

REVIEW

Australian Energy Market Commission

STAGE 2 FINAL REPORT

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

Commissioners

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Stage 2 Final Report

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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. The AEMC has two principal functions. To make and amend the national electricity and gas rules - and to conduct independent reviews of the energy markets for the MCE.

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Summary

Given that the Stage 1 Final Report found competition was not effective in the ACT electricity retail market, the purpose of the Stage 2 Final Report is to recommend to the ACT Government ways to promote competition in the residential ACT market. The AEMC considers that the lack of customer awareness and the unique characteristics of the ACT market are significant factors limiting competition in the ACT. This is best addressed through a package of reforms which empower and support customers to make efficient decisions and make it easier for second tier retailers to enter into and expand within the market.

Therefore, the final recommendations consist of a package of policy measures to be undertaken concurrently to foster customer awareness and reduce the 'stickiness' of customers, including:

- instigating a consumer education program for small electricity users that provides information on the electricity market to facilitate efficient decisions;
- setting up a marketing campaign to inform customers of contractual details and obligations and the set up of a website containing baseline information relating to the ACT market;
- continuing to monitor the effectiveness of the customer protection and switching arrangements; and
- implementing nationally consistent frameworks, such as the NECF, as soon as practicable, to improve the harmonisation of regulatory requirements between the ACT and other jurisdictions.

The details of the customer awareness and marketing campaigns should be a matter for the ACT Government. However, for these campaigns to be effective, it is important that the information is easy to access on an ongoing basis. Furthermore, that it removes any misconceptions that customers may have regarding the electricity supply chain, or the process to, and implications of, switching retailers while also reducing the transaction costs of switching for consumers.

In conjunction with the above measures to foster customer awareness and improve harmonisation of regulatory obligations, the AEMC considers that the removal of transitional franchise tariff (TFT) and its replacement by a monitoring program would deliver increased competitive pressure in the ACT market as it removes regulatory risk for retailers and allows the competitive market to develop. In particular, the increased degree of competition will keep prices at cost reflective levels. Therefore, the AEMC recommends that on 1 July 2012, the ACT Government:

- removes the TFT for small consumers of electricity;
- establishes a monitoring program on all prices and products (and other relevant matters) relating to the supply of electricity to small customers in the ACT; and

- maintains the monitoring program for a three year period with a review at the conclusion of this initial period to assess whether the program should continue for a second period.

It is important that the package of measures work together in a co-ordinated and efficient way. In this regard, the AEMC considers that the timing of initial series of reforms is vital and advises that both the customer awareness education and marketing campaigns are initiated prior to the removal of retail price regulation on 1 July 2012.

During this Review, some second tier retailers have raised concerns in relation to the joint marketing activities of ActewAGL as a potential barrier to entry. The AEMC notes that the AER will be evaluating the guidelines for cost allocation and ring fencing as part of its distribution regulatory determination in 2014. The AEMC considers that this process is the most appropriate framework for assessment of this issue.

In reaching these recommendations, the AEMC had regard to stakeholder submissions to the Stage 2 Draft Report and considered various reforms to the pricing arrangements and non-pricing options and assessed their ability to ultimately support an environment which encourages competition in the ACT electricity market.

Contents

1	Introduction	1
1.1	Purpose of the Stage 2 Final Report.....	1
1.2	Structure of the Stage 2 Final Report.....	1
2	Framework for the review	3
2.1	Findings on the effectiveness of competition.....	3
2.2	Regulatory obligations	7
2.3	Benefits of competitive markets	8
2.4	Effective competition in the ACT.....	8
2.5	Principles of good regulatory practice	9
3	Advice on measures to improve competition	11
3.1	Final advice	11
3.2	Removal of retail price regulation	12
3.3	Monitoring program.....	13
3.4	Consumer awareness campaign	15
3.5	Marketing campaign.....	17
3.6	Frameworks governing the customer protection and switching process	19
3.7	Implementing nationally consistent frameworks.....	19
3.8	Review of the cost allocation and ring-fencing guidelines.....	20
3.9	Implementation	23
3.10	Responsible body	24
	Abbreviations.....	26
A	Consultation process	28
A.1	Outline of process	28
A.2	Issues Paper	28
A.3	Public forum on the Stage 1 Draft Report.....	29
A.4	Stage 1 Draft Report.....	29
A.5	Stage 1 Final and Stage 2 Draft Reports	30

B	Summary of submissions to the Stage 2 Draft Report.....	31
	B.1 Submissions received	31
	B.2 Summary of stakeholder responses.....	31
C	Non-pricing options	35
	C.1 Introduction	35
	C.2 Option (i): customer education and information.....	35
	C.3 Option (ii): harmonisation of regulatory requirements across jurisdictions.....	40
	C.4 Option (iii): amending the competitive environment between incumbent and second tier retailers.....	44
D	Pricing options.....	48
	D.1 Introduction	48
	D.2 Option (A): retain the current TFT.....	48
	D.3 Option (B): change the approach to setting the TFT	50
	D.4 Option (C): replace the TFT with reporting and monitoring.....	56
	D.5 Option (D): removal of retail price regulation	60
	D.6 Draft findings	61
E	Evaluation of combined options	63
	E.1 Benefits and costs of options	63
	E.2 Combinations of pricing and non-pricing options	68
F	Cost allocation and ring-fencing guidelines.....	72

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).

1.1 Purpose of the Stage 2 Final Report

The Stage 1 Final Report sets out the AEMC's reasons and analysis to support its finding that competition in the electricity retail market of the ACT is not effective. The major reason for this conclusion is that there are a number of inter-linking factors creating a perception for second tier retailers that entry and expansion in the ACT market is not economically justifiable. Importantly, the retail allowance does not appear to be sufficient for second tier retailers to recover their costs and earn a return that is commensurate with the risks of supplying electricity in the market. As a consequence, limited retailer rivalry and choice for consumers have been observed in the market.

As a result of the finding that competition in the ACT electricity retail market is not effective, the AEMC is required to provide advice on options to promote competition. That is, approaches on how to develop an environment where competition will be encouraged and the competitive pressure on ActewAGL Retail (the dominant incumbent) will be increased. Therefore, the purpose of the Stage 2 Draft Report was to provide possible options that may improve the effectiveness of competition. Stakeholders were invited to comment on these options.

The Stage 2 Final Report assesses the draft advice provided in the Stage 2 Draft Report in conjunction with stakeholder feedback and any further analysis. The Stage 2 Final Report provides the AEMC's final advice to the MCE and the ACT Government on approaches to promote competition in the ACT electricity retail market.

1.2 Structure of the Stage 2 Final Report

The remainder of the Stage 2 Final Report is structured as follows:

- **Chapter 2** summarises the analytical framework that has been utilised in forming options that will promote competition;
- **Chapter 3** assesses the draft advice and stakeholder submissions including any further analysis by the AEMC;
- **Chapter 4** summarises the AEMC's final advice on promoting effective competition in the electricity retail market in the ACT;
- **Appendix A** summarises the consultation process for the Stage 2 Final Report;

- **Appendix B** provides a summary of submissions on the Stage 2 Draft Report;
- **Appendix C** outlines the non-pricing options that were provided in the Stage 2 Draft Report;
- **Appendix D** provides the pricing options that were provided in the Stage 2 Draft Report;
- **Appendix E** summarises the evaluation of the combined pricing and non-pricing options that were provided in the Stage 2 Draft Report; and
- **Appendix F** outlines a cross-jurisdictional comparison of the cost allocation and ring-fencing guidelines with respect to marketing.

2 Framework for the review

This chapter explains the policy and analytical frameworks that underpin the development of the AEMC's recommendations for improving effective competition in the ACT retail electricity market. The chapter is structured as follows:

- a summary of the AEMC's findings from the Stage 1 Final Report on the effectiveness of competition in the ACT electricity retail market;
- a discussion on the benefits of competitive markets;
- an explanation of what effective competition means in the context of the ACT; and
- an outline of the key principles of good regulatory practice.

2.1 Findings on the effectiveness of competition

The AEMC's finding is that competition in the ACT electricity retail market for small customers is not effective. There are a number of inter-linking factors for this:

- the weak presence of second tier retailers in the market reduces the overall level of awareness of full retail contestability (FRC), which is likely to make customers 'sticky' and therefore more difficult to attract away from ActewAGL Retail;
- the lack of awareness of FRC and ActewAGL Distribution's provision of distribution services could also give customers the perception that the product offered by ActewAGL Retail is more valuable than the product offered by other retailers (that is, there is a perceived product differentiation). This perception would increase the level of stickiness;
- the relatively small size of the market (approximately 150 000 customers) means that there are fewer customers over which to spread the fixed costs incurred to enter the ACT market. Therefore there is a risk to retailers that they may not capture a sufficient mass of customers over which to spread their upfront fixed costs;
- the corporate structure of ActewAGL Retail and its economies of scale and scope are likely to provide it with cost advantages over a single fuel supply efficient new entrant; and
- the regulated price is based on the efficient costs of ActewAGL Retail rather than a new entrant retailer.

As a consequence, the actual margins available to second tier retailers may not be the same as those earned by ActewAGL Retail. Importantly, second tier retailers do not perceive the margins available to them to be a sufficient rate of return that is commensurate with the risks and uncertainties of operating in the market over the

long-term. This perceived imbalance between the risk and reward of operating in the ACT has resulted in few retailers entering into (or expanding within) the market. Consequently, there has been very little retailer rivalry observed and there are currently limited offers available to small electricity customers in the market. However, the AEMC notes some evidence of competitive pressures, that is, ActewAGL Retail responding to the threat of entry from second tier retailers, especially around 2006-07.

In reaching this conclusion, the AEMC analysed the electricity retail supply market in the ACT (the relevant market) with reference to the MCE criteria. A summary of the AEMC's findings, covering each of the MCE criteria, is set out in sections 2.1.1 to 2.1.3.¹

In its submission to the Stage 2 Draft Report, ActewAGL Retail stated that it did not agree with the conclusion reached by the AEMC. ActewAGL Retail believes that 'competition in the ACT is effective, as evidenced by [the] constant threat of competitor entry, the resultant ongoing product innovation and the continually high service standards and customer satisfaction achieved by ActewAGL Retail'.² ActewAGL Retail also raised concern that the AEMC's conclusions have changed substantially without relevant supporting evidence and analysis being presented.

The conclusion has not changed between the Stage 1 Draft and Final reports. The overall conclusion that competition in the ACT electricity retail market is not effective remains the same; however, the relative importance of the factors contributing to this conclusion have been modified to more accurately reflect the complexities of the ACT market.

It is necessary for the AEMC to set a threshold of competition to be effective. In defining such a threshold for effective competition, the AEMC has had regard to a number of objective standard measures of competition in addition to the unique characteristics of the ACT market. That is, for competition to be effective, product innovation, customer satisfaction, evidence of customer switching and the threat of entry into the market by competitive second tier retailers must be evident for both incumbent and second tier retailers. As evidenced in the Stage 1 Draft and Final Reports the AEMC does not consider that this threshold has been met in the ACT electricity retail market.

Furthermore, in assessing the relative importance of the factors contributing to the lack of competition in the ACT market, we note that the issue of customer stickiness has a high degree of circularity. That is, as customer stickiness increases, retailer involvement decreases, which in turn makes customers more sticky as they are unaware of alternative retailers operating in the market, or opportunities to switch.

In addition, the transitional franchise tariff (TFT) in itself is not a barrier to entry, but the cost differences between the incumbent and second tier retailers is a basis for low

¹ For further information see: AEMC, *Review of the effectiveness of competition in the electricity retail market of the ACT - Stage 1 Final Report*, 24 November 2010.

² ActewAGL Retail submission, 23 December 2010, p. 1.

levels of competition in the ACT. Therefore, it is important to reduce the 'cost' of competing in the ACT, which the AEMC considers its recommendations will assist in.

With respect to ActewAGL Retail's comments on economies of scope and scale, the AEMC based its revised conclusion in the Stage 1 Final Report on the structure of ActewAGL Retail and its related businesses. ActewAGL is unique within the NEM and cannot be directly compared with retailers in other jurisdictions. The scope of the products the ActewAGL Retail provides, such as billing, cash collection and credit management, is a mix of both contestable and non-contestable services, including, electricity, telecommunications, natural gas, water and sewerage.³ Therefore, the AEMC concluded that the scope of services provided by ActewAGL Retail was greater than just electricity and gas, as is typical of retailers in other jurisdictions. Furthermore, given that the customer base of each of these services and the dominant position of ActewAGL Retail in the ACT market, the economies of scale place ActewAGL Retail in a similar position to other retailers competing across multiple jurisdictions. However, the AEMC does not consider that economies of scope are a sufficient barrier to prevent competition from developing if the recommended package of measures are implemented.

2.1.1 Market structure

The market structure in the ACT is not consistent with what would be expected in a market with effective competition, although certain demand-side characteristics of the market in themselves appear to be attractive to retailers. This finding is based on the following observations:

- although the ACT market is small, a number of 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 incomes⁴, appear to make the market attractive to retailers;
- while there are 19 retailers licensed in the ACT, only four licensees have small customers, of which only two retailers are accepting new customers. Therefore, the ACT market is dominated by the incumbent retailer, which has maintained a total share of the market greater than 90 per cent since FRC was introduced;
- since FRC commenced, retailer rivalry has been limited and has weakened more recently. However, ActewAGL Retail's 'win-back' campaign in response to the increased level of retailer rivalry in 2006-07 suggests that it responds well to competitive pressures; and
- the unique characteristics of the market may make it difficult for second tier retailers to profitably enter into and expand within the market.

³ ActewAGL electricity network cost allocation method - ActewAGL submission to the Australian Energy Regulator, February 2008, p. 10.

⁴ It is important to note that there is also a significant number of low income households in the ACT.

2.1.2 Market conduct

The conduct of retailer 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:

- there is little retailer rivalry, as evidenced by limited marketing, product offerings and price rivalry. The incumbent retailer is the only retailer marketing in traditional media, in addition to maintaining a significant amount of promotional activity;
- 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);
- there is a lack of awareness and understanding by customers of FRC; and
- customer switching from the incumbent to second tier retailers has decreased markedly since 2007 and remains low today.

2.1.3 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:

- the actual margins available to second tier retailers may not be the same as those earned by ActewAGL Retail because of the unique characteristics of the market. Importantly, it appears that second tier retailers do not perceive the margins available to them to be sufficient to recover their costs and earn a rate of return that is commensurate with the risks and uncertainties of operating in the market over the long-term;
- the limited amount of retailer activity has resulted in a relatively low level of product innovation and offerings in the ACT retail electricity market, therefore, there is limited choice for customers; and
- customers appear to be satisfied overall by the quality of service in the ACT. This suggests that despite ActewAGL Retail's dominance, competitive pressure (that is, the threat of entry or expansion) has encouraged it to maintain a high quality of service. Additionally, 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 consumers have problems with their retailer. This is consistent with the low number of

complaints that the ACT Civil and Administrative Tribunal (ACAT) has received from non-hardship consumers.

2.1.4 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.

2.2 Regulatory obligations

Having found that competition in the ACT electricity retail market is not effective, there are a number of regulatory obligations that the AEMC is required to have regard to when formulating its advice to the ACT Government. The assessment framework consists of two complementary elements outlined in the AEMA and the Revised Statement of Approach (RSoA). In brief, the Australian Energy Market Agreement (AEMA) provides the context for the AEMC to structure its advice to the ACT Government on retail price controls to promote competition in the market going forward. The RSoA outlines the concepts and framework for the Retail Reviews and the regulatory obligations the AEMC must have regard to, for example, the national electricity objective. In formulating its advice, the AEMC has also had regard to the South Australian and Victorian Retail Reviews.

Under clause 14.12 of the AEMA, where competition is not yet effective for a market, group of users, or a region, the AEMC must publicly report on:

- retail energy price controls (including those furthering social welfare and regional equity objectives) that can be imposed by the relevant State or Territory but which should, to the extent possible, not hinder further development of competition and ensure that the benefits outweigh the costs, and costs are minimised; and
- retail energy price controls that could be retained under the existing arrangements or be transferred to the AER and the AEMC at the discretion of each jurisdiction (such a transfer would not include the funding of community service obligations).

In assessing each of the non-pricing and pricing options outlined in chapters three, four and five of this report; the AEMC has, to the extent possible, considered the relevant costs and benefits. Furthermore, as required under Parts two and three of the RSoA, the AEMC has undertaken this assessment with a view to furthering the national electricity objective. Specifically, whether the options considered are consistent with the long term interests of consumers.

2.3 Benefits of competitive markets

Where competition is effective in promoting economic efficiency, there is generally no need for price regulation. Regulated prices will almost always be an imperfect substitute for prices determined by the competitive processes of a market and are likely to impose costs and distortions that would not otherwise be present. Specifically, as regulators have imperfect information, regulated prices will generally either be set too low, deterring investment and innovation, or too high, to the detriment of consumers. That is, it is a regulator that faces the risk of pricing decisions that would otherwise be taken by a business. Regulated pricing arrangements also lack the flexibility and timeliness of market prices. The distortions price regulation causes and the administrative and compliance costs it imposes are likely to be higher, and the benefits lower, where price regulation is imposed on a competitive market compared to a situation where the market is not competitive.

Consumer representatives have raised concerns regarding issues that go beyond the operation and performance of the competitive market, such as the affordability of energy for low income households. Such representatives often assert that retail price regulation can be used to ensure that affordability of energy supply is maintained.

The AEMC acknowledges that affordability issues are an important matter to consider when reviewing the operation of a market. However, these issues are better addressed through appropriately targeted policies rather than by intervening to distort the efficient operation of the market. If wholesale energy costs rise in the future (due to, for example, the introduction of an emissions trading regime, investment shortfalls or scarcity of energy sector inputs), price regulation is not the answer and indeed could exacerbate the underlying causes of increased prices. Price regulation affects all market participants, not just those consumers experiencing hardship. A competitive market ensures that energy prices reflect the real costs of energy supply and sends appropriate price signals to firms regarding investment decisions and to consumers regarding their energy use, resulting in lowest overall cost of supply in the long-term.

Consequently, it is preferable to establish a market that operates free of regulatory intervention (to the greatest extent possible) and then implement specific, targeted policies to assist those consumers that would benefit from financial and non-financial assistance to address affordability concerns. This is not a simple matter; however, it is an appropriate objective and relevant to the ACT Retail Review.

2.4 Effective competition in the ACT

As noted by Origin Energy, the ACT electricity market is unique within Australia. It is the only market that consists of a single vertically integrated incumbent holding a dominant market share.⁵

⁵ Origin Energy submission, 27 August 2010, p. 3.

Also given the relatively small size of the ACT electricity market, a market structure resembling perfect competition – where there are multiple suppliers offering numerous products to consumers – may seem unlikely to occur. However, this is not to say that the market does not have the potential to become more competitive and provide better outcomes for consumers over time.

A dominant service provider that is placed under competitive pressure from a number of second tier retailers looking to enter the market (that is, the market is contestable) will need to reduce prices towards (marginal) costs, and to improve service levels, in order to attract customers and gain market share. Where it does not, it provides opportunities for competing or new entrant retailers to undercut its prices (and/or offer higher levels of service), and therefore take market share. In the longer term, competition also provides incentives to innovate to reduce costs, in order to reduce prices further (or increase profits).

If there is a credible threat of entry in the ACT market, the dominant incumbent will need to price its products at a competitive level in order to maintain (or gain) market share. The competitive pressure on the dominant incumbent will be enhanced if consumers are also actively participating in the market and are willing to seek out alternative products rather than continue with the 'standard products'. However, evidence of active switching between retailers it is not essential for a market to be considered competitive.

2.5 Principles of good regulatory practice

Given the AEMC's finding that competition in the ACT electricity retail market is not effective, the task of the AEMC is to provide advice to the MCE and the ACT Government on 'ways to promote the growth of effective competition' in accordance with clause 14.11(c) of the AEMA. In considering options to promote effective competition, the AEMC is guided by the principles of good regulatory practice.

The Council of Australian Governments (COAG) has developed a guide to best practice regulation for Ministerial Councils and intergovernmental standard-setting bodies. This includes bodies established by statute, or administratively by government, to deal with national regulatory problems. Each government agreed to ensure that regulatory processes in its jurisdiction will be consistent with the following principles:⁶

1. establishing a case for action before addressing a problem;
2. a range of feasible policy options must be considered, including self-regulatory, co-regulatory and non-regulatory approaches, and their benefits and costs assessed;
3. adopting the option that generates the greatest net benefit for the community;

⁶ COAG, *Best practice regulation - a guide for ministerial councils and national standard setting bodies*, October 2007, p. 4.

4. in accordance with the Competition Principles Agreement,⁷ legislation should not restrict competition unless it can be demonstrated that:
 - (a) the benefits of the restrictions to the community as a whole outweigh the costs; and
 - (b) the objectives of the regulation can only be achieved by restricting competition;
5. providing effective guidance to relevant regulators and regulated parties in order to ensure that the policy intent and expected compliance requirements of the regulation are clear;
6. ensuring that regulation remains relevant and effective over time;
7. consulting effectively with affected key stakeholders at all stages of the regulatory cycle; and
8. government action should be effective and proportional to the issue being addressed.

The COAG Guide discussed the above principles and some of the factors that government bodies should consider in applying these principles to the regulation making process when assessing potential responses to policy problems.⁸

The AEMC has had regard to the COAG principles of best practice regulation in providing its advice in this Stage 2 Final Report for the ACT Retail Review. In considering the options available that may promote the development of effective competition in the ACT, including consumer protection provisions and any regulatory or legislative changes, the AEMC has considered the objectives of each regulatory instrument, the options available for achieving that objective and the costs and benefits of those options.

⁷ COAG agreed to the principles of competition policy in February 1994 and agreed to achieve and maintain consistent and complementary competition laws and policies to apply to all businesses in Australia.

⁸ COAG, *Best practice regulation - a guide for ministerial councils and national standard setting bodies*, October 2007, pp. 4-6.

3 Advice on measures to improve competition

3.1 Final advice

In conducting the analysis for the Stage 2 Draft Report, the AEMC considered a number of non-pricing and pricing options.⁹ In order to promote competition in the ACT, it was determined that a combination of both non-pricing and pricing options should be used.¹⁰ The first component of that advice focused primarily on the reduction of customer stickiness through a consumer education and marketing campaign. Following an observable increase in customer awareness the second component entailed the removal of regulated retail prices for small customers.

Following analysis of stakeholder submissions to the Stage 2 Draft Report, the AEMC has essentially maintained its draft advice. That is, the best way to promote competition in the ACT electricity retail market is a package of reforms to reduce the barriers to competition and culminating in the removal of TFT.

The AEMC still considers that the lack of customer awareness is a significant factor preventing competition from developing further in the ACT. Therefore, the final advice to the ACT Government consists of measures to foster customer awareness and reduce the 'stickiness' of customers and promote an environment where second tier retailers are able to enter into, and expand within, the ACT market, including:

- the removal of the TFT and implementation of a price monitoring regime;
- establishing this monitoring program for a period of three years, with a review at the conclusion of the initial period to assess whether the program should continue for a second period;
- a consumer education program for small electricity users that provides information on the electricity market;
- setting up a marketing campaign to inform customers of contractual details and obligations and the set up of a website containing baseline information relating to the ACT market;
- continuing to monitor the effectiveness of the customer protection and switching arrangements; and
- implementing nationally consistent frameworks, such as the NECF, as soon as practicable, to improve the harmonisation of regulatory requirements between the ACT and other jurisdictions.

In relation to the draft advice on the possible merit in reviewing the guidelines for cost allocation relevant to ActewAGL, the AEMC notes that in 2014 the AER will evaluate

⁹ See Appendix C for the non-pricing options and see Appendix D for the pricing options analysed.

¹⁰ See Appendix E for an analysis of the combined options.

this as part of its distribution pricing determination. The AEMC considers that this would be the most opportune time for an assessment of this issue.

3.2 Removal of regulated retail prices for small customers

3.2.1 Recommendation

That the ACT Government remove the TFT for small customers from 1 July 2012.

This would be achieved by the Attorney General not issuing the ICRC with a terms of reference to undertake a regulated retail pricing determination.

3.2.2 Rationale for recommendation

While the AEMC has determined that competition in the ACT electricity retail market is not effective at this time, evidence suggests that the threat of entry by second tier retailers places competitive pressure on ActewAGL Retail. Especially, during the period 2006-07 evidence outlined in the Stage 1 Final Report suggests that competition was much more vigorous. Therefore, with the aim of promoting competition going forward and through the removal of any barriers to the entry and operation of second tier retailers, the AEMC has recommended the removal of TFT for small customers in the ACT.

With the removal of price regulation and its replacement with a public monitoring regime (outlined in section 3.3 below), prices would be determined by the market and information on those prices would be publicly reviewed by the relevant regulator. It is expected that ActewAGL Retail would remain, certainly in the short term, the most significant retailer in the market. This recommendation has the benefits of removing the regulatory risk associated with pricing determinations, increasing competitive pressure on ActewAGL Retail and improving the availability of information for both government decision making and consumers through the monitoring program.

In submissions to the Stage 2 Draft Report, the ESAA considered that 'removing price regulation directly targets the source of the barrier to competition in the ACT and hence will be more effective in promoting competition than the other pricing options that sought to preserve the regulated price framework'.¹¹ ActewAGL Retail, the ERAA and Origin Energy all supported the AEMC's recommendation to remove regulated retail prices.

The AEMC considers that this recommendation would be further enhanced if the consumer awareness program is effectively implemented prior to the removal of regulated retail prices and conducted on an ongoing basis thereafter. It is crucial that the ACT Government is committed to the customer awareness program for it to be executed effectively.

¹¹ ESAA submission, 24 December 2010, p. 3.

In addition, the threat of the ACT Government re-introducing direct price regulation if it considers this appropriate may also act as a deterrent to retailer misconduct. However, the AEMC considers that competition should be given an opportunity to develop, as new entrants may take time to establish a position in the market. The combination of these actions should provide an environment that is conducive to competition further developing in the ACT.

For example, the threat of entry from second tier retailers should encourage ActewAGL Retail in particular, to provide products that consumers desire at prices they are willing to pay. For example, to price at a level higher than this will provide an opportunity to a second tier retailer to enter the market and take customers away from ActewAGL Retail.

There is a risk that prices could increase as a result of the removal of the TFT. Therefore, the AEMC considers it very important that the removal of price regulation is undertaken concurrently with its other recommendations to reduce the other barriers to increased competition, for example customer stickiness.¹²

3.3 Monitoring program

3.3.1 Recommendation

The objective of the price monitoring program, which could be undertaken by the ICRC or the AER, would be to identify and publish trends in standing offer and market prices over the previous 12 month period. It would also contain other relevant information, such as switching rates of consumers and available products. The report should inform market participants and the ACT Government on the structure, conduct and performance of the market.

The AEMC envisages that an annual report would be published. This would use information and data provided by ActewAGL Retail and other active retailers in the market, as well as any relevant publicly available information and data.¹³ The annual report could include:

- customer market shares of each active retailer;
- historical customer switching rates;
- indices for some of the key cost inputs (for example, wholesale electricity costs);
- historical average standing offer charges for each retailer by customer type (that is, residential and small business);
- historical average market offers for each retailer by customer type;

¹² The recommendations to reduce customer stickiness are outlined in sections 3.4 and 3.5 below.

¹³ This monitoring program is similar to that adopted by Victoria following its removal of retail price regulation. For further information, see <http://www.esc.vic.gov.au/>

- bench marking prices in the ACT against other jurisdictions;
- analysis of the location and consumption of those customers on market offers;
- marketing behaviour of active retailers;
- analysis of Energy Concessions for disadvantaged customers; and
- historical customer complaints (possibly provided by ACAT).

3.3.2 Rationale for recommendation

In providing both customers and the government with comfort during the initial transition to market based pricing, the ESAA considered it 'imperative that the price monitoring arrangements are designed carefully to be transparent and provide regulatory certainty for industry'.¹⁴

However, ActewAGL Retail considered 'price monitoring [to be] a second-best alternative to deregulation, and is not required in the ACT'.¹⁵ Notwithstanding this point, it considered that price monitoring 'must provide certainty and transparency to retailers, particularly in relation to the nature and extent of regulator involvement, and the triggers that may prompt the ACT Government to re-introduce price regulation'.¹⁶

The AEMC considers that the primary purpose of requiring price monitoring and reporting is to provide greater transparency and information to consumers, retailers and policy decision makers. The benefit of this approach relative to the option of removing price regulation without monitoring and reporting on prices, is that stakeholders will remain informed about the structure, conduct and performance of the ACT electricity retail market and therefore be able to make better informed decisions.

Importantly, greater information and transparency should lead to improved policy decision making (for example, the need for changes in the Energy Concession overtime). Additionally, if in the future the ACT Government determined that price regulation was once again necessary, this information would be relevant to making this decision. Finally, this information is also helpful to regulators in other jurisdictions for bench marking purposes.

In response to the submission from ActewAGL Retail, the AEMC also considers that the price monitoring reports would also provide a timely indication of any market failure. If concerns arise, this could trigger a further inquiry by the AEMC into the effectiveness of electricity retail competition in the ACT. If the AEMC did conduct another review, it would be undertaken in accordance with the AEMA and provide the

¹⁴ ESAA submission, 24 December 2010, p. 3)

¹⁵ ActewAGL Retail submission, 23 December 2010, p. 3.

¹⁶ *ibid.*

basis for policy decisions on appropriate responses to any demonstrated market failure. This could include recommending direct price regulation.¹⁷

3.4 Consumer awareness campaign

3.4.1 Recommendation

The AEMC recommends that the ACT Government undertake a campaign to educate electricity consumers in the ACT and increase the level of awareness of their ability to switch retailers.

A consumer awareness and education campaign would contain the following information for residential and small business customers:

- their rights under the consumer protection framework;
- information relating to the electricity supply chain and the roles of retail, distribution and transmission companies in the market (also informing that changing retailer does not jeopardise supply service);
- the options and procedures available for seeking redress or complaining about marketing or selling misconduct;
- information about the competitive market including the nature of market contracts, the cooling off period and how to choose the best product to suit an individual's situation; and
- changes that may occur in relation to the calculation of the regulated price (standing offers and market contract offers).

To measure the success of the campaign the AEMC recommends that the ACT Government undertake a survey at a later date to gauge the change in awareness.¹⁸

3.4.2 Rationale for recommendation

This recommendation is intended to reduce the level of customer stickiness in the ACT electricity retail market. Evidence in the Stage 1 Final Report showed that only 60 per cent of customers in the ACT market were aware of full retail contestability and their ability to choose a retailer. In addition, there was a perception in the market that switching away from ActewAGL Retail would impact on a customer's electricity supply. That is, a perception that electricity supplied by ActewAGL Retail has an inherently higher value than that supplied by other retailers. Therefore, the apparent

¹⁷ AEMA, clauses 14.14(b) and 14.14 (c).

¹⁸ The results of the consumer survey detailed in this report could be utilised as a reference benchmark.

limited awareness of consumers about the ACT electricity market and their ability to choose a retailer is impacting on the behaviour of consumers and, consequently, on the performance of the market.

It may also be making it more difficult for second tier retailers to attract customers away from ActewAGL Retail. Hence a second tier retailer may need to spend more money and resources compared to the incumbent to attract customers. Therefore, in order for consumers to gain equitable access to the competitive market, they need to be able to obtain product information on an ongoing basis that is readily available and easy to understand. This suggests that there is a need for an appropriately targeted and timely consumer awareness and education campaign to inform customers of rival electricity suppliers in the ACT, the roles of companies in the supply chain and the nature of market contracts within the competitive market.

The ESAA considered that the 'design and implementation of measures to inform consumers of their ability to participate in the market must take care to avoid providing a competitive edge or disadvantage to businesses by inadvertently favouring new entrant retailers over incumbents or vice versa'.¹⁹ Similarly, ActewAGL Retail considered that the program should focus on 'making customers aware of their rights, while being neutral among competing retailers'.²⁰

The AEMC agrees with the comments made by the ESAA and ActewAGL Retail. The primary aim of the customer awareness program should be to inform consumers about the availability of choice of electricity supplier, the corresponding rights and obligations of consumers in signing contracts for the supply of electricity, and the implications of switching retailer.

However, ActewAGL Retail noted concern that 'the AEMC has presented no evidence or analysis which explains why and how customer awareness levels of only 60 per cent are significantly detrimental to competition'.²¹

The AEMC notes that for the majority of customers within the ACT market, ActewAGL Retail is the *de facto* electricity supplier. Therefore, the AEMC considers that for competition to be effective, an important precondition is that customers are aware of their right to choose an alternative supplier and thereby have the ability to choose the best deal, product and/or service to meet their individual needs. That is, measuring the awareness of competition can assist in identifying any gaps or missing information in a customers' understanding of the choices available to them. Similarly, the United Kingdom energy regulator Ofgem notes:²²

“that the extent to which customers are aware and the extent to which they exercise those choices could have far reaching implications for the structure of the market and the conduct of suppliers. For instance, a decrease in

19 Energy Supply Association of Australia submission, 24 December 2010, p. 3.

20 ActewAGL Retail submission, 23 December 2010, p. 5.

21 *ibid.*

22 Ofgem, April 2004, Domestic competitive market review 2004 - a review document, p. 18.

customer awareness could act to lower switching rates, which could in turn deter future growth and entry by suppliers into the market.”

To place this in the context of the ACT electricity retail market, in the Stage 1 Draft and Final reports, the AEMC reported that in the ACT customer awareness of FRC is 60 per cent and of those aware of FRC only 50 per cent of customers are able to name an alternative supplier to ActewAGL Retail.²³ The AEMC considers that this result is likely to be significantly detrimental to competition in the ACT electricity retail market and could be a reason for the limited number of second tier retailers operating in the market. Therefore, a consumer awareness program would be a good first step to increasing customer awareness in the ACT.

The AEMC also considers that the consumer education program should not be not a 'one-off' program, but is undertaken on an ongoing basis to maintain a high level of awareness. It is also very important that there is a high degree of input and presence by the ACT Government, as the success of this education program will be dependent on the resources employed and the design of the campaign.

In summary, the AEMC considers that the consumer education campaign is an important element in promoting customer awareness and should focus on informing customers about how they can get the best outcome from a competitive market. The AEMC considers that the ACT Government is best placed to decide the best method and content of an effective education campaign. A program similar to that run by the ICRC at the commencement of FRC focusing on how customers gain the best out of a competitive market would seem an appropriate starting point.²⁴

3.5 Marketing campaign

3.5.1 Recommendation

The AEMC recommends that the ACT Government undertakes a marketing campaign and creates a website.

The marketing campaign should be undertaken in parallel with the customer education program and could include the following elements:

- list of licensed retailers;
- range of offers available;
- terms and conditions of contracts;

²³ That is, the ACT market consists of 150 000 households, which implies that 60 000 households are unaware of FRC. Of the remaining 90 000 households, 45 000 households are only aware of ActewAGL Retail as a supplier of electricity. In total, 105 000 households, or 70 per cent of the ACT electricity retail market are aware of only one electricity supplier - ActewAGL Retail.

²⁴ Details of the campaign previously undertaken by the ACT Government can be found at, Australian Capital Territory, November 2002, *Utilities Act (Electricity full retail competition public awareness campaign) Ministerial Direction 2002 (No. 1)*.

- meaning of the terms and conditions in simple language;
- contract details; and
- what to do when changing suppliers.

The main purpose of the website is to provide baseline information to consumers relating to the ACT market. It is probably appropriate that the website also contains the information in the consumer awareness and education program outlined in section 3.4. It would also provide links to private comparator websites, retailers active in the ACT and information relating to the options and procedures available for seeking redress or complaining about marketing or selling misconduct.

The AEMC recommends that the ACT Government initially rely on private websites to provide comparative information on products and tariffs available in the ACT. This is primarily due to the low number of retailers currently offering products in the ACT electricity retail market. As the number of retailers and product offers increases, the ACT Government should ensure that consumers can assess comparable information on market offers. This may be achieved either through its own website, or an accredited private website.²⁵ The AEMC considers this would be the best balance between costs and benefits.

3.5.2 Rationale for recommendation

With respect to the introduction of a pricing comparator and consumer education program, TRUenergy considered that 'it is difficult to see how these will be effective in the ACT when there is such a limited number of retailers competing in the market in the first place'.²⁶ However, TRUenergy noted its support for these strategies as necessary steps in the removal of retail price regulation.

The AEMC agrees with TRUenergy and notes that for the subsequent marketing campaign to be effective, consumers require an element of choice. That is, the supply-side of the market must be improved in parallel to provide customer with a greater number of supply options. As the number of retailers operating in the ACT increases, more consumers will consider switching either electricity retailers or services to better suit their needs. In turn, this may encourage retailers to offer a greater range of products to address consumer interest in alternatives to the standard supply services.

The AEMC notes that currently there are not many retailers actively participating in the ACT market, therefore, the creation of a comparator website at this time could be a costly exercise with low benefits for consumers. However, going forward, as the number of retailers operating in the ACT and the number of products offered increases, there may be merit in the ACT Government creating its own independent website of

²⁵ The Essential Services Commission's of Victoria (ESC) and South Australia (ESCOSA) both provide standing offer information on their respective websites.

²⁶ TRUenergy submission, 22 December 2010, p. 2.

standing offers. The information on the website would also be of assistance for the reporting on the monitoring program.

Stickiness is a function of the transaction cost to switch electricity suppliers and it is therefore important to consider ways in which this cost may be reduced. Therefore, this campaign should investigate innovative alternative ways of enabling consumers to switch retailers.

In summary the AEMC encourages the ACT Government to undertake a marketing campaign and create a website; however, to balance the costs of implementation and updating the information versus the benefits of the additional information on market offers, the AEMC leaves the timing of these initiatives up to the ACT Government. Nevertheless, it is advisable that the marketing campaign is implemented prior to the removal of retail price caps, because it will inform consumers of contractual obligations and conditions, thereby facilitating efficient decision making.

3.6 Frameworks governing the customer protection and switching process

3.6.1 Recommendation

That the ACT Government continue to monitor the effectiveness of the customer protection and switching arrangements following the removal of price regulation.

3.6.2 Rationale for recommendation

During the course of the AEMC review, no stakeholders have raised concerns regarding the effectiveness of the customer protection and switching arrangements. In the absence of stakeholder concerns, the AEMC has not undertaken an independent analysis of these arrangements.²⁷

The monitoring of the effectiveness of these regimes following the removal of price regulation would be prudent to ensure increases in switching, for example, do not impact on the effectiveness of the arrangements.

3.7 Implementing nationally consistent frameworks

3.7.1 Recommendation

The AEMC recommends that the ACT Government implements the National Energy Customer Framework (NECF) as soon as practicable.

²⁷ The AEMC assessed the social welfare and equity objectives as part of Stage 1 to make sure that they are met through clearly specified and transparently funded territorial community service obligations. See Chapter 8 of the Stage 1 Final Report for further information.

When the government is designing and implementing jurisdictional specific legislation the implications for all market participants should be assessed to ensure that administrative costs are minimised.

3.7.2 Rationale for recommendation

Throughout the ACT Retail Review, it was noted that there are a number of ACT specific obligations on electricity retailers, for example the feed-in tariff. Different requirements between jurisdictions are not an ACT specific issue; however, whatever the degree of difference, retailers must accommodate the specific requirements if they are to participate in the market. This becomes an administrative cost (for example, developing IT systems) - largely upfront - to a retailer; however, the average cost will decline as its number of customers increases. That is, it is easier for the incumbent to bear the lower average costs per customer, compared with a new entrant. Therefore, when designing and implementing jurisdictional specific legislation it is important to consider the implications for all retailers operating in the market, such that the costs to each participant are minimised.

The aim of this recommendation is to facilitate the harmonisation of legislative requirements across jurisdictions or between the ACT and surrounding jurisdictions. There are a number of ways in which this could be achieved. The best solution is to have better harmonisation across jurisdictions, which could be facilitated through a nationally consistent legislative framework, for example, the NECF.

In its submission to the Stage 2 Draft Report, Origin Energy considered that the 'co-ordination with NECF implementation may assist in reducing regulatory costs for both regulators and retailers, with retailers also benefiting from more harmonised regulatory requirements'.²⁸

The NECF involves the harmonisation of State-based regulatory frameworks for the retail energy market and energy distribution sector into a single set of national rules (with the exclusion of retail price regulation and community service obligations). Specifically for retailers, the NECF is predominantly implemented through licence conditions. This will mean that retailers operating in the national electricity and natural gas markets will only require one licence (issued by the AER) and will be subject to a consistent set of rules across all jurisdictions. The AEMC recommends that the ACT Government implement the NECF in the ACT as soon as practicable.

3.8 Review of the cost allocation and ring-fencing guidelines

3.8.1 Recommendation

The AEMC is not recommending a review of the cost allocation and ring-fencing guidelines at this time. The AER will conduct a review of these guidelines as part of its distribution determination for ActewAGL Distribution for the next regulatory period

²⁸ Origin Energy submission, 23 December 2010, p. 3.

from 2014-19. The AEMC considers that this would be the appropriate time for any such review to be undertaken.

3.8.2 Rationale for recommendation

Throughout the ACT Retail Review process, stakeholders have raised ring-fencing as an issue that should be considered in the context of promoting competition in the ACT electricity retail market. One particular concern, was the allocation of money for marketing activities, which under the current ring fencing provisions may be undertaken jointly by the retail and distribution businesses.

In its Stage 2 Draft Report, the AEMC recommended that there was merit in reviewing the cost allocation guidelines relating to ActewAGL. The main reason for that recommendation was to ensure that the frameworks were adequately robust to support competition in the ACT market.

In its submission to the Stage 2 Draft Report, TRUenergy considered that the 'biggest impediment to competition in the ACT market is the Actew Corporation', in so far as, Actew/AGL has a significant advantage in being able to bundle electricity, gas, telephony and television products, which other second tier retailers do not have and cannot replicate.²⁹ TRUenergy questioned the 'requirement for regulated monopoly entities to spend money on the promotion of their brand, given their customers do not have a market choice about using their services'.³⁰ It considered that the 'marketing and branding of Actew/AGL represents the most significant issue affecting competition in the retail market in the ACT and that the simplest and most effective way of addressing this would be to substantially improve the ring fencing between Actew Corporation's individual entities'.³¹

Similarly, Origin Energy noted that of the options presented by the AEMC to stimulate retail competition and improve the ability of second tier retailers to enter the market, 'to separate the retail business from the Actew Group [is] the only effective means of ensuring separate business dealings with the Actew Group and would ultimately achieve a more competitive outcome'.³² However, Origin Energy acknowledges that 'this would be difficult to achieve in the short to medium term'.³³

Table F.1 in Appendix F provides a cross jurisdictional comparison of the cost allocation and ring-fencing guidelines as they relate to marketing. The AEMC notes that while the cost allocation and ring-fencing guidelines are unique to each company, in most cases there is no separation between the retail and distribution businesses. For example, in Queensland, the ring-fencing guidelines prohibit a marketing person from the distribution company to work in the retail business. Similarly, in Victoria if a

29 TRUenergy submission, 22 December 2010, p. 1.

30 *ibid.* p. 2.

31 *ibid.*

32 Origin Energy submission, 23 December 2010, p. 2.

33 *ibid.*

distribution and retail company share the same website, each page must clearly identify which company is being represented. Therefore, while each company has slightly different guidelines, essentially they all aim to maintain a separation between the distribution and retail businesses.

ActewAGL Retail queried 'how ActewAGL's corporate structure or behaviour in respect of cost allocation and internal transactions can be raised in the reports as factors impacting competition, when this line of argument is completely unwarranted and without foundation'.³⁴ ActewAGL Retail considered that the 'policy options regarding cost allocation and ring fencing ... must be withdrawn in the Stage 2 Final Report', as there is no evidence of problems that need to be addressed.³⁵

As the AEMC noted in the Stage 2 Draft Report, there is no evidence to suggest that ActewAGL Retail is undertaking activities that are contrary to its cost-allocation or ring-fencing guidelines. The AEMC also assessed a range of options including, rebranding the electricity business of ActewAGL Retail, or the complete removal of the ActewAGL Retail business unit from the Actew business group. However, these two options did not appear proportional responses given the materiality of the issue and were rejected in favour of a review of the ring-fencing guidelines. In principle, the AEMC does not consider that joint marketing between the retail and distribution businesses should be prevented as long as two conditions hold:

1. costs are appropriately allocated (on the basis of the value added to each business unit); and
2. it does not mislead consumers in relation to the roles of each business unit.

Therefore, a degree of transparency as to which part of the business is sponsoring each event may assist to distinguish between ActewAGL Retail and Distribution. The AEMC considers that the consumer education program will also help customers to distinguish between ActewAGL's retail and distribution businesses.

Currently, Chapter 11 of the National Electricity Rules provide transitional arrangements for the cost allocation and ring-fencing guidelines relevant to ActewAGL for the regulatory period 2009-2014. As such, the current cost allocation and ring-fencing guidelines have been approved by the AER. From 2014, ActewAGL will be required to follow the cost allocation methodology obligations under Chapter 6 of the Rules. At the time of the next distribution determination, the AER will review both the cost allocation and ring-fencing guidelines as part of its approval process. Therefore, the AEMC considers that this would be the most appropriate time for a review of this issue.

³⁴ ActewAGL Retail submission, 23 December 2010, p. 2.

³⁵ *ibid.*

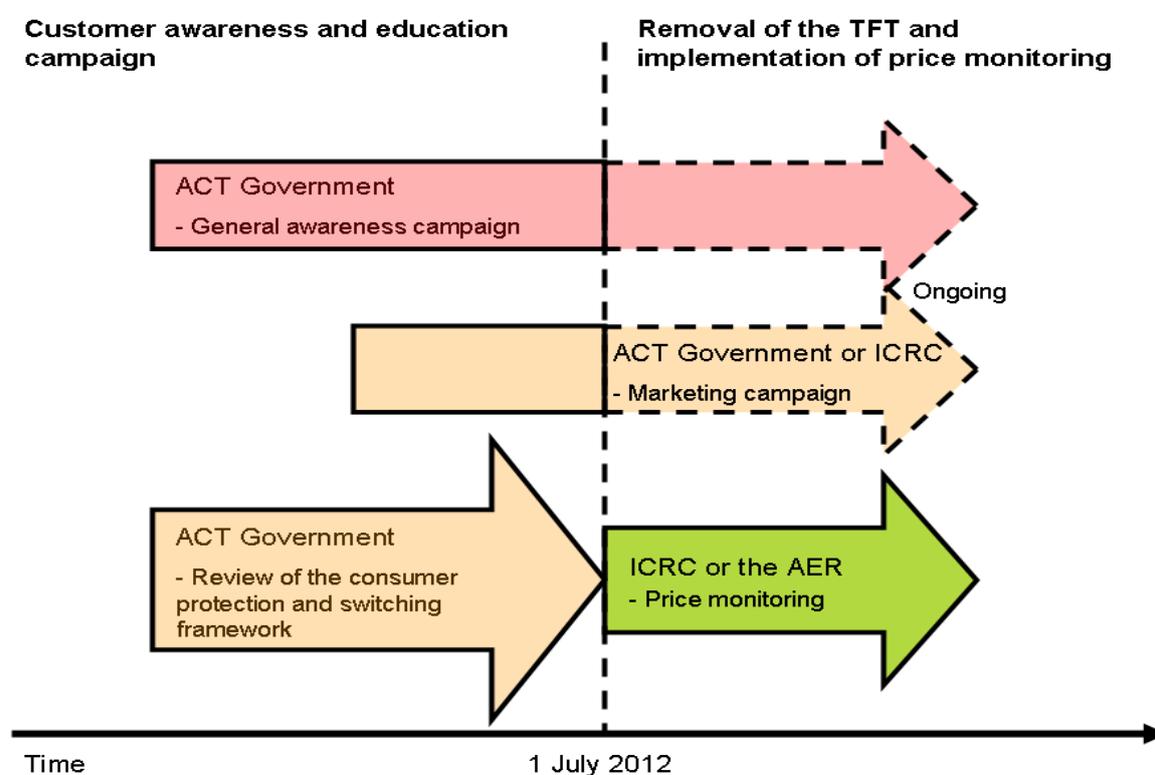
3.9 Implementation of the package of policy reforms

3.9.1 Recommendation

The AEMC recommends a series of reforms leading to the removal of regulated retail prices from 1 July 2012. In the lead up to the removal of price regulation, the AEMC recommends the instigation of the customer awareness and education campaign, review of the customer protection framework and the commencement of the marketing campaign.

A graphical representation of this staggered approach is outlined in Figure 3.1 below.

Figure 3.1 Graphical representation of the implementation process



3.9.2 Rationale for recommendation

The ICRC's latest pricing determination sets the regulated price through to 30 June 2012. Therefore, the ACT Government will have at least 12 months from the release of the AEMC's Stage 2 Final Report to consider and implement the advice contained in that report. The AEMC considers that this would provide sufficient time for the ACT Government to undertake a targeted customer awareness campaign prior to the removal of the TFT. It was recommended that the awareness campaign continues beyond the expiry of the current TFT. This would allow time to educate customers of FRC and their ability to switch retailers, while also providing second tier retailers an incentive and sufficient time to enter into the market. An ongoing source of easy to

access information for consumers is crucial to the effective implementation of this program.

However, the ESAA³⁶ and ActewAGL Retail³⁷ also considered it important that 'the implementation of the phase two measures are kept separate from the outcomes of phase one' and do not hinder or prevent the timely removal of price regulation.

To be effective, it is very important that the series of reforms leading up to the removal of retail price caps work together. The success of these recommendations is dependent on the resources employed and the ultimate design of the programs. The AEMC considers that the customer awareness and education program should be implemented first and the marketing campaign should start just before removal of the TFT. These programs should not be dependent on the actual entry of second tier retailers, because the threat of entry can be sufficient to maintain competitive pressure in the market.

The ESAA noted that the 'proposed time to lift the regulation - at the expiration of the current Transitional Franchise Tariff path on 30 June 2012 - is appropriate and strikes a balance between stability for industry and consumers and the imperative of reform'.³⁸ Similarly, ActewAGL Retail noted that 'setting a clear date for the removal of price regulation will provide consumers, retailers and the ACT Government with certainty, allowing for a smooth transition to a fully deregulated retail electricity market'.³⁹ Origin Energy also supported the '1 July 2012 target to remove price regulation'.⁴⁰

The AEMC agrees with stakeholders that 1 July 2012 would appear to be the most appropriate time to remove retail price caps and begin the price monitoring arrangements. This date is also the target commencement date of the NECF. The recommendation to undertake the monitoring program for a period of three years, provides an opportunity for the ACT Government to assess all aspects of the market.

3.10 Responsible body for monitoring

3.10.1 Recommendation

The AEMC recommends that the ICRC initially undertake the monitoring program. When the ACT Government implements the NECF, it can then decide whether this role is continued by the ICRC or transferred to the AER as part of its new functions under the National Electricity Retail Law.

The government may also consider extending its monitoring program to include natural gas. While there has been no retail price regulation for some time, the limited activity in that market (as indicated by the limited available data) suggests that

³⁶ ESAA submission, 24 December 2010, p. 3.

³⁷ ActewAGL Retail submission, 23 December 2010, p. 3.

³⁸ ESAA submission, 24 December 2010, p. 3.

³⁹ ActewAGL Retail submission, 23 December 2010, p. 3.

⁴⁰ Origin Energy submission, 23 December 2010, p. 3.

increasing available information could improve the level of competition and would be a limited additional cost.

3.10.2 Rationale for recommendation

Clause 14.12 of the AEMA states that the AEMC must publicly report on:

- retail energy price controls that could be retained under the existing arrangements or be transferred to the AER and the AEMC at the discretion of each jurisdiction.

For example, under the proposed framework for the NECF, the AER will assume responsibility for the enforcement of the proposed National Electricity Retail Law and the National Electricity Retail Rules. This is likely to include responsibility for the regulation of electricity and natural gas retail markets (with the exception of retail price regulation) for most jurisdictions within Australia. Therefore, the AEMC notes the growing role of the AER in the development of retail markets and the possible role it could have in monitoring prices in the future. However, it may still be appropriate for the ICRC to undertake this monitoring role, given their extensive expertise in the energy sector of the ACT.

Origin Energy noted that as the 'timing coincides with the current target commencement date for NECF implementation and to adhere to the principle of national consistency, the AER may be the appropriate body to take on the price monitoring role ... if the NECF [is] delayed there are no obstacles to the ICRC fulfilling this role'.⁴¹

The AEMC considers that the ICRC would be best placed to undertake the monitoring program initially. Following implementation of the NECF the ACT Government is best placed to consider whether the ICRC or the AER should undertake this role.

⁴¹ Origin Energy submission, 23 December 2010, pp. 3-4.

Abbreviations

ACAT	ACT Civil and Administrative Tribunal
ACCC	Australian Competition and Consumer Commission
ACT	Allen Consulting Group
ACT Retail Review	Review into the effectiveness of competition in electricity retail market in the Australian Capital Territory
ACTCOSS	ACT Council of Social Service
AEMA	Australian Energy Market Agreement
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
CAC	Customer Acquisition Cost
CARC	Customer Acquisition and Retention cost
Consumer Agencies	Care Inc, ACTCOSS, and Uniting Care Australia
CPI	Consumer Price Index
CSOs	Community Service Obligations
DECCEW	Department of the Environment, Climate Change, Energy, and Water
ESC	Essential Services Commission of Victoria
ERAA	Energy Retailers Association of Australia
ESAA	Energy Supply Association of Australia
ESCOSA	Essential Services Commission of South Australia
FRC	Full Retail Contestability
GGAS	Greenhouse Gas Abatement Scheme
ICRC	Independent Competition and Regulatory Commission

IPART	Independent Pricing and Regulatory Tribunal of NSW
LRMC	Long Run Marginal Costs
MCE	Ministerial Council on Energy
NEM	National Electricity Market
QCA	Queensland Competition Authority
ROC	Retail Operating Costs
RSoA	Revised Statement of Approach
TFT	Transitional Franchise Tariff
WEC	Wholesale Electricity Costs

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 Stage 1 Draft Report setting out its draft findings on this matter. Submissions will be invited and subsequently, a Stage 1 Final Report will be published.
- 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 Stage 2 Draft Report will be published for consultation. This will set out draft advice to the relevant jurisdictional Minister and the MCE. Following the consideration of submissions, the AEMC will publish a Stage 2 Final Report containing its final advice.

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. Submissions closed on 9 April 2010 and seven submissions were received from:

- ACT Civil and Administrative Tribunal (ACAT);
- ACT Minister for Energy;
- ActewAGL Retail;
- Energy Retailers Association of Australia (ERAA);
- Origin Energy;
- Public Interest Advocacy Centre (PIAC); and

- TRUenergy.

A summary of the submissions, outlining the main issues raised by stakeholders, is provided at Appendix D of the Stage 1 Draft Report. All submissions are available from the AEMC's website.

A.3 Public forum on the Stage 1 Draft Report

A public forum was held in Canberra, on 13 August 2010, to discuss the draft findings presented in the Stage 1 Draft Report. The purpose of the public forum was 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 Stage 1 Draft Report.

A summary of this forum was published on the AEMC's website.

A.4 Stage 1 Draft Report

On 30 July 2010, the AEMC published its Stage 1 Draft Report for the ACT Retail Review. The AEMC's draft finding was that competition in the ACT electricity retail market is not effective. Stakeholders were invited to provide submissions in response to the draft finding. Submissions closed on 27 August 2010 and eight submissions were received from the following organisations:

- ACT Council of Social Services (ACTCOSS);
- ActewAGL Retail;
- Care Inc., ACT Council of Social Service (ACTCOSS) and Uniting Care Australia (together referred to as the Consumer Agencies);
- Energy Retailers Association of Australia (ERAA);
- Energy Supply Association of Australia (ESAA);
- Independent Competition and Regulatory Commission (ICRC);
- Origin Energy; and
- TRUenergy.

A summary of the submissions, outlining the main issues raised by stakeholders, is provided at Appendix B of the Stage 1 Final Report. All submissions are available from the AEMC's website.

A.5 Stage 1 Final and Stage 2 Draft Reports

On 24 November 2010, the AEMC published its Stage 1 Final Report for the ACT Retail Review. The final report reiterated the AEMC's finding that competition in the ACT electricity retail market is not effective. The Stage 1 Final Report provided stakeholders and other interested parties with the AEMC's reasoning and analysis supporting its decision.

In accordance with the stage two objective outlined in section A.1 above, the AEMC also published its draft advice to the ACT Government on ways to promote competition in the ACT electricity retail market on 24 November 2010. Stakeholders were invited to provide submissions in response to this draft advice. The closing date for submissions was 24 December 2010 and five submissions were received from the following organisations:

- ActewAGL Retail;
- Energy Retailers Association of Australia (ERAA);
- Energy Supply Association of Australia (ESAA);
- Origin Energy; and
- TRUenergy.

A summary of the submissions, outlining the main issues raised by stakeholders with respect to the draft advice is provided at Appendix B of this Stage 2 Final Report. All submissions are available from the AEMC's website. The publication of this Stage 2 Final Report formally completes the two stage process for the assessment of competition in the electricity retail market of the ACT.

B Summary of submissions to the Stage 2 Draft Report

B.1 Submissions received

ActewAGL Retail, 23 December 2010

Energy Retailers Association of Australia (ERAA), 24 December 2010

Energy Supply Association of Australia (ESAA), 24 December 2010

Origin Energy, 23 December 2010

TRUenergy, 22 December 2010

B.2 Summary of stakeholder responses

The table below provides a summary of the submissions to the Stage 2 Draft Report. Further discussion is contained in Chapters 3 as relevant.

Chapter heading	Sub-topic level 1	Sub-topic level 2	Issue raised in submission
Phase 1 recommendations	Instigation of a consumer education program		<p>The ESAA (p. 3) considered that the 'design and implementation of measures to inform consumers of their ability to participate in the market must take care to avoid providing a competitive edge or disadvantage to businesses by inadvertently favouring new entrant retailers over incumbents or vice versa'. Similarly, ActewAGL Retail (p. 5) considered that the program should focus on 'making customers aware of their rights, while being neutral among competing retailers'.</p> <p>However, ActewAGL Retail (p. 5) noted concern that 'the AEMC has presented</p>

Chapter heading	Sub-topic level 1	Sub-topic level 2	Issue raised in submission
			no evidence or analysis which explains why and how customer awareness levels of only 60 per cent are significantly detrimental to competition'.
		Timing of implementation	<p>The ESAA (p. 3) noted that the 'proposed time to lift the regulation - at the expiration of the current Transitional Franchise Tariff path on 30 June 2012 - is appropriate and strikes a balance between stability for industry and consumers and the imperative of reform'. Similarly, ActewAGL Retail noted that 'setting a clear date for the removal of price regulation will provide consumers, retailers and the ACT Government with certainty, allowing for a smooth transition to a fully deregulated retail electricity market'.</p> <p>The ESAA (p. 3) and ActewAGL Retail (p. 3) also considered it important that 'the implementation of the phase two measures are kept separate from the outcomes of phase one' and do not hinder or prevent the timely removal of price regulation. Similarly Origin Energy (p. 3) supported the '1 July 2012 target to remove price regulation'.</p>
	Instigation of a marketing campaign for internet and telephone campaign		With respect to the introduction of a pricing comparator and consumer education program, TRUenergy (p. 2) considered that 'it is difficult to see how these will be effective in the ACT when there is such a limited number of retailers competing in the market in the first place'. However, TRUenergy noted its support for these strategies as necessary steps in the removal of retail price regulation.
	Review of the customer protection and switching process frameworks		No submissions received in relation to this point.
	Implementation of nationally consistent frameworks		Origin Energy (p. 3) considered that the 'co-ordination with NECF implementation may assist in reducing regulatory costs for both regulators and retailers with retailers also benefiting from more harmonised regulatory requirements'.
	Review of the guidelines for cost allocation		TRUenergy (p. 1) considered that the 'biggest impediment to competition in the ACT market is the Actew Corporation'. TRUenergy also noted that Actew/AGL has a significant advantage in being able to bundle electricity, gas, telephony and

Chapter heading	Sub-topic level 1	Sub-topic level 2	Issue raised in submission
			<p>television products, which other second tier retailers do not have and cannot replicate. To this end, TRUenergy (p. 2) questioned the 'requirement for regulated monopoly entities to spend money on the promotion for their brand, given their customers do not have a market choice about using their services'. That is, the 'marketing and branding of Actew/AGL represents the most significant issue affecting competition in the retail market in the ACT and that the simplest and most effective way of addressing this would be to substantially improve the ring fencing between Actew Corporation's individual entities'.</p> <p>On the other hand, ActewAGL Retail (p. 2) queried 'how ActewAGL's corporate structure or behaviour in respect of cost allocation and internal transactions can be raised in the reports as factors impacting competition, when this line of argument is completely unwarranted and without foundation'. ActewAGL considered that the 'policy options regarding cost allocation and ring fencing ... must be withdrawn in the Stage 2 Final Report', as there is no evidence of problems that need to be addressed.</p>
Phase 2 recommendations	Removal of regulated retail prices		<p>The ESAA (p. 3) considered that 'removing price regulation directly targets the source of the barrier to competition in the ACT and hence will be more effective in promoting competition than the other pricing options that sought to preserve the regulated price framework'. Similarly, ActewAGL Retail (p. 3), the ERAA (p. 1) and Origin Energy (p. 1) supported the AEMC's draft advice to remove regulated retail prices in the ACT.</p>
	Establishment of a price monitoring regime		<p>In providing both customers and the government with comfort during the initial transition to market based pricing the ESAA (p. 3) considered it 'imperative that price monitoring arrangements are designed carefully to be transparent and provide regulatory certainty for industry'.</p> <p>However, ActewAGL Retail (p. 3) considered 'price monitoring [to be] a second-best alternative when compared with full price deregulation, and is not required in the ACT'. Notwithstanding this point, should price monitoring be introduced into the ACT the program 'must provide certainty and transparency to retailers, particularly in relation to the nature and extent of regulator involvement,</p>

Chapter heading	Sub-topic level 1	Sub-topic level 2	Issue raised in submission
			and the triggers that may prompt the ACT Government to re-introduce price regulation'.
		Regulatory body to administer price monitoring	Origin Energy (pp. 3-4) noted that as the 'timing coincides with the current target commencement date for NECF implementation and to adhere to the principle of national consistency, the AER may be the appropriate body to take on the price monitoring role ... if the NECF [is] delayed there are no obstacles to the ICRC fulfilling this role'.
	Time period of the monitoring regime of three years		The ESAA (p. 3) noted that in the period following 30 June 2012, 'it is possible ... that a carbon price is introduced to the energy sector. This can be expected to increase retail electricity prices'.
	Other issues	Economies of scale and scope	ActewAGL Retail (p. 4) contends that in the Stage 2 Draft Report the AEMC noted 'economies of scale and scope are a reason for the absence of effective competition in the ACT market ... [but] provides no evidence or analysis to support this conclusion'. In terms of economies of scale, ActewAGL Retail has a customer base of 130 000 customers, which is much smaller than potential competitors, therefore there is no basis on which to argue that it enjoys economies of scale relative to its competitors. In terms of economies of scope, ActewAGL Retail pointed to analysis in the Victorian and South Australian Retail Reviews that stated 'electricity only retailers are unlikely to experience any material disadvantage relative to dual fuel competitors'.

C Non-pricing options

The following is the non-pricing option chapter from the Stage 2 Draft Report.

C.1 Introduction

The Stage 1 Final Report concluded that there are a number of non-pricing issues inherent in the ACT electricity retail market that are impacting on its operation and, potentially, the degree of competition that currently exists. In brief, these non-pricing issues are:

- a low level of consumer awareness of the ability to switch retailers and who those alternative retailers may be (that is, customer stickiness);
- little consumer understanding of the implications of switching retailers (for example, that this does not have an impact on the physical supply of electricity); and
- concern from second tier retailers about additional factors that could be constraining their ability to enter into and expand within the market (such as, different regulatory requirements between jurisdictions, the dominance of ActewAGL Retail and its economies of scale and scope).

This chapter is divided into three options that outline potential changes that could be undertaken to address these concerns and improve the competitive nature of the market. The first option pertains to the demand-side of the market and consumer awareness, while the other two options focus on considerations that address the supply-side of the market. Specifically, the three options that have been considered by the AEMC are:

- customer education and awareness (to reduce customer stickiness and inform them of the operation of the market);
- achieving greater harmonisation of regulatory requirements across jurisdictions (that is, reducing the differences in the ACT requirements relative to other jurisdictions, to lower compliance and administrative costs for retailers); and
- strategies for increasing the prominence of second tier retailers relative to the incumbent (that is, the consideration of possible rebranding or possible merit in reviewing the guidelines on ActewAGL regarding cost allocation).

Each of these options are outlined below.

C.2 Option (i): customer education and information

To overcome the low level of consumer awareness of switching and the electricity supply chain, a targeted consumer education campaign could be introduced in the

ACT. At present the level of awareness is low and the availability of information is limited.

C.2.1 Outline of this option

In its report for the Stage 1 Draft Report, Roy Morgan Research concluded that, on balance, the survey of residential users of electricity suggests that competitiveness is not strongly present in the ACT electricity retail market. ActewAGL Retail is the dominant electricity supplier, providing retail services to 91 per cent of the customers surveyed. Consumer awareness of full retail contestability (FRC) in the ACT is 60 per cent, which is lower than that observed in other jurisdictions. For example, in South Australia awareness is 82 per cent and in Victoria it is 94 per cent. In addition, 51 per cent of respondents could not name an electricity retailer alternative to their current one. Not unexpectedly, the degree of switching between retailers by customers has been very low at approximately 10 per cent. A similar result was obtained from the survey of small business customers.⁴²

In addition, Roy Morgan Research's focus group survey report noted that participants wanted information that allows them to make informed decisions and comparisons about electricity supply services available to them – such as clearer cost comparisons, better disaggregation of cost components, and information about the discounts available.⁴³

The apparent limited awareness of consumers about the ACT electricity market and their ability to choose a retailer is impacting the behaviour of consumers and, consequently, on the performance of the market. It may also be making it more difficult for second tier retailers to attract customers away from ActewAGL Retail. Therefore, in order for consumers to gain equitable access to the competitive market, they need to be able to obtain product information that is readily available and easy to understand. This suggests that there is a need for an appropriately targeted and timely consumer awareness and education campaign to inform customers of rival electricity suppliers in the ACT and the roles of companies in the supply chain.

There are two aspects to an adequate customer awareness campaign. Firstly, an awareness and education dimension to improve understanding for residential and small business customers about:

- their rights under the consumer protection framework;
- the electricity supply chain and the roles of retail, distribution and transmission companies in the market (and that changing retailer does not jeopardise the supply service);
- the options and procedures available to them for seeking redress or complaining about marketing or selling misconduct; and

⁴² Roy Morgan Research Residential Report, p. 1; Roy Morgan Research Small Business Report, p. 1.

⁴³ Roy Morgan Research Focus Group Report, pp. 18-20.

- the changes that may take place in relation to the calculation of the regulated price.

Secondly, a marketing dimension to facilitate choice, including:

- the range of alternative retailers and their contact details; and
- the benefits of seeking alternative offers and information from retailers and other sources (for example, information provided through a centralised website) regarding their electricity supply options.

Consumer education should not be limited to a short period or be conducted as a one-off event. It is equally important that this information be available to consumers on an ongoing basis and periodically brought to their attention through publicity campaigns.

To assist in this, there is a role for the establishment of a website that provides the information noted above, as well as up to date information on available offers from all licensed retailers active in the ACT. Similar websites already exist in other jurisdictions in Australia and overseas. Comparison or estimator tools and calculators allowing consumers to compare available offers are also widespread in other industries, notably financial services and mobile telephone communications, driven in part by a comparatively greater degree of product complexity, differentiation and innovation and corresponding demand from consumers for product information and explanation.

C.2.2 Achieving this outcome

The AEMC considers that the ACT Government would be the most appropriate body to introduce an education and information awareness campaign in the ACT. In this instance, this could be undertaken by the relevant government department (DECCEW). A marketing campaign to assist customers' understanding of the switching process and provide a product information and comparison website could also be provided by either DECCEW or the ICRC.

In the Australian energy market, the Essential Services Commission of Victoria (ESC), Essential Services Commission of South Australia (ESCOSA), Independent Pricing and Regulatory Tribunal of NSW (IPART) and the Queensland Competition Authority (QCA) provide online offer comparison or estimation tools.⁴⁴ These tools may be accessed through the organisations' respective websites. They provide a means of enabling consumer access to energy offer information at their convenience. In general, there are two methods by which energy offer information is compared:

- comparison of a customer's existing supply arrangements with a new offer; or
- an estimate of charges payable, based on historical consumption, under a range of possible offers in the marketplace.

⁴⁴ For example see, www.myenergyoffers.nsw.gov.au/

Both methods provide an indication of the possible comparative savings available to a customer and what steps can be taken to change electricity service or provider.

For example, the ESC energy comparator provides a comparison of the charges payable under a new market offer with the consumer's current supply arrangement, based on information provided by the consumer about current billing and usage and the new offer. The ESC approach allows consumers to enter offer-specific elements such as contract length or discounts; however, it does not attempt to ascribe an actual value to these as part of its calculations.

By comparison, ESCOSA does not rely on consumers having a new energy offer to hand, but instead provides estimates of annual energy costs under various available plans and estimated annual savings, based on information provided by the consumer about current usage.⁴⁵ The ESCOSA estimation tool does not factor in contract terms or discounts, although it does note applicable direct debit rebates or one off joining bonuses.

C.2.3 Assessment

A consumer education and information awareness campaign of the nature described above will provide tools to consumers that will allow them to make informed decisions about their electricity supply. Well informed consumers are a feature of a well functioning and competitive market, therefore the AEMC expects that over time, customer awareness will reduce stickiness. In addition, customers will become aware of FRC and supply options in the ACT, as well as the roles of each player in the electricity supply chain.

As noted above, the consumer survey undertaken by Roy Morgan Research in the ACT revealed a general lack of awareness by consumers of their ability to choose an electricity supplier. To show what could be possible if the level of awareness is improved, a comparison of the number of retailers providing services in electrically similar locations (that is, similar number of customers with a similar load) to the ACT was undertaken. The locations chosen were Geelong in Victoria and Newcastle and Queanbeyan in NSW. The awareness of FRC in Victoria and NSW is 94 and 92 per cent respectively, with the assumption that both Geelong, Newcastle and Queanbeyan would have similar levels of awareness. A number of comparative (both government and privately operated) websites were analysed for a postcode in the central business district of each location. The maximum number of retailers operating in each location was ten for Newcastle and Queanbeyan and 12 for Geelong, compared with three in Canberra.

In addition, the AEMC anticipates that as a result of this awareness campaign, the perception of customers regarding their physical electricity supply in the event of a switch would improve. That is, an understanding that the physical supply of electricity

⁴⁵ In addition to government operated websites like ESCOSA's, private independent websites such as Goswitch and Switchwise also provide comparisons of available offers for this and other markets.

by the distribution company will not alter as a result of changing electricity suppliers (retailers).

For these reasons the AEMC considers that increasing the level of awareness in the ACT market could facilitate improved competitive outcomes and reduce customer stickiness.

In the subsequent marketing campaign, the AEMC notes that for it to be effective, consumers require an element of choice. That is, the supply-side of the market must be improved in parallel to provide customers with more supply options. As the number of retailers operating in the ACT increases, more consumers will consider switching either electricity retailers or services to better suit their needs. In turn, this may encourage retailers to offer a greater range of products to address consumer interest in alternatives to the standard supply services. That is, the lower costs incurred by retailers entering the market and attracting customers would facilitate greater active participation in the market by the demand-side. For example, a customer's active use of websites to search for alternative retailers and product offerings would reduce a retailer's customer acquisition costs, thereby reducing overall costs to the market. Consequently, this would result in an environment where competition is encouraged. The AEMC also considers that the marketing campaign by the ACT Government would reduce the marketing costs for second tier retailers considering entry into the ACT market.

In parallel with the marketing campaign, the AEMC recommends that the ACT Government reviews the framework governing the customer protection and switching process. This is primarily to ensure that the framework in place allows for the smooth transfer of consumers from one retailer to another. In the event that a problem should arise, it is essential that consumers are aware of the complaint process. That is, in the first instant, who should be contacted and the process for complaint escalation in the event the issue is not resolved.

In summary, while it is anticipated that the above benefits could be achieved, this option also has a cost. That is, costs would be incurred in the initial setup and ongoing maintenance of a comparative website and the production and implementation of a campaign to inform customers of FRC (whether this be through printed media or advertising on television and radio).⁴⁶ However, over the mid to long-term, these costs are expected to be lower compared with the benefits to consumers of greater choice of both suppliers and products that are reflective of the efficient costs of supply.

⁴⁶ In addition, as consumer awareness of FRC increases, some forms of information dissemination may no longer be required, further reducing costs.

C.3 Option (ii): harmonisation of regulatory requirements across jurisdictions

C.3.1 Outline of this option

There are a number of ACT specific requirements that electricity retailers must comply with. The AEMC acknowledges that in some cases requirements are very similar to those in other jurisdictions (see Table 3.1 below). In other cases, there is a considerable difference. The AEMC notes that the different requirements between jurisdictions are not an ACT specific issue; however, whatever the degree of difference, retailers must accommodate the specific requirements if they are to participate in the market. This becomes an administrative cost (for example, developing IT systems) - largely upfront - to a retailer; however, the average cost will decline as its number of customers increases.

In the ACT there are a number of government initiated programs in the energy sector that place specific legislative requirements on energy retailers operating there. These programs include the feed-in tariff and carbon abatement schemes. For example, in relation to the ACT solar scheme, TRUenergy considers that the feed-in tariff arrangements are a disincentive to retailers entering the market. TRUenergy is of the view that 'while there are similar style schemes in place in other markets, the ACT scheme is considerably more complex as the scheme guarantees eligible customers a set feed-in rate (based on the year of installation) for 20 years'.⁴⁷ In addition, given that the rate may be adjusted annually, there are the added administrative costs of making these system changes and informing customers. These administrative costs may be small; however, as discussed in the Stage 1 Final Report, second tier retailers may be reluctant to incur these upfront fixed costs if they are uncertain about attracting the mass of customers required to spread these costs over.

Table C.1 Comparison of the ACT and NSW regulatory requirements

Regulation/legislation	NSW	ACT
Greenhouse Gas Abatement Scheme (GGAS)	<p><i>Electricity Supply Act 1995</i> (NSW)</p> <p>Requirements the licensee must comply with:</p> <ol style="list-style-type: none"> its greenhouse gas benchmarks; and the <i>Electricity Supply Act 1995</i> (NSW) and statutory instruments in force under that Act, including <i>Electricity Supply (General) Regulation</i> 	<p><i>Electricity (Greenhouse Gas Emissions) Act 2004</i> (ACT)</p> <p>Requirements the licensee must comply with:</p> <ol style="list-style-type: none"> its greenhouse gas benchmark; and the <i>Electricity (Greenhouse Gas Emissions) Act 2004</i> (ACT) and statutory instruments in force under that Act.

⁴⁷ TRUenergy submission, September 2010, p. 2.

Regulation/legislation	NSW	ACT
	<p>2001 (NSW).</p> <p>Part 8A of the <i>Electricity Supply Act 1995</i> (NSW) sets a State greenhouse gas benchmark expressed in tonnes of carbon dioxide equivalent (tCO₂-e) per capita. The initial level in 2003 was set at 8.65 tCO₂-e and progressively dropped to 7.27 tCO₂-e in 2007 remaining at that level until 2012. This represents a reduction of five per cent below the Kyoto Protocol baseline year of 1990.</p>	<p>The licensee must also submit an audited Benchmark Statement to the ICRC annually by 1 March of the year following the compliance year.</p> <p>The Scheme sets a Territory greenhouse gas benchmark expressed in tonnes of carbon dioxide equivalent (tCO₂-e) per capita. The level set for 2005 was 7.96 tonnes per capita. The benchmark was progressively reduced. In 2007, the benchmark was 7.27 tonnes per capita. It will continue at this level until the Scheme ends in 2020. These benchmarks correspond to those adopted in NSW.</p>
GreenPower	<p>Requirements for licensed retailers are contained in the <i>Electricity Supply (General) Regulations 2001</i> (NSW) in clause 45B (1). That is:</p> <ol style="list-style-type: none"> 1. a supplier who offers to supply electricity to residential premises must: <ul style="list-style-type: none"> (a) offer (renewable energy sources offer) each potential new or moving customer the equivalent of a minimum 10% of the total electricity supplied from an accredited renewable energy source; 2. a renewable energy sources offer must state <ul style="list-style-type: none"> (i) whether the electricity to be supplied is under a standard form customer supply contract or negotiated customer supply contract (ii) tariffs/charges under the offer; and 3. a renewable energy sources offer must be a member of and comply with the requirements of an approved accreditation scheme. 	<p>GreenPower offer scheme</p> <p>From 1 April 2009, the Licensee must comply with the following requirements:</p> <ol style="list-style-type: none"> 1. offer a GreenPower product to each new or re-connecting customer of the supplier; 2. at the same time as the GreenPower offer, make each potential new and reconnecting customer of the supplier aware that other products are available to them; 3. disclose all tariffs and charges associated with the GreenPower offer and all other products offered to each potential new and reconnecting customer of the supplier; 4. offer and make a GreenPower product available to all existing customers of the supplier at the existing customer's request; and 5. if a person is supplied a GreenPower product

Regulation/legislation	NSW	ACT
		<p>under a standard customer contract, permit the customer to revoke the supply agreement for the GreenPower product with the supplier without incurring any penalty or termination fee.</p>
<p>Feed-in tariff scheme</p>	<p>Regulatory framework of the Solar Bonus Scheme is set out in the <i>Electricity Supply Act 1995</i> (NSW) and the <i>Electricity Supply (General) Regulation 2001</i> (NSW).</p> <p>The licensee must comply with the <i>Electricity Supply Act 1995</i> (NSW) and statutory instruments in force under that Act.</p> <p>Main aspects of the scheme include:</p> <ul style="list-style-type: none"> • period of operation is seven years from 1 January 2010; • legislation sets out how often the tariff is set; and • there are no reporting obligations for retailers under this scheme. 	<p>Section 6 (3) of the <i>Electricity Feed-in (Renewable Energy Premium) Act 2008</i> (ACT)</p> <p>The licensee must comply with the <i>Electricity Feed-in (Renewable Energy Premium) Act 2008</i> (ACT) and statutory instruments in force under that Act.</p> <p>Main aspects of the scheme include:</p> <ul style="list-style-type: none"> • period of operation is 20 years from connection of the generator; • the rate of the tariff is determined by the Minister for each financial year; and • retailers are required to report quarterly on the number of customers receiving the feed-in tariff and the total amount of the premium paid over this period.

C.3.2 Achieving this outcome

The aim of this option would be to facilitate the harmonisation of legislative requirements across jurisdictions or between the ACT and surrounding jurisdictions. There are a number of ways in which this could be achieved. The best solution is to have better harmonisation across jurisdictions, which could be facilitated through a nationally consistent legislative framework, for example, the National Energy Customer Framework (NECF).⁴⁸ The NECF involves the harmonisation of State-based regulatory frameworks (with the exclusion of retail price regulation and community service obligations) for the retail energy market and energy distribution sector into a single set of national rules. Specifically for retailers, the NECF is predominantly implemented through licence conditions. This will mean that retailers operating in the national electricity and natural gas markets will only require one licence (issued by the AER) and will be subject to a consistent set of rules across all jurisdictions. However, it should be noted that under the NECF, jurisdictional specific programs like the greenhouse gas abatement program and the feed-in tariff scheme outlined in Table 3.1 above, are currently not included.⁴⁹

Another possible approach to achieving greater harmonisation of the legislative requirements between the ACT and surrounding jurisdictions would be the introduction of a third-party provider that dealt exclusively with the fixed costs associated with ACT regulations and legislation for the whole market. For example, the right to operate the feed-in tariff scheme for all ACT customers could be established by government tender. As a result, second tier retailers need not set up specific compliance systems within their billing arrangements to take into account ACT specific regulations. That is, for a fixed fee these aspects could be outsourced to the successful tenderer.⁵⁰ For the efficient operation of such a scheme, all regulatory obligations would need to be removed from the retailers. In practice the AEMC considers that this would be very difficult to achieve.

C.3.3 Assessment

A new supplier entering an electricity retail market, must comply with any specific legislative or regulatory provisions relevant to that market. The fixed entry and administrative costs associated with those provisions are subsequently recovered from consumers as part of the cost associated with the supply of electricity. Therefore, the greater the customer base, the easier it is for a retailer to recover these costs. In the case of the ACT, a new entrant retailer may be more reluctant to enter because it will need

⁴⁸ For further information see, www.ret.gov.au/Documents/mce/emr/rpwg/default.html.

⁴⁹ To this end, jurisdictional policy makers should be aware that the implementation of these policy options often come at a cost that should be minimised where ever possible.

⁵⁰ The fixed fee involved in this transaction would be the cost per customer spread over all customers in the ACT and would be the lowest cost achievable - minimising the burden on the market. It could be appropriate for the ICRC to be given responsibility for the oversight and setting of this fee. This should circumvent some disputes between retailers over access to the particular services provided under this framework.

to cover its fixed costs of entry over a relatively small customer base (130 000 households) before making a profit. That is, potential entrants face relatively high costs per customer to set up in the ACT and this can deter entry if a retailer considers that the actual margin available to a second tier retailer is perceived to be insufficient to recover their costs and earn a return commensurate with the risks of providing electricity in the market over the long-term.⁵¹ As noted in the Stage 1 Final Report, the AEMC acknowledges that ACT specific regulation could be an issue in the ACT market; however, it is not considered to be a decisive factor in the prevention of entry by second tier retailers.

The possible alignment of the regulatory requirements for retailers operating in more than one jurisdiction would have benefits for competition. That is, through harmonisation of regulatory requirements, entry by second tier retailers into other jurisdictions is consequently reduced. This would make it easier and less costly for retailers to operate across jurisdictions. To some degree, this will be the benefit of the NECF. However, even after implementation of the NECF, there are a number of aspects that will remain at the discretion of the jurisdictions.

A third-party provider has been considered as a means of harmonisation of regulatory requirements within the ACT. However, the implementation of this scheme may be difficult in practice and there is no guarantee that it would prove a cost effective method to reducing the fixed costs associated with regulatory barriers. As it may be impossible to isolate all of the impacts on second tier retailers, there is a risk that a third-party provider may increase total costs and reverse competitive outcomes. Nevertheless, if these requirements are also aligned, such that there are no jurisdictional based regulatory differences, retailer rivalry should be greatly enhanced. But, it remains unclear whether the introduction of such harmonisation would remove costs, as it may be too difficult to transfer existing customers from current to new regimes. Therefore, as noted in the Stage 1 Final Report, the AEMC questions whether the costs associated with such options would be offset by the potential benefits to competition.

C.4 Option (iii): amending the competitive environment between incumbent and second tier retailers

C.4.1 Outline of this option

In terms of the structure of ActewAGL Retail, Origin Energy has noted that 'the current ring-fencing arrangements in the ACT may require additional consideration in the context of facilitating effective competition'.⁵² Origin Energy considers that this is an

⁵¹ In Belgium, there are separate regulators for the Flanders, Walloon and Brussels regions, each with different licensing and price control requirements for retailers operating in its region. It has been found that the differences in the requirements on retailers between regions may mean that entry is more limited in each region than would be the case if there was a single set of requirements across the whole country.

⁵² Origin Energy submission, August 2010, p. 3.

issue specific to the market structure of the ACT. That is, 'the ACT market, with a single vertically integrated incumbent holding a dominant market share, is unique in Australia'.⁵³

In addition, consumer advocates have stated:⁵⁴

“We offer a note of caution at this point about the ‘bundling’ arrangements, whereby various essential service and related utility providers, some with shared parentage, are bundled together as a range of services at a discounted rate. We are concerned about the potential for cross subsidisation and the high potential for lack of transparency with this practice. We are also concerned about the actual incidence of costs and benefits and whether low income households have equitable access to any benefits of bundling, or whether they are effectively cross subsidising higher income consumers.”

To address this issue, the AEMC has considered actions that could be taken to create a more level playing field between the incumbent retailer and second tier retailers. The key to this appears to be that under the current organisational structure and operational approach, ActewAGL Retail achieves cost advantages over any of its potential rivals. This seems largely the result of the economies of scale and scope that it obtains from its dominant position in the market and from operating other utility businesses in the ACT.

ActewAGL's winter essentials magazine (as with other editions) contains all of the services that are administered by ActewAGL, which includes TransACT, ActewAGL Energy Shop, ActewAGL Retail, ActewAGL Distribution, Actew Corporation (water and wastewater) and ActewAGL Home Services. Each of these services has similar branding in spite of being a mix of both regulated and contestable services and across different sectors of the economy.

Not only could it be unclear to the householder as to what business unit provides what services (this is previously discussed in relation to consumer understanding of the electricity market), but it provides the opportunity for corporate and other joint costs (notably marketing which is clearly carried out on a joint basis) to be spread across the customers of the various services. In effect, the customer base is much larger than the 130 000 households using electricity services.

C.4.2 Achieving this option

The AEMC has considered two possible changes that could also affect the creation of a competitive environment for second tier retailers. These are:

- re-branding the electricity retail business of ActewAGL Retail; or

⁵³ *ibid.*

⁵⁴ Consumer Agencies submission, 27 September 2010, p. 11.

- the complete removal of the ActewAGL Retail business unit from the Actew business group.

It is envisaged that either of these actions could break down the relationship between ActewAGL Retail and its related businesses and encourage fully 'arms length' transactions to take place.

As an alternative to such changes, there could be merit in reviewing the guidelines on ActewAGL regarding cost allocation . In particular, the ability of joint marketing to be undertaken by the businesses could be assessed.⁵⁵

C.4.3 Assessment

The separation of the electricity retailing business of ActewAGL Retail from other business activities should result in arm's length transactions between the various Actew-related business units. It may diminish the benefits from economies of scale and scope that may be accruing to ActewAGL Retail which are providing it with a cost advantage over second tier retailers. The degree of reduction in the economies of scope and scale will depend on the extent of separation.

However, the AEMC considers that such measures may not be in the best interests of customers. Removing economics of scale is likely to lead increase prices for customers. Plus such an approach could result in changes to the bundling of products and services to customers. In addition, the rebranding of ActewAGL Retail electricity may result in increased costs for the business and a reduction in shareholder value. We note that the extent to which any cross subsidisation exists currently within the ACT market remains unclear.

The AEMC considers that the more appropriate course of action would be to improve the ability for second tier retailers to enter the market. This would in turn maintain the competitive pressure on ActewAGL Retail to price efficiently. The threat of entry and/or active retailer competition will maintain a competitive discipline on ActewAGL Retail ensuring any benefit from economies of scale and scope would be passed through in lower charges for consumers.

A less dramatic and less costly alternative, is to review and strengthen the ring-fencing arrangements now under the AER's jurisdiction. This seems to be a more proportional approach given the materiality of the issue. The AEMC notes that the current arrangements are in place for the regulatory control period 2009-14.⁵⁶ Nevertheless, an earlier reassessment of these arrangements would be positive as it would open the structure of ActewAGL and its operations to independent scrutiny earlier and ensure that cost allocations, information flows and internal transactions are carried out to a high standard.

⁵⁵ ICRC, *Ring fencing guidelines for gas and electricity network service operators in the ACT*, November 2002, p. 12.

⁵⁶ National Electricity Rules, clause 6.17.1(b)

One particular issue is the allocation of money for marketing activities, which under the current ring fencing provisions may be undertaken jointly by the retail and distribution businesses. The AEMC however considers that the effect of this joint marketing may be reduced through the customer awareness campaign, as it would make customers more aware of alternative retailers operating in the market.

D Pricing options

The following is the pricing option chapter from the Stage 2 Draft Report

D.1 Introduction

The Stage 1 Final Report concluded that the actual margins available to second tier retailers may not be the same as those earned by ActewAGL Retail because of the unique characteristics of the ACT market (for example, customer stickiness). Importantly, given that retailers are not entering into or expanding within the ACT retail electricity market, it appears that second tier retailers do not perceive the margins to be a sufficient rate of return that is commensurate with the risks and uncertainties of operating in the market over the long-term.

Appendix C discussed non-pricing options that could be introduced to improve the current level of competition by making it easier (that is, reducing the costs and risks) for second tier retailers to enter into and expand within the market (for example, reducing customer stickiness). This chapter focuses on the pricing options that may also be considered to increase the degree of competition in the market.

Specifically, the pricing options being considered include:

- Option (A) - retain the current TFT (that is, maintain the status quo);
- Option (B) - change the approach to setting the TFT;
- Option (C) - replace the TFT with reporting and monitoring; and
- Option (D) - remove retail price regulation.

Each of these options are described below as well as the implications associated with each option.

D.2 Option (A): retain the current TFT

The status quo option is to retain retail price regulation in its current form. That is, retain retail price regulation and have the ICRC continue with its current approach to setting prices.

D.2.1 Outline of this Option

Maintaining the current price setting arrangements does not appear to be a viable option in the long-term given that the Stage 1 Final Report found that competition in the ACT electricity retail market is not effective, and the purpose of the Stage 2 Draft Report is to recommend ways to increase the level of competition.

The AEMC is of the view that implementing only non-pricing options, without also eventually making changes to the current price setting arrangements, will be insufficient to encourage second tier retailers to enter into and expand within the market. Therefore, an increase in retailer rivalry or at least the competitive pressure on ActewAGL Retail created through the threat of entry would not be expected to occur. As a result, it is unlikely that consumers would benefit in the long-run from greater product innovation and offerings. However, consumers would continue to benefit financially from relatively low electricity prices based on ActewAGL Retail's efficient costs, which incorporate its cost advantages.

D.2.2 Achieving this outcome

No changes to the legislation for the ICRC or the terms of reference would be required under this option.

D.2.3 Implications

Given that retailers are not entering into or expanding within the ACT retail electricity market, it appears that second tier retailers do not perceive the margins to be a sufficient rate of return that is commensurate with the risks and uncertainties of operating in the market over the long-term. The AEMC is of the view that the non-pricing options alone will not adequately reduce the costs and risks for second tier retailers considering whether to enter into and expand within the market. Therefore, under this option the likelihood for enhanced competition (including improvements in the threat of entry and expansion) in the ACT electricity retail market is low.

Importantly, the inherent risks associated with price regulation will remain. This is because regulated prices are almost always imperfect substitutes for prices determined by the competitive processes of a market. Notably, when setting prices, regulators are constrained by both imperfect information and the frequency in determinations. As a result, there is a risk that retailers get stuck (that is, having made investments to acquire customers) providing retail services to recover those investments at prices that do not accurately reflect their costs. Retailers must consider this risk both now and in the future when deciding whether to enter into and expand within a market.

However, consumers are likely to benefit (at least in the short-term) from paying relatively low electricity prices based on ActewAGL Retail's efficient costs. This is because ActewAGL Retail may have slight cost advantages over second tier retailers because it undertakes some activities on behalf of other Actew and ActewAGL business units, thereby, possibly benefiting from synergies across the business units. Some economies of scope would also be expected to bring ActewAGL Retail some relative cost advantages.

Additionally, this option was supported by the Consumer Agencies' joint submission to the Stage 1 Draft Report.⁵⁷ For example, they noted that the lack of market size in

⁵⁷ The Consumer Agencies consists of Care Inc, ACTCOSS and Uniting Care Australia.

the ACT constitutes a suboptimal condition. That is, the economies of scale in production mean that only a small number of electricity retailers can profitably enter the market, thus effective competition is forestalled. Therefore, they suggested that 'the second best, and therefore optimum outcome given the market circumstances, is for continuation of current arrangements, which seeks [to protect] customers and maintain adequate regulation to keep the dominant retailer in check'.⁵⁸ However, the AEMC notes that two firms can be sufficient to create vigorous competition in a market.

Notwithstanding the above point, the purpose of the Stage 2 Draft Report is to recommend ways to promote competition in the ACT retail electricity market. Implementing non-pricing options, without also eventually making changes to the current price setting arrangements, is likely to result in only a marginal increase in competition (if any).

D.3 Option (B): change the approach to setting the TFT

Another option being considered by the AEMC is to retain retail price regulation in the ACT electricity market, but change the approach to setting the TFT. This Option aims to maintain price regulation while attempting to address the issue that second tier retailers do not perceive the margins to be a sufficient rate of return that is commensurate with the risks and uncertainties of operating in the market over the long-term.

D.3.1 Outline of this Option

On the basis that retail price regulation is to remain in the ACT, there are a number possible changes that could be made, these include:

- changing the basis of the calculation of the TFT from the efficient costs of ActewAGL Retail to the costs of a single fuel supply efficient new entrant. This should address concerns raised by some stakeholders that the current basis for calculating costs is not appropriate and does not result in a TFT that is compatible with encouraging retailer competition;
- changing the methodology for periodically adjusting the TFT over time from a cost-based approach to an index-based approach. That is, changing the TFT over time to reflect changes in cost inputs (for example, wholesale electricity prices). This could assist retailers in dealing with volatile cost inputs (depending on the current frequency of pricing determinations) although it will still require the calculation of an initial price level; and
- directly passing through changes in wholesale electricity costs and any carbon tax or cost imposed by government schemes such as an Emissions Trading Scheme (ETS). This would allow the regulated retail price to recover

⁵⁸ Consumer Agency submission, 27 September 2010, pp. 10-11.

uncontrollable and volatile cost inputs in a more timely manner. However, this may have negative implications for consumers.

Each of these options are discussed in more detail below.

D.3.2 Achieving this outcome

Changing the methodology for determining the TFT requires two adjustments to the current arrangements, namely:

- changes to the terms of reference provided by the ACT Attorney-General to the ICRC; and
- changes to the ICRC Act and/or the Utilities Act to insert specific requirements relating to pricing decisions for the electricity retail market.

D.3.3 Implications

The aim of altering the approach to calculating the TFT is to ensure that actual margins provide second tier retailers a sufficient rate of return that is commensurate with the risks and uncertainties of operating in the market over the long-term. This should increase retailer rivalry in the market or at least the competitive pressure on ActewAGL Retail created through an enhanced threat of entry. Importantly, the TFT would need to reflect the costs and risks involved for a single fuel supply efficient new entrant providing retail services in the ACT. Therefore collecting information from second tier retailers would be required. Additionally, a 'full' Customer Acquisition Cost (CAC) or Customer Acquisition and Retention Cost (CARC) allowance would need to be included.⁵⁹

Change the basis of the TFT calculation

Changing the basis of the TFT calculation from the efficient costs of ActewAGL Retail to the costs of a single fuel supply efficient new entrant could increase the TFT in the short-term (if the non-pricing options are not also undertaken). Notably, this will require the calculation and inclusion of a 'full' allowance for CAC/CARC.⁶⁰ The reason why the TFT may increase in the short-term is because it is currently based on ActewAGL Retail's efficient costs, which are likely to be lower than the costs second tier retailers would incur to operate in the market, due to its economies of scale and scope and the other unique characteristics of the market (for example, customer stickiness).

⁵⁹ 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 and switching customers. Similarly, a CARC allowance is set to recover the costs of acquiring new customers and retaining existing customers. All else being equal, CARC is lower than CAC.

⁶⁰ Currently the TFT only includes an allowance for sales and marketing costs to communicate the TFT arrangements. This cost element was determined in 2003 and has been escalated for inflation over time.

However, prices do not need to increase for the degree of competition to improve in the market. Instead, the unique characteristics of the market can be addressed to make it easier for second tier retailers to enter into and expand within the market (although this would require also implementing the non-pricing options). This is the most efficient and beneficial outcome for consumers and so is in line with the National Electricity Objective (NEO).

Finally, this change would result in an approach that is more in line with the price setting approaches used by regulators in other jurisdictions (for example, NSW and QLD - Box D.1).

Box D.1: Overview of NSW and QLD retail price setting methodologies

The methodology used to set prices by the Independent Pricing and Regulatory Tribunal (IPART) in NSW and the Queensland Competition Authority (QCA) in Queensland is different from that used by the Independent Competition and Regulatory Commission (ICRC) in the ACT. In particular, for the calculation of the Retail Operating Costs (ROC) and Wholesale Electricity Costs (WEC) allowances. These methodologies are briefly summarised here.

ROC allowance:

The ICRC sets the TFT to allow for the recovery of the efficient costs incurred by the incumbent retailer, ActewAGL Retail. The ICRC does not include a 'full' Customer Acquisition Cost (CAC) or Customer Acquisition and Retention Cost (CARC) allowance, although the ROC does include some sales and marketing costs to communicate the TFT arrangements.

In contrast, IPART currently sets its prices based on a standalone incumbent retailer that is not vertically integrated into electricity distribution and has economies of scale with an existing customer base to defend. Additionally, in its most recent determination, IPART switched from including a CAC allowance in the ROC to incorporating an estimate of CARC.

QCA sets prices based on the costs of a representative retailer, rather than an actual retailer, which has a significant share of the market, is efficient and has a customer base that is representative of all customers in Queensland connected to the NEM. The QCA has included a CARC component in each of its determinations since 2007.

WEC allowance:

Since 2007 the ICRC has used independent and verifiable market-based information on the price of forward contracts. This approach takes into account the spot price for the NSW-ACT region of the NEM, load profile and hedging costs.

Historically IPART set the WEC allowance based on the Long Run Marginal Cost

(LRMC) of electricity generation, but recently has changed its approach to calculate market-based costs of energy, or the higher of market-based and LRMC costs. Additionally, IPART now includes a specific 'volatility allowance' to account for market risk.

The QCA initially estimated the WEC allowance on the basis of the standalone LRMC cost of the most efficient combination of generating technologies for the Queensland region, but later moved to a 50/50 weighting of LRMC and market-based costs.

This change should ensure that second tier retailers are able to recover their costs and earn a rate of return that is commensurate with the risks involved in operating in the market. However, it does not address the unique characteristics of the ACT market, and so without also implementing the non-pricing options, could increase prices in the short-term.

Nevertheless, this option should increase retailer rivalry in the market, or at least the competitive pressure on ActewAGL Retail, created through the threat of second tier retailer entry and expansion. This should also encourage improved product innovation and more product offerings. However, the actual outcome (that is, retailer entry and expansion) could depend on the conduct of ActewAGL Retail, which may be able to utilise its cost advantages and set market prices below the level that second tier retailers would entice entry and expansion by second tier retailers.

Additionally, the regulatory risk that the prices will not accurately reflect costs at some point in the future still remains due to imperfect information and the timing between determinations. Finally, this approach requires determining the costs of a single fuel supply efficient new entrant, which could be difficult to define and calculate.

In summary, changing the basis of the TFT from the efficient costs of ActewAGL Retail to the costs of a single fuel supply efficient new entrant, is likely to have the following implications:

- prices could increase in the short-term (without also implementing the non-pricing options);
- second tier retailers should be able recover their costs and earn a rate of return that is commensurate with the risks involved in operating in the market;
- retailer rivalry may increase in the market, or at least the competitive pressure on ActewAGL Retail; and
- improvements in product innovation and offerings.

Additionally, the regulatory risk that the prices will not accurately reflect costs (both now and in the future) remains. Finally, this approach requires determining the costs of a single fuel supply efficient new entrant, which may be difficult to define and calculate.

Indexing the TFT

Some stakeholders have indicated that one of the problems of the current approach to setting the TFT is that it may not always track fluctuations (in particular, increases) in the cost elements over time. For example, increased wholesale electricity prices during a pricing period (that is, between ICRC determinations) would not be reflected in the TFT. It has been suggested that this is one deterrent for second tier retailers considering whether to enter into and expand within the market. Changing the methodology for calculating the TFT from a cost build-up approach to an index-based approach could work to address this issue. An index-based approach may also prove to be a simpler method for adjusting the regulated retail price over time.

In assessing an index-based approach to adjusting the TFT, it is first necessary to determine the most appropriate index to track changes in energy costs. Possible options could be one, or a combination of:

- an index based on changes in the CPI. However, there is evidence that suggests energy costs have historically increased at a rate greater than CPI. If this is the case, then an alternative index should be considered;
- an index based on the market contracts available in the ACT (similar to the approach to be adopted in South Australia, see Box D.2 below). This option would be difficult because there are currently very few trackable market contracts available in the ACT. Therefore, this could result in a volatile index. In addition, using market contracts would create a circularity problem as it would be in the interest of a dominant incumbent to increase market prices (to the extent possible) in order to increase the regulated price; or
- an index that tracks movements in the wholesale electricity market. To date, wholesale electricity costs have been the most volatile component of the cost base and this indexing approach would provide some cost recovery certainty for retailers (it essentially shifts some of the WEC-related risks from retailers to consumers). However, retailers have other uncontrollable costs in addition to their wholesale market costs. Thus, retailers would still be exposed to some uncontrollable cost movements during a pricing period. This suggests that the ICRC would still need to realign prices and costs periodically.

Additionally, consideration needs to be given to:

- whether the index should be bound by a floor and cap to limit the possible volatility for consumers during the pricing period;
- how often should prices adjust with the index over time; and
- how often should the cost base be reassessed. There would be a benefit (in terms of lower regulatory costs) if the time between recalculating the cost base was long. However, if parties are uncertain about the performance of this approach then a shorter period may be preferred. A shorter period also provides greater assurance that prices are cost reflective.

However, even if an index can suitably track retailer costs, resulting in a simplified process for updating the TFT over time, the ICRC would still need to determine the initial cost base. If the initial cost build-up is not based on a single fuel supply efficient new entrant, the level of competition is unlikely to improve (as set out in Option A). Therefore, the most appropriate approach may be a combination of changing the basis of the TFT and an index-based approach. The implications of doing this would be the same as changing the basis of the TFT, although regulatory costs could be reduced through less frequent pricing determinations.

Notwithstanding, it should be acknowledged that, to date, the ICRC has generally (with the exception of the most recent pricing decision) set regulated prices annually. This relatively high frequency increases the likelihood that the regulated retail price will be cost reflective (for ActewAGL Retail) even if all of the components are not entirely controllable. As a result, if price regulation remains in the ACT, the benefits from adopting an index-based approach to adjusting the TFT over time appear limited (unless the ICRC is planning to set prices less frequently).

Box D.2: Overview of the SA indexing approach

The Essential Services Commission of South Australia (ESCOSA) has confirmed plans to move to a new way of setting electricity standing contract prices from 1 January 2011, replacing the traditional cost-build up approach. Its new hybrid cost and index-based approach will result in annual price reviews with new standing contract prices taking effect on August 1 each year. In a final report on its new methodology, ESCOSA says it needs to change the existing approach to setting electricity standing contract prices because of the ongoing uncertainties and volatility that are currently impacting the wholesale market due largely to uncertainties over carbon pricing and the development of other climate change policies. At present, less than 30 per cent of residential customers remain on the electricity standing contract with most customers purchasing electricity under a competitive 'market contract'.

ESCOSA decided the best way for fixing electricity standing contract prices is to implement a hybrid cost-based and index-based approach, called the Relative Price Movement (RPM) approach. The major elements of the RPM methodology include:

- a review of costs in year one of the price path period via the usual cost build-up approach, to determine prices to apply from 1 January 2011;
- allowing standing contract prices to change at the commencement of each financial year of the price path (beginning 1 July 2011), in line with changes to market contract prices in SA. The Commission will calculate an RPM index, measuring the change in weighted average market contract prices to determine the allowed change in standing contract prices; and
- changes in the standing contract price resulting from the RPM index calculation will be bound by a floor and cap, to provide some certainty over

the extent to which prices will move over the price path period.

Should the RPM index calculation breach the floor or cap, prices will be fixed at the floor or cap. If there are sufficient grounds to allow standing contract prices to move beyond the floor or cap, the Commission may undertake a 'special circumstances' review.⁶¹

Direct pass through

Directly passing through changes in wholesale electricity costs and/or any carbon tax or cost imposed by government schemes such as an ETS would allow regulated retail prices to change with various cost drivers. This would reduce the risk for second tier retailers considering entering into and expanding within the ACT electricity market because it would allow the recovery of certain, pre-specified uncontrollable costs. As a result, retailer rivalry or the competitive pressure on ActewAGL Retail could improve. However, this method is likely to:

- create more volatility in the TFT, which some consumers may find difficult to manage. To counter this, price smoothing approaches could be developed. However, this could result in inefficient price signals to consumers; and
- not address the question of whether the cost base for the TFT is appropriate or sufficient to encourage enhanced competition.

While this method may provide greater certainty to retailers that changes in certain cost elements will be passed onto consumers promptly, it does not address whether the underlying cost base is appropriate. As a result, it would make sense to explore this option in combination with changing the basis of the TFT from the efficient costs of ActewAGL Retail to the costs of a single fuel supply efficient new entrant. However, retailers are better placed to manage the risks associated with changes in cost inputs (for example, wholesale electricity prices) through their hedging arrangements. Therefore, a direct pass through mechanism does not appear to be appropriate.

D.4 Option (C): replace the TFT with reporting and monitoring

An alternative to maintaining retail price regulation (either in its current form or in an amended form) is to replace it with a price monitoring and reporting program.

D.4.1 Outline of this Option

This option would allow prices to be determined by the market rather than the ICRC. As a transitional measure to completely removing price regulation, a period of market monitoring by either the ICRC or the AER could be established. This is similar to the approach taken in Victoria in removing retail price regulation for small electricity consumers (see Box D.3 below). The objective of this price monitoring scheme would

⁶¹ Power Industry News 703, *New SA pricing methodology*, 16 August 2010.

be to identify and publish trends in standing and market offer prices over the previous 12 month period (that is, after the event) as well as other relevant information such as switching rates of consumers and available products. These reports should inform market participants and the ACT Government on the structure, conduct and performance of the market. In addition, it promotes transparency and so discipline on the conduct of ActewAGL Retail.

However, it is important to note that despite the removal of price regulation, the prices will end up at the same level in Options B and C (assuming the prices are set correctly in Option B). This is because the regulated prices in Option B would be set at the level that second tier retailers are able to recover costs and earn a rate of return commensurate with the risks of operating in the market, which is the same level that second tier retailers would enter into and expand within the market in Option C (that is, the market price). Therefore, it is important to reduce the risks and costs for second tier retailers to enter into and expand within the market (through the non-pricing options). This will either result in increased retailer rivalry or greater competitive pressure on ActewAGL Retail through an enhanced likelihood of entry and expansion. Regardless, it is likely to result in improvements in product innovation and offerings.

The price monitoring reports would also provide a timely indication of any market failure. If concerns arise, this could trigger a further inquiry by the AEMC into the effectiveness of electricity retail competition in the ACT. If the AEMC did conduct another review, it would be undertaken in accordance with the AEMA and provide the basis for policy decisions on appropriate responses to any demonstrated market failure. This could include recommencing direct price regulation.⁶²

ActewAGL Retail has emphasised this point noting that 'in assessing whether re-regulation is appropriate, it is necessary to undertake a detailed analysis of whether it is the *best* option for addressing the problem, taking account of the potential costs and benefits, using an economic cost benefit framework'.⁶³ A price monitoring program would provide the required information and analysis to make such a decision.

The AEMC notes that 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. It suggested that a price monitoring program be established as an interim measure to full market deregulation.⁶⁴ The ICRC considered 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. However, this suggestion was not implemented by the ACT Government at that time.

⁶² AEMA, clauses 14.14(b) and 14.14(c).

⁶³ ActewAGL Retail submission, 6 September 2010, p. 8.

⁶⁴ ICRC, *Final Report - Retail prices for non-contestable electricity customers*, April 2006, pp. 15-23.

Box D.3: Price monitoring and reporting in Victoria

In February 2008, the AEMC completed its review of the effectiveness of competition in energy retailing in Victoria and concluded that there is effective competition in the retail supply of electricity and gas in Victoria. Accordingly, the AEMC provided advice on ways to remove retail price regulation in Victoria.

The Victorian Government subsequently removed price regulation for small consumers from 1 January 2009. Since that time prices have been set by retailers, who are required to publish standing offers and market offer prices in the Victorian marketplace.⁶⁵

However, the Essential Services Commission (ESC) continues to monitor the standing offer and market offer prices set by retailers and is still required to formally report to the Minister for Energy and Resources under section 39A of the Electricity Industry Act 2000 and section 47 of the Gas Industry Act 2001 on these prices and other features of the competitive market.⁶⁶

In a separate report, the ESC also describes how well energy retailers treat their customers, including those experiencing financial hardship, against established performance indicators. In doing so, this reviews retailers' call centre performance and complaints.

In December 2009, the ESC published its first price monitoring report, which provides government, consumers and other interested parties with information regarding the operation of Victoria's competitive market.⁶⁷

The purpose of the report was to improve transparency of the performance of the retail energy industry by providing information on the standing and market offer products available to consumers in Victoria and an analysis of energy costs over time compared with tariffs being offered by retailers in other jurisdictions.

D.4.2 Achieving this outcome

To achieve the outcome of replacing the TFT with a reporting and monitoring regime, it would first need to be decided whether the ICRC or the AER would undertake the price monitoring program. Then, instead of issuing a terms of reference to the ICRC to undertake a pricing determination, the ACT Attorney-General would need to request the ICRC or AER to undertake a price monitoring program for a certain period. This could be initially set at three years with a review into the program at the conclusion of that time. The terms of reference could specify the matters that the ICRC or AER should report on. These should include the key indicators of market structure, conduct

⁶⁵ Essential Services Commission, *Energy Retailers: Comparative Price Report - Pricing and the Competitive Market 2008-09*, December 2009, p. 8.

⁶⁶ *ibid*, p. 1.

⁶⁷ *ibid*.

and performance that it deems relevant, such as switching, prices and product offerings. It would also be important to obtain information from all of the licenced retailers in the market to obtain a complete view on the market and provide useful information to the public and the government. Appendix C provides more information on a possible price monitoring and reporting framework.

Importantly, the ACT Government would retain the option to re-introduce price regulation if it considered that this course of action was warranted.

D.4.3 Implications

This option does not provide any ex ante assessment or review of retail prices being offered by the incumbent or any other retailer active in the small consumer segment of the electricity market. The removal of the TFT will allow the market to determine a price, product range and degree of rivalry. The monitoring program would report on prices and other matters that have been available over the previous 12 months to the public.

However, it is likely to reduce regulatory costs (relative to the status quo) because pricing determinations would no longer be required. This assumes that the costs associated with monitoring and reporting will be lower than the costs related to a pricing determination. Additionally, the risks associated with regulation (both now and in the future) would be removed.

In considering the possible implications, it is important to note that in the ACT gas market, prices have moved very little and the number of active retailers has not increased greatly since the market was deregulated. However, there is no public monitoring and reporting program and so there is little information available on the operation of the gas market.

The AEMC also notes ActewAGL Retail's submission to the Stage 1 Draft Report that, 'any price surveillance or monitoring regime must be designed in a way that does not impose unreasonable regulatory risk, burden or uncertainty'.⁶⁸ The AEMC agrees with this comment.

In a competitive market, the prices, product range and number of active retailers would be determined by the market. ActewAGL Retail, which is likely to currently possess some cost advantages relative to second tier retailers, may be able to increase prices up to the point where no additional retailers have an incentive to enter into and expand within the market (if the non-pricing options are not also undertaken). However, this depends on the relative economies of scale and scope of second tier retailers and whether there are constraints for entry and expansion. Therefore, prices could increase in the short-term (although this unlikely to occur if the non-pricing options are also implemented).

⁶⁸ ActewAGL Retail submission, 6 September 2010, p. 8.

Nevertheless, if the unique characteristics of the ACT market are addressed, prices are unlikely to increase in the short-term, and it is possible that prices would actually fall over time as a result of larger retailers with greater economies of scale (taking advantage of the size of their operations in other jurisdictions) entering the market (although it could still be difficult for these retailers to match ActewAGL Retail's scope in this market). Therefore, it is critical to address the unique characteristics of the ACT market that are constraining effective competition.

Additionally, the monitoring and reporting role of either the ICRC or the AER would play an important factor in the operation of the market. Public monitoring would improve consumer, retailer and government information about the market. Importantly, the reports would inform the ACT Government on the structure, conduct and performance of the market and whether it is necessary to reintroduce price regulation. In addition, the reporting promotes transparency and so discipline on the conduct of ActewAGL Retail.

D.5 Option (D): removal of retail price regulation

This Option is the complete deregulation of electricity prices in the ACT, without price monitoring or public reporting.

D.5.1 Outline of this Option

This Option is essentially the same as Option (C) without the price monitoring and reporting program

D.5.2 Achieving this outcome

The complete removal of retail price regulation in the ACT could be achieved by the ACT Attorney-General not providing the ICRC with a terms of reference. This is the favoured option of ActewAGL Retail that considered 'the AEMC should consider a first best option, being the recommendation of full price deregulation'.⁶⁹

It should be noted that even following complete deregulation, the ACT Government would retain the ability to reintroduce full retail price regulation under the ICRC (or Utilities) Act should it be required in the future. However, in the absence of a monitoring and reporting program, it would be difficult to determine whether a market failure has occurred and reintroducing regulation is necessary.

D.5.3 Implications

As with Option (C), this Option does not provide any ex ante assessment or review of retail prices being offered by the incumbent or any other retailers active in the small consumer segment of the electricity market. The complete removal of the price

⁶⁹ ActewAGL Retail submission, 6 September 2010, p. 8.

regulation would allow the market to determine a price, product range and degree of rivalry. However, there is no control over what prices will be and given ActewAGL Retail's economies of scale and scope in the market, its prices (and products) will likely be central to any retailer rivalry.

In support of this Option, ActewAGL Retail noted that following deregulation of natural gas prices in the ACT from 2004, there has been little evidence of significant price increases. For example, ActewAGL Retail noted that 'the ease and success of this transition demonstrates that a price monitoring system may be an unnecessary and costly step in the deregulation process, particularly when considered in the context of the seven years of transitional pricing arrangements in the ACT'.⁷⁰ It should be noted that retailer rivalry in the natural gas sector has however remained low since price regulation ceased.

The only real difference between this Option and Option (C) is that it does not include any structured public monitoring and reporting program. While there is a benefit of lower regulatory costs, the disadvantage is that consumers, retailers and the ACT Government are unlikely to be fully informed about the products, prices and activity in the market. This will make it more difficult for decision makers to determine whether it is necessary to reintroduce price regulation. Notwithstanding, the threat of reintroducing price regulation still remains. The AEMC notes that in the long-term, it may make sense to eventually move to this Option after a period of price monitoring and reporting.

D.6 Draft findings

In summary, the key implications of each pricing Option include:

- Option (A) - prices are likely to remain relatively low; however, it is unlikely that retailer rivalry or the competitive pressure on ActewAGL Retail will improve. As a result, there are unlikely to be improvements in product innovation and offerings. In addition, the regulatory risk that the prices will not accurately reflect costs (both now and in the future) remains;
- Option (B) - prices could increase in the short-term (if non-pricing options are not also undertaken); however, retailer rivalry should improve, or at least the competitive pressure on ActewAGL Retail. This should ensure that second tier retailers are able to recover their costs and earn a rate of return that is commensurate with the risks involved in operating in the market and so greater product innovation and offerings. Notwithstanding, the regulatory risk that the prices will not accurately reflect costs (both now and in the future) remains. Additionally, it may be difficult to adequately define a single fuel supply efficient new entrant;
- Option (C) - prices could increase in the short-term (if the non-pricing options are not also undertaken); however, prices would end up at the same level as Option

⁷⁰ ActewAGL Retail submission, 6 September 2010, p. 8.

(B). In addition, retailer rivalry should improve, or at least the competitive pressure on ActewAGL Retail. This should result in the most efficient level of prices in the long-run and greater product innovation and offerings (assuming other market constraints are reduced). Finally, monitoring and reporting promotes transparency and so discipline on the conduct of ActewAGL Retail and provides decision makers with information on whether the reintroduction of regulated prices is necessary; and

- Option (D) - the implications are the same as Option (C) except consumers, retailers and the ACT Government are likely to be less informed about the products, prices and activity in the market. This will make it more difficult for decision makers to determine whether it is necessary to reintroduce price regulation, although the threat reintroducing price regulation still remains. Additionally, the regulatory costs associated with price monitoring and reporting would be removed.

These pricing options need to be considered with the various non-pricing options to determine the combination that will be most effective in promoting competition in the ACT electricity retail market. The next chapter looks at both the non-pricing and pricing options to determine the combination that will be most effective in improving the level competition in the market.

E Evaluation of combined options

The following is the evaluation of the combined non-pricing and pricing options replicated from the Stage 2 Draft Report.

E.1 Benefits and costs of options

This section considers the costs and benefits of implementing the various pricing and non-pricing options that have been outlined in the previous chapters of this report and develops the recommended approach for improving competition in the ACT electricity retail market. In doing so, the AEMC has had regard to the analytical framework set out in Chapter 2. That is, this analysis has been carried out with reference to the national electricity objective, the objectives of the AEMA, the benefits of competitive markets and principles of good regulatory practice.

E.1.1 Benefits and costs of non-pricing options

Appendix C described the non-pricing options aimed at improving the environment for retail entry for both the demand and supply side issues identified in the Stage 1 Final Report. These options look to:

- improve customer education and information;
- minimise the effects of ACT specific regulatory and legislative requirements on the entry conditions for second tier retailers; and
- improve the competitive environment between the incumbent and second tier retailers entering the market through a review of cost allocation requirements on ActewAGL.

The level of costs and benefits of these options are ultimately dependent on the pricing option selected. However, independent of that choice, the costs and benefits associated with each of these options are summarised below.

Option (i) - improve customer education and information

This option is to address the low level of consumer awareness of the ability to switch retailers and to combat the lack of understanding by consumers on the implications of switching retailers (that is, the differences between transmission, distribution and retail in the electricity supply chain).

Pros	Cons
<ul style="list-style-type: none">• provides information and tools to consumers that will allow them to make informed decisions about their electricity supply.	<ul style="list-style-type: none">• direct costs of implementing an education and information campaign for the ACT Government.

Pros	Cons
<ul style="list-style-type: none"> • this information could encourage consumers to consider switching either electricity retailers or services to better suit their needs. • could encourage retailers to offer a greater range of products to address consumer interest in alternatives to standard supply services, resulting in increased retailer rivalry. 	<ul style="list-style-type: none"> • risk that it is ineffective if these factors prevent retail competition. • start-up costs associated with website design and ongoing maintenance. • some on-going cost to retailers to provide required information for the website.

Option (ii) - harmonisation of regulatory requirements across jurisdictions

During consultation stakeholders noted that in the ACT there are specific regulatory requirements that retailers are required to address. As noted in the Stage 1 Final Report, stakeholders highlighted the historical dominance of ActewAGL Retail and the ACT's feed-in tariff scheme as potential disincentives to second tier retailers entering the market. Therefore, this option assesses methods that could be utilised to harmonise the regulatory requirements across jurisdictions to improve the entry conditions of the ACT electricity retail market for second tier retailers.

Furthermore, to improve the harmonisation of cross jurisdictional regulatory requirements, implementation of the NECF should be undertaken as soon as practicable.

Pros	Cons
<ul style="list-style-type: none"> • aligns the ACT market more closely with other jurisdictions. • lowers compliance and administrative costs for retailers. • provides opportunities for retailers that are active in other jurisdictions to extract any available benefits in economies of scale in operating in both jurisdictions. 	<ul style="list-style-type: none"> • the ACT Government will need to take into account policy developments in other jurisdictions when setting its own energy policies. • on-going costs to achieve inter-jurisdictional agreement - transitional arrangements to change, which may impact on existing users. • risk that retailer rivalry does not improve as a result of improving inter-jurisdictional consistency. • unlikely to be effective as difficult to isolate effects/costs for second tier retailers.

Option (iii) - amending the competitive environment between incumbent and second tier retailers

This option aims to address the competitive advantage of ActewAGL Retail due to its inherent cost advantages. The aspects that are analysed under this option are the

rebranding of the ActewAGL businesses (that is, corporate separation) and a review of the cost allocation arrangements between ActewAGL Distribution and ActewAGL Retail.

Pros	Cons
<ul style="list-style-type: none"> decreases second tier retailers' cost disadvantage relative to ActewAGL Retail. reduces barriers to entry and expansion for second tier retailers. could encourage greater rivalry between ActewAGL Retail and second tier retailers. may encourage retailers to offer a greater range of products and services. 	<ul style="list-style-type: none"> reduces efficiency benefits created through ActewAGL Retail's economies of scale and scope, which could otherwise be passed on to consumers. regulatory costs to review and amend ring-fencing requirements for ActewAGL Retail.

Of the non-pricing options outlined above, the AEMC considers that improved customer awareness and swift adoption of the NECF would be the most influential in promoting competition in the ACT electricity retail market. There may also be merit in reviewing the cost allocation between the ActewAGL business units.

E.1.2 Benefits and costs of pricing options

As set out in Appendix D, the AEMC has considered four pricing options in forming its draft advice on ways to promote competition in the ACT electricity retail market. These are:

- (A) retain the current TFT;
- (B) change the TFT to that of a single fuel supply efficient new entrant;
- (C) replace the TFT with reporting and monitoring; and
- (D) remove retail price regulation.

The benefits and costs associated with each of these pricing options are summarised below.

Option (A) - retain the current TFT

This option assesses the impacts to the ACT electricity retail market of maintaining the current price regulation regime.

Pros	Cons
<ul style="list-style-type: none"> regulated prices remain relatively low (consumers benefit from ActewAGL) 	<ul style="list-style-type: none"> does not address the other unique characteristics of the ACT electricity retail

Pros	Cons
Retail's cost advantages).	<p>market limiting the effectiveness of competition in the market.</p> <ul style="list-style-type: none"> likely to improve the level of competition. unlikely to be improvements in product innovation and offerings. regulatory risk that the prices will not accurately reflect costs (both now and in the future). the actual margins available to second tier retailers may not be the same as those earned by ActewAGL Retail. the margins available to second tier retailers could continue to be perceived as insufficient to account for the risks of operating in the market over the long-term.

Option (B) - change the approach to setting the TFT

Across the NEM, each jurisdiction uses slightly different methodologies to calculate regulated prices. This option canvasses several changes that could be made to how the regulated price is set in the ACT. The changes range from the simple addition of a cost element for customer acquisition and retention costs to changing the basis of the calculation from the efficient costs of the incumbent retailer to that of an efficient single fuel provider new entrant.

Pros	Cons
<ul style="list-style-type: none"> price setting methodology is likely to be aligned more closely with that of other jurisdictions; should ensure that second tier retailers are able to recover their costs and earn a rate of return that is commensurate with the risks involved in operating in the market. retailer rivalry could improve, or at least the competitive pressure on ActewAGL Retail. should encourage improvements in product innovation and offerings. 	<ul style="list-style-type: none"> does not address the other unique characteristics of the ACT electricity retail market limiting the effectiveness of competition in the market. without the implementation of the non-pricing options, there could be a possible increase in prices in the short-term until competition in the market is developed. may be difficult to adequately define a single fuel supply efficient new entrant. regulatory risk that the prices will not accurately reflect costs (both now and in the future).

Option (C) - replace the TFT with reporting and monitoring

An alternative to maintaining retail price regulation (either in its current form or in an amended form), is to replace it with a public price monitoring program overseen by the ICRC or the AER.⁷¹ This option aims to eliminate the TFT as a possible deterrent to second tier retailers entering the ACT market.

Pros	Cons
<ul style="list-style-type: none"> retailer rivalry could improve, or at least increase the competitive pressure on ActewAGL Retail. should encourage improvements in product innovation and offerings. some administrative and regulatory costs related to price monitoring and reporting, but these should be less than the costs of the current price setting approach. improved information to assist government decision making (as compared to Option D). greater information (from the monitoring program) available to consumers and to retailers (as compared to Option D). 	<ul style="list-style-type: none"> does not address the other unique characteristics of the ACT electricity retail market limiting the effectiveness of competition in the market. without the implementation of the non-pricing options, there could be a possible increase in prices in the short-term until competition in the market is developed. some administrative and regulatory costs associated with carrying out a price monitoring and reporting regime.

Option (D) - remove retail price regulation

In the ACT, price regulation of natural gas for small customers was removed in 2004. Therefore, this option was to assess the likely impacts on the market of undertaking a similar approach with electricity price regulation.

Pros	Cons
<ul style="list-style-type: none"> retailer rivalry could improve, or at least the competitive pressure on ActewAGL Retail. should encourage improvements in product innovation and offerings. administrative and regulatory costs are removed. 	<ul style="list-style-type: none"> does not address the other unique characteristics of the ACT electricity retail market limiting the effectiveness of competition in the market. without the implementation of the non-pricing options, there could be a possible increase in prices in the short-term until competition in the market is developed. lack of transparency and an information deficiency to guide policy decision making (for example, whether there is a need to

⁷¹ Note that this is the approach utilised by the ESC in Victoria.

Pros	Cons
	reintroduce price regulation in the future). <ul style="list-style-type: none"> • lack of market information readily available to consumers and retailers.

E.2 Combinations of pricing and non-pricing options

The AEMC has concluded that a mixture of non-pricing and pricing options is required. In respect of the non-pricing options, the Stage 1 Final Report concluded that:

- the weak presence of second tier retailers in the market reduces the overall level of awareness of full retail contestability, which is likely to make customers 'sticky' and therefore more difficult to attract away from the incumbent, ActewAGL Retail;
- this lack of awareness of FRC and ActewAGL Distribution's provision of distribution services could also give customers the perception that the products offered by ActewAGL Retail (that is, electricity) is more valuable than the product offered by other retailers (that is, there is a perceived product differentiation). This perception would increase the level of stickiness; and
- there may be possible merit in reviewing the guidelines for costs allocation relevant to ActewAGL.

Therefore, these non-pricing aspects are common to all of the combined options that have been considered by the AEMC.

Consequently, the question is which pricing option should be combined with the non-pricing changes and the timing of those measures, to provide the provide the greatest likelihood that the goal of improving competition in the market is achieved. However, the assessment carried out in the Stage 2 Draft Report indicated that not all combinations of options appear to be equally successful in meeting this goal. The table below sets out a summary of the various options that have been discussed in this report.

Table E.1 Summary of price and non-price options

Options	Option elements	Comments
1	A – retain the TFT (i) improve customer awareness and (ii) implement the NECF.	Prices remain relatively low (consumers benefit from ActewAGL Retail's economies of scale and scope). Customer awareness less likely to be effective. No evidence that regulated prices have not been sufficient for ActewAGL Retail to

Options	Option elements	Comments
		<p>recover its costs.</p> <p>Retailer rivalry and competitive pressure on ActewAGL Retail unlikely to improve.</p> <p>Regulatory risks remain.</p> <p>Product innovation and differentiation could remain low.</p>
2	<p>B – change the TFT to an efficient single fuel new entrant</p> <p>(i) improve customer awareness and (ii) implement the NECF.</p>	<p>Does not address the other unique characteristics of the ACT electricity retail market limiting the effectiveness of competition in the market.</p> <p>Without the implementation of the non-pricing options, there could be a possible increase in prices in the short-term until competition in the market is developed.</p> <p>Retailer rivalry may improve over the medium-term.</p> <p>Regulatory risks remain.</p>
3	<p>C – replace the TFT with reporting and monitoring</p> <p>(i) improve customer awareness and (ii) implement the NECF.</p>	<p>Without the implementation of the non-pricing options, there could be a possible increase in prices in the short-term until competition in the market is developed.</p> <p>TFT-related barriers are removed.</p> <p>May encourage improvement in competition.</p> <p>Administrative costs of monitoring.</p> <p>Increased information to improve policy decision making - work with other public information for consumers.</p> <p>Better informed market.</p>
4	<p>D – remove retail price regulation</p> <p>(i) improve customer awareness and (ii) implement the NECF.</p>	<p>Without the implementation of the non-pricing options, there could be a possible increase in prices in the short-term until competition in the market is developed.</p> <p>TFT-related barriers are removed.</p> <p>May encourage improvement in competition.</p> <p>No administrative costs.</p> <p>Requires the customer education campaign to increase information available to the market.</p>

Options	Option elements	Comments
		Does not provide information for decision makers to re-regulate if required.

Table E.1 indicates that the first combined option (**Option 1**) of retaining the current TFT and addressing consumer awareness of competition in addition to the other issues identified in the non-pricing options is unlikely to be successful in creating and sustaining a more competitive environment. If the TFT is not changed at all, then second tier retailers could continue to be reluctant to enter the market. It is expected that customer awareness would be enhanced through an education and information campaign and aid in the reduction of customer stickiness. However, if second tier retailer entry is not also enhanced the benefits of undertaking a consumer awareness program will be limited.

In brief, if the TFT is retained in the long term then the value of implementing the other options decreases significantly. In addition, the regulatory costs of setting the TFT will continue as well as the cost to the market of distorting the market by government intervention. Over the long-term this combination is unlikely to improve competition.

The first alternative to the above is to retain the TFT, although fix it at the efficient costs of a new entrant, and implement non-pricing changes to the market to address the other barriers to entry (**Option 2**). As discussed in Appendix D, the success of this pricing option is somewhat dependent on the degree of change that is carried out. The inclusion of an allowance for CAC/CARC in the TFT alone will be unlikely to encourage retailers to enter (or consider entering) the market. This is because the basis of the cost build up would still be ActewAGL Retail's efficient costs. As a result, it is unlikely that the retail allowance will be sufficient for a second tier retailer.

The calculation of the TFT on the basis of a single fuel supply efficient new entrant may be more successful in its relevance to potential entrants. However, this approach raises questions over the assumptions required about a single fuel supply efficient new entrant. In other jurisdictions, such as NSW and Queensland, the potential new entrants used to set a cost base are specifically described. Therefore, it may be necessary for the ICRC to develop a description for a single fuel supply efficient new entrant in the context of the ACT market. However, with option 2, the overall risk of regulatory failure remains.

In addition, the degree of change made to the TFT will also influence the success of the changes that can be carried out to address the other barriers to entry. There may be some benefits arising from implementing a consumer education program and addressing the cost advantages that ActewAGL Retail has over second tier retailers. However, if retailer rivalry remains limited because retail price regulation remains in place, the benefits from the other actions may not be significant. In addition, the regulatory costs of setting the TFT will continue as well as the cost of distorting the market by regulatory intervention. In conclusion, this course of action is not recommended.

The third pricing option is to replace price regulation with a public monitoring program (**Option 3**). This allows prices to be determined by the market and information on these prices to be publicly reviewed by the relevant regulator. While ActewAGL Retail would remain, certainly in the short term, the most significant retailer in the market, this option has the benefit of removing ex ante price regulation in the market.

This arrangement would be enhanced if the consumer awareness program is also implemented - improving the operation of the demand side of the market - and the other barriers to entry are redressed. The threat of the ACT Government re-introducing direct price regulation if it considers this appropriate would remain and may also act as a deterrent to retailer misconduct. Together, the combination of these actions should provide an environment that is conducive to a contestable market. That is, even if there are not numerous retailers active in the market in the short term, the threat of entry from a number of retailers should be more realistic. The credible threat of entry in itself will encourage ActewAGL Retail in particular, to provide products that consumers desire at prices that they are willing to pay. To price at a level higher than this, for example, will provide encouragement to a second tier retailer to enter the market quickly and compete against ActewAGL Retail. An attempt to increase prices above justified levels would also increase the likelihood that direct price regulation would be re-introduced by the ACT Government.

The fourth option discussed in Appendix D was to remove price regulation entirely (**Option 4**). That is, remove all prices with no oversight by either the ICRC or the AER. As with the previous option, this would provide an arrangement that should encourage second tier retailers to compete on price. The threat of the ACT Government re-introducing direct price regulation if it considers it appropriate would remain and may act as a deterrent to retailer misconduct.

Again, as with the previous option, the benefits of this choice would be enhanced if the actions aimed at addressing the non-pricing issues are also enacted. However, in this case, the introduction of the consumer awareness campaign is more critical. Without a monitoring program, the consumer education role of the ACT Government (through the relevant department) becomes the only source of information available about the market and its developments. While useful to market participants, this would not provide the ACT Government with all information that would be relevant to making policy decisions in relation to the small customer segment of the electricity market. The AEMC considers that there is an element of safety in retaining monitoring in the short-term as competition is fostered in the market. However, in the long-term, monitoring could be removed.

For this reason, while this fourth option should see some success in achieving the goal of promoting competition, it is not the AEMC's preferred course of action. Instead, the AEMC's draft advice to the ACT Government is to implement the various non-pricing elements contained within Option 3 above, in addition to the subsequent removal of the TFT.

F Cost allocation and ring-fencing guidelines

Cost allocation methodology

The AER is responsible for regulating the revenues of Distribution Network Service Providers (DNSPs) in the National Electricity Market (NEM) in accordance with the National Electricity Law (NEL) and the National Electricity Rules (NER).

Under the NER, the AER is required to develop and publish certain models, guidelines and schemes. The cost allocation guidelines set out arrangements to manage the attribution of direct costs and the allocation of shared costs by DNSPs between different categories of distribution services. The categories of distribution services are: standard control services, alternative control services, negotiated distribution services and non-regulated services.

Ring-fencing guidelines

As with the cost allocation methodology, under the NER the AER is responsible for implementing, reviewing and updating the ring-fencing guidelines. The AER is also responsible for measuring a DNSPs compliance with the ring-fencing guidelines.

Ring-fencing is the identification and separation of business activities, costs, and decision making within an integrated entity where part of the entity is providing monopoly services and another is providing services in a competitive market. The purpose of ring-fencing is to ensure that businesses operating in regulated monopoly industries do not use their monopoly power, or collude with associated businesses, to give those associated businesses an unfair advantage over their market competitors. It is also intended to reduce or eliminate both incentives and opportunities for such anti-competitive behaviour. Specifically, the guidelines aim to prevent the deliberate and discriminatory transfer of information and resources from a monopoly business to an associated business.

Table F.1 Cross jurisdictional comparison for a sample of cost allocation and ring-fencing guidelines

Reference to marketing	ActewAGL	Ergon Energy	Energy Australia	SP Ausnet
Cost allocation methodology	<p>Under allocation of retail costs to electricity networks:</p> <ul style="list-style-type: none"> Marketing - includes network specific marketing, other marketing (which includes publications such as Yellow Pages, internet development and website maintenance), sponsorships and overheads. <p>Note: marketing costs are allocated directly to the relevant business as far as possible. For example, the cost of electricity network specific marketing is allocated directly to electricity networks.</p> <p>Other marketing costs, are shared among electricity, gas and water in proportion to customer numbers.</p>	<p>Under customer and stakeholder relations:</p> <ul style="list-style-type: none"> Marketing - based on work allocation. 	<p>Under external related works:</p> <ul style="list-style-type: none"> Marketing and bad debts management costs - direct operating costs. <p>Note: within EnergyAustralia, retail is one of the four operating divisions and is responsible for energy sales, marketing and wholesale activities.</p>	<p>Under the network operating costs:</p> <ul style="list-style-type: none"> Marketing - standard control/non-regulated.
Ring-fencing guidelines	<p>Joint marketing - for the purposes of these guidelines joint marketing is defined as joint advertising, promotions, presentations, and project development. The ICRC does not oppose joint marketing as</p>	<p>The QCA opted to include a requirement that marketing staff do not work for both the distribution and retailing businesses. However, where there are arguments for doing so, the guidelines permit the</p>	<p>A DNSP must not, in the provision of prescribed distribution services to any person, whether a customer or otherwise, communicate with that person in a way that would favour the DNSP over</p>	<p>Distributors and retailers will be required to brand and market themselves in a manner that minimises any potential for customer confusion. However, they will not be required to adopt</p>

Reference to marketing	ActewAGL	Ergon Energy	Energy Australia	SP Ausnet
	<p>such and does not propose to ring fence such activities, for example, by requiring separate brand names. Nor is the ICRC concerned with joint marketing that promotes generic energy services. However, the ICRC is concerned to prevent the network business from leveraging its market power into the competitive market.</p>	<p>use of common staff in non-marketing activities while ensuring QCA is aware of such an arrangement.</p>	<p>an independent accredited service provider in the provision of contestable services to the person.</p> <p>Note: an example of the type of communication referred to above is marketing by the DNSP.</p>	<p>different brand names.</p> <p>To improve the clarity of communications with customers, the guideline will provide that a distributor must use best endeavours to make it clear to customers that it is an electricity distributor carrying on a distribution business. Equally, a retailer must use best endeavours to make it clear to customers that it is an electricity retailer carrying on a retail business.</p> <p>If a distributor and a retailer share a website, then it must be clear on each page of the website whether the distributor or the retailer is responsible for that page. In addition, each page must deal with only content directly relevant to the responsible distributor or retailer. If a distributor advertises a retailer's retail goods and services on a page, then it must allow non-discriminatory access by all retailers to advertise on the page or have a link on the page to their websites.</p>

Note: The Ring-fencing guidelines for the ACT, NSW and Queensland were sourced on the AER's website and the Victorian ring-fencing guidelines were sourced from the Essential Services Commission of Victoria.

The cost allocation methodologies were sourced from each of the companies homepages.