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17 MAY 2010

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ATTORNEY GENERAL
MINISTER FOR THE ENVIRONMENT, CLIMATE CHANGE AND WATER
MINISTER FOR POLICE AND EMERGENCY SERVICES
MINISTER FOR ENERGY

MEMBER FOR MOLONGLO

Dr John Tamblyn
Chairman
Australian Energy Market Commission
PO Box A2449
SOUTH SYDNEY NSW 1235

Dear Dr Tamblyn

Thank you for your letter of 4 March 2010 advising of the Commission commencing the review of the effectiveness of competition in the electricity retail market in the ACT and the release of the associated Issues Paper. I apologise for the delay in responding.

I understand that meetings have occurred between officials. In addition to these meetings, and the exchange of information that I expect will continue to occur, I considered that it might be worthwhile making some comments on the issues raised by the review. While this is not a formal submission, I hope my comments will be useful in indicating the ACT's experience and perspective on the degree of contestability in the ACT electricity retail market. For convenience I have addressed my remarks to the questions raised in the issues paper.

Are there features of the ACT electricity retailing environment that have a bearing on the development of competition?

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 National Electricity Market (NEM). These barriers are comparable to those in other jurisdictions, ensuring secure and reliable supply and customer protection. All the electricity retail licensees in the ACT are operating in other jurisdictions, many in both gas and electricity markets, and are subject to rules governing the necessary minimum conditions for participation. Regulatory barriers do not seem to be an impediment to market entry.

The National Energy Customer Retail Framework (NECF) will reduce these barriers, making it easier for new retailers to enter the market and to operate across the NEM. The regulatory burden should reduce as retailers will face only one regulatory set of compliance requirements rather than a number of them. Licensing will also be replaced by a business authorisation process that may be lighter handed and less administratively burdensome than the multiple jurisdictional requirements they now face.

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While there are low regulatory barriers to entry, other barriers which may be affecting the development of competition are worth noting. The Independent Competition and Regulatory Commission (ICRC) has raised the following issues as potential barriers¹:

- *The dominance of ActewAGL Retail and its related companies in the retail electricity and related markets.* ActewAGL Retail is a well-established brand and has substantial loyalty. In a number of reviews ActewAGL Retail's market dominance has been referred to as a principal reason for retailers being licensed to supply but not actively participating in the ACT small customer market. There are currently 18 electricity suppliers in the ACT, a number that has been fairly constant over the past 3 years, up from 12 suppliers in 2000-01.² Contrarily, some retailers have indicated that market share is not the real issue, arguing that customers may be willing to switch retailers but that there is a constraint in the Transitional Franchise Tariff (TFT) being set too low to allow deep discounting.
- *The relatively small size of the ACT electricity market compared to Victoria, New South Wales and Queensland.* The ACT is relatively small but it is a concentrated market with high energy demand given hot summers and cold winter temperatures. Moreover, other jurisdictions are not homologous markets; each is a combination of smaller regional markets, e.g., Sydney-Newcastle-Wollongong. As such, a comparison of the ACT relative to New South Wales or Victoria may be misleading. A more appropriate comparison may be with smaller markets of similar size such as Newcastle, Wollongong or Geelong.
- *Administrative costs associated with schemes such as the feed-in tariff in the ACT.* This was raised by a retailer, who argued that such schemes had high administrative and set-up costs for new entrants, especially small retailers that do not have the critical mass of customers across which to spread those costs.³
- *Lack of customer information about, and knowledge of, competition.* The ICRC has argued that this may be a significant issue in the lack of development of intense rivalry in the ACT market, although the empirical data to make reliable conclusions on this issue is absent. There has been information disseminated in the ACT market about the benefits of competition and the exercise of choice of retailer. In 2003, to coincide with the launch of Full Retail Contestability (FRC), the ICRC released a pamphlet on how informed choices might be made and established a reference on its website to provide information on FRC. However, while from time to time there has been information about retail supply provided to customers in the market, much of that burden has fallen on the regulator or ActewAGL Retail. Competitors have not sought to generate customer awareness about competition to the degree that has been evident in other jurisdictions.⁴

While there have been a relatively large number of suppliers licensed in the ACT, there has been relatively few that have been active across all consumer groups. There has been more competition for commercial customers than for the residential sector of the market. Even though there are currently 18 licensed retailers only 3 have significant numbers of small customers.

¹ Independent Competition and Regulatory Commission. Draft Decision, Retail Prices for Non-Contestable Electricity Customers 2010-2012, Report 5 of 2010, p.49.

² *ibid* p.3.

³ *ibid* p.49.

⁴ *ibid* p.50.

While it could be argued that competition has been low, it is likely that the existence of the threat of entry has been a more important feature in moderating prices and stimulating a variety of product offerings than actual rivalry across all customer groups. ActewAGL Retail's development of bundled offers with discounts of up to 25% are possibly not so much a response to existing market participants but a defence against the possibility of future retailers entering the market.

Are retailers competing vigorously to acquire new customers and retain existing customers?

The conclusions reached by the ICRC suggest that there is not vigorous rivalry in the ACT retail electricity market. The ICRC points to a relatively low level of churn, a relatively low intensity of competition for residential customers, low price competition and low levels of marketing activity as characteristic of the ACT retail market. Moreover, EnergyAustralia, amongst others, submitted to the ICRC review its view that the level of competition in the ACT market has been declining. On the contrary, other retailers have submitted that there is competition in the ACT market. ActewAGL Retail, TRUenergy and Origin Energy Retail each indicate that while there are issues that are retarding the development of competition, competition itself exists in the ACT. TRUenergy and Origin Energy Retail both argue that price is the greatest restraint on competition in the ACT.⁵

Both the SoftLaw Community Project, in its submissions to the ICRC, and the ACT Civil and Administrative Tribunal (ACAT), in its submission on the AEMC Issues Paper, went further claiming that in their view there is no current significant competition in the ACT.⁶ The evidence does not bear out this view, although the extent of competition is now less than it has been at times in the past. That may be a result of external factors impacting on the market, such as the global financial crisis, uncertainty arising from the imminent shift of retail regulation to the Australian Energy Regulator (AER) and the impact of the Commonwealth Government's Carbon Pollution Reduction Scheme and renewable energy and energy-efficiency programs and jurisdictional programs affecting retail supply, such as the feed-in tariff arrangements and the sale of the NSW electricity retail assets. These matters have a destabilising effect not only on investment in infrastructure but willingness to explore new market opportunities.

In terms of whether retailers are market responsive, the range of product offerings available suggests that product innovation and differentiation is present. Bundled products, a variety of tariff structures, plans and services are available. It is not surprising that ActewAGL Corporation is a leader in this area, given its market share and its fairly aggressive marketing strategy. ActewAGL Corporation has been active in promoting its brand and its products, including its retail service, and has been prominent in providing information in the market through promotions and media exposure, which has benefitted ActewAGL Retail. Certainly the incumbent has been more consistently active in brand promotion than other competitors.

I believe that it is significant that when new offerings occur, with initiatives such as the feed-in tariffs related to environmental sustainability, there is a strong level of interest and a steady uptake of those products and arrangements. This demonstrates a level of awareness in the community and a willingness by customers to consider their electricity supply options. Furthermore, suppliers are adapting to changing circumstances and seeking to attract customers with new services and products.

⁵ TRUenergy submission to the AEMC Review Issues Paper, 9 April 2010 and Origin Energy Retail submission to the AEMC review Issues Paper, 12 April 2010.

⁶ SoftLaw Community Project submission to the ICRC Review of Retail Prices for Non-Contestable Electricity Customers 2010-2012, p.48.

Are customers participating in the competitive market?

The Commission's Issues Paper referred to customer churn rates as an indicator of whether customers are participating in the competitive market. On that measure the level of participation in the ACT is relatively low compared to other jurisdictions, noting that a direct comparison with other jurisdictions may not be the most appropriate comparison. In mid-2009, about 20% of customers were on negotiated contracts in the ACT, compared to more than 44% in Queensland, 54% in Victoria and 69% in South Australia.⁷ Interestingly, the level of participation in 2009 was less than for the years ending 30 June 2006, 2007 and 2008.⁸ However, in addition to the concerns regarding a comparison between jurisdictions, there are other reasons why these comparisons may be misleading. For example, it may be relevant to consider that the churn rate in Queensland occurred at the same time as its electricity retailing businesses were being privatised, in which circumstances a high level of churn might be expected. Victoria has a very active competitive retail market, with particularly active door-to-door marketing and telemarketing, which may explain a large amount of the activity in that jurisdiction. South Australia also has a substantial level of churn and is considered a 'hot market' in international surveys. Victoria was considered the hottest market in the world in 2008.

The AER raises an interesting point in its report on the State of the Energy Market: churn rates may disguise the true level of participation in the competitive market if they are looked at in aggregate. All switches are not indicative of competition in the market; some switches are customers choosing to move to better rates or products offered for negotiated contracts by their current retailer rather than switching retailers. The appropriate indicator of competition is the churn rate for customers moving between retailers not moving between different kinds of contract offered by the same retailer.

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 for services being offered. I believe that there is sufficient information in the market for customers to be fully informed about the products available and their price. I would, however, raise two issues. One is that more information may be available about some providers than others. ActewAGL Retail is very active in promoting its services and products, while others are not investing the same amount of effort in promotion. That may help explain the level of internal switching within ActewAGL Retail compared to the level of switching to a new retailer. The other point is that there is information available about how the market operates in general, which should support the competitive market.

Are the price outcomes and service offerings consistent with what may be expected in an effectively competitive market?

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. Pricing has not precluded market entry and there have been no retailer failures, except for Jack Green, which was a small retailer in the ACT market and the failure occurred as a consequence of its operation outside the ACT. On the surface there seems to be both efficiency and an absence of rent seeking.

⁷ ICRC Draft Decision, p.47. see also AER State of the Energy Market 2009, p.205.

⁸ 20% in 2006, 24% in 2007 and 21% in 2008 [figures rounded] see ICRC loc cit.

In terms of the efficiency of regulated pricing, the ICRC has consistently sought to strike an effective balance between environmental and social considerations, and providing an adequate return on investment, which is a requirement of section 21 of the *Independent Competition and Regulatory Commission Act 1997* (ICRC Act). ICRC pricing has reflected the trends in regulated pricing in the NEM and has been fair for both customers and suppliers.

What role do regulated retail price and electricity-specific concessions currently play?

Given that 80 per cent of customers remain on non-negotiated contracts the regulated price provides a balance between environmental, social issues, efficiency and reasonable return to ActewAGL Retail. ActewAGL Retail, as the incumbent supplier, has a range of obligations under the market rules that other retailers do not, such as retailer of last resort responsibilities and the incumbent's obligation to supply provision of Government-funded concessions for a variety of persons under Federal and ACT Government programs and community service obligations not applicable to other retailers (the Government has reviewed existing concession arrangements, increasing the energy concession for low-income households by 10 per cent). Those costs are reflected in regulated prices and in payments from the Government. These matters do not deter competition and do not provide the incumbent with competitive advantages unavailable to other retailers.

There is a question about whether regulated tariffs deter competition or whether they are a necessary safety net for the development of competition. On the one hand there is an argument that regulated tariffs should be removed and customers required to sign up to negotiated contracts and associated pricing in a competitive market. Since FRC was introduced in 2003, it has been the Government's view that the choice to remain on a non-negotiated contract should remain while consumers gained confidence about the operation of the competitive market. Consumers in the ACT appear relatively indifferent to the benefits that might arise from competition. Certainly the level of churn in the market would seem to indicate that there is a level of indifference, but it is unclear what precisely that indifference implies. Is the market exhibiting some 'failure', such as scale economies deterring entry, or is the customer base disinterested?

Are the benefits of FRC equally accessible to all classes of customers?

While FRC is available to all customers it is less certain that all customers are able to access the benefits of FRC. Clearly there is a level of social and economic dependence in the ACT community, as there is in all jurisdictions. However, the Government has consumer protection and social policy programs operating to identify those in need and to address those needs. Generally, there should be no potential consumers who do not have access to electricity.

Consumer protections are comprehensive and available to ensure that even those who have consistent difficulties in sustaining their contractual supply obligations have access to an essential service. There are no structural impediments to supply being available to customers, and opportunities to access competitive offers are available.

The ACAT made a submission to you on the issues raised in the AEMC Issues Paper of 4 March 2010. In it, ACAT argued that there is no current competition in the market and that there are no marketing activities being undertaken except for ActewAGL Retail. It further argues that the lack of beneficial competition means that the TFT is playing a valuable role for consumers in the ACT. It notes that there are more non-negotiated contracts than negotiated ones and that energy is an essential service, especially important for the health and wellbeing of the elderly and frail in the ACT's winter temperatures. In these circumstances ACAT's view is that price regulation should be maintained.⁹

⁹ Australian Capital Territory Civil and Administrative Tribunal submission to the AEMC Issues Paper, 8 April 2010, p.3.

ACAT's views address the effectiveness of competition in the ACT electricity market indirectly. While those views may not shed clear light on the competitiveness issues, ACAT raises other issues important to the final outcome of the review. For example, I agree that energy is an essential service and has substantial if not life threatening consequences if the market cannot be sustained. Also, I support the view that in considering the existence of competition it is important to consider it in a wider context, including the level of amenity that electricity provides and the environmental and social dimensions of energy supply. The ICRC Act has specific provisions that provide for these issues to be considered. These matters are reflected also in legislation and codes in other jurisdictions and the national rules, although perhaps not as lucidly as the ACT legislation. It is important to keep these issues to the forefront when considering the benefits of competitive markets in delivering not only efficient pricing but also in providing community welfare.

The ACT's regulations also address consumer protections dealing with information asymmetries. I expect that these protections and welfare issues will not be left unaddressed in the review and the final consideration of the effectiveness of competition. I note that in the NECF framework, these nationally-consistent consumer protection arrangements are currently being developed.

Moreover, jurisdictions will continue to have some responsibility for consumer protection as a complement to the national framework. Competition would not hinder the maintenance of consumer protections. Rather, it may be argued that the existence of a vigorously competitive market makes consumer protection more likely. Certainly the nature of the complaints that ACAT mentioned are consistent with rivalry between suppliers. For example, they are about competitive market issues such as customer transfers between retailers, billing, access to information about the nature of contracts, what responsibilities parties have in contracts and whether the services customers receive are consistent with service expectations.

Finally, I think it is important to clearly reiterate the ACT Government's views on energy reform and particularly competition reform. Firstly, the ACT was a signatory to the National Competition Policy Reform and the Australian Energy Markets Agreement (AEMA). Secondly, the Government encouraged competition by deciding to open the market to FRC in 2003, while retaining some transitional measures to provide confidence for consumers making the choice of retailers.

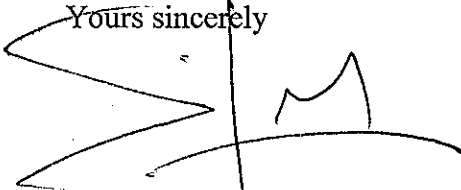
In approving FRC, the Government was satisfied that there were net benefits to removing regulation where appropriate to promote the development of variety in products, innovation in services, lower prices and choice of supplier. Those objectives remain important to the ACT energy market. For that reason the ACT Government continues to support national developments. Most recently, the Government has reiterated its 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.¹⁰

The most significant change in the near future, apart from the potential for removal of price regulation from the competitive market, is the implementation of the NECF. The ACT is fully participating in that process, including the transfer of retail regulation to the AER in 2011.

¹⁰ ACT Government. Draft Sustainable Energy Policy 2010-20, December 2009, pp.17-18.

The ACT is committed to ensuring that the review is effective and results in guidance on activities to encourage further development of competition in the ACT retail electricity sector. I look forward to future opportunities for consultation. Once the AEMC's views are known, the Government will consider its response.

Yours sincerely

A handwritten signature in black ink, appearing to be 'Simon Corbell', written over a vertical line that extends from the 'Yours sincerely' text.

Simon Corbell MLA
Minister for Energy

13-5-10