

22 JUNE 2004

Energy Retailers Association  
of Australia Incorporated

NCP Inquiry  
Productivity Commission  
PO Box 80  
Belconnen ACT 2616

e-mail: [ncp@pc.gov.au](mailto:ncp@pc.gov.au)

Dear Sir/Madam

### **Review of National Competition Policy Arrangements**

The Energy Retailers Association of Australia (ERAA) is pleased to comment on energy related matters arising out of the Issues Paper released by the Productivity Commission (the Commission). The ERAA welcomes the opportunity to participate in the Commission's inquiry and contribute to further increasing the efficiency of the retail electricity and reticulated gas markets ("retail energy market") in Australia.

The ERAA represents the core of Australia's energy retail organisations and is the peak body representing energy retailers in Australia.

We note that the Commission has been asked to:

- Report on the impact of National Competition Policy (NCP) and related reforms undertaken to date on the Australian economy and community, and
- Identify areas offering opportunities for significant gains to the Australian economy from removing impediments to efficiency and enhancing competition.

The ERAA believes that significant progress has been made on energy market reform through the Ministerial Council on Energy (MCE) energy market reform program, particularly in the large non-regulated customer markets where price reductions and efficiency improvements have contributed to efficiency gains for Australian industry. The various jurisdictional regulators as part of their reviews have quantified these benefits.

However, there is still work to be done on energy market reform and we are optimistic that the MCE program is capable of resolving most of the remaining areas of concern. We believe that there is opportunity to improve the focus of the reforms to areas that will contribute most to increasing the efficiency and enhancing competition.

The ERAA believes that the following issues need to be addressed by the MCE to increase the effectiveness of competition in the retail energy market:

- Extension of full retail contestability;
- Appropriate institutional and governance arrangements;
- An efficient and consistent national regulatory and market framework; and
- Phasing out of retail price regulation.

Effective resolution of these issues will ensure that:

- Benefits of competition are fully realised across all retail energy markets and that customers are protected through robust competition; and
- Appropriate incentives are in place to achieve investment in demand and supply side initiatives to ensure security and reliability on energy supply and to meet the environmental goals in an efficient manner.

Each of these matters is discussed in detail below.

#### Full contestability in retail energy markets

Full retail contestability has been introduced in the majority of the retail energy markets in the eastern states. Some governments have introduced contestability in the “large” customer markets but have deferred introduction of competition in the “small” customer market subject to further assessment of costs and benefits.

The ERAA believes that where a cost benefit analysis identifies a net benefit, markets should be opened to competition so that the full benefits can be realised.

The ERAA also believes that the costs and benefits of extending competition to other services in the retail energy market should be further investigated. As a principle, regulatory and government decisions should not impede the development of a competitive market in such services.

Some jurisdictional governments have implemented arrangements to manage wholesale risk in the energy markets. The regulators have included these arrangements in their retail pricing decisions. As a consequence, the resulting regulated prices underestimate the true risks and costs of supply. The failure to reflect all risks faced by retailers in the retail energy market has resulted in issues of competitive neutrality and has the potential to impact on investment.

The ERAA believes that cost benchmarks should be fully cost reflective to promote investment in generation, new entrants into the retail sector, and encourage demand management and energy efficiency.

#### Appropriate institutional and governance arrangements

The move towards a national regulator provides an opportunity to improve on the current institutional and governance arrangements.

The following principles are critical for an effective institutional and governance framework:

- Adequate consultation with all stakeholders, including industry, consumer groups and governments in all steps of the process;
- Transparent, clear and well defined objectives and decision making frameworks for the new institutions;
- Delineation of responsibility for rule making and enforcement; and
- Appropriate appeal rights and accountability for market funded institutions.

The ERAA is concerned that these principles do not appear to be clearly incorporated into the elements of the MCE reform program.

### Efficient and consistent national regulatory and market framework

The complexity of consumer protection arrangements and differences in regulatory requirements across jurisdictions impose significant compliance costs upon retailers which in turn diminish the benefits that would otherwise flow from energy market reform. This has been confirmed by the Victorian Essential Services Commission, which has now conducted two separate investigations into the effectiveness of retail competition and on both occasions, concluded that regulatory complexity and inconsistency represents a primary impediment to effective competition.

A recent paper to the Commission by the Institute of Public Affairs<sup>1</sup> estimates the annual cost of regulation incurred by electricity and gas supplying firms (generation, transmission and distribution) at \$88 million. Distribution and retail companies incur about half of this cost. There are a further 450 staff employed by governments in mainline economic regulation alone, 175 of these with the major regulatory agencies.

In addition to the direct costs of regulation inappropriate regulation can add substantial indirect costs through distorting and delaying the benefits of competition being realised, or add to externalities through inefficiency.

Governments and regulators introduced regulation at the commencement of full retail contestability to protect customers in the event that competition was not effective. However, after two and half years of fully retail contestability and evidence of effective competition, we are concerned with an increasing tendency to regulate the retail energy market including the manner in which competition should occur or the manner in which certain objectives should be realised. Regulatory intervention should only occur where there is a demonstrated market failure. Two examples of such intervention where no market failure is occurring are:

- Mandatory rollout of interval meters to reduce demand, as opposed to market based incentives that will reduce demand;
- Regulated price comparators and calculators to increase competition, instead of allowing energy brokerage services to evolve through commercial opportunities.

These regulatory decisions are based on the untested belief that certain outcomes will be achieved if the prescribed steps are taken. However, it is not certain that the prescribed steps (which entail additional costs) will achieve the desired objectives nor that the prescribed steps are the most efficient means of achieving the objectives.

Efficient regulatory frameworks should provide the incentives to drive appropriate behaviour instead of regulating the behaviour itself. The risk with the latter is that it may not achieve the intended objectives and have other unintended consequences and add unnecessary costs.

In this context the development of a national framework for electricity and gas retailing is welcomed as a unique opportunity to deliver further efficiencies in the retail energy market. However it is vital that the framework is shaped by sound principles of efficiency, and is not allowed to be unreasonably influenced by interest groups, including retailers, regulators and consumer groups which has characterised retail market regulation to date.

---

<sup>1</sup> Paperburden Costs of Economic Regulation of the Gas and Electricity Supply Industry, An IPA Submission to the Productivity Commission by Alan Moran, Energy Issues Paper No. 29, November 2003.

As part of the commitment to energy market reform, the MCE<sup>2</sup> agreed that further reform should be taken to:

*Streamline and improve the quality of economic regulation across energy markets, to lower the cost and complexity of regulation facing investors, enhance regulatory certainty and lower barriers to competition.*

It is the ERAA's view that development of a national framework must be set against this guiding principle, and would be further assisted through the establishment of a number of supporting principles:

- Competition is to be preferred over regulation, and represents the most effective form of customer protection;
- The Trade Practices Act, Privacy Act and Fair Trading legislation provide for a comprehensive National Consumer Protection regime across all jurisdictions (Duplicating provisions within energy regulation increases compliance cost and complexity with no associated increase in consumer protection);
- A corollary of reliance on competition and the current presence of a comprehensive National Consumer Protection Regime (above) is that high standards must be met to justify the adoption of new national regulations. Further, a justification against those standards must be met for a jurisdiction to adopt alternate words or intent for a regulatory outcome;
- The regulatory framework should allow for efficient regulatory change management processes to enable regulatory arrangements be improved or modified when necessary; and
- National consistency should not be viewed as an end in itself, but a means to improving the quality of regulation.

It is our view that a national regime to licensing and consumer protection codes is preferable to the retention and continuation of the current jurisdictional approach. Jurisdictions have demonstrated an inability to deliver nationally consistent outcomes, despite obligations to do so in their enabling legislation.

A single national regulator for gas and electricity has been proposed by the MCE. However, there is no firm process for achieving harmonisation and no firm agreement to reduce jurisdictional regulation. A clear process, understood by all participants, is critical.

Ensuring consistency in retail market arrangements to the extent economically justified is also important. In this respect we support the move towards a national approach to the development of business-to-business (B2B) arrangements and development of an electricity market for WA based on the national electricity market arrangements in the eastern states.

#### Retail price regulation

The ERAA does not support the underlying premise of a recent MCE SCO discussion paper that in the transition to effective competition, price regulation remains a legitimate and ongoing role for governments to facilitate consumer protection goals.

Whilst based on an accepted premise that effective competition is the ultimate goal, it is the ERAA's view that the causative link is the exact opposite – that price regulation

---

<sup>2</sup> Ministerial Council of Energy's report to COAG, *Reform of Energy Markets*

is a key impediment of effective competition. For a market to be effectively competitive, prices must be determined by competitive market forces.

Whilst retail price controls remain, efficient market outcomes will be distorted and effective competition inhibited. For example, demand side responses require flexible and innovative pricing structures to be effective. Price controls prevent these innovations from developing, and thus frustrate the very objectives that governments are seeking from demand side response.

With regard to facilitating consumer protection, the decision of governments in the mid 1990s to introduce competition into retail energy markets was based on, in our view, the correct presumption that competition provides the most effective form of customer protection available. This presumption is consistent with economic theory and a wealth of experience of the success of competitive markets in effectively and efficiently delivering most of the goods and services customers want.

The sooner market competition sets customer prices - and not a regulator – the sooner more efficient outcomes will be realised.

The ERAA recognises that governments may wish to pursue social equity and/or affordability issues. To the extent that governments identify these issues, they should be addressed not through price controls which inhibit competition, but through direct and transparent government payments

While artificially low regulated tariffs remain attractive alternatives to market contracts, competition from retailers will continue to be stifled. The ERAA would promote that regulated tariffs should transition to cost-reflective levels quickly and then, ultimately be removed. Governments may continue to monitor prices and take action under competition law or alternatively maintain reserve powers under jurisdictional regulations.

The ERAA welcomes the moves, made in most jurisdictions where full retail contestability has been introduced, towards a light-handed form of regulation of retail prices for residential and small business customers. For example, a four-year price path has been agreed for Victoria, and light-handed approaches to price paths for South Australia and NSW gas are currently under consideration. At the conclusion of these price paths (after 5 to 6 years of full retail contestability), the ERAA expects that the retail energy will have strong competition and considers that jurisdictions should not continue with price regulation.

If you have any queries on the content of this submission, please contact myself or Nicole Stillman at the ERAA Secretariat on 0417 101 452.

Yours sincerely,

*Transmission by e-mail*

Deane Russell  
Executive Director  
Energy Retailers Association of Australia Inc.  
0419 444 112