

19 December 2012

Review of regulated retail prices and charges for electricity 2013 to 2016
Independent Pricing and Regulatory Tribunal
PO Box Q290
QVB Post Office NSW 1230

By email: ipart@ipart.nsw.gov.au

Dear Sir/Madam

RE: Review of regulated retail prices and charges for electricity 2013 to 2016 – Electricity Issues Paper

The Energy Retailers Association of Australia (ERAA) and the Energy Supply Association of Australia (esaa) (the Associations) welcome the opportunity to make a joint submission on the *Review of regulated retail prices and charges for electricity 2013 to 2016 – Electricity Issues Paper* (the Issues Paper).

The Associations have consistently advocated for deregulation of the retail energy market to drive the best outcomes for consumers. Open, competitive energy markets free from distortions such as retail price regulation naturally encourage prices to be efficient through the development of market offers. Competition in retail electricity markets, as in other sectors of the Australian economy, incentivises businesses to improve service, develop products that meet consumer needs and find ways to lower their costs and to pass these savings onto consumers. This ensures that retail prices are set as low as is sustainably possible while businesses can still make an appropriate return.

As noted in the Issues Paper, retail price regulation cannot protect customers from general financial stress. Much of the increase in energy prices over recent years has been due to higher cost factors outside retailers' control, and price regulation does not protect customers from the price shocks associated with changes in regulatory and policy settings.¹

The Associations agree with IPART's preliminary view that competition in the NSW retail electricity market has increased since 2010.² The evidence contained in the Issues Paper demonstrates a robustly competitive market that would benefit from a light-handed regulatory approach. If retail prices are to be regulated, they should be cost-reflective and

¹ IPART (2012), *Review of regulated retail prices and charges for electricity 2013 to 2016 Electricity - Issues Paper*, p.2.

² IPART (2012), *Review of regulated retail prices and charges for electricity 2013 to 2016 Electricity - Issues Paper*, p.24.

derived from a consistent and predictable price setting methodology. If regulated tariffs are set below the cost of supply it impedes the efficient operation of the market, creating financial pressure for industry participants to absorb costs that cannot be passed on. This removes incentives for energy companies to enter the market and compete for small-use customers. Conversely, in the event that prices are set above the cost of supply – including an appropriate retail margin – competition will erode margins back to efficient levels. The risks are thus asymmetric, with greater adverse consequences arising from setting the regulated price too low.

For this reason, the Associations call for the retention of a long run marginal cost (LRMC) price floor when estimating energy cost allowance. The terms of reference for the 2013 determination state that the energy cost allowance should be set no lower than 25% of the weighted average of the market-based cost of purchasing electricity and 75% of the LRMC of electricity generation. The Issues Paper states that the purpose of setting wholesale energy costs below LRMC is to put downward pressure on retail prices. The Associations maintain competition not regulation is the best way to limit price rises, as regulation does not address underlying causes.

The use of LRMC as the floor is a highly relevant reference to set an appropriate safety net 'price to beat'. Sufficient head room is essential so that retailers can provide customers with a competitive market offer whilst maintaining costs. The Associations believe this approach is consistent with the Government's mandate to facilitate competition in the NSW retail market, and will provide the investment certainty required to facilitate further competition in NSW and ensure a smooth transition to price deregulation.

Any questions about our submission should be addressed to either David Lee, email dlee@eraa.com.au telephone (02) 8241 1835, or Kieran Donoghue, email kieran.donoghue@esaa.com.au telephone (03) 9205 3116.

Yours sincerely



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