

27 August 2010

John Pierce  
Chairman  
Australian Energy Market Commission  
PO Box A2449  
Sydney South NSW 1235

By Email: [submissions@AEMC.gov.au](mailto:submissions@AEMC.gov.au)

Dear Mr Pierce

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

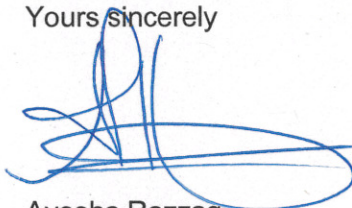
Thank you for the opportunity to respond to the Australian Energy Market Commission's (AEMC's) *First Draft Report – Review of the effectiveness of competition in the electricity retail market in the ACT*.

ActewAGL Retail welcomes the AEMC's review, noting that the purpose is to provide a basis for recommendations on the possible removal, retention or re-introduction of retail price regulation, in accordance with the Australian Energy Market Agreement. We believe that the AEMC's conclusions in the *First Draft Report* provide a clear and strong basis for a recommendation to remove retail price regulation in the ACT.

ActewAGL Retail's responses to the matters raised in the *First Draft Report* are set out in the attached submission. We look forward to ongoing consultation with the AEMC on policy issues and options in stage 2 of the review.

Please contact Leanne Holmes, Manager Economic Regulation (0412 850 715) if you would like to discuss any aspect of our submission.

Yours sincerely



Ayesha Razzaq  
General Manager Retail

*Let's power ahead.*



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

## ActewAGL Retail response to AEMC First Draft Report

6 September 2010

(amended response)

(Original response submitted 27 August 2010)



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## Key points

- The potential problems and significant risks associated with regulating retail tariffs in a market that is open to competition are widely acknowledged. As noted by the Ministerial Council on Energy, regulated energy price setting has the potential to conflict with and impede efficient market outcomes if prices are not set at cost reflective levels.
- These problems and risks remain apparent in the ACT retail electricity market, which has been fully open to competition since 2003.
- The Australian Energy Market Commission (AEMC) has identified the level of the regulated retail tariff as the primary barrier to market entry and expansion in the ACT electricity market. This conclusion is strongly supported by retailers, as indicated by the results from the surveys commissioned by the AEMC, as well as retailer submissions.
- The AEMC also concludes that other barriers to entry and expansion are “comparatively minor” and not likely to impede competition. ActewAGL Retail notes that retailers have also expressed this view in survey responses and submissions.
- The AEMC has underestimated the importance of some key indicators in its assessment of the effectiveness of competition, particularly the strong threat of entry and the extent of product innovation that has arisen as a result of the competitive pressure in the ACT market.
- ActewAGL Retail notes that even if the AEMC’s overall draft conclusion regarding the effectiveness of competition is accepted, the appropriate policy response for the ACT retail electricity market is for retail price regulation to be removed.
- The removal of price regulation in the ACT would be consistent with the commitments set out in the Australian Energy Market Agreement (AEMA). The AEMA includes the commitment of signatories to remove price regulation if competition is found to be effective. However, it also recognises that even if competition is found to be not effective, removing price regulation may still be the appropriate policy response.
- There have been seven years of a transitional regulated electricity price in the ACT, which was expected to provide the necessary scope and framework to set a commercial based transitional franchise tariff (TFT), but this has not yet occurred. Therefore, ActewAGL Retail does not support a policy of continuing retail price control regulation.
- Any recommendation for a transitional price monitoring arrangement, which is supported by ActewAGL Retail only as a second best alternative, should be designed



to operate in a way that does not undermine the potential benefits of the removal of price regulation.



## 1. Introduction

ActewAGL Retail welcomes the Australian Energy Market Commission (AEMC) *Review of the effectiveness of competition in the electricity market in the ACT*, and appreciates the opportunity to respond to the *First Draft Report*, released by the AEMC on 30 July 2010.

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

The *First Draft Report* sets out the AEMC's detailed assessment of the effectiveness of competition in the ACT market. The purpose of the assessment, stage 1 of the review, is to provide the basis for stage 2 where the AEMC will make recommendations on the "retention, removal or re-introduction of retail energy price controls", in accordance with the Australian Energy Market Agreement (AEMA).<sup>1</sup> The AEMC plans to release its stage 2 *Second Draft Report* (policy recommendations) at the same time as the stage 1 *First Final Report*. ActewAGL Retail therefore takes this opportunity to comment on appropriate policy responses to the issues raised in the *First Draft Report*, for the AEMC's consideration in preparing the *Second Draft Report*.

ActewAGL Retail considers the evaluation of policy options as the most critical part of the AEMC review, and we therefore provide our initial comments on policy issues and options in the following section. Comments on specific elements of the AEMC's assessment of competition in the *First Draft Report* are then provided in section 3. ActewAGL Retail looks forward to the opportunity for more detailed consultation on policy issues following the release of the AEMC's *Second Draft Report* in October.

## 2. Key issues and options for the ACT retail electricity market

### 2.1 Regulating tariffs in a market open to competition

ActewAGL Retail has argued strongly and consistently in successive Independent Competition and Regulatory Commission (ICRC) reviews of ACT retail electricity tariffs that there are significant risks and costs associated with setting a fixed regulated price in a market that is open to competition, as the ACT retail electricity market has been since 2003.

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<sup>1</sup> AEMA, July 2009, clause 14.11(a)



The difficulty and risk associated with setting the transitional franchise tariff (TFT) has been recognised by the ICRC in successive TFT reviews. For example, the ICRC noted in its final decision for the 2011-12 TFT:

While the Commission has made every effort to ensure the TFT is set at an appropriate level, the mere requirement to set a tariff introduces the risk of the Commission establishing an inappropriate price that is either too high or too low.<sup>2</sup>

The ICRC has also commented:

“An inappropriate regulated price, and its subsequent inflexibility, may act to increase the likelihood of a retailer failing.”<sup>3</sup>

The Ministerial Council on Energy (MCE) Standing Committee of Officials has also noted a range of specific problems with retail price regulation, including:

inappropriately regulated prices can dampen the development of a fully competitive market by making it less attractive for competing companies to provide innovative products to consumers; and

possible discouragement of elements of investment or innovation due to market uncertainty over future price regulation.<sup>4</sup>

The risks associated with setting a regulated tariff are exacerbated in an increasingly complex market environment. This was noted recently in the context of the possible introduction of policies to deal with climate change:

“The variability and uncertainty created in the transition will make it extremely difficult for regulators to determine a wholesale cost allowance that is competitive, but still allows a retail business to manage its risk. If the regulator makes an error, retail competition could be diminished, or worse still, a retailer could suffer financial distress, or fail.”<sup>5</sup>

The widely acknowledged potential problems with setting a regulated retail tariff in markets open to competition are clearly apparent in the ACT retail electricity market. Based on independent advice from consultants the Allen Consulting Group (ACG), the AEMC concludes:

the exclusion of a CAC/CARC allowance in the cost index that determines regulated prices has resulted in margins that do not appear commensurate with the prevailing financial conditions of the market and the risks involved in providing retail services.<sup>6</sup>

The AEMC has found that the resulting regulated retail tariff has:

...had the effect of deterring potential entrants from entering into, or expanding within, the ACT retail electricity market.<sup>7</sup>

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<sup>2</sup> ICRC, June 2010, Final Decision – *Retail prices for non-contestable electricity customers 2010-12*, p. 7

<sup>3</sup> ICRC, June 2009, Final Decision – *Retail prices for non-contestable electricity customers 2009-10*, p. 61

<sup>4</sup> MCE Standing Committee of Officials, March 2004, Discussion Paper - *Improving user participation in the Australian energy market*, p. 17

<sup>5</sup> Farrier Swier, 2009, *Managing CPRS transition: implications for electricity price regulation*, p. 3

<sup>6</sup> AEMC, July 2010, First Draft Report – *Review of the effectiveness of competition in the electricity retail market in the ACT*, p. 71



This conclusion is reinforced by retailers, who have identified the regulated tariff as the key problem in the ACT retail electricity market. In the report commissioned by the AEMC, GA Research concludes:

Most of the inactive licensed retailers have indicated that the removal of retail electricity price regulation would be the trigger they need to commence their pursuit of customers within the market.<sup>8</sup>

This comment by retailers also supports the AEMC conclusion that other barriers are not likely to impede competition.

## 2.2 Options for addressing the problems in the market

### 2.2.1 The requirements of the Australian Energy Market Agreement

The AEMA provides clear guidance on appropriate policy responses to the issues arising from the AEMC's assessment of competition. Clause 14.11(c) requires the AEMC to provide advice on:

- (i) ways to phase out retail price regulation if competition is determined to be effective and an appropriate timeframe; or,
- (ii) ways to promote the growth of effective competition for those users or areas of a jurisdiction which do not enjoy effective competition.

As noted by the AEMC at the public forum in Canberra, removal of price regulation could be the appropriate policy recommendation under either case – if competition is determined to be effective or if it is not. If competition is determined by the AEMC to not be effective, then removal of price controls or the application of more lighted handed regulation would be the preferred policy response under the AEMA, if the AEMC considers it likely to promote the growth of effective competition.

The AEMA also contains important commitments regarding the possible retention of retail price regulation. In deciding whether to retain price regulation, where competition is assessed as not effective, AEMA signatories are required to take account of the costs and benefits. Clause 14.12 says:

The Parties agree that where competition is not yet effective for a market, group of users or region:

- (a) retail energy price controls (including those furthering social welfare and regional equity objectives) can be imposed by the relevant State or Territory but should, to the extent possible, not hinder further development of competition and ensure that the benefits outweigh the costs and the costs are minimised.

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<sup>7</sup> AEMC, July 2010, First Draft Report – *Review of the effectiveness of competition in the electricity retail market in the ACT*, p. i

<sup>8</sup> GA Research, June 2010, Retailer Research Report – *Australian Energy Market Commission Review into the effectiveness of competition in the electricity retail market – ACT*, p. 5



The AEMA commitment regarding equity and welfare objectives is also particularly relevant to the AEMC's competition review. Clause 14.11(b) says:

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

## 2.2.2 Removal of retail price regulation

Given the AEMA commitments outlined above, and the AEMC's conclusions that the "primary barrier to entry and exit is the low regulated TFT" and other barriers are "comparatively minor",<sup>9</sup> ActewAGL Retail considers that removal of retail price regulation is clearly the appropriate policy option for the ACT retail electricity market.

The option of removing retail price regulation directly targets what the AEMC has identified as the critical barrier to competition in the ACT retail electricity market. It also addresses the fundamental problems such as regulatory risk, which have been widely acknowledged by regulators, including the ICRC, as well as governments and energy retailers (as discussed in section 2.1 above). ActewAGL Retail agrees with the ICRC's view on the likely long term benefits of removing the regulated TFT from the market:

This will allow the market to find the most appropriate pricing structures and encourage competition in the development of alternative products and levels of service. It will encourage retailers to develop their own risk-management strategies to address the volatility likely to result from the range of emerging climate change policies.<sup>10</sup>

ActewAGL Retail recognises that, where competition is determined to be not effective, the AEMA does provide some scope for retaining price regulation where there is a clear net benefit. The AEMA conditions attached to a decision to retain regulation – that the benefits must outweigh the costs and the costs must be minimised – are critical here.<sup>11</sup>

ActewAGL Retail acknowledges that it is difficult to establish an empirical basis for comparing outcomes with and without price regulation. We note that the ICRC concluded in its final decision for the 2011-12 TFT:

...the Commission considers that a 'regulated' franchise tariff is likely to provide greater benefits to customers than a fully 'competitive' tariff.<sup>12</sup>

However, the ICRC did not provide convincing or compelling evidence in support of its conclusion regarding the net economic benefits of choosing to set a TFT below the commercial level.

In light of the significant problems and costs associated with retaining price regulation, as discussed in section 2.1 above, any decision to retain price regulation must be accompanied by rigorous evidence based conclusions using an economic framework, that is then exposed

<sup>9</sup> AEMC. July 2010. *First Draft Report: Review into the effectiveness of competition in the electricity retail market in the ACT*. p. 5

<sup>10</sup> ICRC, June 2010, Final Decision – *Retail prices for non-contestable electricity customers 2010-12*, p. 7

<sup>11</sup> AEMA clause 14.12

<sup>12</sup> ICRC, June 2010, Final Decision – *Retail prices for non-contestable electricity customers 2010-12*, p. 57



to critical review, to properly assess whether the benefits outweigh the costs. Furthermore, given the AEMA requirement that “costs must be minimised”, it is not sufficient to show that maintaining price regulation will achieve some goals, such as social or equity objectives. The relevant question is not whether maintaining a regulated price will help to address some social objectives, but rather whether it is the *best* way to address those objectives.

### 2.2.3 Addressing social welfare and equity objectives

ActewAGL Retail strongly supports the position, as set out in the AEMA, that social objectives should be addressed directly and through transparently funded measures which do not impede competition. ActewAGL Retail has argued consistently in submissions to the TFT reviews that it is not appropriate to use the regulated tariff to achieve social objectives. The ICRC has also stated this position:

the regulated retail tariff is not intended to be a safety net to be used for social or targeted support for smaller customers. Setting the regulated retail tariff at a level to ensure that low-income and vulnerable customers can afford their electricity bills creates several market distortions.<sup>13</sup>

ActewAGL Retail has recently re-launched an improved and comprehensive Staying Connected program for customers experiencing ongoing financial hardship. Staying Connected offers support and information to low-income and vulnerable customers, including flexible payment plan options and incentive schemes for customers who make regular payments on their account. As a part of this program, ActewAGL Retail also offers a referral service to other agencies that provide assistance and support for those customers experiencing financial hardship, and provides practical advice on reducing energy and water consumption in order to better align consumption with capacity to pay.

ActewAGL Retail firmly believes that initiatives such as the Staying Connected Hardship Program are a much more effective and appropriate mechanism for assisting those customers who are low-income and/ or vulnerable, when compared with relying on a regulated retail tariff. ActewAGL Retail also notes that the arrangements for supporting those in need – through consumer protection provisions, ActewAGL Retail’s hardship program and ActewAGL Retail’s provision of a standard contract – have worked effectively in the case of the ACT retail gas market, which has been unregulated since 2004.

### 2.2.4 Transitional measures – price monitoring

ActewAGL Retail notes that a phased removal of price regulation, with a period of price monitoring/pricing agreements, is one of the policy options identified in the AEMA.<sup>14</sup> ActewAGL Retail considers that this would be a second best solution, compared with full deregulation.

In both the Victorian and South Australian competition reviews, the AEMC recommended a regime of price monitoring following the removal of direct retail price regulation. The recommendation was accepted in Victoria, but not South Australia. The Essential Services

<sup>13</sup> ICRC, June 2010, Final Decision – *Retail prices for non-contestable electricity customers 2010-12*, p. 56

<sup>14</sup> AEMA, July 2009. *Notice of Amendment to the Australian Energy Market Agreement*. s14.14 (b)



Commission of Victoria monitors and reports on retail electricity prices in Victoria. Retailers must publish a range of offers, to help consumers compare energy prices. Other obligations on retailers, including the obligation to supply and the consumer protection framework, remain in place. The Victorian Government retains a reserve power to reinstate price regulation if competition is found to be no longer effective.<sup>15</sup> The ICRC has previously stated that the adoption of a regulatory arrangement similar to that in Victoria would be in the long-term best interests of consumers in the ACT.<sup>16</sup>

ActewAGL Retail acknowledges that the arrangement in Victoria appears to be a successful form of light-handed regulation. However, any price surveillance or monitoring regime must be designed in a way that does not impose unreasonable regulatory risk, burden or uncertainty. The arrangements should be for a clearly defined and limited period and the use of legislative powers to regulate retail prices in future should be a last resort option only. ActewAGL Retail agrees with the AEMC's view that price control regulation should only be reintroduced:

“following a review by the Commission which determined that competition was no longer effective and that direct retail price regulation would be an appropriate response.”<sup>17</sup>

However, ActewAGL Retail emphasises 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 all the potential costs and benefits, using an economic cost benefit framework.

In assessing the potential costs and regulatory burden associated with transitional price monitoring arrangements, the AEMC should also take account of relevant requirements under the new National Energy Customer Framework, and ensure that there is no costly overlap or duplication.

ActewAGL Retail believes the AEMC should consider a first best option, being the recommendation of full price deregulation. In the ACT, regulation of gas retail prices ceased from 2004. 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 to date. The competitive gas market would likely enhance the effects of electricity retail price deregulation on competition as most licensed retailers offer both energy sources.

### **3. The AEMC's assessment of competition**

The AEMC has identified a broad range of relevant indicators of effective competition, and has drawn heavily on survey responses, submissions and detailed analysis by independent

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<sup>15</sup> AER, December 2009, *State of the Energy Market*, p. 18

<sup>16</sup> ICRC, April 2009, *Draft Decision: Retail Prices for Non-contestable Electricity Customers 2009-10*, p. 69

<sup>17</sup> AEMC, February 2008, Second Final Report: *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria*, p. 24



consultants in reaching its conclusions. ActewAGL Retail provides in section 3.1 and 3.2 below some comments on the AEMC's conclusion regarding the level of the TFT.<sup>18</sup>

ActewAGL Retail accepts that, on the basis of some of the AEMC's indicators, the ACT retail electricity market does not exhibit the characteristics of an effectively competitive market. However, ActewAGL Retail has concerns about some elements of the AEMC's assessment of the effectiveness of competition. ActewAGL Retail's comments on the nature and extent of competition in the ACT retail electricity market are set out in sections 3.2 and 3.3 below.

### 3.1 Price and profit margins

#### 3.1.1 Terms of reference for ICRC price directions

The AEMC concludes in the *First Draft Report* that the ICRC's terms of reference require it to calculate the regulated retail tariff on the basis "of the efficient costs incurred by ActewAGL Retail".<sup>19</sup>

This is not correct. The requirement for the ICRC to consider ActewAGL Retail's costs is only in relation to the recovery of additional and specific cost arising from Australian Government and Territory policy obligations imposed on ActewAGL Retail as the incumbent mass market retailer, such as the cost of the feed-in tariff scheme, which must be passed through to customers.<sup>20</sup>

It is not to be confused with, and does not relate to, the need to reflect the commercial costs of a retailer in a competitive market environment under the terms of reference per section 20 of the *ICRC Act 1997*, which explicitly refers to the need to provide an appropriate return on investment and also to the costs of providing the regulated service.<sup>21</sup>

This was also noted by Origin Energy who think the ICRC's application of section 20 of the *ICRC Act 1997* has not reflected:

"...new entrant acquisition and marketing costs as elements of:

- an appropriate return on investment [clause 20(2)(d)]; and
- part of the cost base of a regulated industry [clause 20(2)(e)]."<sup>22</sup>

<sup>18</sup> See ICRC, August 2010, Submission to First Draft Report – *Review of the effectiveness of competition in the electricity retail market in the ACT*

<sup>19</sup> AEMC, July 2010. *First Draft Report: Review into the effectiveness of competition in the electricity retail market in the ACT*, p. ii

<sup>20</sup> Corbell, S MLA ACT Attorney-General, August 2009, Disallowable Instrument DI2009-196 – *Independent Competition and Regulatory Commission (Price direction for the supply of electricity to franchise customers) Terms of Reference Determination 2009*, item 3

<sup>21</sup> ICRC Act 1997, subsections 20(d) and (e)

<sup>22</sup> Origin Energy, April 2010, Submission – *AEMC review of the effectiveness of competition in the electricity retail market in the ACT*, p. 2.



### 3.1.2 Effective margins analysis

The analysis conducted by ACG for the AEMC on price levels and effective profit margins in the ACT retail electricity market provides clear evidence of the risks involved in price regulation in a market that is open to competition.

ACG correctly identifies that the absence of a CAC/CARC allowance from the regulated retail price in the ACT is a key difference between the ACT and other jurisdictions.<sup>23</sup> ActewAGL Retail has consistently identified and requested that a CAC/CARC allowance should be reflected in the regulated price set by the ICRC, as it is a legitimate and measurable market-based cost. ActewAGL Retail notes that other retailers, both in the AEMC review and the ICRC's most recent review of retail electricity prices, have also expressed strong views on the necessity of including this cost component in the regulated price build-up.<sup>24</sup> ActewAGL Retail notes that the finding by ACG confirms its own assessment of the issue, and is also consistent with the ICRC's own commercial intelligence on competitive price levels in the ACT.

ActewAGL Retail notes that, in its submission on the *First Draft Report*, the ICRC has expressed concern about ACG's methodology and findings, and suggested that the ACG analysis which the AEMC has relied upon to inform its *First Draft Report*:

...Failed to note that the build up of retail operating costs (ROC) as used by the ICRC already incorporates a sales and marketing cost element which has been adjusted annually by movements in the Consumer Price Index. Thus the ROC used in the ACT already includes some element of a CAC/CARC cost, the presence of which should be taken into account in the analysis on effective margins undertaken by ACG.<sup>25</sup>

The ICRC's advice that the ROC includes "some element" of a CAC/CARC confirms that the current ROC allowance does not *fully* reflect a commercial CAC/CARC. The ICRC's ROC allowance, and the sales and marketing component within it, was established in 2003, when the competitive forces in the retail energy market were very different to the present. ActewAGL Retail considers that subsequent CPI-only adjustments have not kept pace with the costs of responding to actual and potential competition in the ACT.

As part of its assessment of the AEMC/ACG analysis, the ICRC also argues:

Consideration should also be given to the actual dollar value of the ROC allowance made by the ICRC by comparison to other jurisdictions.<sup>26</sup>

In its report, ACG had already noted that much the same argument had already been made by the ICRC in its final decision for 2010-12 prices, where the ICRC found that the ROC in the

<sup>23</sup> The Allen Consulting Group, July 2010, Price and Profit Margin Analysis – *Review of the effectiveness of competition in the electricity retail market in the ACT*, p. 2

<sup>24</sup> See Energy Australia, March 2010, Submission to ICRC Issues Paper – *Retail Prices for Non-contestable Electricity Customers 2010-2012*, p. 1 and Origin Energy, April 2010, Submission to AEMC Issues Paper– *Review of the effectiveness of competition in the electricity retail market in the ACT*, p. 1

<sup>25</sup> ICRC, August 2010, Submission to AEMC First Draft Report – *Review of the effectiveness of competition in the electricity retail market in the ACT*, p. 5

<sup>26</sup> ICRC, August 2010, Submission to AEMC First Draft Report – *Review of the effectiveness of competition in the electricity retail market in the ACT*, p. 5



ACT is broadly comparable with the ROC allowances in other jurisdictions, taking into account economies of scale, but this excluded CAC/CARC where applicable.<sup>27</sup> ActewAGL Retail's prior analysis is consistent with the ACG's conclusion that:

...the ICRC's ROC is significantly below the ROC+CARC figure used by other regulators when economies of scale are taken into account, and it is the ROC+CARC figure that determines the revenue cap in jurisdictions that add CARC, not the ROC alone.<sup>28</sup>

What is relevant to retailers operating in a competitive market environment is full commercial cost recovery, as required under the TFT terms of reference.

In further querying the role the absence of CAC/CARC has played in stifling competitive market outcomes in the ACT, the ICRC has dismissed the inclusion of a CAC/CARC component in the TFT as being unlikely to attract retailers to enter or re-enter the ACT market.<sup>29</sup> However, the ICRC notes it had been advised a CAC/CARC component equal to, or greater than, ACG's medium level CAC/CARC would increase the TFT by the minimum level "...retailers have identified as being required to re-enter the ACT market."<sup>30</sup>

ActewAGL Retail notes ACG's conclusion that:

Our analysis of regulated retail tariffs, taking into account a competitor's cost of acquiring new customers suggests that competing retailers would need to accept (significantly) lower margins to attract new customers than what is generally considered reasonable in electricity retailing.<sup>31</sup>

And agrees with the AEMC conclusion that the margins in the ACT are:

...less than what retailers expect to prevail in a market that has effective competition.<sup>32</sup>

## 3.2 Indicators of effective competition

ActewAGL Retail agrees with the AEMC's comment:

Understanding the level of competition in a market is dependent on the interaction of a number of interrelated factors.<sup>33</sup>

<sup>27</sup> The Allen Consulting Group, July 2010, Price and Profit Margin Analysis – *Review of the effectiveness of competition in the electricity retail market in the ACT*, p. 16

<sup>28</sup> The Allen Consulting Group, July 2010, Price and Profit Margin Analysis – *Review of the effectiveness of competition in the electricity retail market in the ACT*, p. 16

<sup>29</sup> ICRC, August 2010, Submission to AEMC First Draft Report – *Review of the effectiveness of competition in the electricity retail market in the ACT*, p. 7

<sup>30</sup> ICRC, August 2010, Submission to AEMC First Draft Report – *Review of the effectiveness of competition in the electricity retail market in the ACT*, p. 7

<sup>31</sup> The Allen Consulting Group, July 2010, Price and Profit Margin Analysis – *Review of the effectiveness of competition in the electricity retail market in the ACT*, p. 5

<sup>32</sup> AEMC, July 2010, First Draft Report – *Review of the effectiveness of competition in the electricity retail market in the ACT*, p. 61

<sup>33</sup> AEMC, July 2010, First Draft Report – *Review of the effectiveness of competition in the electricity retail market in the ACT*, p. 8



While the AEMC has presented a detailed analysis of a broad range of indicators, ActewAGL Retail considers the AEMC has underestimated the importance of one key indicator – the threat of entry by competing retailers.

In support of its conclusion that competition in the ACT retail electricity market for small customers is not effective, the AEMC presents a “cross jurisdictional comparison with Victoria and South Australia in accordance with key MCE criteria”.<sup>34</sup> ActewAGL Retail notes that the cross-jurisdictional comparison, represented in the spider web diagram shown in figure 2.1, provides a misleading summary of the extent of competition, as it does not take account of other important indicators such as the threat of entry.

The threat of entry is identified by the MCE, and included in the AEMA, as one of six key indicators of the extent of competition in retail energy markets:

“the threat of new entry creates pressures to reduce prices and improve service – to be ascertained by analysis.”<sup>35</sup>

The AEMC emphasises that only 2 retailers are currently active in the ACT market. However, 19 retailers are licensed, and are therefore potential entrants at any given point in time. Retailer comments in the surveys undertaken for the AEMC review and the high level of retailer interest and participation in the review indicate that there is a high degree of interest in entering the ACT market, if the TFT is removed. A key finding of the GA Research survey of retailers, commissioned by the AEMC for this review, was:

While it is relatively small, the electricity retailers interviewed report that they see the ACT as an attractive market for small consumers.<sup>36</sup>

Furthermore,

Most of the retailers interviewed that are currently inactive (yet to commercially enter this market) stated that they would definitely become active in the market if the right regulatory conditions were in place.<sup>37</sup>

The potential entry by competing retailers ensures there is strong pressure on ActewAGL Retail to incur costs to retain its customers by continually improving its service and offering attractive prices and products. ActewAGL Retail's performance in providing high levels of customer service, which have been favourably commented on by customers during this review,<sup>38</sup> and innovative products provides clear evidence that the competitive pressure is present and strong.

<sup>34</sup> AEMC, July 2010, First Draft Report – *Review of the effectiveness of competition in the electricity retail market in the ACT*, p. 5

<sup>35</sup> AEMA. July 2009. *Notice of Amendment to the Australian Energy Market Agreement. Annexure 3, (6)*

<sup>36</sup> GA Research, June 2010, Retailer Research Report – *Australian Energy Market Commission Review into the effectiveness of competition in the electricity retail market – ACT*, p. 4

<sup>37</sup> GA Research, June 2010, Retailer Research Report – *Australian Energy Market Commission Review into the effectiveness of competition in the electricity retail market – ACT*, p. 4

<sup>38</sup> Roy Morgan Research, June 2010, *Effectiveness of competition in the ACT electricity market – A qualitative study of business and domestic consumers*, p. 2



### 3.3 Retail products and services

As part of its analysis of market performance, the AEMC has considered the number and nature of retail products and services, focusing on the market offers and discounts available to customers in the ACT retail market.

In its discussion of the range of product services available, the AEMC concludes:

It is useful to compare the level of innovation and product differentiation in the ACT electricity market to that of other jurisdictions. A review of offers available via website brokers to NSW and Victorian small electricity customers indicates there are numerous offers available from several retailers...In summary, there are significantly more, and a greater variety of, offers available to customers in NSW and Victoria compared to what is currently available in the ACT.<sup>39</sup>

ActewAGL Retail considers that a simple survey approach of the number of products currently on offer by electricity retailers across jurisdictions does not provide an appropriate comparison. This method of comparison only provides a snapshot of the current market rather than a more useful long-term evaluation of product innovation and differentiation in the market. Further, it would be expected that the much larger markets in Victoria (where the market is deregulated) and NSW (where the regulated price is higher than the ACT) would have a more diverse customer base and therefore necessitate a larger selection of products in order for retailers to maintain their customer base.

The AEMC concludes:

The level of product innovation and differentiation in the ACT electricity retail market appears to be weak at present.<sup>40</sup>

ActewAGL Retail does not agree with this conclusion. ActewAGL Retail offers a variety of products which have evolved over the past decade with changing market conditions including bundled service offers, discounts, the One Call Connects All (OCCA) contact centre and Green Energy combinations. ActewAGL Retail notes that in the Australian Energy Regulator's (AER's) *State of the Energy Market*, ActewAGL Retail is listed as having more electricity retail price offers (20) than any of the retailers in Victoria, South Australia, New South Wales and Queensland.<sup>41</sup>

In its analysis of discounts offered by electricity retailers in the ACT, the AEMC considers that the low effective retail margins likely to be faced by second tier retailers competing in the ACT market prevent them from offering attractive discounts.<sup>42</sup> As a result, the AEMC asks:

What is the source of ActewAGL Retail's competitive advantage that allows it to bundle and discount so extensively?<sup>43</sup>

<sup>39</sup> AEMC, July 2010, First Draft Report – *Review of the effectiveness of competition in the electricity retail market in the ACT*, p. 63

<sup>40</sup> AEMC, July 2010, First Draft Report – *Review of the effectiveness of competition in the electricity retail market in the ACT*, p. 65

<sup>41</sup> Australian Energy Regulator, December 2009, *State of the Energy Market 2009*, p. 203

<sup>42</sup> AEMC, July 2010, First Draft Report – *Review of the effectiveness of competition in the electricity retail market in the ACT*, p. 64



In answering this question, the AEMC notes that other retailers do not view ActewAGL Retail's bundled discounts as a primary barrier to entry. ActewAGL Retail agrees with the AEMC's conclusion that ActewAGL Retail's ability to offer bundled discounts is not a primary barrier to entry.

ActewAGL Retail's ability to offer competitive discounts and attractive bundled services is a result of a strong desire to maintain market leadership, and deliver optimal outcomes to consumers through innovative business development. ActewAGL Retail notes that a number of retailers licensed to sell electricity in the ACT are also licensed to retail gas. These retailers could offer discounts for 'bundled' services, similar in nature to those offered by ActewAGL Retail.

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<sup>43</sup> AEMC, July 2010, First Draft Report – *Review of the effectiveness of competition in the electricity retail market in the ACT*, p. 64