmes'.</p> <p>ActewAGL Retail (p. 11) considered that 'the Government or regulator can ensure appropriate consumer protection without suppressing retail prices ... the needs of disadvantaged customers can, and should, be addressed by direct measures'. Furthermore, the ACT Minister (p. 6) noted that 'it is important to keep these issues [environmental and social dimensions of energy supply] to the forefront when considering the benefits of competitive markets in delivering not only efficient pricing, but also in providing community welfare'.</p>	
			<p>PIAC (p. 4) stated that the Issues Paper 'fails to recognise that price regulation is a mechanism to address existing market failure, and the inability for disadvantaged consumers facing financial hardship to participate effectively in the energy market. Whilst competition failure may not be the cause of hardship and problems with affordability, the difficulties faced by people in hardship to effectively participate in the market is an indicator of market failure, and provides a strong rationale for the continuation of price regulation'.</p>	As above.
		Other	<p>The ACT Minister (p. 6) reiterated that 'the ACT was a signatory to the National Competition Policy Reform and AEMA and secondly, the Government encouraged competition by deciding to open the market to FRC in 2003'. Furthermore, the Minister expressed support 'for the reform process in the release of its Draft Sustainable Energy Policy: increasing customer choice by removing the regulated electricity tariff, replacing regulation with price monitoring and restraints on the frequency of price changes'.</p>	The AEMC has had regard to the ACT Government's draft sustainable energy policy as part of this Review.

Framework elements	MCE criteria	Sub-topic	Issue raised in submission	AEMC response
			<p>PIAC (p. 5) stated in its submission that the AEMC has not mentioned the possible impact of the <i>Human Rights Act 2004</i> (ACT) (the HRA) on any proposal to remove price regulation. 'Under section 40B of the HRA, 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. Under section 40, a public authority includes an entity whose functions include functions of a public nature, when it is exercising those functions for the Territory. Under section 40A, the provision of gas, electricity and water supply are taken to be functions of a public nature'.</p>	<p>The AEMC, in making draft recommendations for this review, has considered the HRA, and considers that it has not acted in a way that is incompatible with a human right under the HRA. See section 8.2.</p>

## **E Summary of consultancy reports**

### **E.1 The Allen Consulting Group - Price and profit margin analysis**

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).

#### **E.1.1 Terms of reference**

The Allen Consulting Group (ACG) was engaged to undertake an analysis of electricity retail price and profit margins in the ACT. Specifically, ACG was asked to:

- comment on the attractiveness of entry into, and expansion within, the ACT electricity retail market based on the estimated profit margins available under the regulated retail price for the period 2003 to 2011; and
- based on a comparison of market prices to the regulated retail prices, comment on the attractiveness of entry into, and expansion within, the market for the period 2003 to 2011.

#### **E.1.2 Approach**

To undertake this analysis, ACG conducted the following tasks:

- a desktop review of the approach used by the ICRC to determine ActewAGL Retail's efficient cost base;
- a description and justification of any required changes to the ICRC methodology, and recalculating estimates of the efficient cost base incorporating those changes; and
- estimating profit margins associated with the regulated retail price in the ACT over the relevant period.

#### **E.1.3 Key findings**

ACG found that the ICRC's approach to determining regulated electricity tariffs in the ACT is mostly similar to that used by regulators in other jurisdictions where FRC has been introduced. That is, regulated tariffs are calculated by deriving three main retail cost components: WEC, ROC, and a retail margin to account for risks and uncertainties.

However, ACG observed that the most significant difference between the ICRC's approach and that applied by most other regulators is that the electricity tariff determinations do not include a customer acquisition (and retention) costs (CAC or

CARC) item in the ROC. In other jurisdictions this is intended to account for the cost of acquiring new customers (CAC) and sometimes also retaining existing customers (CARC) in a competitive market. These cost items include marketing costs and the costs of transferring customers. The inclusion of an allowance for CAC or CARC essentially raises the 'price to beat' for competing retailers offering market contracts.

ACG has noted that the ICRC must attempt to balance efficiency and equity objectives when setting prices, which often conflict. The ICRC has considered whether or not to include a CAC or CARC allowance a number of times. However, given its terms of reference, the ICRC has always decided not to include a CAC/CARC allowance.

In order to investigate the implications of not including a CAC/CARC allowance, ACG recalculated ActewAGL Retail's regulated electricity tariffs, including a range of CAC/CARC allowances that reflect the amounts allowed in other jurisdictions. Including CAC/CARC costs in the ROC has a significant impact on the retail margins a competing firm would actually achieve if it were undertaking marketing initiatives to attract new customers.

ACG therefore concluded that the 'effective' retail margins (after taking into account a CAC/CARC allowance) might be too low to encourage entry in the ACT electricity retail market. As a result, entry into and expansion within this market would not have been (and is unlikely to be) attractive.

Additionally, ACG highlighted the fact that only two retailers (ActewAGL Retail and TRUenergy) are currently actively participating in this market and that they offer similar tariffs for market contracts with comparable discounts for direct debit agreements or prompt bill payments. However, ActewAGL Retail also offers bundling discounts of up to 25 per cent off customers' electricity bills (up to a \$500 cap) if a customer combines a number of services provided by ActewAGL and its affiliate TransACT. These services include: electricity, natural gas, fixed phone line service, green energy, subscription TV, mobile phone service, broadband, and internet.

ACG then stated,<sup>205</sup>

“[t]he analysis we have undertaken in this report points to two key reasons why few or no new competing market offers are currently available to electricity retail customers in the ACT:

- Our analysis of regulated retail tariffs, taking into account a competitor's cost of acquiring new customers suggests that competing retailers would need to accept (significantly) lower margins to attract new customers than what is generally considered reasonable in electricity retailing;
- Additionally, it appears that competing retailers have not matched the multi-service discounts that ActewAGL Retail offers its electricity

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<sup>205</sup> ACG Price and Profit Margin Analysis, p. 5.



customers that also purchase telecommunications services from its affiliate.”

ACG concluded that given these factors, entry and expansion in the ACT electricity retail market would have been unattractive from 2007 onwards, and that this remains the case today.

## **E.2 Roy Morgan Research - Consumer surveys**

Roy Morgan Research, *Effectiveness of competition in the ACT electricity market: A qualitative study of domestic and business consumers*, June 2010. (Roy Morgan Research Focus Group Report).

Roy Morgan Research, *Effectiveness of competition in the ACT electricity retail market: Small businesses*, June 2010. (Roy Morgan Research Small Business Report).

Roy Morgan Research, *Effectiveness of competition in the ACT electricity retail market: Residential users*, June 2010. (Roy Morgan Research Residential Report).

### **E.2.1 Terms of reference**

Roy Morgan Research was engaged to undertake a quantitative and qualitative analysis of the experiences and perceptions of small customers in the electricity market of the ACT. For both the quantitative and qualitative surveys, Roy Morgan Research was specifically asked to assess:

- the awareness of full retail contestability and opportunities to choose and/or change their energy retailer;
- the extent to which small customers actively participate in the competitive market, that is the prevalence of switching;
- the extent to which small customers respond to marketing activities undertaken by retailers;
- the ease of obtaining, understanding and comparing information about energy offers; and
- the rationale or motivation underlying the decision to switch or not switch retailer.

### **E.2.2 Approach**

To undertake the quantitative analysis, Roy Morgan Research conducted the following tasks:

- in collaboration with the AEMC created a questionnaire that was based on the survey used in other states for a similar purpose;

- conducted computer assisted telephone interviews (CATI) on a statistically significant sample (that is, 464 small business and 1 002 residential users of electricity) for the ACT;
- weighted the data where appropriate; and
- analysed and reported the data in order to assess the effectiveness of competition in the ACT electricity retail market.

Similarly, to undertake the qualitative (focus group) survey, Roy Morgan Research conducted the following tasks:

- used a CATI screener questionnaire to solicit participants for each of the four focus groups, consisting of residential switchers and non-switchers and small business switchers and non-switchers;
- in collaboration with the AEMC created a discussion guide;
- facilitated the focus group; and
- analysed and reported the perceptions of consumers regarding the effectiveness of competition in the ACT.

### **E.2.3 Key findings**

#### **Residential users**

Roy Morgan Research concluded that, on balance, the survey of residential users of electricity suggests that competitiveness is not strongly present in the ACT retail electricity market. One provider dominates the market (91 per cent of respondents were ActewAGL Retail customers and 51 per cent of respondents could not name an alternative electricity retailer servicing the ACT). Switching was rare with only ten per cent of respondents indicating that they have switched since the introduction of FRC in July 2003. In addition, information about alternative electricity retailers and offers were infrequently sought, with more than three quarters of respondents having never been approached by a retailer and more than 90 per cent of respondents noting that they have never approached a retailer themselves.

#### **Small business users**

Roy Morgan Research concluded that ActewAGL Retail is a dominant force in the supply of electricity to small businesses in the ACT with a share of almost 90 per cent of all customers surveyed. Satisfaction with current arrangements and inertia were cited as the main reasons keeping small businesses from getting very involved in information collection and the search for better offers. There was some awareness of competing companies (by 50 per cent of those surveyed), but competitiveness overall is not strongly present in the ACT business electricity market. Switching was a rare event, with only nine per cent of businesses indicating they have switched since the

introduction of FRC. In addition, changing business plans with their current electricity supplier was rare. Finally, new offers or additional benefits or incentives for small business users to consider were not prominent, with only six per cent of businesses having looked for information on alternative offers.

## **Focus groups**

The focus groups conducted by Roy Morgan Research suggested that the ACT electricity market was not very competitive. Most participants saw ActewAGL Retail as the dominant utility force in the ACT with a number of advantages over other retailers. While most participants were aware they have a choice of electricity suppliers, most struggled to name more than two or three alternative suppliers. Several of the participants had switched suppliers or modified service plans, but many more had not switched away from ActewAGL Retail, had not given much consideration to switching, or were not aware of alternatives. Participants' perceptions of competition as a concept were varied. The support for a publicly owned utility was evident in the discussion about the presence or value of competition in the ACT. Some participants noted that the free-market may not be the right model for electricity as it was perceived this would lead profit-driven companies to cost-cutting and poor service quality. By contrast, other participants viewed competition as good for the public and for business. These participants considered that competition keeps companies honest, encourages them to strive to retain their customers and as a result, consumers benefit through downward pressure on price and a wider range of product offers.

## **E.3 GA Research - Retailer interviews**

GA Research, *Australian Energy Market Commission review into the effectiveness of competition in the electricity retail market - ACT: Retailer research report*, June 2010. (GA Research Retailer Interviews).

### **E.3.1 Terms of reference**

GA Research was engaged to undertake qualitative market research on electricity retailers licensed in, or licensed to operate in, the ACT. Specifically, GA Research was asked to assess:

- the extent to which retailers compete for customers and the basis upon which retailers compete;
- marketing strategies utilised by retailers;
- the extent to which retailer entry and expansion is affected by market structure and conditions, including the regulatory framework;
- tariff and product innovation and flexibility;
- the importance of dual fuel and green energy products; and

- to the extent possible, changes in these matters over time.

### **E.3.2 Approach**

GA Research conducted ten in-depth interviews with one or more senior representatives from each of the retailers that participated. The retailers were classed as either 'active' retailers, where they currently had existing small customers, or 'inactive', where they did not have small customers. The interviews followed a structured line of enquiry focussing on the items identified in the terms of reference.

### **E.3.3 Key findings**

GA Research concluded from most of the retailers interviewed, that the ACT electricity market for small customers currently has a low level of effective competition. In the retailers' opinion, the predominant reason for this is continued price regulation at a low rate that does not reflect the true costs or provide the necessary commercial margins for either inactive retailers to justify entering the market or for the smaller active players to ramp up their efforts and recommence active marketing activities. However, comments from the retailers interviewed indicated that the dominant retailer, ActewAGL Retail, is aggressively competing to retain its existing customers and acquire new customers, and that it does this because it feels the constant threat of the other retailers, both active and inactive.

If retail price regulation is removed, the retailers that were interviewed indicated that there would be much greater competitive activity within the ACT market, and that they are likely to respond relatively quickly to such a change.

Longer term, most of the retailers interviewed suggested that other initiatives such as the National Energy Customer Framework will provide added incentives for retailers to compete more actively within the ACT. Most of the retailers considered that keeping the regulated price as low as it is now could potentially be seen as beneficial for ACT residents and small businesses 'in the short-term'. In the long-term, there is a risk of a larger price shock when the time does come for the retail price to become cost reflective. Many of those interviewed noted that removing the regulated price would be likely to lead to short term price hikes but that it is in the ACT Government's long-term interest in terms of creating a more competitive market and better consumer choice.

## Abbreviations

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
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
BoM	Bureau of Meteorology
CAC	customer acquisition cost
CARC	customer acquisition and retention cost
CPI	consumer price index
CSOs	community service obligations
DECCEW	Department of Environment, Climate Change, Energy and Water
ERAA	Energy Retailers Association of Australia
ESC	Essential Services Commission of Victoria
FRC	full retail contestability
ICRC	Independent Competition and Regulatory Commission
IPART	Independent Pricing and Regulatory Tribunal of NSW
MCE	Ministerial Council on Energy
NEM	National Electricity Market
NMI	National Metering Identifier

PIAC	Public Interest Advocacy Centre
ROC	retail operating costs
RoLR	Retailer of Last Resort
RSoA	Revised Statement of Approach
TFT	Transitional Franchise Tariff
WEC	wholesale electricity costs