

9 April 2010

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Chairman
Australian Energy Market Commission
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Dear Dr Tamblyn,

Submission responding to Australian Energy Market Commission (AEMC) Review of the effectiveness of competition in the electricity market in the ACT Issues Paper

Thank you for the opportunity to comment on the 4 March Issues Paper which commences the AEMC's review of the *Effectiveness of Competition in the Electricity Market in the ACT*. ActewAGL understands that the AEMC is working in accordance with the terms of the Australian Energy Market Agreement (AEMA) and the request for advice from the Ministerial Council on Energy (MCE).

ActewAGL believes that evidence shows the ACT electricity market is competitive. It is characterised by a high degree of rivalry, with 19 licensed retailers of varying sizes currently or potentially competing in a variety of ways and delivering a range of competitive offers to customers. The threat of further entry is ever present, as structural and strategic barriers to entry are low. Customers have responded to the competitive offers that have increasingly become available since the introduction of full retail contestability (FRC) in 2003.

Given that the market is competitive, ActewAGL believes the regulated retail tariff should be removed, allowing customers to capture the benefits that can arise from a market free of regulatory constraints. The attached submission details our comments.

ActewAGL Retail looks forward to continuing to work with the AEMC throughout this review. Please contact Leanne Holmes on 0412 850715 if you would like to discuss this submission.

Yours sincerely



Ayesha Razzag
General Manager Retail

Review of the effectiveness of
competition in the ACT electricity market

ActewAGL Retail response to AEMC
Issues Paper

April 2010

ActewAGL

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Overview

Since the introduction of full retail contestability (FRC) in 2003 the Australian Capital Territory (ACT) retail electricity market has changed dramatically. Prior to the introduction of FRC, almost all customers were supplied by a single supplier under a regulated retail tariff.

In contrast, the market is now fully competitive, characterised by what the Australian Energy Market Commission (AEMC) describes as the key elements of effective competition: rivalry between competing suppliers, the threat of entry by new suppliers, and informed customers who are willing to change suppliers in response to more attractive offers.¹ The ACT electricity market is now characterised by:

- *A high degree of rivalry*, with 19 licensed retailers of varying sizes currently or potentially competing in a variety of ways, such as doorknocking campaigns and advertising, and delivering a range of competitive offers to customers. Discounts of up to 25 per cent compared with the regulated tariff are available, indicating strong price competition. Retailers are also competing on non-price terms – for example by offering alternative contract terms and incentives such as gift vouchers.
- *The ever present threat of further entry*, as structural and strategic barriers to entry are low. The market is relatively small, but costs of entry are low. Proximity to other large markets makes it relatively easy for retailers to operate across more than one jurisdiction, as several do, and to spread costs across a larger customer base. Seven of the competing retailers are also licensed to supply gas in the ACT, and are therefore able to compete by making dual fuel offers.
- *A high degree of customer response* to the competitive offers that have increasingly become available. Around 22 per cent of ACT electricity customers are now on negotiated contracts, according to the latest publicly available data.² Ongoing competition for customers is strong, with customer survey results for 2008/09 showing that almost 30 per cent of ActewAGL Retail's ACT customers have received one or more offers from competing retailers.

ActewAGL Retail notes that the Independent Competition and Regulatory Commission (ICRC) has previously assessed the extent of competition in the ACT electricity market, using very similar criteria and indicators to those the AEMC intends to use in the current review. In each of its reports since 2006, the ICRC has concluded that the ACT market exhibits the characteristics of a competitive market.

ActewAGL Retail considers that continuing retail price regulation in the ACT threatens to undermine the ongoing development of competition. This conclusion has also been made strongly by the ICRC in each of its reviews since 2006. Given that the market is competitive, the regulated retail tariff should be removed, as it has been with gas in the ACT since 2002, allowing customers to capture the benefits that can arise from a market free of regulatory constraints.

¹ AEMC 2009, *Revised statement of approach*, December, p. 9

² ICRC 2009, *Licensed electricity, gas, water and sewerage utilities compliance and performance report 2007/08*, p. 5

1. Introduction

ActewAGL Retail welcomes the Australian Energy Market Commission's (AEMC) *Review of the effectiveness of competition in the electricity market in the ACT*, and appreciates the opportunity to respond to the *Issues Paper* released by the AEMC on 4 March 2010.

ActewAGL is a multi-utility business formed in 2000 as two partnerships, ActewAGL Distribution and ActewAGL Retail. ActewAGL Distribution owns and operates the electricity network in the Australian Capital Territory (ACT). ActewAGL Retail purchases and retails electricity and gas services in the ACT and throughout the Capital Region (including Goulburn, Yass, Young, Nowra and Bega) and manages customer service and marketing. As a market leader, ActewAGL Retail delivers high levels of service to its customers, and offers a variety of competitive products.

ActewAGL Retail agrees with the AEMC's view, as set out in its *Revised Statement of Approach*, that effective competition hinges on the degree of rivalry in the market, the threat of new entrants and the extent to which informed customers are willing to change suppliers in response to more attractive offers.³ The ACT electricity market is characterised by a high degree of rivalry, with 19 licensed retailers of varying sizes currently or potentially competing in a variety of ways and delivering a range of competitive offers to customers. The threat of further entry is ever present, as structural and strategic barriers to entry are low. Customers have responded to the competitive offers that have increasingly become available since the introduction of full retail contestability (FRC) in 2003. Around 22 per cent of ACT electricity customers are now on negotiated contracts, according to the latest publicly available data.⁴

The following submission provides ActewAGL Retail's responses to the questions and matters raised by the AEMC in the *Issues Paper*. Where possible, ActewAGL Retail has provided evidence to support its claims on the extent of competition in the ACT market. In keeping with the AEMC's framework and approach for assessing the effectiveness of competition, the following sections examine: the structure of the market (how it has developed in recent years and the current situation, including any barriers to entry and the impact of the regulatory framework); market conduct (the behaviour of both customers and retailers); and market outcomes and performance. In addition, each question raised by the AEMC in the *Issues Paper* is addressed in Attachment 1.

2. The ACT electricity market

2.1 Background to the development of competition

Competition has been progressively introduced in the ACT retail electricity market since 1998. Prior to 1998 ActewAGL was the only electricity retailer in the ACT. In 1998, customers consuming more than 160 megawatt hours per year (MWh/yr) were made contestable,

³ AEMC 2009, *Revised statement of approach*, December, p. 9

⁴ ICRC 2009, *Licensed electricity, gas, water and sewerage utilities compliance and performance report 2007/08*, p. 5

enabling them to enter into negotiated contracts with ActewAGL and other licensed retailers. The threshold was lowered to 100 MWh/yr in July 2001. From 1 July 2003 customers below the 100 MWh/yr threshold, essentially households and small businesses, were made contestable, opening the market fully to competition.

Since the introduction of FRC in 2003, the Independent Competition and Regulatory Commission (ICRC) has undertaken, at the direction of the ACT Government, many reviews of regulated retail prices, setting six short-term retail price determinations. These were intended to transition to a market free of price regulation. In each of these reviews the ICRC considered the extent of market competition and the role of ongoing retail price regulation. In the 2006 review the ICRC found that the ACT market exhibited the characteristics of a competitive market and recommended that the regulated transitional franchise tariff (TFT) be discontinued.⁵ However, the ACT Government has not implemented this recommendation, and has issued a terms of reference for a further 2 years of transitional price regulation to 2011/12. Nevertheless the ICRC has maintained its position as a proponent of the removal of retail price regulation.⁶

In both the 2007/08 and 2008/09 Final Decisions the ICRC stated that:

“the regulatory mechanism cannot develop prices which are as responsive to demand and supply signals as prices in a competitive and open marketplace.”⁷

In its 2009/10 Final Decision the ICRC expressed concerns regarding the continuation of short-term price regulation and the ability of the regulator to set appropriate prices, particularly in light of an increasingly complex market environment:

“An inappropriate regulated price, and its subsequent inflexibility, may act to increase the likelihood of a retailer failing.”⁸

The ICRC further concluded:

“In conjunction with a strengthening of consumer protection arrangements, the best way of dealing with these uncertainties is to remove price regulation and allow retailers to develop their own risk management strategies.”⁹

Since the ICRC’s 2006 conclusion that the ACT retail electricity market was sufficiently competitive to support the removal of the TFT, the extent of competition in the market has strengthened considerably and customers have responded to the competitive offers available. For example, the ICRC reported in early 2006 that approximately 17 per cent of ACT electricity customers were on negotiated contracts.¹⁰ In its most recent annual utilities’ performance and compliance report, the ICRC reported that in 2007/08 (the latest year for which published data

⁵ ICRC 2006, *Retail prices for non-contestable electricity customers, Final Report, April, pp. 2-3.*

⁶ ICRC 2009, *Retail prices for non-contestable electricity customers 2009–10, Final Decision, June, p. 56.*

⁷ ICRC 2008, *Retail prices for non-contestable electricity customers 2008-09, Final Decision, June, p. 12 & ICRC 2007, Retail prices for non-contestable electricity customers 2007-08, Final Decision, June p. 61*

⁸ ICRC 2009, *Retail prices for non-contestable electricity customers 2009–10, Final Decision, June, p. 61.*

⁹ ICRC 2009, *Retail prices for non-contestable electricity customers 2009–10, Final Decision, June, p. 7.*

¹⁰ ICRC 2006, *Retail prices for non-contestable electricity customers, Final Decision, April, p. 17.*

is available) 33,360 customers, or 22 per cent of the customer base, were on negotiated contracts.¹¹ Ongoing competition for customers is strong, with ActewAGL customer survey results for 2008/09 showing that almost 30 per cent of ActewAGL Retail's ACT customers have received one or more offers from competing retailers.

These and other indicators of the competitiveness of the ACT electricity market are examined in the following sections.

2.2 Current market structure

There are currently 19 licensed electricity retailers in the ACT¹² supplying electricity to nearly 160,000 metered supply points.¹³ During 2007/08 all but 5 of the licensed retailers were actively supplying customers in the ACT.¹⁴ While ActewAGL Retail is the dominant retailer in the ACT market, its major competitors in the ACT are also large and active retailers in other markets, particularly in neighbouring New South Wales, but also in Victoria and Queensland.

Seven of the electricity supply licence holders are also licensed to supply gas in the ACT. This means that they can make dual-fuel offers to customers and provide bundled offers to customers choosing to have both electricity and gas services with the same retailer.

The residential and commercial structure of the ACT and the relative lack of an industrial base distinguishes the ACT from other State and Territory electricity markets. The ACT retail customer base is relatively small, comprising just over 150,000 customers. Residential and small business customers consuming less than 100 MWh/yr represent around 98 per cent of the customer base. Only 1,287 customers consumed more than 160 MWh/yr in 2007/08.¹⁵ While the total customer base is relatively small, average consumption per residential customer is relatively high, largely reflecting the climate in the ACT. Only the Northern Territory and Tasmania have a higher average consumption of electricity per residential customer.¹⁶

The ACT customer base is relatively transient, with around 9 per cent of the ACT population moving in or out of their premises annually. Retailers actively encourage people to take their accounts with them rather than switching when they move. Customers moving from interstate, particularly New South Wales, often remain loyal to their retailer, rather than switching to ActewAGL Retail.

The ACT has the highest average disposable income in Australia. Where electricity costs represent a relatively smaller proportion of the household budget, customers may not have as strong an incentive to seek out and respond to alternative market offers. This has implications for the way in which retailers compete, with a strong incentive to provide information to customers, for example through doorknocking campaigns, and to compete on non-price terms,

¹¹ ICRC 2009, *Licensed electricity, gas, water and sewerage utilities compliance and performance report 2007/08*, p. 5

¹² ICRC, 2009, *Annual Report*, p ix

¹³ ICRC 2009, *Licensed electricity, gas, water and sewerage utilities compliance and performance report 2007/08*, p. xi

¹⁴ ICRC 2009, *Licensed electricity, gas, water and sewerage utilities compliance and performance report 2007/08*, p. 8

¹⁵ ICRC 2009, *Licensed electricity, gas, water and sewerage utilities compliance and performance report 2007/08*, p. 4

¹⁶ ICRC 2009, *Licensed electricity, gas, water and sewerage utilities compliance and performance report 2007/08*, p. 7

such as service quality. ActewAGL Retail's market research indicates that just under half of its customers rate price as highly important when choosing an electricity retailer.

2.3 Barriers to entry, expansion and exit

ActewAGL Retail recognises that the threat of entry by competing suppliers is a key driver of competition, and barriers to entry, expansion or exit could therefore limit the extent of competition in a market. As the AEMC has noted, these barriers may be structural, strategic or related to the legal and regulatory framework.¹⁷

ActewAGL Retail considers that the evidence of strong actual entry of competing retailers in the ACT (with all but 5 of the 19 licensed retailers active, as noted above) indicates that barriers are not impeding the development of competition in the ACT electricity market.

ActewAGL Retail also notes that the ICRC has previously examined potential barriers to entry in the ACT electricity market and concluded:

“The investigation of barriers to entry indicated that there were no barriers impacting upon the competitive state of the market. The Commission found that retailers currently operating in other states are also licensed in the ACT and, despite the strong market presence of the incumbent supplier, ActewAGL, these retailers do not regard the barriers to entry to the ACT market as insurmountable.”¹⁸

Nevertheless, ActewAGL Retail addresses below the potential barriers that the AEMC has identified in the *Issues Paper*. In addition, we address regulatory barriers, in particular the regulated TFT, separately in the following section.

The first potential barrier referred to in the *Issues Paper* is access to wholesale energy supplies and risk mitigation tools. ActewAGL Retail considers that this does not represent a relevant barrier, as all current and potential retailers face the same market conditions. As the AEMC notes in the *Issues Paper*, a barrier to entry involves a relative disadvantage for an efficient potential entrant relative to the established firm. It does not include a cost or impediment that applies more or less equally to any party, new or established, participating in electricity retailing.¹⁹ ActewAGL Retail considers that any evidence that some retailers may find it more difficult or costly to access risk management tools should not be taken as an indication of a barrier to entry, but rather an indicator of the efficient functioning of financial markets, where firms must make internal commercial decisions and choose the tools and hedging strategies which best suit their needs and circumstances.

The AEMC also identifies economies of scope and scale as potential barriers. Economies of scale arise where average costs decline as output increases. ActewAGL Retail notes that opportunities to achieve economies of scale in the ACT are limited given the small size of the market. For example, in NSW there are 4.5 million customers and in Queensland there are 2

¹⁷ AEMC 2008, *Review into the effectiveness of competition in the South Australian retail electricity market, First final report, appendices*, p. 136.

¹⁸ ICRC 2006, *Retail prices for non-contestable electricity customers, Final Decision*, April, p. 1

¹⁹ AEMC 2010, *Review into the effectiveness of competition in the ACT retail electricity market, Issues Paper*, p. 8.

million customers, compared with approximately 0.15 million customers in the ACT. While there are clearly advantages from a larger customer base, this base need not be confined to one territory or zone. Retailers wishing to enter the ACT market could utilise the economies of scale they derive from their operations in other markets. Accordingly, ActewAGL Retail considers that economies of scale do not represent a barrier to entry in the ACT retail electricity market.

Economies of scope arise when the cost of one firm producing a given level of output of two or more products is less than the total cost if the products were produced by separate firms. The AEMC suggests that this could be an issue given that in the ACT “vertical integration is present between the incumbent retailer and distributor.”²⁰ However, the vertical integration does not provide any inefficient or unfair cost advantage to ActewAGL Retail. Access to the distribution network is regulated by the Australian Energy Regulator (AER), and ActewAGL Retail and ActewAGL Distribution comply with strict ring-fencing requirements (involving regulatory and administrative burdens). ActewAGL Distribution is also subject to strict cost allocation requirements, to ensure costs are appropriately allocated and not shifted to the regulated business. The vertical integration therefore provides no competitive advantage to ActewAGL Retail.

The AEMC also raises the possibility that ActewAGL Retail’s ability to offer multi-utility products may provide a competitive advantage. However, as noted above, seven other licensed retailers also have the option of providing bundled gas and electricity offers in the ACT. ActewAGL Retail notes that the presence of multi-utility and dual-fuel offers indicates a healthy and competitive market, where rivals are seeking ways to differentiate their product and meet the diverse needs of customers, rather than simply supplying a homogeneous electricity retailing product.

ActewAGL Retail also notes that even if there are some advantages from the relatively large customer base in a particular market location, and the ability to make multi-utility offers, it is important to also recognise that there are some disadvantages and costs associated with being the incumbent supplier. As the AEMC recognised in the South Australian retail competition review:

“an inherited customer base in a competitive environment may also disadvantage a host retailer”

and:

“By virtue of their obligations to offer to supply, the host retailers may be left with the burden of serving customers that are commercially less attractive to new retailers, for example, by reason of the customers’ load profiles, demographics, locations or credit risk profiles.”²¹

ActewAGL Retail notes that as the incumbent mass market retailer in the ACT, it is also limited by its obligations as Retailer of Last Resort. ActewAGL Retail has the responsibilities and costs of its obligation to supply, as well as being a prudent mass market retailer responsible

²⁰ AEMC 2010, *Review into the effectiveness of competition in the ACT retail electricity market, Issues Paper*, p. 10

²¹ AEMC 2008, *Review into the effectiveness of competition in the South Australian retail electricity market, First final report, appendices*, p. 161

for maintaining high levels of service and security of supply for its existing and potential customers.

2.4 Regulatory constraints

ActewAGL Retail agrees with the AEMC's position that the regulatory obligation that is the principal focus of the ACT competition review is the regulated retail price.²²

The potential for a regulated retail price to seriously undermine the development of competition is widely recognised. ActewAGL Retail has long held the view that maintaining retail price regulation in the competitive ACT market has the potential to create significant costs, denying consumers the benefits that flow from a truly competitive market, free of regulatory constraints. ActewAGL Retail has argued strongly and consistently in successive ICRC TFT reviews that retail price regulation poses a threat to the development of competition and an ongoing risk to the incumbent supplier.

The ICRC has noted in each of its TFT reports since 2006 the potential for the regulated tariff to impede the development of competition. For example, in the 2006 Final Decision the ICRC said:

"The Commission takes the view that the existence of the regulated tariff may restrict the development of a truly competitive market."²³

The role of regulated retail tariffs as barriers to competition has also been recognised in the context of national energy policy reforms. In its 2007 report to the Council of Australian Governments, the Energy Reform Implementation Group also concluded that:

"there is an inherent contradiction between (i) waiting for competition to emerge before removing price caps, and (ii) the fact that binding price caps themselves constitute impediments to competition."²⁴

The AEMC has also noted the potential costs of setting the regulated tariff too low, in its reviews of competition in both the Victorian and South Australian retail electricity markets.

ActewAGL Retail notes the ACT Government is aware of the importance of retail price deregulation and the need to establish competitive market outcomes. In the terms of reference issues to the ICRC for the review of electricity prices for non-contestable customers for the period 2010 to 2012, the ACT Government specifically requires that the ICRC formally investigate the:

²² ActewAGL Retail notes that the proposed National Energy Customer Framework legislative package includes an obligation to supply for designated retailers at its published standing offer price on a standard contract. Therefore, standard contracts, standing offer tariffs and the obligation to supply are expected to remain a feature of retail markets, with or without the regulation of retail prices. MCE Standing Committee of Officials, *National Energy Customer Framework: Second exposure draft*, November 2009.

²³ ICRC 2006, *Retail prices for non-contestable electricity customers, Final Decision*, April p. 15

²⁴ Energy Reform Implementation Group 2007, *Energy reform – the way forward for Australia, Report to the Council of Australian Governments, Executive summary*, p. 9.

“price level that would facilitate vigorous competition and the short-run and long-run costs and benefits of instituting such a price and the need to ensure appropriate consumer protection.”²⁵

Further, ActewAGL Retail notes that in the *Draft Sustainable Energy Policy 2010-2020 Discussion Paper*, the ACT Government raised the question of removing retail electricity price regulation in order to facilitate increased customer information and consumer choice in the ACT.²⁶ In raising this matter, the ACT Government recognises the positive market and consumer impact removing price regulation could have.

The AEMC also raises in the *Issues Paper* the matter of continued retail price regulation under the introduction of carbon pricing policies.²⁷ ActewAGL Retail believes the risks of the regulated price being set incorrectly are significant. As consultants Farrier Swier have stated in their report *Managing CPRS transition: implications for electricity price regulation*:

“The variability and uncertainty created in the transition will make it extremely difficult for regulators to determine a wholesale cost allowance that is competitive, but still allows a retail business to manage its risk. If the regulator makes an error, retail competition could be diminished, or worse still, a retailer could suffer financial distress, or fail.”²⁸

ActewAGL notes the successful transition in Victoria to a fully competitive retail electricity market free of regulatory burdens and constraints, following the removal of retail price regulation and the creation of a price monitoring scheme. ActewAGL believes such an approach is the next logical step in the ongoing development of the ACT retail electricity market.

3. Market conduct

Evidence on the market conduct of both suppliers and customers is an important element of any assessment of the extent of competition. ActewAGL Retail believes that the strong ongoing rivalry between ACT suppliers, and the responses of customers, reflected in active switching to market-based contracts, as well as awareness of rival offers, indicates a market where competition is as effective as it can be, while it remains subject to the constraints of a TFT as discussed above.

3.1 Rivalry between retailers

ActewAGL Retail believes there is healthy rivalry between electricity retailers in the ACT. While ActewAGL Retail recognises its market leading position as an electricity retailer in the ACT, it notes that this position is hard earned and aggressively defended. It cannot be

²⁵ Corbell, S Attorney-General, Australian Capital Territory, 2009 *Independent Competition and Regulatory Commission (Price Direction for the Supply of Electricity to Franchise Customers) Terms of Reference Determination 2009* (Disallowable instrument DI2009-196), item 2

²⁶ ACT Department of Environment, Climate Change, Energy and Water, *Draft Sustainable Energy Policy 2010-2020*, pp. 17-18

²⁷ AEMC 2010, *Review into the effectiveness of competition in the ACT retail electricity market, Issues Paper*, p. 11

²⁸ Farrier Swier, 2009, *Managing CPRS transition: implications for electricity price regulation*, p. 3

maintained by a passive presence. ActewAGL Retail is aware it operates in a competitive market and that it may need to respond quickly at any point to maintain its market share.

ActewAGL Retail also notes it maintains a range of non-price and marketing activities to maintain its standing in the ACT. ActewAGL Retail was one of the first energy retailers in Australia to offer an account management system so that small, medium and large customers are able to view and track their transactions and consumption. In 2008, ActewAGL Retail redeveloped the account management system, improving web navigation and creating new tools for customers such as the ability to estimate their upcoming bills online. Since 2002, ActewAGL's website has received quarterly awards from independent benchmarking company Global Reviews as the top energy website. It has also topped the Utility and Telecommunications category more than once, beating other major utility firms such as Telstra.

3.2 Customer responses

Since the introduction of FRC in 2003, customers have embraced the opportunity to switch to market-based contracts. According to the latest available figures published by the ICRC, 22 per cent of customers are on negotiated contracts.²⁹

While high rates of customer switching to market-based contracts and/or alternative retailers can be used as an indicator of the level of competition in the market, reflecting the availability of attractive offers or the effectiveness of retailer marketing, caution must be exercised in interpreting churn rates. A low level of churn does not necessarily reflect a lack of competition. Rather, it may reflect a high level of customer satisfaction with their existing retail offer.

ActewAGL Retail considers that generally, customers will only switch providers if they are offered a better price or service option than the provider they are currently with, or the customer has had a bad experience with their current supplier. However, ActewAGL Retail recognises that an individual can face substantial transaction costs when faced with the decision to change electricity suppliers and individuals may decide that these costs may outweigh the benefits.

4. Market performance and outcomes

ActewAGL Retail considers that the range of differentiated products and services available, at discounts relative to the regulated tariff, is an indicator of competition in the ACT market.

4.1 Price and product offers

Since the introduction of FRC in 2003, ACT customers have been offered a range of discounted prices for electricity and bundled services. Discounts of up to 25 per cent relative to the regulated tariff are available to customers bundling seven eligible energy and

²⁹ ICRC 2009, *Licensed electricity, gas, water and sewerage utilities compliance and performance report 2007/08*, p. 5

telecommunications services provided by ActewAGL and TransACT. Broker sites (for example www.switchpower.com.au and www.switchselect.com.au) identify discounts of 3 to 4 per cent through various providers. However there is anecdotal evidence of ACT customers being offered 7 to 10 per cent off the regulated electricity tariff.

Other forms of competitive offers observed in the ACT market include:

- special offers such as one month free;
- gift vouchers;
- magazine subscriptions;
- special contract terms;
- bundled savings on related products such as solar electricity, solar hot water systems or heat pumps;
- quality of customer service, customer management and billing processes; and
- accessibility (for example easy access to a local shopfront).

4.2 Profit margins

Profit margins are identified by the AEMC as one of the indicators of the extent of competition. ActewAGL Retail considers that caution should be exercised when analysing or estimating profit margins and drawing inferences about the extent of competition, particularly where the market is distorted by the presence of a regulated tariff. While low profit margins may be interpreted as an indicator of strong competition in a market free of significant regulatory constraints, low margins in the presence of a regulated tariff may reflect that the tariff has been set too low in relation to the costs and risks of being an incumbent mass market supplier, with adverse implications for the development of competition.

ActewAGL Retail considers the margins available for retail businesses are an important factor influencing the development of competition. The retail margin represents the return that a retailer requires in order to attract the necessary investment to provide retail services. Therefore, the retail margin should be commensurate with risks associated with providing retail energy services. A low margin will result in retailers not generating sufficient returns and consequently scaling back their activity to only service high value customers, potentially limiting competitive offers available to lower demand or higher risk customers. Alternatively, margins at reasonable levels would encourage competitors to enter the market, further enhancing competition to all segments of the market.

As 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. In this regard ActewAGL Retail notes EnergyAustralia's comments that:

“the current 5% (*the margin allowed as part of the regulated TFT*) retail margin does not adequately reflect the risks or cost levels faced by retailers and as such does not encourage a competitive retail electricity market within the ACT.”³⁰

5. Access to the benefits of competition

ActewAGL Retail notes that the ACT Government is currently reviewing the energy concession arrangements and believes the Government is best placed to support low-income and vulnerable customers through targeted concessions and programs. ActewAGL Retail agrees with the ICRC’s position that the TFT is not intended to be a ‘safety net’ tariff to be used for social or targeted support for smaller customers.³¹

ActewAGL Retail considers that competitive pricing and product innovation pressures in the market combined with consumers having the freedom to choose from a number of retailers protects consumer interests in a more efficient manner than continued price regulation.

ActewAGL Retail believes the Government or regulator can ensure appropriate consumer protection without suppressing retail prices. The problem with suppressing prices to protect consumers is well documented with Verve Energy in Western Australia.³² The needs of disadvantaged customers or customers with special requirements can, and should, be addressed by direct measures. This principle is also embodied in the Australian Energy Market Agreement, where clause 14.11(b) says:

“Social welfare and equity objectives will be through clearly specified and transparently funded State and Territory community service obligations that do not materially impede competition.”

At present, market-based contractual arrangements co-exist with a heavily regulated default tariff, constraining and inhibiting proper market operation and the development of increased competition. Allowing the competitive market to determine prices free of regulatory constraints will position retailers to best cope with current and emerging economic and market conditions, as well as government policies in areas such as climate change. ActewAGL Retail believes this will then position consumers to best obtain the benefits from a fully competitive market.

³⁰ Energy Australia, 2010, *Submission on ICRC Issues Paper – Retail prices for non-contestable electricity customers 2010-12*, p. 2

³¹ ICRC 2009, *Retail prices for non-contestable electricity customers 2009–10, Final Decision*, June, p. 47

³² See for example, Verve Energy, 2009, *Annual Report 2008/09*; Government of Western Australia Office of Energy, 2009, *Final Recommendations Report: Review of Electricity Tariff Arrangements*; Deloitte, 2009, *Review of Verve Energy: Report for the Minister for Energy; Training and Workforce Development*.

Attachment 1: Responses to AEMC questions

AEMC question	ActewAGL Retail response
Market definition	
<p>1. What characteristics of the ACT electricity retail market should the AEMC take into consideration when defining the market for this review?</p>	<p>The AEMC should take into account a range of characteristics which shape both the supply side and the demand side of the market. For example:</p> <ul style="list-style-type: none"> ▪ there are 19 licensed electricity suppliers in the ACT, and all but 5 have been active in recent years; ▪ several of the competing suppliers are also licensed suppliers of gas in the ACT; ▪ most of the active suppliers are also active in other jurisdictions or markets; ▪ the market is relatively small, and dominated by residential customers; ▪ the customer base is relatively transient, with a relatively high degree of interstate movements; ▪ the customer base has relatively high disposable income, and factors such as service and product loyalty may be more important drivers of choice than price; and ▪ the ACT electricity market should not be considered a geographically isolated market, but rather part of a larger market which spreads across neighbouring NSW. <p>The relevant characteristics of the market are discussed further in section 2.2 of this submission.</p>
Market structure	
<p>2. Have the structural conditions for electricity retailing in the ACT supported or hindered the development of effective competition? Are these structures likely to support or impede further</p>	<p>The structural conditions in the ACT have not hindered the development of competition. The market is relatively small, but costs of entry are low. Proximity to other large markets makes it relatively easy for retailers to operate across more</p>

<p>improvements in competition in the future?</p>	<p>than one jurisdiction, and to spread costs across a larger customer base.</p>
<p>3. Are there barriers to entry that impact on the development of effective competition? Have these barriers dissuaded prospective electricity retailers from entering or can they be overcome? Are these barriers likely to persist or abate?</p>	<p>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>ActewAGL Retail's size does not provide a cost advantage relative to its major competitors, which are also large retailers in other markets. 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> <p>Structural and strategic barriers to entry and exit are discussed further in section 2.3.</p> <p>However the regulated TFT remains a significant potential barrier to retailer entry and the development of effective competition. This barrier can be overcome by the removal of the TFT, as discussed in section 2.4.</p>
<p>4. Are there barriers to expansion or exit that impact on the development of effective competition? Have these barriers dissuaded prospective electricity retailers from entering or can they be overcome? Are these barriers likely to persist or abate?</p>	<p>As noted above, the only significant barrier is the presence of the regulated TFT.</p>
<p>5. Are there unique or specific features of the ACT electricity retailing environment that may support or impede the development of competition? For example, retailers offering multi utility and dual fuel products.</p>	<p>As discussed in response to the previous two questions, and in section 2.4, the regulated TFT is the feature of the ACT electricity retailing environment which may impede the development of competition.</p> <p>Evidence of retailers offering multi-utility and dual fuel products is an indication of healthy competition, not an impediment to competition.</p>
<p>Market conduct</p>	
<p>6. To what extent do retailers compete</p>	<p>Retailers compete strongly to acquire new</p>

<p>with each other to acquire new customers and retain existing customers?</p>	<p>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).</p>
<p>7. What does the current level of rivalry between retailers indicate about electricity retailing in the ACT?</p>	<p>The degree of active rivalry fluctuates widely, as would be expected in a relatively small market. Responses are quick when one firm makes a move, indicating a high degree of competition. ActewAGL Retail's ability to respond to market offers has assisted it in retaining customers and maintaining market share.</p>
<p>8. Has retail price regulation encouraged or impeded tariff innovation, product differentiation and service competition?</p>	<p>ActewAGL Retail believes that the move to FRC has 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.</p> <p>However continuing to regulate prices in a competitive market threatens to deny consumers the benefits from a fully competitive market.</p>
<p>9. On what basis, and to what extent, might retailers be expected to compete in the future?</p>	<p>Price and customer service will continue to be crucial.</p> <p>Anecdotal evidence suggests that customers churning to ActewAGL Retail often move because they are not getting very good service from other providers operating in the ACT (for example, call centres are not local, there is no shopfront to visit).</p> <p>As it does now through its 'Lets power ahead' campaign, ActewAGL will continue to promote its commitment to the environment and the community.</p> <p>Given the projected price increases for electricity and heightened interest in the environment, in the future retailers are likely to focus largely on green initiatives and energy efficiency products. ActewAGL Retail already offers customers a choice of plans for green energy and provides</p>

	energy efficiency advice and environmental information in customer communication materials.
10. What does the nature and extent of marketing activity indicate about the level of competition? What do the types of marketing activities undertaken by retailers indicate about the level of competition?	<p>The nature and extent of marketing activity is a good indicator of the strength of competition in the ACT market.</p> <p>ActewAGL Retail is aware it operates in a competitive market and that it may need to respond quickly at any point to maintain its market share.</p> <p>The marketing strategies used by competing retailers – for example doorknocking campaigns – also indicate that they are aware of what must be done in order to attract customers in the ACT.</p>
11. Is there evidence of retailers engaging in mis-selling and other anti-competitive marketing practices?	ActewAGL Retail is aware that the ICRC monitors the behaviour of energy retailers closely in order to prevent these practices from occurring.
12. What effect, if any, does retailer exposure to fluctuations in wholesale electricity price have on retailers' ability to offer competitive product and service offerings?	The impact of wholesale price fluctuations on retailers depends on how the retailers manage risk. Each retailer must make a commercial decision about its risk management strategy.
13. What motivates customers to switch from a standing offer to a market contract or to switch retailer? For those customers who are not willing to participate in the competitive market, what underpins their decision to remain on a standing offer?	<p>Customers tend to be motivated to switch to a market contract or a new retailer if they are made aware of a better offer (for example through a trade show or a doorknocking campaign) or they have a bad experience with their current retailer.</p> <p>Customers also tend to go through a period of heightened awareness of alternative offers during a disconnection/reconnection process (for example when moving house).</p> <p>However, even when made aware of competitive alternative offers many customers will not switch, because they are happy with the service provided by the existing supplier, or they remain loyal to the existing supplier, or simply because they perceive it is not worth the effort of switching. ActewAGL Retail notes, however, that changing retailers (particularly moving away from the standing offer</p>

	tariff) is relatively straightforward.
14. Are customers able to access information that is easy to understand, relevant and up to date, and enables competing offers to be compared? Do customers rely on this information when deciding whether to switch? If not, why not?	ActewAGL Retail believes 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.
Market performance	
15. Are retailers able to recover their efficient costs at current standing and market offer contract tariffs? Are future expected profit margins likely to be sufficient to encourage new entry and increase competition or will new entry be deterred?	<p>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.</p> <p>If the TFT is retained in the future, there will be ongoing uncertainty about whether expected profit margins will be sufficient.</p> <p>This is discussed further in section 4.2.</p>
16. Do retailers actively compete to offer the products, services, prices and other conditions of supply which are most attractive to customers? Do retailers respond to changes in consumer preferences?	<p>Yes. ActewAGL Retail Marketing and Product Development teams undertake constant market research, and review all emails and online forms received from customers. All these communications require responses and will often require ActewAGL Retail to reflect on a particular process or product to determine whether any improvements can be made.</p> <p>Feedback from customers and other market research undertaken is therefore used to identify trends and common themes, which may lead to changes to ActewAGL Retail's business processes in response to these customer preferences.</p>
17. To what extent do retailers compete with each other in terms of price to acquire new customers and retain existing customers?	<p>Price is often the most important factor for customers. ActewAGL Retail considers that customers will come firstly for price, and will then stay for service.</p> <p>ActewAGL Retail is constantly monitoring the</p>

	<p>market. ActewAGL Retail employs a team of Marketing staff and a full-time Energy Product Manager dedicated to monitoring competitor offers and generating market responses.</p>
<i>Other considerations</i>	
<p>18. Are there classes of customers who are unable to access the benefits of competition? If so, what factors contribute to the difficulties experienced by these customers?</p>	<p>ActewAGL Retail appreciates the importance of protecting the interests of some disadvantaged or special needs customers, and considers that the best way to address any problems is through directly targeted programs. This is discussed in section 5.</p>