esaa Energy Supply Association of Australia www.esaa.com.au

ABN 98 052 416 083
Level 2
451 Little Bourke St
Melbourne
GPO Box 1823
Melbourne
Victoria 3001
P +61 3 9670 0188
F +61 3 9670 1069
E info@esaa.com.au

RECEIVED
20 AUG 2008

15 August 2008

Trim Record: 08-46579

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235
Ref: EOR0017/2

Via email: submissions@aemc.gov.au

Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in South Australia – First Draft Report

The Energy Supply Association of Australia (esaa) welcomes the opportunity to comment on the Australian Energy Market Commission's (AEMC) Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in South Australia – First Draft Report (the draft report).

esaa is the peak industry body for the stationary energy sector in Australia and represents the policy positions of the Chief Executives of over 40 electricity and downstream natural gas businesses. These businesses own and operate more than $120 billion in assets, employ 49,000 people and contribute $14.5 billion directly to the nation's Gross Domestic Product.

esaa fully supports the preliminary findings of the draft report that competition is effective for both small electricity and natural gas customers in South Australia. A study undertaken for esaa by CRA International into the effect of retail price regulation found that price regulation in contestable retail energy markets is likely to confer little or no public benefit but impose considerable direct and indirect costs, thus reducing overall welfare[1]. Direct costs occur for government regulators and retailers during the price determination process, and indirect costs occur by dampening competition and reducing efficiency. Given the findings of the draft report, esaa encourages the AEMC to provide advice to the Ministerial Council on Energy (MCE) as soon as practical recommending the efficient phasing out of retail price regulation in South Australia.

The AEMC, in applying the MCE criteria for the effectiveness of competition, have identified three key analytical strands to inform its approach to the review. These are:

- Consumer behaviour, attitudes and information requirements in relation to the purchase of energy products and services;
- The nature and extent of rivalrous behaviour between energy retailers; and
- Conditions for entry into and expansion in energy retailing in South Australia.

[1] esaa (January 2007) The effects of retail price regulation in Australian energy markets, CRA International, page 5. (http://www.esaa.com.au/papers__submissions.html), posted 26 June 2007

The draft report presents strong evidence in each of these three strands to support its findings of effective competition in South Australia including:

- Customers are actively responding to retailer offers with well over half of small electricity and gas customers having moved from standing to market contracts;
- Substantial entry into the energy markets has occurred since the introduction of Full Retail Contestability, with new retailers supplying around 42 percent of the small customer energy market; and
- Retailer rivalry is evident, with price competition based mainly around discounts from the regulated retail standing contract.

The draft report also identifies that the continued regulation of retail price is itself an impediment to the ongoing viability of small retailers in South Australia, noting that:

> 'the ability of electricity retailers to pass on higher input costs to small customers is constrained by standing contract prices which act, in effect, as a price ceiling and place an upper limit on the margin available to retailers'.

The draft report cites increased electricity wholesale market costs related to the recent tightening of supply and demand and emerging climate change policy responses as factors which are currently putting pressure on retailer margins. This is subsequently reducing incentives for retail expansion and entry in South Australia. It is also noted that most retailers have suggested that current retail prices are insufficient to cover the cost of new hedge contracts. The concern raised is that unless standing contract prices are able to accommodate higher input prices then retailer viability and effective competition could be at risk.

esaa agrees with the AEMC's observations and considers that the imminent introduction of an emissions trading framework under the Federal Government's proposed Carbon Pollution Reduction Scheme in particular will exacerbate the risks associated with ongoing price regulation.

Recent modelling undertaken for esaa by ACIL Tasman[2] shows that retailers will face increases in real electricity tariffs of 24 and 28 percent respectively under a 10 and 20 percent emissions reduction scenario in the period to 2020. Additionally, the ACIL study indicates that the liquidity of contractual markets could be impacted as more marginal, emissions intensive generators reduce their output and contractual positions in the market in response to increasing emissions permit prices. Retailers rely on the availability of long term contracts with generators in order to hedge their exposure to electricity wholesale market price volatility.

The likely impacts of climate change policies on energy markets underscore the importance of ensuring that retail prices are both cost reflective and flexible enough to allow retailers to pass through energy cost increases. Removing retail price regulation would achieve this aim and ensure that South Australia's customers are delivered least-cost energy through the competitive pressures identified by the AEMC in the draft report. Price flexibility would also enable retailers to dynamically respond to changes in wholesale costs and contract with more marginal generators and ensure both supply reliability and ongoing financial viability.

[2] esaa June 2008 'The impact of an ETS on the energy supply industry'. Available from: http://www.esaa.com.au/reports_studies.html

The ability to efficiently pass through costs associated with climate change policies to consumers will also be essential for the effective operation of the emissions trading scheme by providing price signals for consumers to engage in optimal energy efficiency and demand reduction measures.

esaa's strong view is that given the demonstrable effectiveness of retail competition in South Australia and the significant challenges facing the energy supply sector over the coming decades, the AEMC should adopt the draft report's findings in full and provide advice to the MCE as soon as practical recommending the efficient phasing out of retail price regulation.

Yours sincerely,

Brad Page
Chief Executive Officer